FORM 10-Q

ADAPTEC INC - ADPT

Filed: November 07, 2005 (period: September 30, 2005)

Quarterly report which provides a continuing view of a company's financial position

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10-Q - QUARTERLY REPORT PURSUANT TO SECTIONS 13 OR 15(D)

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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	**94-2748530**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
691 S. MILPITAS BLVD., MILPITAS, CALIFORNIA	**95035**
(Address of principal executive offices)	(Zip Code)

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

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act)
Yes ☒ No ☐

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

The number of shares of Adaptec's common stock outstanding as of November 2, 2005 was 113,376,831.

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Source: ADAPTEC INC, 10-Q, November 07, 2005

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ADAPTEC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three-Month Period Ended		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands, except per share amounts)			
Net revenues	$ 83,234	$ 99,752	$ 155,749	$ 198,609
Cost of revenues	54,315	53,145	103,525	104,992
Gross profit	28,919	46,607	52,224	93,617
Operating expenses:				
Research and development	15,680	22,336	31,856	46,127
Selling, marketing and administrative	16,273	20,153	33,555	37,248
Amortization of acquisition-related intangible assets	1,761	2,392	3,777	4,888
Restructuring charges	478	1,928	518	2,747
Goodwill impairment	90,602	—	90,602	—
Total operating expenses	124,794	46,809	160,308	91,010
Income (loss) from continuing operations	(95,875)	(202)	(108,084)	2,607
Interest and other income	4,523	3,659	8,131	5,502
Interest expense	(868)	(1,145)	(1,840)	(2,267)
Income (loss) from continuing operations before income taxes	(92,220)	2,312	(101,793)	5,842
Provision for (benefit from) income taxes	2,557	(10,443)	3,445	(9,345)
Income (loss) from continuing operations	(94,777)	12,755	(105,238)	15,187
Discontinued operations, net of taxes (Note 4)				
Loss from discontinued operations, net of taxes	(4,053)	(20,818)	(29,565)	(23,240)
Loss from disposal of discontinued operations, net of taxes	(6,976)	—	(6,976)	—
Loss from discontinued operations	(11,029)	(20,818)	(36,541)	(23,240)
Net loss	$ (105,806)	$ (8,063)	$ (141,779)	$ (8,053)
Net income (loss) per share:				
Basic				
Continuing operations	$ (0.84)	$ 0.12	$ (0.93)	$ 0.14
Discontinued operations	$ (0.10)	$ (0.19)	$ (0.32)	$ (0.21)
Net loss	$ (0.94)	$ (0.07)	$ (1.26)	$ (0.07)
Diluted				
Continuing operations	$ (0.84)	$ 0.10	$ (0.93)	$ 0.12
Discontinued operations	$ (0.10)	$ (0.15)	$ (0.32)	$ (0.17)
Net loss	$ (0.94)	$ (0.06)	$ (1.26)	$ (0.05)
Shares used in computing net income (loss) per share:				
Basic	112,965	110,312	112,705	110,076

Diluted	112,965	134,140	112,705	131,302

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Source: ADAPTEC INC, 10-Q, November 07, 2005

ADAPTEC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

	September 30, 2005	March 31, 2005
	(in thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 79,025	$ 441,588
Marketable securities	409,951	84,968
Restricted cash and marketable securities	1,665	1,766
Accounts receivable, net	74,121	70,159
Inventories	33,119	60,204
Prepaid expenses and other current assets	33,493	26,081
Current assets of discontinued operations	10,626	—
Total current assets	642,000	684,766
Property and equipment, net	47,045	56,180
Restricted marketable securities, less current portion	3,870	4,615
Goodwill	—	91,486
Other intangible assets, net	25,064	79,457
Other long-term assets	10,293	47,002
Long-term assets of discontinued operations	26,671	—
Total assets	$ 754,943	$ 963,506
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 52,702	$ 61,637
Accrued liabilities	86,374	116,007
Current liabilities of discontinued operations	4,554	—
Total current liabilities	143,630	177,644
¾% Convertible Senior Subordinated Notes	225,000	225,000
3% Convertible Subordinated Notes	11,992	35,190
Other long-term liabilities	3,692	15,349
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Common stock	113	112
Additional paid-in capital	167,846	165,707
Deferred stock-based compensation	(699)	(2,416)
Accumulated other comprehensive income (loss), net of taxes	(1,066)	706
Retained earnings	204,435	346,214
Total stockholders' equity	370,629	510,323
Total liabilities and stockholders' equity	$ 754,943	$ 963,506

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Source: ADAPTEC INC, 10-Q, November 07, 2005

ADAPTEC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Six-Month Period Ended	
	September 30, 2005	September 30, 2004
	(in thousands)	
Cash Flows From Operating Activities:		
Net income (loss) from continuing operations	$ (105,238)	$ 15,187
Adjustments to reconcile 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	264	1,519
Non-cash effect of tax settlement	—	(4,068)
Loss on extinguishment of debt	102	—
Depreciation and amortization	13,044	19,037
Deferred income taxes	—	31
Other non-cash items	(129)	104
Changes in assets and liabilities (net of acquired businesses)	(15,050)	(18,442)
Net Cash Provided by (Used for) Operating Activities of Continuing Operations	(16,405)	13,477
Net Cash Provided by (Used for) Operating Activities of Discontinued Operations	5,080	(13,466)
Net Cash Provided by (Used for) Operating Activities	$ (11,325)	$ 11
Cash Flows From Investing Activities:		
Purchases of certain net assets in connection with acquisitions, net of cash acquired	—	(65,380)
Maturities of restricted marketable securities	844	1,369
Purchases of property and equipment	(5,416)	(6,486)
Proceeds from the sale of property and equipment	2,684	—
Purchases of marketable securities	(438,060)	(211,741)
Sales of marketable securities	107,141	296,524
Maturities of marketable securities	4,511	42,777
Net Cash Provided by (Used for) Investing Activities of Continuing Operations	(328,296)	57,063
Net Cash Provided by (Used for) Investing Activities of Discontinued Operations	(1,655)	(59,341)
Net Cash Provided by (Used for) Investing Activities	(329,951)	(2,278)
Cash Flows From Financing Activities:		
Repurchases and redemption of long-term debt	(22,988)	—
Proceeds from issuance of common stock	2,554	3,771
Net Cash Provided by (Used for) Financing Activities	(20,434)	3,771
Effect of Foreign Currency Translation on Cash and Cash Equivalents	(853)	(306)
Net Increase (Decrease) in Cash and Cash Equivalents	(362,563)	1,198
Cash and Cash Equivalents at Beginning of Period	441,588	102,463
Cash and Cash Equivalents at End of Period	$ 79,025	$ 103,661

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Source: ADAPTEC INC, 10-Q, November 07, 2005

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 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 year ended March 31, 2005, which was filed with the SEC on June 14, 2005. The second quarters of fiscal 2006 and 2005 ended September 30, 2005 and October 1, 2004, respectively. For presentation purposes, the accompanying financial statements have been shown as ending on September 30. The results of operations for the second quarter and first half 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 $13.8 million in the first half 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 of its IBM i/p Series RAID component business ("IBM i/p Series RAID Business") to International Business Machines ("IBM") and on September 29, 2005 the Company's Board of Directors approved management's recommendation to divest its systems business. The IBM i/p Series RAID Business sale and the planned divestiture of the systems business have been accounted for as discontinued operations. Accordingly, the Company has reclassified the underlying Unaudited Condensed Consolidated Statements of Operations and 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. 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. In addition, in the second quarter of fiscal 2006, the Company reorganized its reportable segments. At September 30, 2005 the Company's reportable segments were DPS and DSG, which are described more fully in Note 14.

The net income (loss) per share and shares used in computing net income (loss) per share for diluted discontinued operations, net loss and related disclosures for the second quarter and first half of fiscal 2005 have been corrected from the amounts disclosed in the Form 8-K filed with the Securities and Exchange Commission on November 3, 2005.

The glossary of acronyms and accounting rules and regulations referred to within this Quarterly Report on Form 10-Q is listed in alphabetical order in Note 17.

Source: ADAPTEC INC, 10-Q, November 07, 2005

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. The Company is currently evaluating the impact of adopting this statement; however, the Company expects that it will have a significant impact on the Company's consolidated financial statements. The impact on the Company's consolidated financial statements will depend on the transition method, the option-pricing model used to compute fair value and the inputs to that model such as volatility and expected life. 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 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. SAB 107 creates a framework that is premised on two overarching themes: (a) considerable judgment will be required by preparers to successfully implement FAS No. 123(R), specifically when valuing employee stock options; and (b) reasonable individuals, acting in good faith, may conclude differently on the fair value of employee stock options. Key topics covered by SAB 107 include valuation models, expected volatility and expected term. The Company will apply the principles of SAB 107 in conjunction with its adoption of SFAS No. 123(R).

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.

At its March 2004 meeting, the EITF reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarified the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under SFAS No. 115 and investments accounted for under the cost method or the equity method. In September 2004, the FASB delayed the recognition and measurement guidance to be applied to other-than-temporary impairment evaluations. The FASB expects to issue additional implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads. If this additional implementation guidance is issued as currently written, the Company may have to recognize

Source: ADAPTEC INC, 10-Q, November 07, 2005

unrealized losses on investments in the Statements of Operations. If there is a material decline in the fair value of investments, the Company's financial statements could be adversely affected.

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 loss and net 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		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands, except per share amounts)			
Net loss, as reported	$ (105,806)	$ (8,063)	$ (141,779)	$ (8,053)
Add: Deferred stock-based compensation expense included in reported net loss	1,029	873	1,303	1,678
Deduct: Total stock-based compensation expense determined under the fair value-based method, net of tax	(2,884)	(2,589)	(6,380)	(6,086)
Pro forma net loss	$ (107,661)	$ (9,779)	$ (146,856)	$ (12,461)
Basic net loss per share:				
As reported	$ (0.94)	$ (0.07)	$ (1.26)	$ (0.07)
Pro forma	$ (0.95)	$ (0.09)	$ (1.30)	$ (0.11)
Diluted net loss per share:				
As reported	$ (0.94)	$ (0.06)	$ (1.26)	$ (0.05)
Pro forma	$ (0.95)	$ (0.07)	$ (1.30)	$ (0.09)

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.

Source: ADAPTEC INC, 10-Q, November 07, 2005

The fair value of options granted in the second quarter and first half 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		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
Employee Stock Option Plans:				
Expected life (in years)	2.5	3	2.5	3
Risk-free interest rates	4.2 %	2.9 %	4.1 %	2.9 %
Expected volatility	39 %	56 %	38 %	56 %
Dividend yield	—	—	—	—
ESPP:				
Expected life (in years)	1.1	1.4	1.1	1.4
Risk-free interest rates	3.8 %	2.1 %	3.8 %	2.1 %
Expected volatility	39 %	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. The consideration has been included in "Prepaid expenses and other current assets" on the Unaudited Condensed Consolidated Balance Sheet. 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.

Under the terms of the arrangement, IBM forgave all outstanding liabilities that existed at June 30, 2005 which were due under the Distribution Agreement that was entered into in December 2004. 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. These amounts have been included in "Accrued Liabilities" and "Other Long-Term Liabilities" on the Unaudited Condensed Consolidated Balance Sheets. A loss of $7.0 million was incurred on the disposal of the IBM i/p Series RAID Business.

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		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)			
Net revenues	$ 15,357	$ 5,186	$ 19,809	$ 5,186
Income (loss) from discontinued operations before income taxes	3,694	(2,604)	(14,663)	(5,604)
Provision for (benefit from) income taxes	(833)	11,809	(642)	10,811
Income (loss) from discontinued operations, net of taxes	$ 4,527	$ (14,413)	$ (14,021)	$ (16,415)

Source: ADAPTEC INC, 10-Q, November 07, 2005

The components of net assets related to the discontinued operations 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.

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

	Three-Month Period Ended		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)			
Net revenues	$ 16,466	$ 16,762	$ 37,897	$ 33,407
Loss from discontinued operations before provision for income taxes	(8,538)	(8,222)	(15,476)	(8,735)
Provision for (benefit from) income taxes	42	(1,817)	68	(1,910)
Loss from discontinued operations, net of taxes	$ (8,580)	$ (6,405)	$ (15,544)	$ (6,825)

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

	September 30, 2005
	(in thousands)
Inventories	$ 10,542
Prepaid expenses	84
Current assets of discontinued operations	10,626
Property and equipment, net	1,911
Other intangibles, net	24,730
Other long-term assets	30
Total assets of discontinued operations	37,297
Accrued liabilities	(4,554)
Current liabilities of discontinued operations	(4,554)
Net assets of discontinued operations	$ 32,743

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:

	September 30, 2005	March 31, 2005
	(in thousands)	
Raw materials	$ 10,601	$ 15,914
Work-in-process	4,142	7,435
Finished goods	18,376	36,855
Total	$ 33,119	$ 60,204

In the first half of fiscal 2006, the Company recorded an excess inventory adjustment of $1.9 million related to the transition of its products to comply with the European Union Restriction on Use of Hazardous Substances Directive.

Accrued Liabilities:

	September 30, 2005	March 31, 2005
	(in thousands)	
Tax related	$ 48,003	$ 57,538
Acquisition related	3,650	6,748
Accrued compensation and related taxes	16,697	18,304
IBM distribution agreement	—	11,575
Other	18,024	21,842
Total	$ 86,374	$ 116,007

Source: ADAPTEC INC, 10-Q, November 07, 2005

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 half 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)
Balance at June 30, 2005	48,617	41,985	90,602
Goodwill impairment	(48,617)	(41,985)	(90,602)
Balance at September 30, 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 14, 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 in the second quarter of fiscal 2006. Factors that led to this conclusion were industry technology changes such as parallel to serial technology and migration of core functionality to server chipsets; required increased investments that eventually led to the sale of the 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:

	September 30, 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	$ (26,295)	$ 74,009	$ (26,265)
Supply agreement	—	—	7,600	(1,140)
Customer relationships	1,047	(643)	1,290	(631)
Trade names	674	(520)	10,930	(1,523)
Foundry agreement	—	—	600	(90)
Subtotal	41,299	(27,458)	94,429	(29,649)
Intellectual property assets and warrants	41,623	(30,400)	41,942	(27,265)
Total	$ 82,922	$ (57,858)	$ 136,371	$ (56,914)

Amortization of other intangible assets was $3.5 million and $4.1 million in the second quarter of fiscal 2006 and 2005, respectively. Amortization of other intangible assets was $7.2 million and $8.3 million in the first half of fiscal 2006 and 2005, respectively.

Source: ADAPTEC INC, 10-Q, November 07, 2005

The annual amortization expense of the other intangible assets that existed as of September 30, 2005 is expected to be as follows:

	Estimated Amortization Expense	
	Acquisition-related Intangible Assets	Intellectual Property Assets
	(in thousands)	
Fiscal Years:		
2006 (remaining six months)	$ 3,376	$ 3,216
2007	5,726	6,316
2008	2,534	1,691
2009	2,205	—
2010 and thereafter	—	—
Total	$ 13,841	$ 11,223

7. Interest and Other Income

The components of interest and other income for the second quarter and first half of fiscal 2006 and 2005, were as follows:

	Three-Month Period Ended		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)			
Interest income	$ 3,969	$ 3,034	$ 7,543	$ 5,760
Payment of license fee with NSE	—	—	—	(1,250)
Loss on redemption of debt	(16)	—	(102)	—
Foreign currency transaction gains (losses)	(63)	295	(380)	339
Other	633	330	1,070	653
Total	$ 4,523	$ 3,659	$ 8,131	$ 5,502

In the second quarter of fiscal 2006, the Company repurchased $3.4 million in aggregate principal amount of its 3% Convertible Subordinated Notes (“3% Notes”) on the open market for an aggregate price of $3.4 million, resulting in an immaterial loss. In the first half of fiscal 2006, the Company repurchased $23.2 million in aggregate principal amount of its 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.

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 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 12 for further discussion of the Eurologic Holdback.

Source: ADAPTEC INC, 10-Q, November 07, 2005

8. Restructuring Charges

In the first half of fiscal 2006, the Company recorded provision adjustments of $0.5 million related to severance and benefits as actual costs were lower than anticipated and additional lease costs related to the estimated loss of facilities that the Company subleased in California through April 2008 and the United Kingdom through December 2005, the end of the lease term. This restructuring charge pertained to the Company's restructuring plans that it implemented in each quarter of fiscal 2005, and the 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. 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 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 half of fiscal 2006:

	Severance And Benefits	Other Charges	Total
		(in thousands)	
Reserve balance at March 31, 2005	$ 896	$ 1,627	$ 2,523
Provision adjustments	(198)	716	518
Cash paid	(611)	(595)	(1,206)
Reserve balance at September 30, 2005	$ 87	$ 1,748	$ 1,835

The Company anticipates that the remaining restructuring reserve balance of $1.8 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. 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.

Source: ADAPTEC INC, 10-Q, November 07, 2005

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

	Three-Month Period Ended					
	Continuing Operations		Discontinued Operations		Net loss	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands, except per share amounts)					
Numerators:						
Income (loss)	$ (94,777)	$ 12,755	$ (11,029)	$ (20,818)	$ (105,806)	$ (8,063)
Adjustment for interest expense on 3/4% Notes, net of taxes	—	454	—	454	—	454
Adjustment for interest expense on 3% Notes, net of taxes	—	196	—	196	—	196
Adjusted income (loss)	$ (94,777)	$ 13,405	$ (11,029)	$ (20,168)	$ (105,806)	$ (7,413)
Denominators:						
Weighted average shares outstanding—basic	112,965	110,312	112,965	110,312	112,965	110,312
Effect of dilutive securities:						
Employee stock options and other	—	2,306	—	2,306	—	2,306
3/4% 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	112,965	134,140	112,965	134,140	112,965	134,140
Income (loss) per share:						
Basic	$ (0.84)	$ 0.12	$ (0.10)	$ (0.19)	$ (0.94)	$ (0.07)
Diluted	$ (0.84)	$ 0.10	$ (0.10)	$ (0.15)	$ (0.94)	$ (0.06)

Source: ADAPTEC INC, 10-Q, November 07, 2005

	Six-Month Period Ended					
	Continuing Operations		Discontinued Operations		Net loss	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands, except per share amounts)					
Numerators:						
Income (loss)	$ (105,238)	$ 15,187	$ (36,541)	$ (23,240)	$ (141,779)	$ (8,053)
Adjustment for interest expense on 3/4% Convertible Senior Subordinated Notes, net of taxes	—	917	—	917	—	917
Adjustment for interest expense on 3% Notes, net of taxes	—	—	—	—	—	—
Adjusted income (loss)	$ (105,238)	$ 16,104	$ (36,541)	$ (22,323)	$ (141,779)	$ (7,136)
Denominators:						
Weighted average shares outstanding—basic	112,705	110,076	112,705	110,076	112,705	110,076
Effect of dilutive securities:						
Employee stock options and other	—	2,002	—	2,002	—	2,002
3/4% Convertible Senior Subordinated Notes	—	19,224	—	19,224	—	19,224
3% Notes	—	—	—	—	—	—
Weighted average shares and potentially dilutive common shares outstanding—diluted	112,705	131,302	112,705	131,302	112,705	131,302
Income (loss) per share:						
Basic	$ (0.93)	$ 0.14	$ (0.32)	$ (0.21)	$ (1.26)	$ (0.07)
Diluted	$ (0.93)	$ 0.12	$ (0.32)	$ (0.17)	$ (1.26)	$ (0.05)

Diluted loss per share from continuing operations, discontinued operations and net loss for the second quarter and first half 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 loss for the second quarter and first half of fiscal 2005 because their inclusion would have been anti-dilutive. The items excluded for the second quarters and first half of fiscal 2006 and 2005 from continuing operations, discontinued operations and net loss were as follows:

	Three-Month Period Ended		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)			
Outstanding employee stock options	19,461	—	19,820	—
Warrants(1)	19,874	—	19,874	—
3/4% Convertible Senior Subordinated Notes	19,224	—	19,224	—
3% Notes	880	—	1,154	2,298

(1) In connection with the issuance of its 3/4% 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 3/4%

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 year ended March 31, 2005.

10. Comprehensive Loss

The Company's comprehensive 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		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)			
Net loss	$ (105,806)	$ (8,063)	$ (141,779)	$ (8,053)
Net unrealized gains (losses) on marketable securities, net of taxes	(1,231)	60	(810)	(3,034)
Foreign currency translation adjustment, net of taxes	(157)	101	(962)	(53)
Comprehensive loss	$ (107,194)	$ (7,902)	$ (143,551)	$ (11,140)

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

	September 30, 2005	March 31, 2005
	(in thousands)	
Unrealized losses on marketable securities	$ (1361)	$ (546)
Foreign currency translation, net of tax of $197 at September 30, 2005 and $834 at March 31, 2005	295	1,252
Total	$ (1,066)	$ 706

11. 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 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 second quarter and the first half of fiscal 2005 also differed from the combined United States Federal and state statutory income tax rate of 40% due to a benefit of $9.9 million from discrete events relating to the method and amount of settled controversies. As a result of the settlement, $4.1 million previously recorded as a tax provision has been reclassified as a reduction to additional paid-in capital, $1.8 million previously recorded as a tax provision has reversed, and a $4.0 million tax benefit associated with a refund claim has been recognized during the second quarter of fiscal 2005.

12. 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

Source: ADAPTEC INC, 10-Q, November 07, 2005

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.

13. 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.

Source: ADAPTEC INC, 10-Q, November 07, 2005

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 half of fiscal 2006 and 2005.

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

	Six-Month Period Ended	
	September 30, 2005	September 30, 2004
	(in thousands)	
Balance at beginning of period	$ 2,084	$ 1,598
Warranties provided	2,745	2,574
Actual costs incurred	(2,880)	(2,783)
Warranties classified as liabilities held for sale (Note 4)	(354)	—
Balance at end of period	$ 1,595	$ 1,389

14. Segment Reporting

In the second quarter of fiscal 2006, the Company reorganized its internal organization structure related to its OEM and Channel segments. Where historically 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.

For the period ended September 30, 2005, 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 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, interest and other income, interest expense, all administrative expenses and certain research and development, selling and marketing expenses.

Source: ADAPTEC INC, 10-Q, November 07, 2005

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 second quarter of fiscal 2005 and first half 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 second quarters and first half of fiscal 2006 and 2005:

	DPS	DSG	Other	Total
	(in thousands)			
Three-Month Period Ended September 30, 2005:				
Net revenues	$ 72,110	$ 11,124	$ —	$ 83,234
Segment income (loss)	17,712	(1,094)	(108,838)	(92,220)
Three-Month Period Ended September 30, 2004:				
Net revenues	$ 90,398	$ 9,354	$ —	$ 99,752
Segment income	24,586	2,925	(25,199)	2,312
Six-Month Period Ended September 30, 2005:				
Net revenues	$ 135,833	$ 19,916	$ —	$ 155,749
Segment income (loss)	28,235	(1,472)	(128,556)	(101,793)
Six-Month Period Ended September 30, 2004:				
Net revenues	$ 178,651	$ 19,958	$ —	$ 198,609
Segment income	47,826	5,960	(47,944)	5,842

The following table presents the details of unallocated corporate income and expenses for the second quarters and first half of fiscal 2006 and 2005:

	Three-Month Period Ended		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)			
Unallocated corporate expenses, net	$ (21,413)	$ (25,785)	$ (43,727)	$ (48,432)
Restructuring charges	(478)	(1,928)	(518)	(2,747)
Goodwill impairment	(90,602)	—	(90,602)	—
Interest and other income	4,523	3,659	8,131	5,502
Interest expense	(868)	(1,145)	(1,840)	(2,267)
Total	$ (108,838)	$ (25,199)	$ (128,556)	$ (47,944)

15. Supplemental Disclosure of Cash Flows

	Six-Month Period Ended	
	September 30, 2005	September 30, 2004
	(in thousands)	
Non-cash investing and financial activities:		
Deferred stock-based compensation	$ —	$ 7,060
Adjustment for deferred stock-based compensation	414	58
Unrealized loss on available-for-sale securities	(810)	(3,034)

16. 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

Source: ADAPTEC INC, 10-Q, November 07, 2005

assets sold or expected to be sold have been reclassified as Assets of Discontinued Operations on the Unaudited Condensed Consolidated Balance Sheet at September 30, 2005 and the related operations have been reclassified to Loss from Discontinued Operations 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.

Source: ADAPTEC INC, 10-Q, November 07, 2005

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 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. As of September 30, 2005, the Company had utilized $4.1 million of these charges. The Company anticipates that the remaining restructuring reserve balance of $2.6 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 half of fiscal 2006:

	Severance And Benefits	Other Charges	Total
		(in thousands)	
Snap Appliance Acquisition-Related Restructuring Plan:			
Reserve balance at March 31, 2005	155	2,901	3,056
Adjustments	(49)	—	(49)
Cash paid	(60)	(379)	(439)
Reserve balance at September 30, 2005	$ 46	$ 2,522	$ 2,568

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 In-Process Technology
	(in thousands)
IBM i/p Series RAID business(1)	$ 3,000
Snap Appliance(2)	2,200

(1) The in-process projects were related to designing semiconductors and related boards and enhancements to RAID and firmware code.

(2) The identified in-process projects were related to operating system enhancements and system functionality improvements.

The net cash flows from the identified projects were based on estimates of revenues, cost of revenues, research and development expenses, including costs to complete the projects, selling, marketing and administrative expenses, royalty expenses and income taxes from the projects. The Company believes the assumptions used in the valuations were reasonable at the time of the acquisitions. The estimated net

Source: ADAPTEC INC, 10-Q, November 07, 2005

revenues and gross margins were based on management's projections of the projects and were in line with industry averages. Estimated total net revenues from the projects of the IBM i/p Series RAID business and Snap Appliance were expected to grow through fiscal 2009 and decline thereafter as other new products were expected to become available. Estimated operating expenses included research and development expenses and selling, marketing and administrative expenses based upon historical and expected direct expense levels and general industry metrics. Estimated research and development expenses included costs to bring the projects to technological feasibility and costs associated with activities undertaken to correct errors or keep products updated with current information (also referred to as "maintenance" research and development) after a product is available for general release to customers. These activities range from 0% to 5% of net revenues for the in-process technologies.

The effective tax rate used in the analysis of the in-process technologies reflects a combined historical industry specific average for the United States Federal and state statutory income tax rates. The cost of capital reflects the estimated time to complete the projects and the level of risk involved. The following discount rates were used in computing the present value of net cash flows for the acquired companies: between 23% and 28% for the IBM i/p Series RAID business and approximately 24% for Snap Appliance.

The percentage of completion was determined using costs incurred by the IBM i/p Series RAID business and Snap Appliance prior to their respective acquisition dates compared to the estimated remaining research and development to be completed to bring the projects to technological feasibility. The Company estimated, as of the respective acquisition dates for the IBM i/p Series RAID business and Snap Appliance, that the projects were approximately 50% complete and 25% complete, respectively. All projects outstanding as of the acquisition date for the IBM i/p Series RAID business ceased as of September 30, 2005 with the sale of the business. All projects outstanding as of the acquisition date for Snap Appliance were completed as of September 30, 2005.

Pro forma financial information for the second quarter and first half of fiscal 2005 has not been disclosed as the acquisitions of the IBM i/p Series RAID business and Snap Appliance were included as part of discontinued operations.

17. Glossary

The following is a list of business related acronyms that are contained within this Quarterly Report on Form 10-Q. They are listed in alphabetical order.

- **ASIC:** Application Specific Integrated Circuit
- **ATA:** Advanced Technology Attachment
- **DAS:** Direct-Attached Storage
- **DPS:** Data Protection Solutions
- **DSG:** Desktop Solutions Group
- **ESPP:** Employee Stock Purchase Plan
- **I/O:** Input/Output
- **IP:** Internet Protocol
- **IPsec:** Internet Protocol Security
- **IRS:** Internal Revenue Service
- **iSCSI:** Internet Protocol SCSI

Source: ADAPTEC INC, 10-Q, November 07, 2005

- **NAS:** Network Attached Storage
- **ODM:** Original Design Manufacturer
- **OEM:** Original Equipment Manufacturer
- **PC:** Personal Computer
- **PCI:** Peripheral Component Interconnect
- **RAID:** Redundant Array of Independent Disks
- **ROC:** RAID on a Chip
- **SAN:** Storage Area Networks
- **SATA:** Serial Advanced Technology Attachment
- **SCSI:** Small Computer System Interface
- **SMI-S:** Storage Management Initiative Specification
- **Ultra DMA:** Ultra Direct Memory Access
- **USB:** Universal Serial Bus
- **VARs:** Value Added Reseller

The following is a list of accounting rules and regulations and related regulatory bodies referred to within this Quarterly Report on Form 10-Q. They are listed in alphabetical order.

- **APB:** Accounting Principles Board
- **APB Opinion No. 20:** Accounting Changes
- **APB Opinion No. 25:** Accounting for Stock Issued to Employees
- **ARB:** Accounting Research Bulletin
- **EITF:** Emerging Issues Task Force
- **EITF No. 95-3:** Recognition of Liabilities in Connection with Purchase Business Combinations
- **EITF No. 96-18:** Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services
- **EITF No. 03-01:** The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments
- **FASB:** Financial Accounting Standards Board
- **FIN:** FASB Interpretation Number
- **FIN 44:** Accounting for Certain Transactions Involving Stock Compensation
- **SAB:** Staff Accounting Bulletin
- **SAB 107:** Share Based Payment
- **SEC:** Securities Exchange Commission
- **SFAS:** Statement of Financial Accounting Standards
- **SFAS No. 3:** Reporting Accounting Changes in Interim Financial Statements

Source: ADAPTEC INC, 10-Q, November 07, 2005

- **SFAS No. 95:** Statement of Cash Flows
- **SFAS No. 115:** Accounting for Certain Investments in Debt and Equity Securities
- **SFAS No. 123:** Accounting for Stock-Based Compensation
- **SFAS No. 123(R):** Share Based Payment
- **SFAS No. 144:** Accounting for the Impairment or Disposal of Long-Lived Assets
- **SFAS No. 146:** Accounting for Costs Associated with Exit or Disposal Activities
- **SFAS No. 148:** Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of SFAS No. 123
- **SFAS No. 151:** Inventory Costs—an amendment of ARB No. 43, Chapter 4
- **SFAS No. 154:** Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and SFAS No. 3

Source: ADAPTEC INC, 10-Q, November 07, 2005

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

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

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

While management believes that the discussion and analysis in this report is adequate for a fair presentation of the information presented, we recommend that you read this discussion and analysis in conjunction with our Annual Report on Form 10-K for the year ended March 31, 2005. Our critical accounting policies have not changed from our year ended March 31, 2005. For a complete discussion of our critical accounting policies, please refer to our Annual Report on Form 10-K for the year ended March 31, 2005.

As discussed below, on September 30, 2005, we completed the sale to International Business Machnies, or IBM, of our IBM i/p Series RAID component business, or IBM i/p Series RAID Business, and on September 29, 2005, the Company's Board of Directors approved management's recommendation to divest our systems business. Both of these businesses have been accounted for as discontinued operations. Accordingly, we have reclassified the underlying Unaudited Condensed Consolidated Statements of Operations and Cash Flows and related disclosures for all periods presented to reflect the IBM i/p Series RAID Business and systems business as discontinued operations. Unless otherwise indicated, and other than balance sheet amounts as of March 31, 2005, the following discussion pertains only to our continuing operations. In addition, in the second quarter of fiscal 2006, we reorganized our reportable segments, which are described more fully in Note 14 to the Notes to the Unaudited Condensed Consolidated Financial Statements.

For your convenience, we have included, in Note 17 to the Notes to the Unaudited Condensed Consolidated Financial Statements, a Glossary that contains a list of (1) key acronyms commonly used in our industry that are used in this Quarterly Report and (2) accounting rules and regulations that are also referred to herein. These key acronyms and accounting rules and regulations are listed in alphabetical order.

Source: ADAPTEC INC, 10-Q, November 07, 2005

Results of Operations

Overview

Our new management team is continuing to perform a thorough analysis of our operations, which it initiated in the first quarter of fiscal 2006, and has begun making a detailed plan of our corporate strategy. This analysis of our operations includes a review of all aspects of our business, including our product portfolio, our relationships with strategic partners and our research and development focus. During the second quarter of fiscal 2006, we implemented the following steps:

- We reorganized our internal organization structure related to our OEM and Channel segments. Where historically our former OEM and Channel segments each offered an integrated set of customer-focused products, the new organization is managed at the product level. At September 30, 2005, our reportable segments were DPS and DSG. As a result of the segment reorganization, an assessment of the recoverability of goodwill was performed and we wrote-off the entire balance of goodwill of $90.6 million in the second quarter of fiscal 2006. All prior periods have been restated to reflect our new segments.
- On September 30, 2005, we sold our 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 our net book value of $0.8 million. We also 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 IBM's i/p Series RAID Business. Under the terms of the nonexclusive license, IBM will pay us royalties for the sale of our board-level products over the next six quarters, which will be recognized as contingent consideration in discontinued operations when earned. A loss of $7.0 million was incurred on the disposal of the IBM i/p Series RAID Business.
- On September 29, 2005, our Board of Directors approved management's recommendation to divest our 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, we have classified the systems business as a discontinued operation in the financial statements. We expect to receive proceeds, less cost to sell, in excess of its carrying value.

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

- Loss of customers;
- Reduced revenue base;
- Impairment of our assets;
- Increased operating costs; and
- Material restructuring charges.

Our future revenue growth remains largely dependent on the success of our data protection solutions, new OEM design wins and our products addressing new technologies (i.e., Serial Attached SCSI, SATA and iSCSI).

In the second quarter of fiscal 2006, our revenues decreased 17% as compared to the second quarter of fiscal 2005 primarily reflecting a decline in sales volumes of our SCSI products, which was partially offset by sales of our serial products primarily sold to OEMs. The decline in gross margin in the second

Source: ADAPTEC INC, 10-Q, November 07, 2005

quarter of fiscal 2006 compared to the second quarter of fiscal 2005 was primarily due to changes in our product and customer mix, which led to lower average selling prices, an excess inventory adjustment of $1.6 million related to our dual tuner products in our DSG segment and fixed costs associated with our manufacturing facilities that were distributed over lower revenue levels. Operating expenses decreased in the second quarter of fiscal 2006 as compared to the second quarter of fiscal 2005, primarily as a result of reduced headcount related to the ServerEngines and Vitesse strategic alliances we entered into in the fourth quarter of fiscal 2005 and decreased infrastructure spending and reduced headcount as a result of restructuring programs implemented in fiscal 2005.

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

	Three-Month Period Ended(1)		Six-Month Period Ended(2)	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
Net revenues	100 %	100 %	100 %	100 %
Cost of revenues	65	53	66	53
Gross margin	35	47	34	47
Operating expenses:				
Research and development	19	23	21	23
Selling, marketing and administrative	19	20	22	19
Amortization of acquisition-related intangible assets	2	2	2	3
Restructuring charges	1	2	0	1
Goodwill impairment	109	—	58	—
Total operating expenses	150	47	103	46
Income (loss) from continuing operations	(115)	0	(69)	1
Interest and other income	5	4	5	3
Interest expense	(1)	(1)	(1)	(1)
Income (loss) from continuing operations before income taxes	(111)	3	(65)	3
Provision for (benefit from) income taxes	3	(10)	2	(5)
Income (loss) from continuing operations	(114)	13	(67)	8
Discontinued operations, net of taxes (Note 4)				
Loss from discontinued operations, net of taxes	(5)	(21)	(19)	(12)
Loss from disposal of discontinued operations, net of taxes	(8)	—	(5)	—
Loss from discontinued operations	(13)	(21)	(24)	(12)
Net loss	(127)%	(8)%	(91)%	(4)%

(1) In the second quarter of fiscal 2006, we recorded a goodwill impairment charge of $90.6 million (Note 6). In the second quarter of fiscal 2005, we implemented a restructuring plan. These transactions affect the comparability of this data.

(2) In the first half of fiscal 2006, we recorded a goodwill impairment charge of $90.6 million. In the first half of fiscal 2005, we made a payment of $1.3 million to Nevada SCSI Enterprises, Inc., or NSE, in the form of a license fee (Note 7) and implemented restructuring plans in the first and second quarters of fiscal 2005. These transactions affect the comparability of this data.

Source: ADAPTEC INC, 10-Q, November 07, 2005

Net Revenues.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Segment Net Revenues:						
DPS	$ 72.1	$ 90.4	(20)%	$ 135.8	$ 178.6	(24)%
DSG	11.1	9.4	19%	19.9	20.0	0%
Total Net Revenues	83.2	99.8	**(17)**%	155.7	198.6	**(22)**%

Net revenues from our DPS segment decreased by $18.3 million and $42.8 million in the second quarter and first half of fiscal 2006, respectively, as compared to the corresponding periods of fiscal 2005, reflecting a decline in sales volumes of our SCSI products, which was partially offset by sales of our serial products primarily to OEMs. The decline in sales volumes of our SCSI products was primarily attributable to the transition from our Ultra 160 products to Ultra 320 products in which we have a lower market share, a shift to lower cost SATA solutions and motherboards that contain built-in SCSI I/O functionality, thus reducing our average selling price.

Net revenues from our DSG segment increased by $1.7 million in the second quarter compared to the second quarter of fiscal 2005 as a result of increased sales of our digital media products and sales of storage products that were introduced in the fourth quarter of fiscal 2005, partially offset by the decline in sales volumes of our SCSI-based desktop computer products. We expect revenues from our SCSI-based desktop computer products to continue to decline as OEMs are incorporating connectivity technologies directly into their products. Net revenues from our DSG segment remained relatively flat in the first half of fiscal 2006 compared to the first half of fiscal 2005.

	Three-Month Period Ended		Six-Month Period Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
Geographical Revenues:				
North America	32%	37%	34%	38%
Europe	31%	31%	31%	30%
Pacific Rim	37%	32%	35%	32%
Total Geographical Revenues	100%	100%	100%	100%

Our overall international revenues increased as a percentage of our total gross revenues in the second quarter and first half of fiscal 2006 as compared to the corresponding periods of fiscal 2005 primarily as a result of the decline in North America sales in the channel. Included in European revenues for the second quarter and first half of fiscal 2006 was $5.7 million and $10.7 million, respectively, of a last time buy customer order.

A small number of our customers account for a substantial portion of our net revenues, and we expect that a limited number of customers will continue to represent a substantial portion of our net revenues for the foreseeable future. IBM, Dell and Hewlett-Packard accounted for 27%, 15% and 12% of our total net revenues, respectively, in the second quarter of fiscal 2006. IBM and Dell accounted for 24% and 14% of our total net revenues, respectively, in the second quarter of fiscal 2005. IBM, Dell and Hewlett-Packard accounted for 26%, 15% and 10% of our total net revenues, respectively, in the first half of fiscal 2006. IBM, Dell and Synnex accounted for 21%, 14% and 11%, respectively, in the first half of fiscal 2005.

Source: ADAPTEC INC, 10-Q, November 07, 2005

Gross Margin.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Gross Profit	$ 28.9	$ 46.6	(38)%	$ 52.2	$ 93.6	(44)%
Gross Margin	35%	47%		34%	47%	

The decline in gross margin in the second quarter and first half of fiscal 2006 compared to the corresponding periods of fiscal 2005 was primarily due to changes in our product and customer mix, which led to lower average selling prices, an excess inventory adjustment of $1.6 million related to our dual tuner products in our DSG segment, fixed costs associated with our manufacturing facilities that were distributed over lower revenue levels and an excess inventory adjustment of $1.9 million recorded in the first half of fiscal 2006 related to the transition of our products to comply with the European Union RoHS Directive. Our gross margins will be significantly impacted in the future by the mix of OEM and channel revenue.

Research and Development Expense.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Research and Development	$ 15.7	$ 22.3	(30)%	$ 31.9	$ 46.1	(31)%

The decrease in research and development expense in the second quarter and first half of fiscal 2006 as compared to the corresponding periods of fiscal 2005 was primarily a result of reduced headcount achieved as a result of the ServerEngines and Vitesse strategic alliances we entered into in the fourth quarter of fiscal 2005, decreased infrastructure spending and reduced headcount as a result of restructuring programs implemented in fiscal 2005 and decreased deferred compensation charges of $0.6 million and $1.4 million in the second quarter and first half of fiscal 2006, respectively compared to the corresponding periods of fiscal 2005. Deferred compensation charges represented the vesting of assumed stock options in connection with our acquisition of Platys Communications, Inc., or Platys, in August 2001. Deferred compensation charges associated with the Platys acquisition ceased in the first quarter of fiscal 2006.

Selling, Marketing and Administrative Expense.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Selling, Marketing and Administrative	$ 16.3	$ 20.2	(19)%	$ 33.6	$ 37.2	(10)%

The decrease in selling, marketing and administrative expense in the second quarter and first half of fiscal 2006 as compared to the corresponding periods of fiscal 2005 was primarily a result of decreased spending due to reductions of our workforce and infrastructure spending as a result of the restructuring plans we implemented in fiscal 2005. This was partially offset by compensation of $1.2 million related to retirement costs of our former Chief Executive Officer.

Source: ADAPTEC INC, 10-Q, November 07, 2005

Amortization of Acquisition-Related Intangible Assets.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Amortization of Acquisition-Related Intangible Assets	$ 1.8	$ 2.4	(26)%	$ 3.8	$ 4.9	(23)%

Acquisition-related intangible assets include patents, core and existing technologies, covenants-not-to-compete, customer relationships and trade names. We amortize the acquisition-related intangible assets over periods which reflect the pattern in which the economic benefits of the assets are expected to be realized, which is primarily using the straight-line method over their estimated useful lives, ranging from three months to five years.

The decrease in amortization of acquisition-related intangible assets in the second quarter and first half of fiscal 2006 compared to the corresponding periods of fiscal 2005 was due to intangible assets that became fully amortized in August 2005 associated with our Platys acquisition and certain intangible assets that became fully amortized in fiscal 2005 associated with our acquisition of Eurologic Systems Group Limited in April 2003.

Restructuring Charges.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Restructuring Charges	$ 0.5	$ 1.9	(75)%	$ 0.5	$ 2.7	(81)%

In the first half of fiscal 2006, we recorded provision adjustments of $0.5 million related to severance and benefits as actual costs were lower than anticipated and additional lease costs related to the estimated loss of facilities that we subleased in California through April 2008 and the United Kingdom through December 2005, the end of the lease term. This restructuring charge pertained to our restructuring plans that we implemented in each quarter of fiscal 2005, and restructuring plans that we 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. 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 our Annual Report on Form 10-K for the year ended March 31, 2005. All expenses, including adjustments, associated with our 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.

Goodwill Impairment.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Goodwill Impairment	$ 90.6	$ —	100%	$ 90.6	$ —	100%

Goodwill is not amortized, but instead is reviewed annually and whenever events or circumstances occur which indicate that goodwill might be impaired. As a result of the segment reorganization discussed above and in Note 14 to the Notes to Unaudited Condensed Consolidated Financial Statements, an

Source: ADAPTEC INC, 10-Q, November 07, 2005

assessment of the recoverability of goodwill was performed. Impairment of goodwill is tested at our operating segment level by comparing each segment's carrying amount, including goodwill, to the fair value of that segment. To determine fair value, our review process uses the income, or discounted cash flows, approach and the market approach. In performing our analysis, we use 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, we wrote-off our entire balance of goodwill in the second quarter of 2006. Factors that led to this conclusion were industry technology changes such as parallel to serial technology and migration of core functionality to server chipsets; required increased investments that eventually led to the sale of the 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.

Interest and Other Income.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Interest and Other Income:						
Interest income	$ 3.9	$ 3.0	31%	$ 7.5	$ 5.8	31%
Payment of license fee with NSE	—	—	—	—	(1.3)	100%
Loss on redemption of debt	0.0	—	(100)%	(0.1)	—	(100)%
Other	0.6	0.7	(9)%	0.7	1.0	(30)%
Total Interest and Other Income	4.5	3.7	**24**%	8.1	5.5	**48**%

Interest and other income is primarily attributable to interest income earned on our cash, cash equivalents and marketable securities, fluctuations in foreign currency gains or losses, realized gains and losses on marketable securities, sublease income received from third parties and loss from the repurchase of our 3% Notes.

The increase in interest and other income in the second quarter and first half of fiscal 2006 as compared to the corresponding periods of fiscal 2005 was primarily due to higher interest income earned on our cash, cash equivalents and marketable securities and a one-time fully paid-up license fee of $1.3 million to NSE, which was recorded in the first half of fiscal 2005, primarily for historical products that incorporated certain technology. This was partially offset by foreign currency fluctuations primarily related to the Euro and a loss of $0.1 million on the repurchase of our 3% Notes for the first half of fiscal 2006. For further discussion on the settlement with NSE and gain on the sale of the property, please refer to Note 7 to the Notes to Unaudited Condensed Consolidated Financial Statements.

Interest Expense.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Interest Expense	$ (0.9)	$ (1.1)	(24)%	$ (1.8)	$ (2.3)	(19)%

Source: ADAPTEC INC, 10-Q, November 07, 2005

Interest expense is primarily associated with our ¾% Convertible Senior Subordinated Notes, or ¾% Notes and 3% Convertible Subordinated Notes, or 3% Notes, issued in December 2003 and March 2002, respectively. The decrease in interest expense for the second quarter and first half of fiscal 2006 compared to the corresponding periods of fiscal 2005 was primarily due to the reduction in the outstanding balances of the 3% Notes, as we repurchased $3.4 million and $23.2 million in aggregate principal amount of our 3% Notes during the second quarter and first half of fiscal 2006, respectively.

Income Taxes.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Provision for (Benefit from) Income Taxes	$ 2.6	$ (10.4)	(124)%	$ 3.4	$ (9.4)	(137)%

Income tax provisions for interim periods are based on our estimated annual effective income tax. The estimated annual tax for fiscal 2006 primarily consists of foreign taxes related to our foreign subsidiaries and interest accrued on prior years' tax disputes. We currently has a full valuation allowance on its net deferred tax assets. The tax rate for the second quarter and first half of fiscal 2005 differed from the combined United States Federal and state statutory income tax rate of 40% primarily due to certain acquisition-related intangible assets, excluding goodwill, that are not fully deductible for tax purposes and interest accrued on prior years' tax disputes. We are engaged in negotiations with the IRS with regard to various tax disputes that may result in the settlement of certain issues. Our 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 second quarter and the first half of fiscal 2005 also differs from the combined United States Federal and state statutory income tax rate of 40% due to a benefit of $9.9 million from discrete events relating to the method and amount of settled controversies. As a result of the settlement, $4.1 million previously recorded as a tax provision has been 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.

Discontinued Operations.

	Three-Month Period Ended			Six-Month Period Ended		
	September 30, 2005	September 30, 2004	Percentage Change	September 30, 2005	September 30, 2004	Percentage Change
	(in millions, except percentages)					
Discontinued Operations	$ (11.0)	$ (20.8)	(47)%	$ (36.5)	$ (23.2)	57%

IBM i/p Series RAID Business: On September 30, 2005, we sold our 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 our net book value of $0.8 million. We also 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 IBM's i/p Series RAID Business. Under the terms of the nonexclusive license, IBM will pay us royalties 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.

Under the terms of the arrangement, IBM forgave all outstanding liabilities that existed at June 30, 2005 which were due under the Distribution Agreement that was entered into in December 2004. Expenses incurred in the transaction primarily include costs of approximately $0.5 million for legal and accounting

Source: ADAPTEC INC, 10-Q, November 07, 2005

fees. In addition, we accrued $0.3 million for lease obligations. A loss of $7.0 million was incurred on the disposal of the IBM i/p Series RAID Business, which was previously included in our DPS segment.

Systems Business: On September 29, 2005, our Board of Directors approved management's recommendation to divest our 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, we have classified the systems business as a discontinued operation in the financial statements . We have entered into an exclusive arrangement with an investment banker to sell this business and expect to receive proceeds, less cost to sell, in excess of our carrying value.

Liquidity and Capital Resources

Key Components of Cash Flows

Cash used for operations was $11.3 million in the first half of fiscal 2006 as compared to cash provided by operations of $0.01 million in the first half of fiscal 2005. Cash used in the first half of fiscal 2006 resulted primarily from our net loss from continuing operations of $105.2 million. This was partially offset by the benefit of non-cash items included in operating results, which primarily consisted of an impairment of goodwill of $90.6 million and depreciation and amortization of $13.0 million. Additional factors included changes to working capital assets and liabilities that decreased cash provided by operating activities by $15.1 million and cash provided by operating activities of discontinued operations of $5.1 million. Operating cash for the first half of fiscal 2005 resulted primarily from our net income from continuing operations of $15.2 million and depreciation and amortization of $19.0 million. This was partially offset by the non-cash effect a tax settlement of $4.1 million, changes to working capital assets and liabilities that decreased cash provided by operating activities of continuing operations by $18.4 million and cash used by operating activities of discontinued operations of $13.5 million.

Cash used for investing activities was $330.0 million in the first half of fiscal 2006, which was primarily due to net sales and maturities of restricted marketable securities and marketable securities, net of purchases, of $325.6 million, proceeds from the sale of property and equipment of $2.7 million and purchases of property and equipment from continuing operations of $5.4 million. Cash used for investing activities was $2.3 million in the first half of fiscal 2005, which was primarily due to net sales and maturities of restricted marketable securities and marketable securities, net of purchases, of $128.9 million, offset by our use of $65.4 million of cash to acquire Snap Appliance and the IBM i/p Series RAID business and cash used in investing activities of discontinued operations of $59.3 million.

Cash used for financing activities of $20.4 million in the first half of fiscal 2006 was primarily driven by the repurchase of $23.2 million in aggregate principal amount of our 3% Notes for $23.0 million. Cash provided by financing activities was $3.8 million in the first half of fiscal 2005, which related to net proceeds received from our issuance of common stock in connection with stock option exercises.

Liquidity. At September 30, 2005, we had $489.0 million in cash, cash equivalents and marketable securities, of which approximately $62.4 million was held by our Singapore subsidiary. In the fourth quarter of fiscal 2005, we repatriated $360.6 million of undistributed earnings from Singapore to the United States and incurred a tax liability of $17.6 million. The repatriated amounts will be used to fund a qualified Domestic Reinvestment Plan, as required by the American Jobs Creation Act of 2004. If we do not spend the repatriated funds in accordance with our reinvestment plan, we may incur additional tax liabilities. We have not provided for U.S. deferred income taxes or foreign withholding taxes on the remaining undistributed earnings since these earnings totaling approximately $255.6 million are intended to be reinvested indefinitely. Although we do not have any current plans to repatriate the remaining undistributed earnings from our Singapore subsidiary to our United States parent company, if we were to

Source: ADAPTEC INC, 10-Q, November 07, 2005

do so, additional income taxes at the combined United States Federal and state statutory rate of approximately 40% could be incurred from the repatriation.

At September 30, 2005, we had $237.0 million of aggregate principal amount in convertible notes outstanding, consisting of $12.0 million in aggregate principal amount of our 3% Notes that are due in March 2007 and $225.0 million in aggregate principal amount of our ¾% Notes that are due in December 2023.

We are required to maintain restricted cash or investments to serve as collateral for the first ten scheduled interest payments on our ¾% Notes. As of September 30, 2005, we had $5.5 million of restricted cash and restricted marketable securities, consisting of United States government securities, of which $1.6 million was classified as short-term and $3.9 million was long-term.

The IRS is currently auditing our income tax returns for fiscal 1997 and final settlement agreements have been filed with the United States Tax Court on all but one issue. In addition, the IRS is auditing our Federal income tax returns for fiscal 1998 through fiscal 2003. We have 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 fiscal 2002 and 2003 audit is ongoing. We believe that we have sufficient tax provisions for these years. We believe the final outcome of the IRS audits will not have a material adverse impact on our liquidity. However, we cannot predict with certainty how these matters will be resolved and whether we will be required to make additional payments.

As of September 30, 2005, we did not have any material changes to our contractual obligations that were disclosed in the Liquidity section of our Form 10-K for the year ended March 31, 2005.

We believe that liquidity provided by our existing working capital, together with expected cash flows from operations and available sources of equity and equipment financing, will be sufficient to support our operations through at least the next twelve months. However, should prevailing economic conditions and/or financial, business and other factors beyond our control adversely affect our estimates of our future cash requirements, we would be required to fund our cash requirements by alternative financing. There can be no assurance that additional financing, if needed, would be available on terms acceptable to us or at all.

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. Our 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, we are required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted

Source: ADAPTEC INC, 10-Q, November 07, 2005

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. We are currently evaluating the impact of adopting this statement; however, we expect that it will have a significant impact on our consolidated financial statements. The impact on our consolidated financial statements will depend on the transition method, the option-pricing model used to compute fair value and the inputs to that model such as volatility and expected life. The pro forma disclosures of the impact of SFAS No. 123 provided in Note 3 of the Notes to the Unaudited Condensed Consolidated Financial Statements may not be representative of the impact of adopting this statement.

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. SAB 107 creates a framework that is premised on two overarching themes: (a) considerable judgment will be required by preparers to successfully implement SFAS No. 123(R), specifically when valuing employee stock options; and (b) reasonable individuals, acting in good faith, may conclude differently on the fair value of employee stock options. Key topics covered by SAB 107 include valuation models, expected volatility and expected term. We will apply the principles of SAB 107 in conjunction with our adoption of SFAS No. 123(R).

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 our financial statements.

At its March 2004 meeting, the EITF reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarified the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under SFAS No. 115 and investments accounted for under the cost method or the equity method. In September 2004, the FASB delayed the recognition and measurement guidance to be applied to other-than-temporary impairment evaluations. The FASB expects to issue additional implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads. If this additional implementation guidance is issued as currently written, we may have to recognize unrealized losses on investments in the Statements of Operations. If there is a material decline in the fair value of investments, our financial statements could be adversely affected.

RISK FACTORS

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

Our new management team is continuing to perform a thorough analysis of our operations, which it initiated in the first quarter of fiscal 2006, and has begun making a detailed plan of our corporate strategy. This analysis of our operations includes a review of all aspects of our business, including our product portfolio, our relationships with strategic partners and our research and development focus. During the second quarter of fiscal 2006, we implemented the following steps:

- We reorganized our internal organization structure related to our OEM and Channel segments. Where historically our former OEM and Channel segments each offered an integrated set of customer-focused products, the new organization is managed at the product level. At September 30,

Source: ADAPTEC INC, 10-Q, November 07, 2005

2005, our reportable segments were DPS and DSG. As a result of the segment reorganization, an assessment of the recoverability of goodwill was performed and we wrote-off the entire balance of goodwill of $90.6 million in the second quarter of fiscal 2006.

- On September 30, 2005, we sold our 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 our net book value of $0.8 million. We also 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 IBM's i/p Series RAID Business. Under the terms of the nonexclusive license, IBM will pay us royalties for the sale of our board-level products over the next six quarters, which will be recognized as contingent consideration in discontinued operations when earned. A loss of $7.0 million was incurred on the disposal of the IBM i/p Series RAID Business.
- On September 29, 2005, our Board of Directors approved management's recommendation to divest our 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, we has classified the systems business as a discontinued operation in the financial statements. We expect to receive proceeds, less cost to sell, in excess of its carrying value.

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

- Loss of customers;
- Reduced revenue base;
- Impairment of our assets;
- Increased operating costs; and
- Material restructuring charges.

If we are unable to successfully complete the divestiture of our systems business it could result in an adverse effect on our business and financial results. Completing the systems divestiture could cause significant diversions of management time and resources. In addition, if the anticipated proceeds, less cost to sell, prove to be less than anticipated, it could lead to an impairment of our assets. Additionally, customers for our systems products could be reluctant to continue to buy from us. We may not be successful in selling the systems business on terms that are acceptable to us or might not be able to find a buyer for the business. We may not be successful in overcoming these risks or any other problems encountered in connection with this divesture which may adversely affect our business, financial position and operating results.

Our operating results have fluctuated in the past, and are likely to continue to fluctuate, and if our future results are below the expectations of investors or securities analysts, the market price of our common stock would likely decline significantly. Our quarterly operating results have fluctuated in the past, and are likely to vary significantly in the future, based on a number of factors related to our industry and the markets for our products. Factors that are likely to cause our operating results to fluctuate include those discussed in this Risk Factors section. In the first half of fiscal 2006, our operating results were materially affected by unusual charges, including a goodwill impairment charge of $90.6 million and an excess inventory adjustment of $1.9 million related to the transition of our products to comply with the RoHS Directive.

Source: ADAPTEC INC, 10-Q, November 07, 2005

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

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

Our operating results may be adversely affected by unfavorable economic and market conditions and the uncertain geopolitical environment. Adverse economic conditions in some markets may impact our business, which could result in:

- Reduced demand for our products as a result of a decrease in capital spending by our customers;
- Increased price competition for our products;
- Increased risk of excess and obsolete inventories;
- Excess facilities and manufacturing capacity; and
- Higher overhead costs as a percentage of revenues.

Demand for our products would likely be negatively affected if demand in the server and network storage markets declines. For example, demand in the server market declined slightly in fiscal 2002 and fiscal 2003, which contributed to a decline in our net revenues. It is difficult to predict future server sales growth, if any. In addition, other technologies may replace the technologies used in our existing products and the acceptance of our products using new technologies in the market may not be widespread, which could adversely affect our revenues.

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

We depend on a few key customers and the loss of any of them could significantly reduce our revenues. Historically, a small number of our customers has accounted for a significant portion of our revenues. During the first half of fiscal 2006, sales to the ten customers from which we received the greatest revenues accounted for approximately 81% of our total gross revenues. In addition, IBM, Dell and Hewlett-Packard represented 27%, 15% and 12%, respectively, of our total net revenues in the first half of fiscal 2006. We believe that our major customers continually evaluate whether or not to purchase products from alternate or additional sources. Additionally, customers' economic and market conditions frequently change. Accordingly, we cannot assure you that a major customer will not reduce, delay or eliminate its purchases from us, which would likely cause our revenues to decline. In addition, we do not carry credit insurance on

Source: ADAPTEC INC, 10-Q, November 07, 2005

our accounts receivables and any difficulty in collecting outstanding amounts due from our customers, particularly customers that place larger orders or experience financial difficulties, could adversely affect our revenues and our net income. Because our sales are made by means of standard purchase orders rather than long-term contracts, we cannot assure you that these customers will continue to purchase quantities of our products at current levels, or at all.

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

- Designing products to meet customer needs;
- Product costs;
- Timely completion and introduction of new product designs;
- Quality of new products;
- Differentiation of new products from those of our competitors; and
- Market acceptance of our products.

Our product life cycles in each of our segments may be as brief as 12 months. As a result, we believe that we will continue to incur significant expenditures for research and development in the future. We may fail to identify new product opportunities and may not develop and bring new products to market in a timely manner. In addition, products or technologies developed by others may render our products or technologies obsolete or noncompetitive, or our targeted customers may not select our products for design or integration into their products. The failure of any of our new product development efforts could have an adverse effect on our business and financial results.

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

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

Technologies:

- ATA
- Fibre channel
- FireWire/1394
- IPsec
- iSCSI
- PCI
- PCI-Express
- PCI-X

Source: ADAPTEC INC, 10-Q, November 07, 2005

- RAID
- Serial Attached SCSI
- SATA
- SCSI
- SMI-S
- Ultra DMA
- USB

Operating Systems:

- Linux
- Macintosh
- Netware
- OS/2
- UNIX
- Windows

If user acceptance of these standards declines, or if new standards emerge, and if we do not anticipate these changes and develop new products, these changes could adversely affect our business and financial results.

If we lose the cooperation of other hardware and software producers whose products are integral to ours, our ability to sustain or grow our revenues could be adversely affected. We must design our products to operate effectively with a variety of hardware and software products supplied by other manufacturers, including the following:

- Microprocessors;
- Peripherals; and
- Operating system software.

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

We depend on contract manufacturers and subcontractors, and if they fail to meet our manufacturing needs, it could delay shipments of our products and result in the loss of customers. We rely on contract manufacturers for manufacturing of a portion of our systems products and subcontractors for the assembly and packaging of the integrated circuits included in our products and for the assembly. We have no long-term agreements with our assembly and packaging subcontractors. We have, from time to time, used board subcontractors to better balance production runs and capacity. For example, we employ Quanta

Source: ADAPTEC INC, 10-Q, November 07, 2005

Computer, Inc. and Sanmina-SCI Corporation to manufacture certain products related to the acquisition of Snap Appliance. We also employ Amkor Technology and Advanced Semiconductor Engineering for our final assembly and test operations related to our ASIC products. We cannot assure you these subcontractors will continue to be able and willing to meet our requirements for these components or services. For example, in the third quarter of fiscal 2005, Quanta Computer, Inc. could not meet our manufacturing needs and as a result initial product delivery dates committed to customers were not met. Any significant disruption in supplies from or degradation in the quality of components or services supplied by, these subcontractors could delay shipments and result in the loss of customers or revenues, which could have an adverse effect on our financial results. Our management team is evaluating increasing the use of contract manufacturers. If they decide to do so the risks identified above will increase.

We are subject to various environmental laws and regulations that could impose substantial costs upon us and may adversely affect our business. The European Parliament has enacted the Restriction on Use of Hazardous Substances Directive, or RoHS Directive, which restricts the sale of new electrical and electronic equipment containing certain hazardous substances, including lead that is currently used in some of the products we manufacture. We are working to modify our manufacturing processes to eliminate lead from our products in accordance with the timelines established in the RoHS Directive. This may require us to make additional capital expenditures. In addition, the costs associated with compliance may negatively impact our operating results and competitive position. For example, in the first half of fiscal 2006, we had an excess inventory adjustment of $1.9 million related to the transition of our products to comply with the RoHS Directive. We are also working with our suppliers to redesign or reformulate their components containing lead to reduce or eliminate lead in our products. If we are unable to comply with the RoHS Directive, we may suffer a loss of revenue, be unable to sell affected products in certain markets or countries and be at a competitive disadvantage.

The European Parliament has also recently finalized the Waste Electrical and Electronic Equipment Directive, or WEEE Directive, which makes producers of electrical and electronic equipment financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. We may incur financial responsibility for the collection, recycling, treatment or disposal of products covered under the WEEE Directive. Because the EU member states have not fully implemented the WEEE Directive, the nature and extent of the costs to comply and fees or penalties associated with non-compliance are unknown at this time. Costs to comply with the WEEE Directive and similar future legislation, if applicable, may also include legal and regulatory costs and insurance costs. We may also be required to take reserves for costs associated with compliance with these regulations.

We entered into strategic alliances with Vitesse for the development of our Serial Attached SCSI ROC product and with ServerEngines to advance our development of iSCSI products, and if these companies fail to develop and bring new products to market in a timely manner it could result in an adverse effect on our business and financial results. In January 2005, we entered into a strategic alliance with Vitesse for it to develop and market the next generation of our Serial Attached SCSI products. In March 2005, we entered into a strategic alliance with ServerEngines to develop and market the next generation of our IP storage products, such as 10Gb iSCSI. Accordingly, we are at risk that Vitesse and ServerEngines may encounter challenges in fulfilling their responsibilities under these alliances, such as timely completing and introducing new product designs, maintaining the quality of new products, minimizing product costs, differentiating new products from those of our competitors and achieving market acceptance of our products. The failure of this new product development effort could have an adverse effect on our business and financial results.

If we do not provide adequate support during our customers' design and development stage, or if we are unable to provide such support in a timely manner, we may lose revenues to our competitors. Certain of our products are designed to meet our customers' specifications and, to the extent we are not able to meet these expectations in a timely manner or provide adequate support during our customers' design and

Source: ADAPTEC INC, 10-Q, November 07, 2005

development stage, our customers may choose to buy similar products from another company. If this were to occur we may lose revenues and market share to our competitors.

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

- Rapid technological advances;
- Frequent new product introductions;
- Evolving industry standards; and
- Price erosion.

Consequently, we must continue to enhance our products on a timely basis to keep pace with market demands. If we do not do so, or if our competition is more effective in developing products that meet the needs of our existing and potential customers, we may lose market share and not participate in the future growth of our target markets. For example, intense competition in the transition from products employing Ultra 160 technology to products employing Ultra 320 technology has adversely affected revenues from our SCSI products. Our future success will depend on the level of acceptance of our external storage products and products based on the next generation SATA and Serial Attached SCSI technologies by new and existing customers. In addition, we expect that our future success will depend significantly on our ability to participate in the ongoing development of the network storage market in which we face intense competition from other companies that are also focusing on networked storage products.

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

- Satisfy any growth in demand for our products;
- Make timely introductions of new products;
- Compete successfully in the future against existing or potential competitors;
- Provide OEMs with design specifications in a timely manner; and
- Prevent price competition from eroding margins.

Costs associated with acquisitions or strategic alliances may adversely affect our results of operations, which could be exacerbated if we are unable to integrate the acquired companies, products or technologies. In fiscal 2005, we acquired Snap Appliance and the i/p Series RAID business from IBM. In fiscal 2004, we acquired Elipsan, ICP vortex, a provider of a broad range of hardware and software RAID data protection products, and Eurologic, a provider of external and networked storage products. In addition, we enter into strategic alliances from time to time with other companies. For example, we entered into strategic alliances with Vitesse and ServerEngines in January and March 2005, respectively. As part of our overall strategy, we may continue to acquire or invest in complementary companies, products or technologies and enter into strategic alliances with other companies. In order to be successful in these activities, we must:

- Conduct acquisitions that are timely, relative to existing business opportunities;
- Successfully prevail over competing bidders for target acquisitions at an acceptable price;
- Invest in companies and technologies that contribute to the growth of our business;
- Incorporate acquired operations into our business and maintain uniform standards, controls and procedures;
- Retain the key employees of the acquired operations; and
- Develop the capabilities necessary to exploit newly acquired technologies.

Source: ADAPTEC INC, 10-Q, November 07, 2005

The benefits of acquisitions or strategic alliances may prove to be less than anticipated and may not outweigh the costs reported in our financial statements. For example, during the first half of fiscal 2006, we sold the IBM i/p Series RAID Business for a loss of $7.0 million and plan to divest our systems business, which includes certain assets we obtained through the Snap Appliance and Eurologic Systems acquisitions.

Completing any potential future acquisitions or strategic alliances could cause significant diversions of management time and resources. If we acquire new businesses, products or technologies in the future, we may be required to assume warranty claims or other contingent liabilities, including liabilities unknown at the time of acquisition, and amortize significant amounts of other intangible assets and, over time, recognize significant charges for impairment of goodwill, other intangible assets or other losses. If we consummate any potential future acquisitions in which the consideration consists of stock or other securities, our existing stockholders' ownership may be significantly diluted. If we proceed with any potential future acquisitions in which the consideration is cash, we may be required to use a substantial portion of our available cash. In addition, we may be required to invest significant resources in order to perform under a strategic alliance or to complete an acquisition, which could adversely affect our results of operations, at least in the short-term, even if we believe the strategic alliance or acquisition will benefit us in the long-term. We may not be successful in overcoming these risks or any other problems encountered in connection with these or other business combinations, investments or strategic alliances. These transactions may adversely affect our business, financial position and operating results.

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

If there is a shortage of components used in our customers' products, our sales may decline, which could adversely affect our results of operations and financial position. If our customers are unable to purchase certain components which are embedded into their products, their demand for our products may decline. For example, beginning in the fourth quarter of fiscal 2005, we experienced the impact of other companies' enterprise drive shortages, which reduced the demand for our SCSI-related products from our OEM and Channel customers. This negatively affected our revenues in the fourth quarter of fiscal 2005. Similar shortages of components used in our customers' products could adversely affect our net revenues and financial results in future periods.

The manufacture and introduction of our products is highly complex. We confront challenges in the manufacturing process that require us to:

- Maintain a competitive manufacturing cost structure;
- Implement the latest process technologies required to manufacture new products;
- Exercise stringent quality control measures to ensure high yields;
- Effectively manage inventory levels;
- Effectively manage the subcontractors engaged in the wafer fabrication, test and assembly of products; and
- Update equipment and facilities as required for leading-edge production capabilities.

Source: ADAPTEC INC, 10-Q, November 07, 2005

We cannot assure you that problems with our manufacturing process may not occur in the future. If any such problems with our manufacturing process were to occur, we might not be able to meet the demands of our customers, which could harm our reputation, result in the loss of customers and adversely affect our net revenues and financial results in future periods.

We currently purchase all of the finished production silicon wafers used in our products from wafer suppliers, and if they fail to meet our manufacturing needs, it would delay our production and our product shipments to customers and negatively affect our operations. Independent foundries manufacture to our specifications all of the finished silicon wafers used for our products. We currently purchase finished production silicon wafers used in our products from Taiwan Semiconductor Manufacturing Company, or TSMC, and IBM. The manufacture of semiconductor devices is sensitive to a wide variety of factors, including the following:

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

We cannot assure you that manufacturing problems may not occur in the future. A shortage of raw materials or production capacity could lead our wafer suppliers to allocate available capacity to other customers. Any prolonged inability to obtain wafers with competitive performance and cost attributes, adequate yields or timely deliveries would delay our production and our product shipments, and could have an adverse effect on our business and financial results. We expect that our wafer suppliers will continually seek to convert their processes for manufacturing wafers to more advanced process technologies. Such conversions entail inherent technological risks that can affect yields and delivery times. If for any reason the wafer suppliers we use are unable or unwilling to satisfy our wafer needs, we will be required to identify and qualify additional suppliers. Additional wafer suppliers may be unavailable, may take significant amounts of time to qualify or may be unable to satisfy our requirements on a timely basis.

We depend on the efforts of our distributors, which if reduced, could result in a loss of sales of our products in favor of competitive offerings. We derived approximately 39% of our gross revenues for the first half of fiscal 2006 from independent distributor and reseller channels. Our financial results could be adversely affected if our relationships with these distributors or resellers were to deteriorate or if the financial condition of these distributors or resellers were to decline.

Our distributors generally offer a diverse array of products from several different manufacturers. Accordingly, we are at risk that these distributors may give higher priority to selling products from other suppliers. A reduction in sales efforts by our current distributors could adversely affect our business and financial results. For example, some of our distributors have threatened to stop selling our products or make pricing of our products non-competitive if we do not agree to absorb their costs to comply with the RoHS and WEEE Directives with respect to our products. Our distributors build inventories in anticipation of future sales, and if such sales do not occur as rapidly as they anticipate, our distributors will decrease the size of their product orders. If we decrease our price protection or distributor-incentive programs, our distributors may also decrease their orders from us. In addition, we have from time to time taken actions to reduce levels of products at distributors and may do so in the future. These actions may affect our net revenues and negatively affect our financial results.

Source: ADAPTEC INC, 10-Q, November 07, 2005

We reorganized our business segments and have planned significant system enhancements and improvements, and these changes could adversely impact our business if not adequately managed and controlled. In the second quarter of fiscal 2006, we reorganized our internal organization structure related to our OEM and Channel segments. Where historically our former OEM and Channel segments each offered an integrated set of customer-focused products, the new organization is managed at the product level. The reorganization has placed demands on our management and our operational and financial infrastructure. In addition, management is in the process of enhancing our supply-chain systems and processes. These system enhancements and improvements require expenditures and allocation of management resources. If these improvements are not implemented successfully, our ability to manage our new organization could be impaired. In addition, we may be required to incur additional expenditures to address these issues, which could harm our financial position.

If we do not meet our restructuring objectives, we may have to implement additional plans in order to reduce our operating costs and may, as a result, incur additional material restructuring charges. We have implemented several restructuring plans to reduce our operating costs in fiscal 2005, fiscal 2004 and fiscal 2003, and recorded related restructuring charges of $5.9 million, $4.3 million and $14.3 million, respectively. The plans included primarily the reduction of our workforce and the consolidation of our manufacturing operations in Singapore. The goals of these plans were to support future growth opportunities, focus on investments that grow revenues and increase operating margins. If we do not meet our restructuring objectives, we may have to implement additional restructuring plans to reduce our operating costs, which could cause us to incur material restructuring charges. Further, these restructuring plans may not achieve the goals we had in implementing them due to such factors as significant costs or restrictions on workforce reductions that may be imposed in some international locales and a potential adverse effect on employee morale that could harm our efficiency and our ability to act quickly and effectively in the rapidly changing technology markets in which we sell our products.

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

Our operations depend on key personnel, the loss of whom could affect the growth and success of our business. In order to be successful, we must retain and motivate our executives, the general managers of our business segments, our principal engineers and other key employees, including those in managerial,

Source: ADAPTEC INC, 10-Q, November 07, 2005

technical, marketing and information technology support positions. In particular, our product generation efforts depend on hiring and retaining qualified engineers. Competition for experienced management, technical, marketing and support personnel remains intense. For example, we transitioned certain research and development efforts to North Carolina, where we have experienced significant competition in our efforts to attract and retain qualified software engineers. The loss of any of these key employees could have a significant impact on our operations. We also must continue to motivate employees and keep them focused on our strategies and goals, which may be particularly difficult due to morale challenges posed by workforce reductions, the announcement of the diverstiture of the systems business and general uncertainty.

Our international operations involve risks, and may be subject to political or other non-economic barriers to our being able to sell our products in certain countries, local economic conditions that reduce demand for our products among our target markets and potential disruption in the supply of necessary components. Many of our subcontractors are primarily located in Asia and we have sales offices and customers located throughout Europe, Japan and other countries. Our international operations and sales are subject to political and economic risks, including political instability, currency controls, changes in import/export regulations, tariffs and freight rates. In addition, because our primary wafer supplier, TSMC, is located in Taiwan, we may be subject to certain risks resulting from political instability in Taiwan, including conflicts between Taiwan and the People's Republic of China. These and other international risks could result in the creation of political or other non-economic barriers to our being able to sell our products in certain countries, create local economic conditions that reduce demand for our products among our target market or expose us to potential disruption in the supply of necessary components or otherwise adversely affect our ability to generate revenue and operate effectively.

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

If the carrying value of our long-lived assets is not recoverable, an impairment loss must be recognized which would adversely affect our financial results. Certain events or changes in circumstances would require us to assess the recoverability of the carrying amount of our long-lived assets. In the first half of fiscal 2006, we recorded a goodwill impairment charge of $90.6 million related to our DPS segment. In fiscal 2005, we recorded a goodwill impairment charge of $52.3 million related to our Channel segment. In fiscal 2004, we recorded an impairment charge of $5.0 million related to certain properties classified as held-for sale and a charge of $1.0 million relating to the decline in value of a minority investment. In fiscal 2003, we recorded an impairment charge of $1.5 million relating to the decline in value of minority investments. In fiscal 2002, we recorded impairment charges of $77.6 million relating to technology acquired in a prior acquisition and the decline in value of minority investments. We will continue to evaluate the recoverability of the carrying amount of our long-lived assets, and we may incur substantial impairment charges which could adversely affect our financial results.

If actual results or events differ materially from those contemplated by us in making estimates and assumptions, our reported financial condition and results of operations for future periods could be materially affected. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. For example, we have identified key accounting estimates in our Critical Accounting Policies in our Annual Report on Form 10-K for the year ended March 31, 2005, which includes revenue, inventory, goodwill and income taxes. In addition, Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended March 31, 2005 describes the significant accounting policies essential to

Source: ADAPTEC INC, 10-Q, November 07, 2005

preparing our consolidated financial statements. The preparation of these financial statements requires estimates and assumptions that affect the reported amounts and disclosures. Although we believe that our judgments and estimates are appropriate and correct, actual future results may differ materially from our estimates.

If we are unable to protect and enforce our intellectual property rights, we may be unable to compete effectively. Although we actively maintain and defend our intellectual property rights, we may be unable to adequately protect our proprietary rights. In addition, the laws of certain territories in which our products are or may be developed, manufactured or sold, including Asia and Europe, may not protect our products and intellectual property rights to the same extent as the laws of the United States. Because we conduct a substantial portion of our operations in Singapore and other locations outside of the United States and sell to a worldwide customer base, we are more dependent on our ability to protect our intellectual property in international environments than would be the case if a larger portion of our operations were domestic.

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

Third parties may assert infringement claims against us, which may be expensive to defend and could divert our resources. From time to time, third parties assert exclusive patent, copyright and other intellectual property rights to our key technologies, and we expect to continue to receive such claims in the future. For example, in fiscal 2005, we, Nevada SCSI Enterprises, Inc. and Thomas A. Gafford (jointly, "NSE") entered into a license and release agreement, pursuant to which we paid NSE $1.7 million as a one-time, fully paid-up license fee to settle NSE's claims that some of our products infringed certain patents. In addition, we entered into a patent cross-license agreement with IBM in May 2000. Under this agreement, which was amended in March 2002, we received a release from infringement claims prior to January 1, 2000 and received the right to use certain of IBM's patents through June 30, 2007. In consideration, we paid, in annual installments, an aggregate patent fee of $13.3 million through June 30, 2004. The risks of our receiving additional claims from third parties may be enhanced in periods such as the one that we are currently entering where we are beginning to offer product lines employing new technologies relative to our existing products.

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

Source: ADAPTEC INC, 10-Q, November 07, 2005

We may be subject to a higher effective tax rate that could negatively affect our results of operations and financial position. Our effective tax rate is benefited by a Singapore tax holiday relating to certain of our products. The tax holiday package, which is effective until fiscal 2010, provides that profits derived from certain products may be exempt from tax, subject to certain conditions. If we do not meet the conditions and requirements of the tax holiday in Singapore, our effective tax rate may increase, which would adversely affect our financial results. We held approximately $62.4 million of cash, cash equivalents and marketable securities at our subsidiary in Singapore at September 30, 2005. During the fourth quarter of fiscal 2005, we repatriated $360.6 million of cash from Singapore to the United States in connection with the American Jobs Creation Act of 2004 which provides a one-time deduction of 85% for certain dividends from controlled foreign corporations. If the amount repatriated does not qualify for the one-time deduction, we could incur additional income taxes at up to the United States Federal statutory rate of 35%, which would negatively affect our results of operations and financial condition. Further, if our subsidiary in Singapore incurs losses in excess of their liquidity we may need to loan our subsidiary in Singapore money that could result in unfavorable tax consequences.

We may be required to pay additional federal income taxes which could negatively affect our results of operations and financial position. On December 15, 2000, we received a statutory notice of deficiency from the IRS with respect to our Federal income tax return for fiscal 1997. We filed a Petition with the United States Tax Court on March 14, 2001, contesting the asserted deficiencies and settlement agreements have been filed with the United States Tax Court on all but one issue. In addition, the IRS is currently auditing our Federal income tax returns for fiscal 1998 through fiscal 2003. We have 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. While we believe we have meritorious defenses against the asserted deficiencies and any proposed adjustments, and that sufficient taxes have been provided, we cannot predict the final outcome of these matters, and the final resolution could adversely affect our results of operations and financial position.

We may be engaged in legal proceedings that could cause us to incur unforeseen expenses and could occupy a significant amount of our management's time and attention. From time to time we are subject to litigation or claims that could negatively affect our business operations and financial position. Such disputes could cause us to incur unforeseen expenses, could occupy a significant amount of our management's time and attention, and could negatively affect our business operations and financial position.

We have in the past financed a portion of our capital expenditure needs from capital market financing, and if we need to seek additional financing, it may not be available on favorable terms. In order to finance strategic acquisitions, capital asset acquisitions and other general corporate needs, we have in the past relied, in part, on the capital markets. Historically, we have been able to access capital markets, but this does not necessarily guarantee that we will be able to access these markets in the future or at terms that are acceptable to us. The availability of capital in these markets is affected by several factors, including geopolitical risk, the interest rate environment and the condition of the economy as a whole. In addition, our own operating performance, capital structure and expected future performance impacts our ability to raise capital. We believe that our current cash, cash equivalents, short-term investments and future cash provided by operations will be sufficient to fund our needs for at least the next twelve months. However, if our operating performance falls below expectations, we may need additional funds, which may not be available on favorable terms, if at all.

We are exposed to fluctuations in foreign currency exchange rates. Because a significant portion of our business is conducted outside the United States, we face exposure to adverse movements in non-United States currency exchange rates. These exposures may change over time as business practices evolve and could have an adverse impact on our financial results and cash flows. Historically, our exposures have related to non-dollar-denominated operating expenses in Europe and Asia. We began Euro-denominated sales to our distribution customers in the European Union in the fourth quarter of fiscal 2003.

Source: ADAPTEC INC, 10-Q, November 07, 2005

Additionally, we purchase a substantial portion of our raw materials and manufacturing equipment from foreign suppliers, and incur labor and other operating costs in foreign currencies, particularly in our Singapore manufacturing facility. An increase in the value of the dollar could increase the real cost to our customers of our products in markets outside the United States where we sell in dollars, and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials to the extent we must purchase components in foreign currencies.

We hold minority interests in privately held venture funds, and if these venture funds face financial difficulties in their operations, our investments could be impaired. We continue to hold minority interests in privately held venture funds. At September 30, 2005, the carrying value of such investments aggregated $3.4 million. We have also committed to provide additional funding of up to $0.4 million. These investments are inherently risky because these venture funds invest in companies that may still be in the development stage or depend on third parties for financing to support their ongoing operations. In addition, the markets for the technologies or products of these companies are typically in the early stages and may never develop. If these companies do not have adequate cash funding to support their operations, or if they encounter difficulties developing their technologies or products, the venture funds' investments in these companies may be impaired, which in turn, could result in impairment of our investment in these venture funds.

Our spin-off of Roxio Inc., which is now known as Napster Inc., may have potential subsequent tax liabilities that could negatively affect our results of operations. Pursuant to our distribution of the Roxio, Inc. common stock, we received an opinion from PricewaterhouseCoopers LLP, or PwC, regarding the tax-free nature of the transaction to us and to our stockholders under Section 355 of the Internal Revenue Code. The validity of the PwC opinion relating to the qualification of the distribution as a tax-free transaction is subject to factual representations and assumptions. We are not aware of any facts or circumstances that would cause such representations and assumptions to be untrue. In addition, the opinion of PwC is not binding on the IRS. If Napster or we fail to conform to the requirements set forth in the IRS regulations, it could cause the distribution to be taxable to us and to our stockholders, and our financial results could be adversely affected.

We may have potential business conflicts of interest with Roxio, which is now known as Napster, with respect to our past and ongoing relationships, and we may not resolve these conflicts on terms favorable to us. Conflicts of interest may arise between Napster and us in areas relating to our past and ongoing relationship, including tax, indemnification and other matters arising from the separation. These and other business conflicts could adversely affect the growth of our business in the future.

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

In addition, The Nasdaq National Market, on which our common stock is listed, has also adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices. We also expect these developments to make it more difficult and more expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, our board members, Interim Chief Executive Officer and Chief Financial Officer could face an increased risk of

Source: ADAPTEC INC, 10-Q, November 07, 2005

personal liability in connection with the performance of their duties. As a result, we may have difficultly attracting and retaining qualified board members and executive officers, which would adversely affect our business.

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

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

We may encounter natural disasters, which could cause disruption to our employees or interrupt the manufacturing process for our products. Our operations could be subject to natural disasters and other business disruptions, which could seriously harm our revenues and financial condition and increase our costs and expenses. Our corporate headquarters are located in California, near major earthquake faults. Additionally, our primary wafer supplier, TSMC, is located in Taiwan, which has experienced significant earthquakes in the past. A severe earthquake could cause disruption to our employees or interrupt the manufacturing process, which could affect TSMC's ability to supply wafers to us, which would negatively affect our business and financial results. The ultimate impact on us and our general infrastructure of being located near major earthquake faults is unknown, but our net revenues and financial condition and our costs and expenses could be significantly impacted in the event of a major earthquake.

Manmade problems such as computer viruses or terrorism may disrupt our operations and harm our operating results. Despite our implementation of network security measures, our servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. Any such event could have an adverse effect on our business, operating results, and financial condition. In addition, the effects of war or acts of terrorism could have an adverse effect on our business, operating results, and financial condition. In addition, as a company with headquarters and significant operations located in the United States, we may be impacted by actions against the United States. We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war.

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

Source: ADAPTEC INC, 10-Q, November 07, 2005

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For financial market risks related to changes in interest rates, equity price and foreign currency exchange rates, reference is made to Item 7A "Quantitative and Qualitative Disclosures About Market Risk" contained in Part II of our Annual Report on Form 10-K for the year ended March 31, 2005. Our exposure to market risk has not changed materially since March 31, 2005.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Interim Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), we conducted an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, our Interim CEO and our CFO have concluded that the design and operation of our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Interim CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Source: ADAPTEC INC, 10-Q, November 07, 2005

PART II. OTHER INFORMATION

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

Our Annual Meeting of Stockholders was held on August 25, 2005, in our principal executive offices located in Milpitas, California. Of the total 112,479,437 shares of our common stock outstanding as of the record date, 102,129,139 shares (91%) were present or represented by proxy at the meeting. The table below presents the voting results of election of our Board of Directors.

	Votes	Votes Withheld
Carl J. Conti	94,398,727	7,730,412
Lucie J. Fjeldstad	90,588,983	11,540,156
Joseph S. Kennedy	85,578,328	16,550,811
Ilene H. Lang	96,936,876	5,192,263
Robert J. Loarie	90,306,502	11,822,637
D. Scott Mercer	94,449,781	7,679,358
Douglas E. Van Houweling	95,514,623	6,614,516

The stockholders approved our stock option exchange program for employees (excluding Section 16 officers and directors) providing for the exchange of stock options previously granted under our Company's stock plans having an exercise price of $7.00 or greater per share for a lesser number of stock to be granted following the expiration of a tender offer to be made to such employees. The proposal received 44,179,183 affirmative votes, 24,260,734 negative votes, 3,703,698 abstentions and 29,985,524 broker non-votes. We decided not to implement this stock option exchange program but instead granted options to purchase approximately 6.3 million shares of our common stock to our employees.

In addition, our stockholders ratified and approved the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending March 31, 2006. The proposal received 99,044,923 affirmative votes, 2,955,318 negative votes, 128,898 abstentions and no broker non-votes.

Item 6. Exhibits

Exhibit Number	Description
Exhibit 10.1	Registrant's 2005 Deferred Compensation Plan
Exhibit 31.1	Certification of Interim Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1	Certification of Interim Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Source: ADAPTEC INC, 10-Q, November 07, 2005

SIGNATURE

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

ADAPTEC, INC.

By: /s/ MARSHALL L. MOHR
Marshall L. Mohr
Vice President and Chief Financial Officer
(principal financial and accounting officer)

Date: November 7, 2005

Source: ADAPTEC INC, 10-Q, November 07, 2005

EXHIBIT INDEX

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Source: ADAPTEC INC, 10-Q, November 07, 2005

Exhibit 10.1

ADAPTEC
2005 DEFERRED COMPENSATION PLAN

(Effective January 1, 2005)

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ADAPTEC
2005 DEFERRED COMPENSATION PLAN
(Effective January 1, 2005)

Adaptec, Inc. has adopted this deferred compensation plan, effective January 1, 2005, entitled the Adaptec 2005 Deferred Compensation Plan (the "Plan"). Adaptec also maintains another deferred compensation plan, entitled the Adaptec Deferred Compensation Plan, which was most recently amended and restated in its entirety, effective July 21, 2004, and which was frozen effective December 31, 2004.

The purpose of the Plan is to provide deferred compensation for a select group of management or highly compensated employees of Adaptec and its subsidiaries. The Plan is intended to be a nonqualified deferred compensation plan. Accordingly, it is intended that the Plan be exempt from the requirements of Parts 2, 3 and 4 of Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") pursuant to Sections 201(2), 301(a)3) and 401(a)(1) of ERISA. This Plan is intended to meet the applicable requirements of the American Jobs Protection Act of 2004.

ARTICLE I
DEFINITIONS

Whenever used herein, the masculine pronoun shall be deemed to include the feminine, and the singular to include the plural, unless the context clearly indicates otherwise, and the following definitions shall govern the Plan:

1.1 "Account and Sub Account" "Account" means the book entry account established under the Plan for each Participant to which the Participant's Salary Deferral Amounts, AIP Deferral Amounts, VIP Deferral Amounts, MIP Deferral Amounts, any Additional Contributions made by the Employer pursuant to Article III, and the Interest with respect thereto shall be credited. Such Account balance shall be reduced by any distributions made to the Participant or the Participant's Beneficiary(ies) and any charges that may be imposed on such Account pursuant to the terms of the Plan.

In addition, a "Sub Account" may be established under the Plan for each Participant who is (i) actively employed by the Employer, (ii) receiving distributions pursuant to a Benefit Distribution Election, and (iii) elects to make Salary deferrals and/or deferrals of amounts payable under the AIP, VIP and/or MIP to this Plan or is receiving Additional Contributions. Such "Sub Account" shall be a book entry account established under the Plan for each such Participant to which the Participant's Salary Deferral Amounts, AIP Deferral Amounts, VIP Deferral Amounts, MIP Deferral Amounts, any Additional Contributions made by the Employer pursuant to Article III, and the Interest with respect thereto shall be credited. Such Sub Account balance shall separately be reduced by any distributions made to the Participant or the

Source: ADAPTEC INC, 10-Q, November 07, 2005

Participant's Beneficiary(ies) and any charges that may be imposed on such Sub Account pursuant to the terms of the Plan.

Account and Sub Account may be referred to herein collectively as "Accounts."

1.2 "Adaptec" means Adaptec, Inc., a Delaware corporation and any successor organization thereto.

1.3 "AIP" means the Adaptec Incentive Plan, as amended from time to time.

1.4 "Additional Contribution" means an Additional Contribution, contributed by the Employer on behalf of a Participant pursuant to Article III.

1.5 "AIP Deferral Amount" means the amount or percentage of bonus or incentive payments that an Eligible Employee is entitled to under the AIP and elects to contribute to the Plan pursuant to a valid Election form in accordance with the provisions of Article III.

1.6 "Benchmark Fund" means one or more of the mutual funds or contracts selected by the Deferred Compensation Committee pursuant to Section 4.3(a).

1.7 "Beneficiary" means one, some, or all (as the context shall require) of those persons, trusts or other entities designated by a Participant to receive the undistributed portion of his/her Accounts following the Participant's death.

1.8 "Benefit Distribution Election" means the form of election, as prescribed by the Plan Administrator and as may be modified from time to time, upon which a Participant shall designate his/her Distribution Date.

1.9 "Benefits" means the amount(s) credited to Participant's Accounts.

1.10 "Board of Directors" or "Board" means the Board of Directors of Adaptec.

1.11 "Change of Control" means (i) a "change in the ownership of a corporation" (ii) a "change in effective control of a corporation" or (iii) a "change in the ownership of a substantial portion of a corporations' assets" as such terms are defined in guidance issued by the Secretary of the Treasury or Internal Revenue Service pursuant to Section 885(e) of the American Jobs Creation Act of 2004, including, Notice 2005-1, Section B, Q&As 11-14.

1.12 "Code" means the Internal Revenue Code of 1986, as amended.

1.13 "Deferred Compensation Committee" means the committee appointed by the Board which shall function as the Plan Administrator and which shall be composed of the individuals serving the Company in the following positions:

(a) Chief Executive Officer of Adaptec

(b) The senior executive of Adaptec responsible for Human Resources

Source: ADAPTEC INC, 10-Q, November 07, 2005

(c) Manager, Employee Benefits

1.14 "Distribution Date" means the date on which distribution of a Participant's Benefits is made or commenced pursuant to Article V.

1.15 "Effective Date" means January 1, 2005.

1.16 "Election" means the form on which a Participant elects to make Salary deferrals and/or deferrals of amounts payable under the AIP, VIP and/or MIP to this Plan. Such Election shall be in a form prescribed by the Plan Administrator as it may be modified from time to time.

1.17 "Eligible Employee" means an employee of the Employer who is a member of a select group of management or highly compensated employees as more particularly described in Article II and who has been designated by the Plan Administrator, in the Plan Administrator's sole discretion, to be eligible to participate in the Plan and shall also include every non-employee member of the Board of Directors.

1.18 "Employer" means Adaptec or a subsidiary thereof that has adopted this Plan with the approval of Adaptec.

1.19 "Interest" means the investment return or loss determined in accordance with Article IV, which shall be credited to the Participant's Accounts.

1.20 "Interest Rate" shall have the meaning set forth in Section 4.3(c).

1.21 "MIP" means the Management Incentive Plan adopted by the Company in July 2004, as it may be amended from time to time.

1.22 "MIP Deferral Amount" means the amount or percentage of bonus or incentive payments that an Eligible Employee is entitled to under the MIP and elects to contribute to the Plan pursuant to a valid Election form in accordance with the provisions of Article III.

1.23 "Participant" means an Eligible Employee who has elected to participate in the Plan by executing an Election form. A Participant shall also mean an Eligible Employee for whom Additional Contributions are made, regardless of whether such Eligible Employee has executed an Election form.

1.24 "Plan" means this Adaptec 2005 Deferred Compensation Plan, as it may be amended from time to time.

1.25 "Plan Administrator" means the Deferred Compensation Committee selected to administer this Plan and to take such other actions as may be specified herein.

1.26 "Plan Year" means the calendar year.

1.27 "Retirement with the Consent of the Employer" means a Participant's voluntary termination of employment or ceasing to serve as a non-employee member of the Board, if prior

Source: ADAPTEC INC, 10-Q, November 07, 2005

to the date employment is terminated or Board membership ceases the Participant completed at least five years of service for the Employer, including service for any subsidiary or former subsidiary either as an Employee or member of the Board.

1.28 "Salary" means the base salary paid by the Employer, but shall not include any other form of compensation, whether taxable or non-taxable, including, but not limited to, bonuses, commissions, overtime, incentive payments, non-monetary awards and other forms of additional compensation. In the case of a Participant who is a non-employee member of the Board, "salary" shall mean all cash compensation for service as a member of the Board.

1.29 "Salary Deferral Amount" means the Salary Deferral Amount which the Participant elects to contribute to the Plan pursuant to a valid Election form in accordance with the provisions of Article III.

1.30 "Termination Event" means the termination of the Participant's employment with the Employer or ceasing to be a member of the Board for any reason, including termination or cessation in the event of Total Disability but not including the Participant's Retirement with the Consent of the Employer.

1.31 "Total Disability" a Participant shall be considered disabled if the Participant is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period, of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three (3) months under an accident and health plan covering employees of the Participant's Employer.

1.32 "Trust" means the legal entity created by the Trust Agreement.

1.33 "Trust Agreement" means that trust agreement entered into between Adaptec and Putnam Fiduciary Trust Company, effective April 1, 2002, as amended effective January 1, 2005, as it may subsequently be amended from time to time.

1.34 "Trustee" means the original Trustee(s) named in the Trust Agreement and any duly appointed successor(s) thereto.

1.35 "VIP" means the Variable Incentive Plan maintained by Adaptec, as it may be amended from time to time.

1.36 "VIP Deferral Amount" means the amount or percentage of bonus or incentive payments that an Eligible Employee is entitled to under the VIP and elects to contribute to the Plan pursuant to a valid Election form in accordance with the provisions of Article III.

Source: ADAPTEC INC, 10-Q, November 07, 2005

ARTICLE II
ELIGIBILITY

2.1 Eligibility. Eligibility for participation in the Plan shall be limited to non-employee members of the Board and to key management or highly compensated employees of the Employer who are selected by the Plan Administrator, in its sole discretion, to participate in the Plan. Individuals who are in this select group shall be notified as to their eligibility to participate in the Plan. For purposes of the Plan, the phrase "select group of management or highly compensated employees" shall include those individuals employed as directors and those individuals employed in positions at a higher level, all as determined by the Plan Administrator.

2.2 Commencement of Participation. An Eligible Employee may begin participation in the Plan upon the Eligible Employee's submission of a valid Election form pursuant to Article III. In order to commence Salary deferrals and/or deferrals of amounts payable under the AIP, VIP and/or MIP, the Election form must be returned to the Plan Administrator within thirty (30) days of the date an individual first becomes an Eligible Employee; otherwise the Election form must be returned to the Plan Administrator in advance of the next subsequent Plan Year, in accordance with rules and procedures established by the Plan Administrator.

2.3 Cessation of Participation. Active participation in the Plan shall end when a Participant's employment terminates for any reason. No contributions to the Plan shall be made with respect to compensation paid after such termination date. Upon termination of employment, a Participant shall remain an inactive participant in the Plan until all of the Benefits to which he or she is entitled under this Plan have been paid in full.

2.4 Suspension of Participation. A Participant who is employed by a subsidiary which has not adopted the Plan shall be a suspended Participant. No contributions to the Plan shall be made on behalf of a suspended Participant. Except as otherwise provided in this Article II, a suspended Participant shall continue to participate in the Plan in accordance with its terms.

ARTICLE III
DEFERRALS AND CONTRIBUTIONS

3.1 Deferral Elections Generally. Each Participant must complete a deferral Election in the form and manner specified by the Committee for each Plan Year with respect to which he or she wishes to defer all or part of his or her Salary or payment under the AIP, VIP and/or MIP. The Salary Deferral Amount, AIP Deferral Amount, VIP Deferral Amount and/or MIP Deferral Amount shall not be paid to the Participant, but shall be withheld and shall be credited to the Participant's Account or Sub Account (as appropriate). To be effective, each such deferral Election must satisfy the following rules:

(a) The deferral Election form must be signed and dated by the Participant, specify the deferral amount or percentage and comply with such other rules and procedures established by the Plan Administrator.

Source: ADAPTEC INC, 10-Q, November 07, 2005

(i) A Participant who is a non-employee member of the Board may elect to reduce his or her Salary by 50% or 100% as set forth in a written Election filed with the Plan Administrator.

(b) All deferral Elections are irrevocable throughout the Plan Year for which they are made. An Election to stop deferrals or to change the Salary Deferral Amount, AIP Deferral Amount, VIP Deferral Amount and/or MIP Deferral Amount will take effect on the first day of the Plan Year that is at least 20 days (or such lesser number of days as the Plan Administrator may specify) after the date the new valid Election form is filed with the Plan Administrator. Notwithstanding the foregoing, in accordance with Notice 2005-1, a Participant may either terminate participation in the Plan or cancel an Election to defer Salary or payments under the AIP, VIP, and/or MIP which are subject to Code Section 409A, provided such termination or cancellation is filed on or before December 20, 2005, in accordance with the rules and procedures established by the Plan Administrator. The amounts subject to any such termination or cancellation shall be includible in income of the Participant in calendar year 2005 or, if later, the Participant's taxable year in which the amount is earned and vested (as defined in Notice 2005-1, Q&A 16).

(c) The deferral Election must generally be received by the Plan Administrator before the beginning of the Plan Year in which the Salary, AIP, VIP and/or MIP is earned; provided, however, in the case of a newly-eligible Eligible Employee, the deferral Election form (i) must be received by the Plan Administrator within thirty (30) days of the date on which the Eligible Employee becomes eligible, and (ii) will be effective with respect to Salary, AIP, VIP and/or MIP earned after the Election.

3.2 Limitations on Deferrals. A Participant's Salary, AIP, VIP, and/or MIP Deferral Amount shall be limited as follows:

(a) The Salary Deferral Amount, AIP Deferral Amount, VIP Deferral, and/or MIP Deferral Amount elected by the Participant shall be reduced by the amount(s), if any, which may be necessary:

(i) To satisfy all applicable income and employment tax withholding and FICA contributions;

(ii) To pay all contributions elected by the Participant pursuant to applicable Adaptec health, welfare and fringe benefit programs; and

(iii) To satisfy all garnishments or other amounts required to be withheld by applicable law or court order.

(b) Any withholding or Salary deferral elections made under an Employer sponsored 401(k) plan shall be determined based on the Participant's compensation after reduction for the Salary Deferral Amount, AIP Deferral Amount, VIP Deferral Amount, and/or MIP Deferral Amount contributed to this Plan.

Source: ADAPTEC INC, 10-Q, November 07, 2005

3.3 Additional Contributions. Additional Contributions may be credited to a Participant's Account or Sub Account (as appropriate) in such amounts and at such times as the Employer may, in its sole discretion, determine and communicate to the Participant. The Employer shall be under no obligation to continue to credit Additional Contributions and may discontinue or change the amount or method of calculating the amount of such Additional Contributions at any time.

3.4 No Withdrawal. Except as provided in Section 5.3 below, amounts credited to a Participant's Accounts may not be withdrawn by a Participant and shall be paid only in accordance with the provisions of this Plan.

ARTICLE IV
ACCOUNTS

4.1 Account and/or Sub Account. An Account shall be established and maintained for each Participant. The Participant's Account shall be credited with the Participant's Salary Deferral Amount, AIP Deferral Amount, VIP Deferral Amount, MIP Deferral Amount and Additional Contributions, if any, made on behalf of each Participant. The Participant's Account shall be credited (debited) with the applicable Interest, as set forth in Section 4.2. The Participant's Account shall be reduced by distributions therefrom and any charges which may be imposed on the Account pursuant to the terms of the Plan.

A "Sub Account" may be established under the Plan for each Participant who is (i) actively employed by the Employer, (ii) receiving distributions pursuant to a Benefit Distribution Election, and (iii) elects to make Salary deferrals and/or deferrals of amounts payable under the AIP, VIP and/or MIP to this Plan or is receiving Additional Contributions. The Participant's Sub Account shall be credited (debited) with all applicable Interest, as set forth in Section 4.2. The Participant's Sub Account shall separately be reduced by any distributions therefrom and any charges that may be imposed on such Sub Account pursuant to the terms of the Plan.

4.2 Interest Credited to Accounts at Least Monthly. Each Account or Sub Account (as appropriate) shall be credited (debited) monthly, or more frequently as the Committee may specify, in an amount equal to the Account or Sub Account (as appropriate) balance on the last day of the prior accounting period multiplied by the Interest Rate.

4.3 Determination of Interest Rate.

(a) The Deferred Compensation Committee shall designate the particular funds or contracts which shall constitute the Benchmark Funds, and may, in its sole discretion, change or add to the Benchmark Funds.

(b) Each Participant may select among the Benchmark Funds and specify the manner in which his or her Accounts shall be deemed to be invested, solely for purposes of determining the Participant's Interest Rate. The Deferred Compensation Committee shall establish and communicate the rules, procedures and deadlines for making and changing

Source: ADAPTEC INC, 10-Q, November 07, 2005

Benchmark Fund selections. The Employer shall have no obligation to acquire investments corresponding to the Participant's Benchmark Fund selections.

(c) The Interest Rate is the investment return, net of administrative fees and investment management fees and other applicable fees or charges for a specified accounting period, of the Benchmark Fund(s) designated by Participant and other applicable fees or charges. The Interest Rate may be negative if the applicable Benchmark Fund(s) sustained a loss during the specified accounting period.

ARTICLE V
BENEFITS

5.1 Distributions.

(a) Timing of Distribution. The amounts credited to a Participant's Account or Sub Account shall be paid (or payment shall commence) within a reasonable time after:

(i) If the Participant is currently employed by the Employer the Benefit Distribution Date, as defined in Section 5.1(b), on which the Participant elected to receive a distribution of Benefits from his/her Account or Sub Account; or

(ii) If the Participant has retired with the Consent of the Employer, the Benefit Distribution Date, as defined in Article 5.1(b), on which the Participant elected to receive a distribution of Benefit, or, if no such Benefit Distribution Election is then in effect, six (6) months (or as soon as administratively feasible thereafter) after the date of such Retirement with the Consent of Employer; or

(iii) If the Participant has a Termination Event, six (6) months (or as soon as administratively feasible thereafter) after the date of such Termination Event;

(iv) The date of the death of the Participant;

(v) A Change of Control Event.

(b) Benefit Distribution Date.

(i) One-Year Advance Election. A Participant may elect a Distribution Date by filing a Benefit Distribution Election form at the time of the deferral Election form in such manner as the Plan Administrator shall specify. Such Benefit Distribution Election form shall specify a Distribution Date which shall be at least one year from the date the Benefit Distribution Election is delivered to the Plan Administrator. Except as otherwise provided in this Article V, the Benefit Distribution Election shall apply to all amounts credited to a Participant's Account on the Distribution Date designated therein, or to such lesser dollar amount as may be specified in the Benefit Distribution Election form. A separate Benefit Distribution Election form must be made with respect to any Sub Account. Except as otherwise

Source: ADAPTEC INC, 10-Q, November 07, 2005

provided in this Article V, a Benefit Distribution Election made with respect to a Participant's Account shall not apply to the Participant's Sub Account.

(ii) Revocation or Amendment of Benefit Distribution Election. A Participant may revoke and/or amend a Benefit Distribution Election previously made only in accordance with the rules under Code section 409(A). Generally, a subsequent election pursuant to this Section 5.1(b)(ii): (A) cannot take effect for twelve (12) months, (B) must occur at least twelve (12) months before the first scheduled payment under a payment at a specified Distribution Date elected pursuant to Section 5.1(b)(i), and (C) must defer a previously elected Distribution Date at least five (5) additional years.

(c) Termination Event. Notwithstanding any prior Benefit Distribution Election, if the Participant has a Termination Event other then a Retirement with the Consent of the Employer, distribution of the Participant's Accounts shall commence six (6) months (or as soon as administratively feasible thereafter) after the Termination Event.

(d) Change of Control Event. In the event of a Change of Control, all Accounts shall be distributed as soon as administratively feasible after the Change of Control.

5.2 Methods of Distribution.

(a) Method of Distribution While Actively Employed or Following a Retirement with the Consent of the Company. If a distribution of the Participant's Benefits commences while he or she is actively employed by the Employer pursuant to the Participant's Benefit Distribution Election or because the Participant's termination of employment satisfies the requirements for Retirement with the Consent of the Company, then such Participant's Accounts shall be paid in one of the following methods specified in his or her most recent valid Election form filed with the Plan Administrator:

(i) a single lump sum payment;

(ii) two payments, on the dates and in the amounts specified in the Participant's Election;

(iii) in twenty (20) substantially equal quarterly payments; or

(iv) in forty (40) substantially equal quarterly payments.

For purposes of this provision, substantially equal payments shall be determined by dividing the Participant's Account balance by the number of payments remaining.

(b) Method of Distribution Following a Termination Event or Death. If a distribution of Benefits is made on account of a Termination Event or the death of a Participant, the Participant's Accounts shall be distributed in a lump sum payment.

(c) Method of Distribution Following a Change of Control. Generally, all Accounts shall be paid in a lump sum payment following a Change of Control. Notwithstanding

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the foregoing, if a lump sum payment will result in an “excess parachute payment”, as that term is defined in the Code, the Plan Administrator, in its sole discretion, may determine that payment shall be made by some other method.

5.3 Financial Hardship Withdrawal. With the consent of the Plan Administrator, a Participant may withdraw up to one hundred percent (100%) of the amount credited to his or her Accounts as may be required to meet a sudden unforeseeable financial emergency of the Participant in accordance with Code Section 409A. Such hardship distribution shall be subject to the following provisions.

(a) The hardship withdrawal must be necessary to satisfy the unforeseeable emergency and no more may be withdrawn from the Participant’s Accounts than is required to relieve the financial need after taking into account other resources that are reasonably available to the Participant for this purpose.

(b) The Participant must certify that the financial need cannot be relieved: (i) through reimbursement or compensation by insurance or otherwise; (ii) by liquidation of the Participant’s assets, to the extent such liquidation would not itself cause an immediate and heavy financial need; (iii) by discontinuing the Participant’s Salary deferrals and deferrals of amounts payable under the AIP, VIP and MIP; or (iv) by borrowing from commercial sources on reasonable commercial terms.

(c) An unforeseeable financial emergency is a severe financial hardship to Participant resulting from a sudden and unexpected illness or accident of Participant or of a dependent of Participant (as defined in section 152(a) of the Code), loss of Participant’s property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of Participant. Neither the need to pay tuition expenses on behalf of the Participant or the Participant’s spouse or children nor the desire to purchase a home shall be considered an unforeseeable emergency.

(d) The Plan Administrator, in its sole discretion, shall determine if there is an unforeseeable financial emergency, if the Participant has other resources to satisfy such emergency and the amount of the hardship withdrawal that is required to alleviate the Participant’s financial hardship.

(e) A Participant shall be prohibited from making any further Salary deferrals or deferrals of amounts payable under the AIP, VIP or MIP and the Employer shall not make any Additional Contributions pursuant to the Plan for the remainder of the Plan Year in which a financial hardship withdrawal occurs.

5.4 Limitation on Distributions to Covered Employees. Notwithstanding any other provision of this Article V, in the event that the Participant is a “covered employee” as defined in section 162(m)(3) of the Code, or would be a covered employee if the Benefits were distributed in accordance with his or her Benefit Distribution Election or hardship, the maximum amount which may be distributed from the Participant’s Accounts, in any Plan Year, shall not exceed one million dollars ($1,000,000) less the amount of compensation paid to the Participant in such Plan

Source: ADAPTEC INC, 10-Q, November 07, 2005

Year which is not "performance-based" (as defined in Code section 162(m)(4)(C)), which amount shall be reasonably determined by the Plan Administrator at the time of the proposed distribution. Any amount which is not distributed to the Participant in a Plan Year as a result of this limitation shall be distributed to the Participant in the next Plan Year, subject to compliance with the foregoing limitation set forth in this Section 5.4.

5.5 Tax Withholding. All payments under this Article V shall be subject to all applicable withholding for state and federal income tax and to any other federal, state or local tax which may be applicable to such payments.

ARTICLE VI
BENEFICIARIES

6.1 Designation of Beneficiary. The Participant shall have the right to designate on such form as may be prescribed by the Plan Administrator, one or more Beneficiaries to receive any Benefits due under Article V which may remain unpaid on the date of the Participant's death. The Participant shall have the right at any time to revoke such designation and to substitute one or more other Beneficiaries in accordance with the rules and procedures established by the Plan Administrator.

6.2 No Designated Beneficiary. If, upon the death of the Participant, there is no valid Beneficiary designation, the Beneficiary shall be the Participant's surviving spouse. In the event there is no surviving spouse, then the Participant's Beneficiary shall be the Participant's estate.

ARTICLE VII
TRUST OBLIGATION TO PAY BENEFITS

7.1 Deferrals Held in Trust. An amount equal to the Salary Deferral Amount, AIP Deferral Amount, VIP Deferral Amount, MIP Deferral Amount and Additional Contributions, if any, made by or on behalf of the Participant shall be transferred to the Trustee within thirty (30) days after the applicable pay period to be held pursuant to the terms of the Trust Agreement.

7.2 Benefits Paid From Trust. All benefits payable to a Participant hereunder shall be paid by the Trustee to the extent of the assets held in the Trust by the Trustee, and by the Employer to the extent the assets in the Trust are insufficient to pay a Participant's Benefits as provided under this Plan.

7.3 Trustee Investment Discretion. The Benchmark Funds established pursuant to Section 4.3 shall be for the sole purpose of determining the Interest and neither the Trustee nor the Employer shall have any obligation to invest the Participant's Accounts in the deemed investment options or in any other investment.

Source: ADAPTEC INC, 10-Q, November 07, 2005

7.4 No Secured Interest. Participants and their Beneficiaries, heirs, successors and assigns shall have no legal or equitable rights, claims or interest in any specific property or assets of the Employer or the Trust. The assets of the Trust shall be subject to the claims of creditors of the Employer. The Employer's obligation under the Plan shall be merely that of an unfunded and unsecured promise of the Employer and except as provided in the Trust Agreement, the Participant (or the Participant's Beneficiary) shall be a general unsecured creditor of the Employer with respect to the payment of Benefits under this Plan.

ARTICLE VIII
PLAN ADMINISTRATION, AMENDMENT AND TERMINATION

8.1 Plan Administration. As Plan Administrator, the Deferred Compensation Committee shall have complete control of the administration of the Plan herein set forth with all powers necessary to enable it properly to carry out its duties in that respect. Not in limitation, but in amplification of the foregoing, the Deferred Compensation Committee shall have the power and authority to:

(a) Construe the Plan and to determine all questions that shall arise as to interpretations of the Plan's provisions, including determination of Eligible Employees, amounts of credits, allocation of assets, method of payment, and participation and benefits under the terms of the Plan;

(b) Establish reasonable rules and procedures which shall be applied in a uniform and nondiscriminatory manner with respect to Elections and Benefit Distribution Elections;

(c) Establish the rules and procedures by which the Plan will operate;

(d) Construe and interpret the Plan and Trust Agreement and adopt rules for Plan administration that are consistent with the terms of the Plan documents;

(e) Compile and maintain all records it determines to be necessary, appropriate or convenient in connection with the administration of the Plan;

(f) Adopt amendments to the Plan document and/or the Trust Agreement which are deemed necessary or desirable to facilitate administration of the Plan and/or to bring these documents into compliance with all applicable laws and regulations, provided that the Deferred Compensation Committee shall not have the authority to adopt any Plan amendment that will result in increased Employer contributions or substantially increased administrative costs unless such amendment is contingent upon ratification by the Board before becoming effective;

(g) Employ such persons or organizations to render service or perform services with respect to the administrative responsibilities of the Deferred Compensation

Source: ADAPTEC INC, 10-Q, November 07, 2005

Committee under the Plan as the Deferred Compensation Committee determines to be necessary and appropriate, including but not limited to actuaries, attorneys, accountants, and benefit, financial and administrative consultants;

(h) Select, review and retain or change the Benchmark Funds used to determine the Interest Rate; in its sole discretion, the Committee may delegate the power, authority and responsibility set forth in this Section 8.1(h) to the Investment Committee appointed pursuant to the Adaptec, Inc. Savings and Retirement Plan;

(i) Direct the investment of assets of the Trust; and

(j) Direct the Trustee and review the performance of the Trustee with respect the Trustee's duties, responsibilities and obligations under the Plan and Trust Agreement.

8.2 Decisions of the Deferred Compensation Committee. Decisions of the Deferred Compensation Committee made in good faith upon any matter within the scope of its authority shall be final, conclusive and binding upon all persons, including Participants and their legal representatives or Beneficiaries.

8.3 Exclusive Benefit. The Deferred Compensation Committee shall perform its duties under the Plan solely in the interest of the Participants and their Beneficiaries. Any discretion granted to the Deferred Compensation Committee shall be exercised in accordance with rules and policies established by the Deferred Compensation Committee.

8.4 Plan Amendment. This Plan may be amended by Adaptec at any time in its sole discretion upon an action of at least two-thirds (2/3) of the members of the Deferred Compensation Committee; provided, however, that no amendment may be made which would alter the nature of a deferral Election or Benefit Distribution Election or which would reduce the amount credited to a Participant's Accounts on the date of such amendment; and provided further that no amendment which would affect the Trustee's obligation may be made without the Trustee's consent.

8.5 Plan Termination. Adaptec, by action of its Board and with the approval of two-thirds (2/3) of the members of the Deferred Compensation Committee reserves the right to terminate the Plan in its entirety at any time upon fifteen (15) days notice to the Participants. If the Plan is terminated, all benefits shall be paid as set forth in Sections 5.1 and/or 5.2. Any amounts remaining in the Trust after all benefits have been paid shall revert to the Employer.

8.6 Additional Power and Responsibility Following a Change of Control. In the event of a Change of Control, the Plan may be amended and/or terminated only by a majority vote of the Deferred Compensation Committee. Additionally, the successor to Adaptec shall have no right to dismiss any member of the Deferred Compensation Committee or add members to the Deferred Compensation Committee without the express consent of a majority of the Deferred Compensation Committee members. Such limitations on the rights of any successor corporation or business entity shall take effect on the date of the Change of Control and shall remain in effect

Source: ADAPTEC INC, 10-Q, November 07, 2005

for a period of twelve (12) months following the Change of Control unless a majority of the members of the Deferred Compensation Committee agrees to withdraw these limitations earlier.

ARTICLE IX
MISCELLANEOUS

9.1 No Assignment. The right of any Participant, any Beneficiary, or any other person to the payment of any benefits under this Plan shall not be assigned, transferred, pledged or encumbered.

9.2 Successors. This Plan shall be binding upon and inure to the benefit of the Employer, its successors and assigns and the Participant and his or her heirs, executors, administrators and legal representatives.

9.3 No Employment Agreement. Nothing contained herein shall be construed as conferring upon any Participant the right to continue in the employ of the Employer as an employee.

9.4 Attorneys' Fees. If the Employer, the Participant, any Beneficiary, the Trustee and/or a successor in interest to any of the foregoing, brings legal action to enforce any of the provisions of this Plan, the prevailing party in such legal action shall be reimbursed by the other party, the prevailing party's costs of such legal action including, without limitation, reasonable fees of attorneys, accountants and similar advisors and expert witnesses.

9.5 Arbitration. Any dispute or claim relating to or arising out of this Plan shall be fully and finally resolved by binding arbitration conducted by the American Arbitration Association in Alameda County, California.

9.6 Governing Law. This Plan shall be construed in accordance with and governed by the laws of the State of California.

9.7 Entire Agreement. This Plan constitutes the entire understanding and agreement with respect to the subject matter contained herein, and there are no agreements, understandings, restrictions, representations or warranties among any Participant and the Employer other than those as set forth or provided for herein.

IN WITNESS WHEREOF, the undersigned certifies that the foregoing is the Adaptec 2005 Deferred Compensation Plan, effective as of January 1, 2005.

ADAPTEC, INC.

Dated: August 25, 2005

By: /s/ Shirley B. Olerich
Title: Vice President, Human Resources

Source: ADAPTEC INC, 10-Q, November 07, 2005

Exhibit 31.1

**CERTIFICATION OF INTERIM CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, D. Scott Mercer, certify that:

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

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

	/s/ D. SCOTT MERCER
	D. Scott Mercer
Date: November 7, 2005	*Interim Chief Executive Officer*

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Marshall L. Mohr, certify that:

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

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

	/s/ MARSHALL L. MOHR
	Marshall L. Mohr
Date: November 7, 2005	*Chief Financial Officer*

Exhibit 32.1

CERTIFICATION OF INTERIM CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, D. Scott Mercer, certify to the best of my knowledge based upon a review of the Quarterly Report on Form 10-Q of Adaptec, Inc. for the quarter ended September 30, 2005 (the "*Form 10-Q*"), that the Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Adaptec, Inc. for the periods covered by the Form 10-Q.

	By: /s/ D. SCOTT MERCER
	D. Scott Mercer
Date: November 7, 2005	*Interim Chief Executive Officer*

I, Marshall L. Mohr, certify to the best of my knowledge based upon a review of the Form 10-Q, that the Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Adaptec, Inc. for the periods covered by the Form 10-Q.

	By: /s/ MARSHALL L. MOHR
	Marshall L. Mohr
Date: November 7, 2005	*Chief Financial Officer*

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