HOW STORAGE TECHNOLOGY ENGINEERED ITS RECOVERY

SMALLER, TIGHTER COMPANY IS ABOUT TO TURN THE CORNER

by J. Robert Lineback

LOUISVILLE, COLO.

In less than a year, Storage Technology Corp. has turned around from what loomed as the worst financial failure in the history of the electronics business to what may be the industry's biggest and fastest exit from Chapter 11. How the quick change was engineered by turnaround veteran Ryal R. Poppa in his short tenure as chairman and chief executive officer is a story of making a company bigger by first making it smaller.

What Poppa and his staff did was discontinue some products, set realistic goals for research and development, and tighten fiscal policies. So far it seems to be working: the company expects an agreement with its creditors in time to get out of Chapter 11 by Jan. 1, and it has a new strategy to combat IBM and a new product to do it with.

Only 14 months after the 17-year-old manufacturer of IBM-compatible mainframe storage and printer peripherals filed under Chapter 11 of the bankruptcy laws in October 1984, it emerged from an arduous period of downsizing with a fourth-quarter profit of $2.22 million on sales of $168.62 million.. That compares with a loss of $406 million on sales of $151.95 million for the same quarter of 1984.

The first quarter of 1986 was good, too, with profits of $5.02 million on revenues of $161.96 million. By way of comparison, in the first three months of 1985 the company scored almost identical revenue but lost $29.69 million. And that's not the end of it: Storage Technology expects to make three profitable quarters in a row at the end of June.

Employees are no longer fleeing. Attrition at the end of 1984 ran at an astonishing annual rate of 57%. It slowed, partly because of the industrywide recession, to near 25% by last summer and now is at a more normal 9%. "The drop in attrition is the result of more knowledge of the facts. Perhaps we have overcommunicated," jokes Poppa (pronounced POP-ee), who joined the company in January 1985 after founder Jesse I. Aweida left.

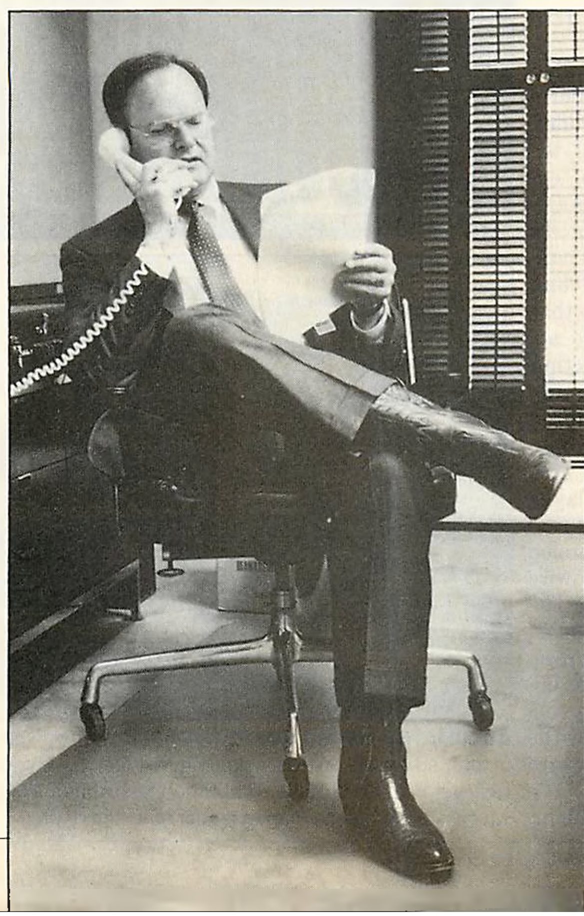
Cash reserves are once again at a healthy level—$240 million, against a low of less than $20 million in the first half of 1985. Customer confidence is back too, says Poppa, and once the shadow of Chapter 11 is lifted, perhaps as soon as January 1987, the company expects to go head-to-head with IBM Corp. for new accounts.

BATTLE READY. But more important than the first profits in nine quarters is what Poppa believes is a new Storage Technology, which the aggressive chairman says is not only lean but also ready for the battle with its giant archrival. Gone are the days of attempting gigantic but risky leaps in systems and mass memory technology over IBM. That's what tripped up the company, according to Poppa: biting off indigestibly large chunks of computer and peripheral technology following unprecedented growth in profits and revenues at the start of the 1980s.

In those heady days, IBM delays in shipping a new mainframe disk drive opened the door to an unexpected wave of 1981 sales for Storage Technology's 8650 plug-compatible disk units. The company quickly expanded. Profits hit their high-water mark in 1981, up 81% to $82.4 million on revenues that were up 53% to $921 million. Revenues peaked the following year at $1.08 billion, but net income ebbed to $64.7 million; in 1983 the company started to bathe in red ink, and losses reached half a billion dollars in 1984. Still, research and development funds streamed into an ill-fated CMOS-based mainframe project, a new semicustom chip business, and a 4-gigabyte 14-in. optical disk system. All three efforts were dropped in 1985.

"Three hundred million dollars thrown away. I don't see anything for any of it," says a still disbelieving Stephen G. Jerritts, Storage Technology's president and chief operating officer. He was recruited by Poppa and the board early in 1985 from Lee Data Corp. of Minneapolis, where he was president. He also is a former president of Honeywell Information Systems.

COLORADO COWBOY. Ryal R. Poppa came riding in on his white horse to rescue Storage Technology from Chapter 11.



The weakening position was compounded toward the middle of the decade by aggressive price cuts and new products from IBM. But, says Poppa, "What got Storage Technology was not IBM, but that the company got overaggressive, launching new businesses into semiconductors, the central processing unit project, and optical storage." Poppa outlines a simple new game plan: "You don't have to announce on the same day that IBM does. Customers will often take as much as a year to evaluate these kinds of products," he says. So from now on, Storage Technology's strategy will be geared toward turning out an equal or slightly better product within a year after IBM's introduction. "We then will concentrate to get the products out quickly and finish out the product lifetime with acceptable margins."

Unlike the small-computer market, Poppa says, mainframe peripherals have active product lifetimes of a decade. Storage Technology's yet-to-be-announced Cimarron tape-cartridge system—which is actually a rare move in the Poppa era to leapfrog IBM—will be unveiled in the fall and is expected to have a life exceeding 10 years.

Cimarron, which includes an automatic cartridge tape library system that changes cartridges without human intervention, will be a major test of Storage Technology's ability to catch and pass IBM, which introduced its competing 3480 tape cartridge system a year ago. Cimarron, which the company says is denser than the 3480, will be Storage Technology's most important new product since it filed under Chapter 11, according to analyst Donald Sinsabaugh, managing director at Swergold, Chefitz & Sinsabaugh Inc., New York.

"Obviously, the company's real strength has been the tape market. That's where they found a home at the beginning," says Sinsabaugh, who believes product introductions and shipments play a more critical role in Storage Technology's survival than a quick exit from Chapter 11.

ALTERNATE SOURCE. "Needless to say, if they don't come out with an archival product which is comparable to the 3480, then there will be major problems," he adds. Sinsabaugh agrees with Poppa's strategy of aiming to equal or match IBM within a year of product introduction. "The point here is that the customers really need a threat or alternative to IBM, and they will continue to buy or lease compatible equipment as long as it is in good working order at a fair price. It is in the customer's own interest to keep people like Storage Technology in business," Sinsabaugh says.

Still, Storage Technology faces a stiff challenge to ramp up production quickly in order to stay in step with IBM's pricing, cautions analyst Michael J. Geran of E. F. Hutton & Co., New York. With at least one product, it seems to be succeeding. The company is pushing up delivery of a new double-density 8380E disk drive to match IBM's 3380 double-density drives. Storage Technology originally announced the drives would be available at the end of 1986; now it's saying July. "We needed that to tell everyone that the company is alive and well," says Jerritts.

He says R&D will be held at 9% of revenues in 1986 for products slated to be introduced over the next couple of years. In 1984, the rate was about 13% of a much greater revenue base. Company executives expect those revenues to be in the range of $725 million to $750 million. "I believe we are poised well on a four-legged stool [disk drives, tape subsystems, printers, and solid-state cache]. And we might be in a position to add another leg when we get out of Chapter 11," Jerritts says.

Despite all the optimism, the company acknowledges that there's a degree of uncertainty inherent in competing with IBM. "No assurance can be given that [Storage Technology] will be able to develop such products within the desired timeframe or that, if developed, the new products will have price/performance advantage comparable to those of new IBM products," the 1985 Form 10-K states. But now Poppa believes that IBM's recent reduced financial performance will make price cuts less likely, giving his company time to ramp up production.

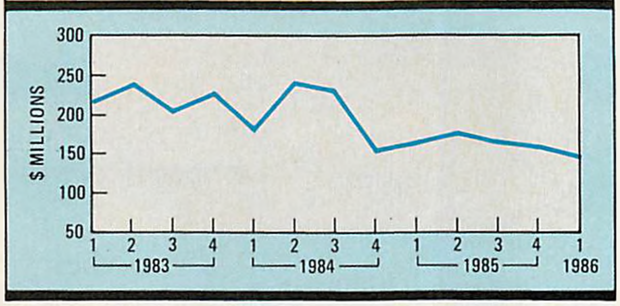
"IBM is the 400-lb gorilla that we must live with every day in this business. There is a misperception that IBM poses some kind of a new threat," says Poppa, who once worked for Big Blue. After that, he became chairman of Pertec Corp., where he engineered a merger with Triumph-Adler of West Germany. Then he moved on to BMC Industries before coming to Storage Technology. "IBM has been a 400-lb gorilla ever since I can remember. It was when I was with them, and yet Storage Technology got into business and was successful before."

"The perception from industry news stories was it would be Chapter 7 [liquidation] or, if we survived, that IBM would roll over and kill us," says Poppa, who personally made 287 customer calls in 1985 to help rebuild market confidence. "In February and March of 1985, I was not so sure," he recalls. "Then in March, rates picked up and continued to rise in April. They were again pretty good in May. I was certain about the recovery by last May."

The recovery won't be complete until Storage Technology's exit from Chapter 11 is completed. Poppa believes an agreement could be signed with creditors as early as this month and no later than July.

"A friend of mine recently suggested that we are writing the book on how to reorganize a high-technology company in Chapter 11. That might be so, but I hope it does not become a best seller," Poppa says. □

REVENUES WERE UP AND DOWN . . .



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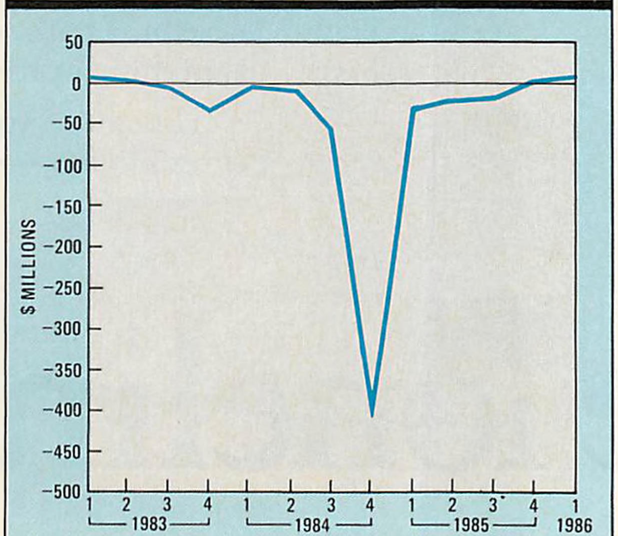

SOURCE: STORAGE TECHNOLOGY CORP.

STORAGE TECHNOLOGY'S BIG SHIFT IN REVENUE (in $ millions)

	1982 Revenue (%)	1983 Revenue (%)	1984 Revenue (%)	1985 Revenue (%)
Disk	559.9 (52)	358.3 (41)	295.1 (37)	228.6 (34)
Tape	379.2 (35)	401.7 (45)	407.5 (50)	344.7 (51)
Printers	85.4 (8)	99.4 (11)	100.4 (12)	99.0 (15)
Other	54.7 (5)	27.2 (3)	5.6 (1)	1.1 (−)
Total	1,079.2	886.6	808.6	673.4

SOURCE: STORAGE TECHNOLOGY CORP.