

StorageTek loss raises questions on controls

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Even in an industry known for surprises, the \$20 million-plus loss expected by Storage Technology Corp. is a shocker. And among computer industry analysts, it has raised fundamental questions about the company's internal financial controls.

A week after the announcement, officers of Louisville-based StorageTek are still not giving interviews. But a definite picture is emerging from official company statements, supported by conversations with analysts and former company officials: StorageTek didn't fully know how much money it was getting for many of its data storage products until company accountants sorted through customer acceptance slips — many of which didn't arrive until just before or even after Sept. 30, when the third quarter ended.

It's not uncommon for manufacturers to ship a large percentage of products in the last weeks of a quarter. And high-tech companies are especially notorious for last-minute pressure to meet sales goals. One firm, Tandem Computers Inc. of Cupertino, Calif., recently had to restate results when it became apparent that some computers were being booked as sales before they even went out the door.

In StorageTek's case, the last-minute sales apparently came through — but at such low profit margins that the company had to drastically restate its expected results.

StorageTek had been telling analysts that it expected to break even or perhaps even post a small profit for the quarter. The problem was compounded because the company's banks had been given the same optimistic projection — which is one reason why the company has been meeting with bankers in an attempt to negotiate new loan agreements.

"One of the reasons why it was a surprise was that marketing, in its enthusiasm to make its goals in product shipments, may have negotiated some deals that did not have very good margins," said Gordon Swartzfager, a StorageTek spokesman.

"We really didn't find out what some of those deals were — plus what we allowed on the return (of older

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products in exchange for new ones) — until after the paper (came) in from the customer.

"I would guess that we will be beefing up our internal controls so that this sort of thing doesn't happen again."

Some of the questions about StorageTek's performance will be answered when the company issues its third-quarter report, expected by the end of this month. Meanwhile, the issue of financial controls could become a key point, especially if any of the shareholder lawsuits filed in the past week in U.S. District Court in Denver make it to trial. Those suits are based on the contention that the company failed to disclose important information about its performance and was unable to effectively manage its rapid expansion.

StorageTek analysts say they are inclined to believe the company's explanation for its losses. But they wonder how a company with so much riding on its quarter-to-quarter performance failed to notice such fundamental problems until the last minute.

"I really don't think they were laying it on me when they said they expected to break even or (do) a little bit better," William D. Easterbrook, an analyst with Kidder, Peabody & Co. Inc., said Monday. Easterbrook said he talked to Jesse Aweida, StorageTek's chairman, a week before the announcement of job terminations and expected loss.

"I think the top management expected that sort of results. They were taken by surprise. If they were surprised, obviously the first possible culprit is financial controls."

"Something is more wrong here than meets the eye," said Stephen T. McClellan, an analyst with Salomon Brothers in New York. The company's explanation for the loss is "plausible," he said, but still "greatly disturbing."

"That tells me that they have very, very poor financial control, if they don't have any handle on what those receipts are looking like until the quarter is over," McClellan said. "You'd think that those receipts would be . . . filtering in during the process of the quarter. If most of them are bunched in the very end of the quarter, that tells me that's also a very, very high-risk situation, that a lot of salesmen were pushing a lot of products at the end of the quarter to make quota, to make their objectives. Then you have to wonder how good that business is.

"Any way you slice it, it shouldn't have happened. And any way you slice it, it tells you negative things about the company."

Apparently, StorageTek's biggest problem with competition and pricing is with its 8380 disk drive, the highest-capacity magnetic disk drive the firm makes. The 8380 stores about 2.5 billion bytes, or characters of data, when hooked up to IBM mainframe computers.

StorageTek salesmen were under pressure long before last month, when IBM cut prices 10 percent on its own high-capacity 3380 disk drive

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Storage Technology flew 'free and loose' with discounts on disk drives

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and controller and StorageTek was forced to follow. IBM had a months-long lead in production of its drive, with many customers locked up by the time StorageTek began cranking up shipments of the 8380 early this year.

"An awful lot of people they were approaching to try to get in there with the 8380 (already) had volume procurement agreements with IBM," said Tom Crotty, an analyst with the Gartner Group in Stamford, Conn. StorageTek began a program to determine how heavily it could discount its own prices and still be profitable, he noted.

StorageTek salesmen "were flying free and loose, just trying to get units placed. Salesmen were discounting all over the place, anything just to get the business."

StorageTek had taken some solace in the fact that two other companies, Control Data Corp. and Memorex Corp., were even farther behind in producing their own 3380-type disk drives. Control Data recently announced it was getting out of the market entirely, while Memorex began reshipping machines after production difficulties.

But while StorageTek appears to have overcome its own technical hiccups with the 8380, the recent loss announcement brings up the question of whether anyone besides IBM can sell the current-generation drives — and turn a profit.

"It's my opinion, quite frankly, that none of these three companies (StorageTek, Control Data and Memorex) will probably ever see a profit off of the single-density program," Crotty said. Adding to StorageTek's disk problems is that IBM is expected to announce later this year or early in 1985 a so-called "double-density" version of the 3380, packing as much as twice the storage capacity.

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