STORAGE TECHNOLOGY CORP
Form 10-Q
May 10, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended April 1, 2005

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ________________ to ________________

Commission File Number: 1-7534

STORAGE TECHNOLOGY CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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. ý Yes o No

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

The registrant had 107,315,018 shares of common stock outstanding as of May 2, 2005.

STORAGE TECHNOLOGY CORPORATION
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April 1, 2005

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

	04/01/05	**12/31/04**
	(Unaudited)	
ASSETS		
Current assets:		

	04/01/05	12/31/04
Cash and cash equivalents	$ 1,000,403	$ 853,410
Short-term investments	105,117	281,028
Accounts receivable	432,027	519,273
Inventories	134,369	123,459
Deferred income tax assets	166,840	174,253
Other current assets	4,425	1,062
Total current assets	1,843,181	1,952,485
Long-term investments	45,591	48,408
Property, plant, and equipment	180,720	177,371
Spare parts for maintenance	50,309	49,048
Deferred income tax assets	46,475	46,569
Other assets	142,170	133,960
Total assets	$ 2,308,446	$ 2,407,841
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 1,318	$ 1,551
Accounts payable	105,950	121,019
Accrued liabilities	486,106	533,839
Income taxes payable	231,617	239,253
Other current liabilities	22,715	59,365
Total current liabilities	847,706	955,027
Long-term debt	10,263	11,006
Total liabilities	857,969	966,033
Commitments and contingencies (Note 4 and 8)		
STOCKHOLDERS' EQUITY		
Common stock, $0.10 par value, 300,000,000 shares authorized; 114,621,988 shares issued at April 1, 2005, and 112,875,937 shares issued at December 31, 2004	11,462	11,288
Capital in excess of par value	1,065,479	1,019,101
Retained earnings	623,520	600,095
Accumulated other comprehensive loss	(27,374)	(38,772)
Treasury stock, 7,214,516 shares at April 1, 2005, and 5,448,350 shares at December 31, 2004, at cost	(190,718)	(134,148)
Unearned compensation	(31,892)	(15,756)
Total stockholders' equity	1,450,477	1,441,808
Total liabilities and stockholders' equity	$ 2,308,446	$ 2,407,841

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

STORAGE TECHNOLOGY CORPORATION CONSOLIDATED BALANCE SHEETS (In Thousands, Except Share 3

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

	Quarter Ended	
	04/01/05	**03/26/04**
Revenue:		
Storage products	$ 266,202	$ 294,606
Storage services	233,054	220,466
Total revenue	499,256	515,072
Cost of revenue:		
Storage products	131,396	149,619
Storage services	133,284	127,250
Total cost of revenue	264,680	276,869
Gross profit	234,576	238,203
Research and development costs	47,371	48,502
Selling, general, and administrative expense	164,645	162,685
Operating profit	22,560	27,016
Interest income	7,176	3,181
Interest expense	(219)	(377)
Income before income taxes	29,517	29,820
Provision for income taxes	(6,092)	(6,471)
Net income	$ 23,425	$ 23,349
EARNINGS PER COMMON SHARE		
Earnings per share:		
Basic	$ 0.22	$ 0.21
Diluted	$ 0.22	$ 0.21
Weighted average shares:		
Basic	106,070	110,551
Diluted	108,532	113,353

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

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

	Quarter Ended	
	04/01/05	**03/26/04**
OPERATING ACTIVITIES		
Cash received from customers	$ 576,374	$ 569,589
Cash paid to suppliers and employees	(521,580)	(493,952)
Interest received	5,859	2,634
Interest paid	(194)	(307)
Income taxes paid	(8,609)	(7,516)
Net cash provided by operating activities	51,850	70,448
INVESTING ACTIVITIES		
Purchases of investments	(27,050)	(151,700)
Proceeds from sale of investments	205,460	125,665
Purchases of property, plant, and equipment	(19,704)	(14,738)
Proceeds from sale of property, plant, and equipment	46	11
Other assets	(4,207)	(25,602)
Net cash provided (used in) investing activities	154,545	(66,364)
FINANCING ACTIVITIES		
Repurchases of common stock	(56,570)	(29,190)
Proceeds from employee stock plans	23,915	27,788
Proceeds from other debt	647	416
Repayments of other debt	(978)	(491)
Net cash used in financing activities	(32,986)	(1,477)
Effect of exchange rate changes on cash	(26,416)	(16,265)
Increase in cash and cash equivalents	146,993	(13,658)
Cash and cash equivalents - beginning of the period	853,410	727,354
Cash and cash equivalents - end of the period	$ 1,000,403	$ 713,696
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net income	$ 23,425	$ 23,349
Depreciation and amortization expense	18,400	20,117
Inventory writedowns	4,814	2,862
Translation loss	8,028	8,981
Other non-cash adjustments to income	25,597	29,120
(Increase) decrease in assets:		
Accounts receivable	77,118	54,517
Inventories	(12,445)	7,144
Other current assets	(8,975)	2,449
Spare parts	(6,589)	(6,032)

	Quarter Ended	
Deferred income tax assets	195	(384)
Increase (decrease) in liabilities:		
Accounts payable	(14,100)	(27,191)
Accrued liabilities	(37,925)	(11,297)
Other current liabilities	(17,865)	(25,326)
Income taxes payable	(7,828)	(7,861)
Net cash provided by operating activities	$ 51,850	$ 70,448

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

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)
(In Thousands)

	Common Shares Issued	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Unearned Compensation	Total
Balances, December 31, 2004	112,876	$ 11,288	$ 1,019,101	$ 600,095	$ (38,772)	$ (134,148)	$ (15,756)	$ 1,441,808
Components of comprehensive income:								
Net income	--	--	--	23,425	--	--	--	23,425
Other comprehensive income	--	--	--	--	11,398	--	--	11,398
Total comprehensive income	--	--	--	23,425	11,398	--	--	34,823
Shares issued upon exercise of stock options	1,237	124	24,288	--	--	--	--	23,352
Shares repurchased under stock repurchase program	--	--	--	--	--	(56,570)	--	(56,570)
Restricted stock activity	570	57	18,933	--	--	--	(16,136)	2,854
Other	(61)	(7)	3,217	--	--	--	--	3,210
Balances, April 1, 2005	114,622	$ 11,462	$ 1,065,479	$ 623,520	$ (27,374)	$ (190,718)	$ (31,892)	$ 1,450,477

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

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

	Quarter Ended	
	04/01/05	**03/26/04**
Net income	$ 23,425	$ 23,349
Other comprehensive income:		
Foreign currency hedging contracts:		
Net gain on foreign currency cash flow hedges, net of tax expense of $4,111 and $583	6,540	928
Reclassification adjustment for net losses included in net income, net of tax benefit of $3,315 and $3,457	5,274	5,499
Unrealized gain (loss) on marketable securities:		
Holding gain (loss), net of tax expense (benefit) of $(147) and $142	(234)	301
Reclassification adjustment for net gains included in net income, net of tax expense of $78 and $415	(182)	(751)
Other comprehensive income	11,398	5,977
Comprehensive income	$ 34,823	$ 29,326

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

STORAGE TECHNOLOGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 BASIS OF PREPARATION

The accompanying interim consolidated financial statements of Storage Technology Corporation and our wholly owned subsidiaries (collectively referred to as StorageTek, we, our, and us) have been prepared on substantially the same basis as our annual consolidated financial statements and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2004. In our opinion, the interim consolidated financial statements reflect all adjustments necessary for the fair presentation of results for the periods presented, and such adjustments are of a normal, recurring nature.

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications include our presentation of auction rate securities. We have made reclassifications to our consolidated statements of cash flows to reflect the gross purchases and sales of these securities as investing activities rather than as a component of cash and cash equivalents. As a result of these reclassifications, net cash used in investing activities increased $48.0 million for the first quarter of 2004. This change in reclassification does not affect previously reported cash flows from operations, cash flows from financing activities, or consolidated statements of operations for any period.

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

NOTE 2 STOCK-BASED COMPENSATION PLANS

We account for stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Stock-based compensation reflected in net income is related to restricted stock.

The following table illustrates the pro forma effect on net income and earnings per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, to stock-based compensation (in thousands, except per share amounts):

	Quarter Ended	
	04/01/05	03/26/04
Net income, as reported	$ 23,425	$ 23,349
Add: Stock-based compensation expense included in reported net income, net of related tax effects	1,918	1,256
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(7,938)	(4,194)
Pro forma net income	$ 17,405	$ 20,411
Earnings per share:		
Basic, as reported	$ 0.22	$ 0.21
Basic, pro forma	$ 0.16	$ 0.18
Diluted, as reported	$ 0.22	$ 0.21
Diluted, pro forma	$ 0.16	$ 0.18

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NOTE 3 INVENTORIES

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

	04/01/05	03/26/04
Raw materials	$ 28,985	$ 26,567
Work-in-process	27,770	21,341
Finished goods	77,614	75,551
	$ 134,369	$ 123,459

NOTE 4 LITIGATION

In August 2002, Ted Marx, a former StorageTek employee who was terminated in 2001, filed suit in California State Superior Court (Los Angeles) against us. The complaint contained claims for wrongful termination, wrongful termination in violation of the California Labor Code, breach of the covenant not to terminate without good reason, breach of contract, breach of the covenant of good faith and fair dealing, failure to pay wages under the California Labor Code, and intentional infliction of emotional distress. In September 2003, we filed a motion for summary judgment. In December 2003, the court ruled in our favor on the claim of breach of the covenant not to terminate without good reason. The trial commenced in May 2004. In June 2004, the jury awarded approximately $2.9 million in compensatory damages and $9.0 million in punitive damages to the plaintiff. In addition, in the first quarter of 2005, the trial court awarded approximately $1.0 million in attorney fees and costs to the plaintiff. We are vigorously seeking to overturn and/or reduce these awards. We have not accrued the damages or the attorney fees for this case, as we do not believe that these amounts represent a loss contingency that meets the definition of probable under SFAS No. 5, Accounting for Contingencies.

We are also involved in a number of other pending legal proceedings that have come up in the ordinary course of business. We believe that any liability as a result of adverse outcomes in such proceedings would not have a material adverse effect on our financial condition taken as a whole. However, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on our financial condition or results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the inability to ship products or components found to have violated third-party patent rights.

NOTE 5 CREDIT FACILITIES

We have a $75.0 million unsecured revolving credit facility (the Revolver) that expires in October 2008. The interest rates for borrowing under the Revolver are based upon our Consolidated Leverage Ratio, which is the ratio of Consolidated Funded Indebtedness to rolling four quarter Consolidated Earnings Before Interest Expense, Taxes, Depreciation, and Amortization (EBITDA). The rate ranges from the applicable LIBOR plus 1.00% to 2.00% or the agent bank s base rate plus 0.00% to 1.00%. We pay an annual commitment fee of 0.175% or 0.200% on any unused borrowings based upon the Consolidated Leverage Ratio. The Revolver contains certain financial and other covenants, including limitations on the payment of cash dividends. We had no outstanding borrowings under the Revolver as of April 1, 2005. However, we had letters of credit totaling approximately $850,200 under the Revolver as of April 1, 2005.

NOTE 6 OPERATIONS OF BUSINESS SEGMENTS

StorageTek is organized into two reportable business segments based on the definitions provided in SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information : storage products and storage services. The storage products segment includes sales of tape, disk, network, and other miscellaneous products. The storage services segment includes maintenance and support services, as well as professional services.

We do not have any intersegment revenue, and segment operating performance is evaluated based on gross profit. The aggregate gross profit by segment equals the consolidated gross profit, and we do not allocate research and development costs; selling, general, and administrative expense; interest income; interest expense; or provision for income taxes to the segments. The following table shows revenue and gross profit by segment (in thousands):

	Quarter Ended	
	04/01/05	03/26/04
Revenue:		
Storage products	$ 266,202	$ 294,606
Storage services	233,054	220,466
Total revenue	$ 499,256	$ 515,072
Gross profit:		
Storage products	$ 134,806	$ 144,987
Storage services	99,770	93,216
Total gross profit	$ 234,576	$ 238,203

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

	Quarter Ended	
	04/01/05	03/26/04
Tape products	$ 211,898	$ 233,089
Disk products	32,491	44,218
Network products	12,798	17,014
Other	9,015	10,285
Total storage products revenue	$ 266,202	$ 294,606

NOTE 7 EARNINGS PER COMMON SHARE

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

	Quarter Ended	
	04/01/05	03/26/04
Net income	$ 23,425	$ 23,349
Weighted average common shares outstanding:		
Basic	106,070	110,551
Effect of dilutive common stock equivalents	2,462	2,802
Diluted	108,532	113,353
Earnings per common share:		
Basic	$ 0.22	$ 0.21
Diluted	$ 0.22	$ 0.21

For the quarters ended April 1, 2005, and March 26, 2004, options to purchase 259,702 and 3,633,948 shares of common stock, respectively, were excluded from the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of our common stock, and therefore, the effect would have been antidilutive.

NOTE 8 INDEMNIFICATIONS AND WARRANTIES

Financial Accounting Standards Board (FASB) Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, requires that a liability be recorded in the guarantor s balance sheet upon issuance of certain guarantees. FIN 45 also requires additional disclosures about the guarantees an entity has issued, including a rollforward of the entity s product warranty liabilities.

In the normal course of business, we are party to a variety of agreements under which we may be obligated to indemnify the other party for certain matters. These obligations typically arise in contracts where we customarily agree to hold the other party harmless against losses arising from a breach of representations or covenants for certain matters such as title to assets and intellectual property rights associated with the sale of products. We also have indemnification obligations to our officers and directors. The duration of these indemnifications varies, and in certain cases, is indefinite. In each of these circumstances, payment by us depends upon the other party making an adverse claim according to the procedures outlined in the particular agreement, which procedures generally allow us to challenge the other party s claims. In certain instances, we may have recourse against third parties for payments that we make.

We are unable to reasonably estimate the maximum potential amount of future payments under these or similar agreements due to the unique facts and circumstances of each agreement and the fact that certain indemnifications provide for no limitation to the maximum potential future payments under the indemnification. We have not recorded any liability for these indemnifications in the accompanying consolidated balance sheets; however, we accrue losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is both probable and reasonably estimable.

We provide warranties associated with the sale of our products. Our standard product warranties provide for the repair or replacement of products that fail to meet their published specifications. In situations where a product fails its essential purpose to the customer, we may also be responsible for refunding the purchase price of the product if we cannot remedy the product failure. We establish a warranty liability for the estimated cost of warranty-related claims at the time revenue is recognized. The following table summarizes information related to our warranty reserves (in thousands):

	Quarter Ended	
	04/01/05	03/26/04
Balance at beginning of period	$ 44,536	$ 43,676
Accruals for warranties issued	11,544	9,478

	Quarter Ended	
Adjustments to warranties	62	(3,723)
Amortization	(16,997)	(13,671)
Balance at end of period	$ 39,145	$ 35,760

NOTE 9 RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4. This statement amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). This statement requires that the above items be recognized as current-period charges, regardless of whether they meet the criterion of abnormal. Additionally, SFAS No. 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005, and is required to be adopted by us in the first quarter of fiscal 2006. We do not expect SFAS No. 151 to have a material impact on our financial condition or results of operations.

In December 2004, the FASB issued Statement No. 123R, Share-Based Payment, which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. In April 2005, the SEC approved a delay in the effective date of SFAS 123R. As a result of this delay, we are required to adopt SFAS No.123R no later than the first quarter of fiscal 2006. We are currently evaluating the impact of SFAS No. 123R on our financial position and results of operations, as well as the timing and method of adoption of SFAS No. 123R. In addition, we have not determined whether the adoption of SFAS No. 123R will result in amounts that are similar to the current pro forma disclosures under SFAS 123. See Stock-Based Compensation Plans above for information related to the pro forma effects on our net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

In December 2004, the FASB issued two Staff Positions (FSPs) that provide accounting guidance on how companies should account for the effects of the American Jobs Creation Act of 2004 (the Act) that was signed into law on October 22, 2004. The Act could affect how companies report their deferred income tax balances. The first FSP is FSP FAS 109-1 (FSP 109-1); the second is FSP FAS 109-2 (FSP 109-2). In FSP 109-1, the FASB concludes that the tax relief from the Act associated with a special tax deduction for domestic manufacturing should be accounted for as a special deduction instead of a tax rate reduction. FSP 109-2 gives a company additional time to evaluate the effects of the Act on any plan for reinvestment of repatriation of foreign earnings for purposes of applying SFAS No. 109, Accounting for Income Taxes. However, a company must provide certain disclosures if it chooses to utilize the additional time granted by the FASB. We are evaluating the impact, if any, these FSPs may have on our consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

All assumptions, anticipations, expectations, and forecasts contained in the following discussion regarding our business, future products, business plans, financial results, performance, and future events are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Our actual results may differ materially because of a number of risks and uncertainties. Some of these risks are detailed below in FACTORS THAT MAY AFFECT FUTURE RESULTS and elsewhere in this Form 10-Q. Forward-looking statements can typically be identified by the use of words such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, i continue, or the negative of such terms, or other comparable words. Forward-looking statements also include the assumptions underlying or relating to any such statements. The forward-looking statements contained in this Form 10-Q represent a good-faith assessment of our future performance for which management believes there is a reasonable basis. We disclaim any obligation to update the forward-looking statements contained herein, whether as a result of new information, future events, or otherwise, except as may be otherwise required by law.

FIRST QUARTER 2005 FINANCIAL OVERVIEW

Financial Results

While we grew net income on a year-over-year basis, this was not the quarter that we expected to deliver. Our $499.3 million of total revenue for the quarter was down 3% compared to the same period last year, and down 6% after adjusting to reflect constant currencies. Our product revenues were down 10%, offset by a 6% increase in service revenue. Within services, our product support and multi-vendor support grew 4% on a year-over-year basis. Professional services grew approximately 15% compared to the first quarter of 2004, continuing a trend of increasing contribution to total service revenue. We experienced revenue declines in all of our geographies except for Latin America, where we saw a 29% increase in revenue. Our North America revenues decreased 8%, European revenues decreased 1%, and Asia-Pacific revenues decreased 8%. We believe most of the revenue shortfall we experienced was due to direct sales transactions that have been pushed out into subsequent quarters. We had solid gross profit margins in both storage products and storage services, and operating expenses were relatively flat to last year. Our operating profit decreased 16%, and net income was relatively flat to last year.

Financial Position and Liquidity

We maintained a strong balance sheet during the first quarter of 2005. Total cash and investments were approximately $1.2 billion. We repurchased another $56.6 million of stock in the first quarter through our stock repurchase program, and we generated $51.9 million in cash flows from operations. Days sales outstanding for the first quarter of 2005 was 79 days, a 6-day improvement compared to the first quarter of 2004. Our inventory levels increased to $134.4 million during the quarter, primarily due to inventory build associated with the sales transactions that were pushed out into subsequent quarters. Our operations continue to be self-funded and our debt-to-capitalization ratio remains constant at 1%.

FINANCIAL OUTLOOK

Our primary challenge is to grow revenue in order to increase operating margins and profitability. In the first quarter, we found that the IT market continued to be unstable, as it has been for the past few years. Consequently, we now believe that our revenue growth for the full year 2005 will be in the 2 to 4% range as compared to 2004. Although our indirect channel sales as a percent of total sales rose to 57% for the current quarter, we believe that the indirect channel sales percentage will decrease back to the normal 45 to 50% range for the year.

Our storage products gross profit margins were better than we expected for the first quarter of 2005. We believe that the combination of new product offerings aimed at the small and medium library markets and an expected increase in the indirect channel sales mix will result in an annualized product margin similar to or perhaps slightly below the 2004 level. With respect to storage services gross profit margins, we expect professional services to become a larger percentage of total services revenue in 2005, and these services typically do not carry the same level of gross profit margin as product support services. Accordingly, our total storage services gross profit margin may be negatively impacted by further success in growing our professional services revenue, although we believe that service margins for 2005 will be relatively flat to 2004.

We believe that research and development expenditures will be approximately $50.0 million per quarter for the rest of 2005, and we expect that selling, general, and administrative expense (SG&A) as a percentage of total revenue will be approximately 28% for 2005. Based on current estimates, we believe that our effective tax rate in 2005 will be approximately 21%, slightly better than we had previously anticipated. We anticipate that we can generate pre-tax income of approximately $260 million during 2005 and increase earnings per share during 2005 by close to 10% over the prior year.

We believe that our strong balance sheet and cash flows will continue to be a competitive advantage for us throughout 2005. Based on these strengths, as well as the key product launches we have planned for 2005, we believe that we are firmly positioned to take advantage of the opportunities created by the ever increasing storage demands placed on our customers.

For a discussion of some of the risks and uncertainties that impact our business, see FACTORS THAT MAY AFFECT FUTURE RESULTS in this Item 2.

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SELECTED CONSOLIDATED STATEMENT OF OPERATIONS DATA

The following table presents Consolidated Statements of Operations data stated as a percentage of total revenue, except for segment gross profit, which is stated as a percentage of the applicable segment revenue. The table also presents the percentage change based on the dollar amounts of each of the items.

	Quarter Ended	**Percentage Increase (Decrease) Based on Dollar Amounts**

			Percentage
	04/01/05	03/26/04	Q1 2005 vs. Q1 2004
Revenue:			
Storage products	53.3%	57.2%	(9.6)%
Storage services	46.7	42.8	5.7
Total revenue	100.0%	100.0%	(3.1)%
Gross profit:			
Storage products	50.6%	49.2%	(7.0)%
Storage services	42.8	42.3	7.0
Total gross profit	47.0	46.3	(1.5)
Operating expenses:			
Research and development costs	9.5	9.4	(2.3)
Selling, general, and administrative expenses	33.0	31.6	1.2
Operating profit	4.5	5.3	(16.5)
Interest income	1.4	0.6	125.6
Interest expense	(0.0)	(0.1)	(41.9)
Income before income taxes	5.9	5.8	(1.0)
Provision for income taxes	1.2	1.3	(5.9)
Net income	4.7%	4.5%	0.3%

The following table presents supplemental data for storage products revenue stated as a percentage of total storage products revenue, and the percentage change based on the dollar amounts of each of the items.

	Quarter Ended		Percentage Increase (Decrease) Based on Dollar Amounts
	04/01/05	03/26/04	Q1 2005 vs. Q1 2004
Supplemental data - storage products revenue			
Tape products	79.6%	75.7%	(5.0)%
Disk products	12.2	15.0	(26.5)
Network products	4.8	5.8	(24.8)
Other	3.4	3.5	(12.3)
Total storage products revenue	100.0%	100.0%	(9.6)%

RESULTS OF OPERATIONS

Storage Products Revenue and Gross Profit Margin

Our storage products revenue primarily consists of sales of tape, disk, and network products, including related software, for the mainframe and open-systems markets. The open-systems market consists of products designed to operate in the UNIX, NT, and other non-MVS operating environments.

Storage products revenue decreased in the first quarter of 2005, compared to the same period in 2004, primarily due to a decrease in tape and disk product sales. A number of customer orders were delayed at the end of the quarter, including some of our Information Lifecycle Management (ILM) solutions. An increase in tape automation sales was more than offset by lower sales of tape drives. We believe the tape drive revenue decrease was primarily due to the migration of existing drives to new libraries. We expect that tape drive revenue will begin to increase once the migration has occurred and as customers look to upgrade their existing drives to newer technology.

Storage products gross profit margin increased in the first quarter of 2005, compared to the same period in 2004, primarily due to a shift in product mix toward our tape automation and virtual software products, which typically sell at higher margins than our disk and network products. Operational efficiencies and ongoing cost reduction activities further contributed to the improved product margins. Product mix, channel mix, and further operational efficiencies are key factors that affect our storage products gross profit margin.

Storage Services Revenue and Gross Profit Margin

Our storage services revenue primarily consists of revenue associated with the maintenance and support of StorageTek products and third-party storage products, as well as professional services revenue associated with various storage consulting activities.

Storage services revenue increased in the first quarter of 2005, compared to the same period in 2004, primarily due to a 4% increase in maintenance and support services revenue. We also had continued strong revenue growth from professional service offerings. Professional services revenue accounted for approximately 12% of total storage services revenue in the first quarter of 2005, compared to 11% for the same period in 2004.

Storage services gross profit margin remained largely unchanged in the first quarter of 2005, compared to the same period in 2004. We believe that the mix of services will continue to shift to more professional services. If professional services become a greater portion of our service revenue, we expect that the resulting change in our services mix would adversely impact our storage services gross profit margin, as professional services typically carry lower margins than our traditional maintenance offerings.

RESEARCH AND DEVELOPMENT

Research and development costs decreased in the first quarter of 2005, compared to the first quarter of 2004, partly due to minimal prototype material for new product launches. With significant product launch activity on the forefront, we anticipate that research and development costs will increase to approximately $50.0 million per quarter for the remainder of 2005. We continue to focus on improving research and development productivity, increasing strategic alignment to support our ILM strategy, and reducing non-essential spending.

SELLING, GENERAL, AND ADMINISTRATIVE EXPENSE

Selling, general, and administrative expense (SG&A) was similar to last year s levels, with the increase primarily due to the additional investments we made in sales personnel as part of our ongoing efforts to increase revenue. As we make investments in sales resources with a focus on revenue growth, we also continue to evaluate our expenses to identify opportunities where we can become more efficient and effective. We believe that SG&A expense for the full year of 2005 will be approximately 28%, consistent with the 2004 level.

INTEREST INCOME AND EXPENSE

Net interest income for the first quarter of 2005 increased significantly compared to the same period in 2004, primarily due to increases in interest rates and a higher cash and investments balance. See LIQUIDITY AND CAPITAL RESOURCES for further discussion of our debt and financing arrangements.

INCOME TAXES

Our effective tax rate was 20.6% for the first quarter of 2005, compared to 21.7% for the same period in 2004. The decrease was primarily due to a shift in the anticipated income projections attributable to different taxing jurisdictions that have varying tax rates. We continue to recognize significant tax benefits associated with our manufacturing operations in Puerto Rico.

We expect the effective tax rate in the first quarter of 2005 to be in effect for the full year based on currently available information. Our effective tax rate may be impacted by a variety of factors, including the overall effectiveness of our global manufacturing strategies, tax legislation, and changes in our estimates regarding the resolution of open tax matters. As described below, we are in the process of evaluating whether to repatriate foreign earnings pursuant to the repatriation provision of the American Jobs Creation Act of 2004 (AJCA). If we decide to repatriate foreign earnings, we expect that our effective tax rate for 2005 would increase.

The AJCA, enacted on October 22, 2004, provides for a temporary 85% dividends received deduction on certain foreign earnings repatriated during a one-year period. The deduction would result in an approximate 5.25% federal tax rate on the repatriated earnings. To qualify for the deduction, the repatriated foreign earnings must be reinvested in the United States pursuant to a domestic reinvestment plan established by a company s chief executive officer and approved by the company s board of directors. Certain other criteria in the AJCA must be satisfied as well. For us, the one-year period during which the qualifying distributions can be made is fiscal 2005.

We are in the process of evaluating whether to repatriate foreign earnings pursuant to the repatriation provision of the AJCA. As of today, uncertainty remains as to how to interpret many of those provisions. As such, we do not expect to be able to complete our evaluation until after Congress or the Treasury Department has provided additional clarifying language on key elements of those provisions. We expect to complete the evaluation of the effects of the repatriation provision within a reasonable period of time following the publication of the additional clarifying language. The range of reasonably possible amounts of unremitted earnings that we are currently considering for repatriation pursuant to the AJCA is from $0 to $500 million. The related potential range of income tax expense which would result from repatriation is currently estimated to be between $0 and $2.6 million. These amounts exclude amounts that have been previously recognized in the financial statements.

We are subject to regular audits by federal, state, and foreign tax authorities. These audits may result in proposed assessments that may result in additional tax liabilities. We recognize liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes will be due. Our income taxes payable balance as reported on the Consolidated Balance Sheet is comprised primarily of tax contingencies that we believe are both probable and reasonably estimable.

Statement of Financial Accounting Standards (SFAS) No. 109 requires that deferred income tax assets be recognized to the extent realization of such assets is more likely than not. Based on the currently available information, we have determined that we will more likely than not realize $213.3 million of deferred income tax assets as of April 1, 2005. Our valuation allowance of approximately $22.6 million as of April 1, 2005, relates principally to foreign net operating loss carryforwards.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Our critical accounting estimates and assumptions are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2004. We have made no material changes to those policies during the three months ended April 1, 2005.

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LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

The following table summarizes our cash flows from continuing operations (in thousands):

	Quarter Ended	
	04/01/05	**03/26/04**
Operating activities	$ 51,850	$ 70,448
Investing activities	154,545	(66,364)
Financing activities	(32,986)	(1,477)

Our cash and cash equivalents balance increased $147 million during the first quarter of 2005, primarily due to an increase in cash provided by investing activities. This increase was primarily due to the net sale of approximately $176 million of auction rate securities during the quarter.

We believe the decrease in operating cash flows as compared to the prior year is largely due to inventory build associated with sales transactions that were pushed out into subsequent quarters. Our financing activities for the first quarter of 2005 include the use of $56.6 million of cash to purchase shares of our stock under the publicly announced share repurchase program, which was partially offset by $23.9 million of proceeds from employee stock plans.

Future Sources and Uses of Cash

We expect that cash flows from operations will continue to serve as our principal source of liquidity, and we believe that we have adequate working capital and financing capabilities to meet our anticipated operating and capital requirements for the next 12 months. However, cash flows from operations could be negatively impacted by a decrease in demand for our products and services as a result of rapid technological changes and other risks described under FACTORS THAT MAY AFFECT FUTURE RESULTS.

Over the longer term, we may choose to fund our operations through the issuance of additional equity or debt financing. The issuance of equity or convertible debt securities could result in dilution to our stockholders, and we cannot provide any assurance that such additional long-term financing, if required, could be completed on favorable terms.

If we decide to repatriate foreign earnings under the AJCA, our liquidity in the United States would increase, although use of the additional liquidity would be restricted by the domestic reinvestment plan required under the AJCA. There would be a corresponding reduction in liquidity in our foreign subsidiaries.

Our stock repurchase program allows us to acquire up to $500.0 million of our common stock. As of April 1, 2005, we had $309.3 million available to repurchase shares under the program. At the current pace of our common stock repurchases, we would exhaust the current repurchase authorization near the middle of next year. We intend to fund future purchases of our common stock under our share repurchase program through cash on hand and cash flows from operations. We continue to review and evaluate alternative uses for our cash, including additional stock repurchases, potential acquisitions, and investments in our business.

FACTORS THAT MAY AFFECT FUTURE RESULTS

We may be materially affected by global economic and political conditions

Our ability to generate revenue growth during the last several years was adversely affected by a difficult global economy as customers delayed their purchase decisions, reduced their information technology spending budgets, increased their purchase authorization approval requirements, and reduced their capital expenditures by maximizing the current capacities of their data storage equipment. These factors continued to persist during the first quarter of 2005 and contributed to a shortfall in revenue and profits relative to our expectations. We expect this global economic trend to continue, and we are sustaining our cost-saving measures to help mitigate the adverse effects of this trend on our business. We cannot provide any assurance that a prolonged weakness in information technology spending will not have additional adverse effects on our financial condition, results of operations, or our ability to generate revenue growth. Furthermore, we cannot provide any assurance that our cost-saving measures will be successful or sufficient to allow us to continue to generate improved operating results in future periods.

Our financial condition and results of operations could also be materially affected by unstable global political conditions. Terrorist attacks or acts of war could significantly disrupt our operations and the operations of our customers, suppliers, distributors, or resellers. We cannot predict the potential impact on our financial condition or results of operations should such events occur.

We may be materially affected by a decrease in demand for our tape products or by an inability to maintain key competitive advantages in tape

During the first quarter of 2005, approximately 80% of our storage products revenue was generated by sales of our tape products. Services associated with our tape products also represent a significant portion of our storage services revenue. For a discussion of risk associated with new products, see We may be materially affected by risks associated with new product development, below. If overall demand for tape storage products declines, or if we lose significant market share in tape, our financial condition and results of operations could be materially affected.

One of the key competitive advantages that our tape products have over competing disk products is that tape products store data at a fraction of the price of disk storage. The price of disk storage continues to decrease rapidly due to competition and decreasing manufacturing costs associated with new disk drive technologies such as ATA disk. We must continue to develop and introduce new tape products that reduce the cost of tape storage at a rate that is similar to or greater than the decline in disk storage costs in order to maintain this competitive advantage. We cannot provide any assurance that we will be able to reduce the cost of our tape products at a rate similar to the decline in disk storage costs.

We may be materially affected by competition and by our ability to execute our ILM strategy

The data storage industry is highly competitive, and customers make their decisions based on a number of competitive factors. We must address each of these factors effectively in order to successfully compete. If we are unable to adapt our products and services to changes in these competitive factors, we may lose market share to our competitors.

Our principal strategy for growing revenue and addressing the competition is our ILM strategy. Our ILM strategy is intended to capitalize on our ability to deliver complete storage solutions that satisfy customer storage requirements around data archive, data protection, and primary storage. These solutions comprise tape, disk, networking, software, and services. We have achieved some initial success in our ILM strategy; however, we must continue to develop and deliver on this strategy in the future in order to grow revenue. We have also seen the adoption of strategies similar to our ILM strategy by our competitors. We cannot provide any assurance that we will successfully execute our ILM strategy or that this strategy will provide us with a competitive advantage in the data storage industry.

We may be materially affected by risks associated with new product development

New product research and development is complex and requires the investigation and evaluation of multiple alternatives, as well as planning the design and manufacture of those alternatives selected for further development. Research and development efforts could be adversely affected by any of the following:

- Hardware and software design flaws
- Product development delays
- Changes in data storage technologies
- Changes in operating systems
- Changes in industry standards

In addition, we have outsourced software development for certain tape and network products. We cannot provide any assurance that our research and development activities will be successful in bringing new products to market.

Manufacturing new products involves integrating complex designs and processes, coordinating with suppliers for parts and components, and managing manufacturing capacities to accommodate forecasted demand. Failure to obtain sufficient quantities of parts and components, as well as other manufacturing delays or constraints, could adversely affect the timing of new product introductions. We have experienced product development and manufacturing delays in the past that adversely affected our results of operations and competitive position.

We introduced significant new products in 2004 and we plan to introduce a number of other significant new products during 2005, including virtual tape products targeted for both the enterprise and open-systems markets. When we introduce new products, we must effectively manage the transition from our existing products to the new products.

If we do not manage the transition effectively, we may be subject to the following adverse effects:

- Excess or obsolete inventory
- Insufficient inventory or manufacturing capacity to meet customer demand
- Delayed customer purchases
- Lost sales if customers purchase from our competitors

Sales of our new products may replace some of the sales of our existing products, and there may be a decline in sales of existing products in the periods leading up to new product introductions. In addition, sales of new products may result in lower service revenues if new products under warranty replace older products being serviced under maintenance agreements. We cannot provide any assurance that we will be able to successfully manage the development, introduction, or transition of new products in the future.

We may be materially affected by the risks associated with expanding our service offerings

Services continue to contribute an increasing amount of our total revenue. Growth in services has partially been driven by service offerings such as storage consulting services, implementation services, and storage management services. The development and delivery of these services are critical to the success of our plan to deliver complete storage solutions to our customers. We must ensure that storage service professionals have the necessary skill sets, experience, tools, and training to support these service offerings. Revenue growth from these service offerings is needed to offset possible future declines in maintenance revenue from our installed service base of products under maintenance contracts as these products are displaced by sales of new StorageTek products under warranty. Any failure to properly develop or deliver our service offerings could have a material adverse effect on our financial condition and results of operations.

We may be materially affected by uneven sales patterns and by our ability to forecast customer demand accurately

In the past, our results have followed a seasonal pattern, which reflects the tendency of customers to make their purchase decisions at the end of a calendar year. During any fiscal quarter, a disproportionately large percentage of total product sales are earned in the last weeks or days of the quarter. We continued to experience these trends during the first quarter of 2005. It is difficult to predict the extent to which these historical trends will continue in the future. We cannot provide any assurance that we will be able to manage our uneven sales patterns.

We prepare and update our forecasts on a regular basis to predict customer demand for our products and services. If actual demand exceeds predicted demand, we may not be able to meet customer requirements in a timely manner due to sourcing, manufacturing, or service constraints. If actual demand is less than predicted demand, we may have excess inventory or an underutilized employee base. We cannot provide any assurance that we will be able to forecast customer demand accurately or respond quickly to changes in customer demand.

Our gross profit margin may be materially affected by product mix, channel mix, and resale of third-party products

We provide a variety of solutions to meet customer needs, including tape, disk, and network products, along with associated software and services. Our products and services contribute varying gross profit margins, and the gross margin on a customer s total solution is dependent on the amounts and types of products or services involved. Gross profit margins may also be impacted by early start-up manufacturing costs associated with new products. We cannot provide any assurance that our future gross profit margin will be similar to our historical gross profit margin.

We market our solutions through a combination of a direct sales organization and indirect channel partners. Direct sales to the end-user customer usually result in higher gross profit margins than indirect channel sales. We cannot provide any assurance that changes in our channel mix will not have a material impact on gross profit margin in the future.

We sell a number of third-party products, and our gross profit margin may be adversely affected if those products become a larger portion of our total storage solutions. We may also be at a cost disadvantage in acquiring third-party products that are manufactured by competitors.

We may be materially affected by our ability to grow our indirect channels successfully

We are continually developing our indirect distribution channels, including original equipment manufacturers (OEMs), value-added distributors (VADs), value-added resellers (VARs), and other distributors. Indirect channel sales contributed approximately 57% of our total product revenue during the first quarter of 2005, compared to 48% in the same period in 2004. Increasing our sales through these indirect channels is critical to expanding our reach into new accounts and the growing open-systems market. Successfully managing the interaction of our direct and indirect channel efforts to effectively reach all of the potential customer segments for our products and services is a complex process. We cannot provide any assurance that we will be successful in expanding our indirect channel sales. Our ability to forecast future demand for our products may be adversely affected by unforeseen changes in demand from our indirect channel partners. Storage products gross profit margins may be adversely impacted to the extent we continue to receive a larger portion of our sales through our indirect channels in the future. Maintenance revenue may also be adversely affected in future periods to the extent that customers of our indirect channel partners elect to purchase maintenance services from our competitors. Our financial results may also be negatively affected if the financial condition of one or more of our channel partners weakens.

We may be materially affected by the risks associated with sole source suppliers

We purchase certain key parts, components, and services from sole source suppliers who we believe are currently the only providers that meet our specifications or for which alternative sources of supply are not readily available.

The following table shows our significant sole source suppliers and the products or services they provide:

Name of supplier	Product or service provided
Imation Corporation	T9840 and T9940 series tape media
Sanmina-SCI Corporation	Printed circuit boards and certain other manufacturing and repair services
Engenio Information Technologies, Inc	Certain FlexLine disk products
Fujitsu Electronics America	Application-specific integrated circuits (ASICs) for various tape and disk products

Name of supplier	Product or service provided
Austria Microsystems	ASICs for various tape products
Herald Datanetics Ltd. (HDL)	Key component used in certain tape products

We also obtain certain key parts and components from less significant sole source suppliers. If a sole source supplier did not continue to provide its products or services, we would need to identify and qualify other acceptable suppliers. This process could take an extended period, and we cannot provide any assurance that we could identify and qualify an alternative source on a timely basis or at an acceptable quality or price. We cannot provide any assurance that significant sole source suppliers will be able to meet our ongoing quality or delivery requirements. Failure to meet these requirements may have a material adverse impact on our financial condition and results of operations.

HDL is located in the People s Republic of China (PRC). Our dependence on HDL is subject to additional risks beyond those associated with other sole source suppliers, including the lack of a well-established court system or acceptance of the rule of law in the PRC, the degree to which the PRC permits economic reform policies to continue, the political relationship between the PRC and the United States, and broader political and economic factors. To date, we have not experienced any material problems securing key components from HDL; however, we cannot provide any assurance that we will not experience material problems in the future.

We may be materially affected by a failure to obtain quality parts and components in a timely manner or by a failure to effectively manage inventory levels

We generally use standard parts and components for our products and believe that there are a number of alternative, competent vendors for most of those parts and components. Certain suppliers have experienced occasional technical, financial, or other problems that have delayed deliveries in the past. An unanticipated failure of one of our suppliers to meet requirements for an extended period, or the inability to secure comparable components in a timely manner, could result in a shortage of key components or products, longer lead times, reduced control over production and delivery schedules, and an inability to fulfill customer orders in a timely manner.

Since we operate in a lean manufacturing environment, we are dependent on a limited supplier base to deliver quality parts and components in a timely manner. A supplier s inability to deliver parts and components on a timely basis, or our failure to effectively manage inventory levels, could have a material adverse effect on our financial condition and results of operations.

We may be materially affected by rapid technological change and evolving industry standards

Short product life cycles are inherent in high-technology industries due to rapid technological change and evolving industry standards. Our financial condition and results of operations depend on our ability to respond effectively to these changes. We cannot provide any assurance that we will be able to successfully develop, manufacture, and market innovative new products or adapt our current products to new technologies or new industry standards. In addition, customers may be reluctant to adopt new technologies and standards, or they may prefer competing technologies and standards.

We may be materially affected by the risks associated with developing and protecting intellectual property

We depend on our ability to develop new intellectual property that does not infringe on the rights of others. We cannot provide any assurance that we will be able to continue to develop such new intellectual property.

We rely on a combination of U.S. patent, copyright, trademark, and trade secret laws to protect our intellectual property rights. We enter into confidentiality agreements relating to our intellectual property with our employees and consultants, and we include confidentiality provisions in license and non-exclusive sales agreements with our customers.

We also file patent and trademark registration applications with foreign governments; however, many foreign countries do not have intellectual property laws that are as well developed as those of the United States.

Despite all of our efforts to protect our intellectual property rights, unauthorized parties may attempt to copy or otherwise obtain or use our intellectual property. Monitoring the unauthorized use of our intellectual property is difficult, particularly in foreign countries. We cannot provide any assurance that we will be able to adequately protect our intellectual property.

We may be materially affected by the risks associated with litigation

We are involved in a number of pending legal proceedings that have come up in the ordinary course of business. We believe that any liability as a result of adverse outcomes in such proceedings would not have a material adverse effect on our financial condition. However, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on our financial condition or results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in an inability to ship products or components found to have violated third-party patent rights.

We may be materially affected if we are unable to attract and retain our key employees

Our future success depends in large part on our ability to attract and retain our key employees. During the past year, several changes were made with respect to the executive management team and their organizational responsibilities. We face significant competition for individuals who possess the skills required to sell our products and services, as well as design, develop, manufacture, service, and market those products and services. An inability to successfully attract and retain these employees could have an adverse effect on our future financial condition and results of operations. Furthermore, there may be a delay between when organizational announcements are made and when the organizations are fully effective.

We may be materially affected by the risks of conducting business outside the United States

International operations accounted for approximately 58% of our revenue in the first quarter of 2005, compared to 57% in the same period in 2004. We also sell products through U.S. indirect channel partners that have some of their end-user customers located outside the United States. We expect that we will continue to generate a significant portion of our revenue from international operations.

Our international business may be affected by changes in demand resulting from global and localized economic, business, and political conditions. We are subject to the risks of conducting business outside the United States, including the following risks:

- Adverse political and economic conditions
- Impositions of tariffs or quotas
- Changes in laws or regulations
- Difficulty in obtaining export licenses
- Potentially adverse tax or labor laws
- The burdens of complying with a variety of foreign laws
- Longer payment cycles typically associated with international sales
- Foreign currency fluctuations
- Other factors outside our control

We expect these risks to increase in the future as we expand our operations in foreign countries. We cannot provide any assurance that these factors will not have a material adverse effect on our financial condition or results of operations in the future.

We may be materially affected by regulatory requirements

The European Union (EU) has finalized the Waste Electrical and Electronic Equipment (WEEE) directive and the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHs) directive. WEEE regulates the collection, recovery, and recycling of waste from electrical and electronic products. Under WEEE, we will be responsible for financing operations for the collection, treatment, disposal, and recycling of past and future covered products. RoHs bans the use of certain hazardous materials including lead, mercury, cadmium, chromium, and two brominated flame-retardants (PBB and PBDE). The EU member states are responsible for determining the specific legal requirements relating to these directives, and since they have not yet finalized their requirements, we are presently unable to reasonably estimate the amount of any costs that may be necessary in order to comply with WEEE or RoHs. We cannot provide any assurance that compliance with WEEE and RoHS will not have a material adverse effect on our financial condition or results of operations.

We are subject to various other regulatory requirements, including the Sarbanes-Oxley Act of 2002. Section 404 of the Sarbanes-Oxley Act requires that we evaluate and determine the effectiveness of our internal control over financial reporting. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our manufacturing operations may be materially affected by weather-related risks

We manufacture and assemble a significant portion of our products in Puerto Rico. Our ability to perform these activities may be significantly affected by weather-related risks beyond our control. We believe that if the Puerto Rico facilities were significantly affected by adverse weather, we could relocate to an alternative facility within a reasonable period of time; however, we cannot provide any assurance that we would be able to relocate to that facility without a material adverse impact on our financial condition or results of operations.

We may be materially affected by restructuring activities

We have recognized significant restructuring charges in the past and it is possible that changes in our business, industry, or in the global economy may necessitate restructuring activities in the future. The necessity for restructuring activities may result in expenses that adversely affect our financial condition and results of operations and may require incremental cash payments.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Rate Risk

Our primary market risk relates to changes in foreign currency exchange rates. The functional currency for our foreign subsidiaries is the U.S. dollar. A significant portion of our revenue is generated by our international operations. The majority of our international operations involve transactions denominated in the euro, Pound Sterling, and Japanese yen. An increase in the exchange value of the U.S. dollar reduces the value of revenue and profits generated by our international operations. As a result, our financial condition, results of operations, and cash flows can be materially affected by changes in foreign currency exchange rates. We attempt to mitigate this exposure as part of our foreign currency hedging program. The primary goal of our foreign currency hedging program is to reduce the risk of adverse foreign currency movements on the reported financial results of our non-U.S. dollar transactions. Factors that could have an impact on the effectiveness of our hedging program include the accuracy of forecasts and the volatility of foreign currency markets. All foreign currency derivatives are authorized and executed pursuant to our policies. We do not hold or issue derivatives or any other financial instruments for trading or speculative purposes.

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

A hypothetical 10% adverse movement in foreign exchange rates applied to our foreign currency exchange rate sensitive instruments held as of April 1, 2005, and as of December 31, 2004, would result in a hypothetical loss in fair value of approximately $43.2 million and $55.4 million, respectively. The decrease in the hypothetical loss is primarily due to a decrease in net outstanding derivatives. These hypothetical losses do not take our underlying international operations into consideration. We anticipate that any hypothetical loss associated with our foreign currency exchange rate sensitive instruments would be substantially offset by gains associated with our underlying international operations.

Interest Rate Risk

Changes in interest rates primarily affect interest income earned on our cash and short-term investments. A hypothetical 10% adverse movement in interest rates applied to our cash and short-term investments would not have a material adverse effect on our financial condition, results of operations, or cash flows.

Credit Risk

We are exposed to credit risk associated with cash equivalents, investments, foreign currency options and forwards, and trade receivables. We do not believe that our cash equivalents, investments, or foreign currency derivatives present significant credit risks, because the counterparties to the instruments consist of major financial institutions, and we manage the notional amount of contracts entered into with any one counterparty. Substantially all trade receivable balances are unsecured. The concentration of credit risk with respect to trade receivables is limited by the large number of customers in our customer base and their dispersion across various industries and geographic areas. Although we have a large number of customers who are dispersed across different industries and geographic areas, a prolonged economic downturn could increase our exposure to credit risk on our trade receivables. We perform ongoing credit evaluations of our customers and maintain an allowance for potential credit losses.

ITEM 4 CONTROLS AND PROCEDURES

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures (as defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934) as of April 1, 2005, the end of the period covered by this report. Based on their evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective.

During the first quarter of 2005, we implemented a new maintenance billing system for all end-user customers within the United States. This system is designed to allow more timely updates to our installed maintenance base and streamline our existing service billing process. We maintained existing key internal controls over the service billing process in the first quarter to support a successful implementation, and will gradually replace the existing controls with new controls during the next 12 months. There were no other changes in our internal control over financial reporting for the quarter ended April 1, 2005, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

ITEM 1 LEGAL PROCEEDINGS

For information regarding legal proceedings, see Note 4 of NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, included in Part 1, Item 1, of this Form 10-Q, which information is incorporated by reference into this Part II, Item 1.

ITEM 2 CHANGES IN SECURITIES, USE OF PROCEEDS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The following table summarizes our purchases of our equity securities during the first quarter of 2005:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)
01/01/05 - 02/04/05	857,200	$ 31.77	857,200	338,618,197
02/05/05 - 03/04/05	482,900	31.68	482,900	323,322,079
03/05/05 - 04/01/05	426,066	32.95	426,066	309,282,001
Total	1,766,166	$ 32.03	1,766,166	

(1) Excludes shares withheld to satisfy minimum tax withholding requirements associated with restricted stock lapses.
(2) On July 8, 2004 our Board of Directors authorized a stock repurchase program to acquire up to $500 million of common stock. Purchases under this repurchase program may be made from time-to-time, in the open market, through block trades or otherwise, and in privately negotiated transactions. There is no fixed termination date for this repurchase program.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Our Annual Meeting of Stockholders (the Annual Meeting) was held on April 27, 2005. A total of 96,182,096 shares of common stock, par value $0.10 per share (the Common Stock), were present at the Annual Meeting, either in person or by proxy, constituting a quorum. The matters voted upon at the Annual Meeting by the stockholders consisted of the four proposals set forth in our definitive Proxy Statement, dated March 21, 2005.

The first proposal related to the election of seven persons to serve on our Board of Directors. The Board s nominees were each elected and received, respectively, the following votes:

Director	For	Withheld
James R. Adams	91,878,795	4,303,301
Charles E. Foster	92,684,631	3,497,465
Mercedes Johnson	95,202,654	979,442
William T. Kerr	77,185,589	18,996,507
Robert E. Lee	63,455,266	32,726,830
Patrick J. Martin	95,053,999	1,128,097
Judy C. Odom	95,733,332	448,764

The second proposal related to ratifying the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for fiscal year 2005. This proposal was approved as detailed below.

The third proposal was a stockholder proposal regarding cumulative voting. The fourth proposal was a stockholder proposal regarding counting of abstentions. These two proposals were rejected as detailed below.

Proposal	For	Against	Abstentions	Broker Non-Votes
Proposal 2	91,982,291	4,148,894	50,911	--
Proposal 3	42,509,977	36,001,925	9,175,421	8,494,773
Proposal 4	31,803,393	55,652,713	231,217	8,494,773

ITEM 6 EXHIBITS

(a) Exhibits:

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

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

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

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

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

3.5 Restated Bylaws of Storage Technology Corporation, as amended through November 16, 2002 (previously filed as Exhibit 3.5 to our Annual Report on Form 10-K for the fiscal year ended December 27, 2002, filed on March 7, 2003, and incorporated herein by reference)

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

10.1 [1]

Storage Technology Corporation Amended and Restated 1987 Employee Stock Purchase Plan, as amended through May 21, 2003 (previously filed as Exhibit 4.6 to our Registration Statement on Form S-8 (Registration No. 333-106930) filed on July 10, 2003, and incorporated herein by reference)

10.2 [1] Storage Technology Corporation Amended and Restated 1995 Equity Participation Plan, as amended through May 20, 2004 (previously filed as Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended Junde 25, 2004, filed on August 2, 2004, and incorporated herein by reference)

10.3 [1] Storage Technology Corporation 2004 Long Term Incentive Plan (previously filed as Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended June 25, 2004, filed on August 3, 2004, and incorporated herein by reference)

10.4 [1] Storage Technology Corporation Management by Objective Bonus Plan (previously filed as Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

10.5 [1] Storage Technology Corporation 2004 Performance-Based Incentive Plan (previously filed as Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended June 25, 2004, filed on August 3, 2004, and incorporated herein by reference)

10.6 [1] Storage Technology Corporation Amended and Restated Stock Option Plan for Non-Employee Directors (previously filed as Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended June 28, 1996, filed on August 12, 1996, and incorporated herein by reference)

10.7 [1] Storage Technology Corporation Flexible Option Plan, dated December 2001 (previously filed as Exhibit 10.5 to our Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)

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

10.9 [1] Offer Letter, dated May 10, 2001, from StorageTek to Michael McLay (previously filed as Exhibit 10.17 to our Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)

10.10[1] Offer Letter, dated February 9, 2001, from StorageTek to Roger Gaston (previously filed as Exhibit 10.20 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

10.11[1] Offer Letter, dated July 16, 2001, from StorageTek to Roy Perry (previously filed as Exhibit 10.28 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

10.12[1] Offer Letter, dated June 27, 2001, from StorageTek to Angel Garcia (previously filed as Exhibit 10.29 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

10.13[1] Form of Executive Severance Agreement (previously filed as Exhibit 10.32 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2002, filed on May 13, 2002, and incorporated herein by reference)

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

10.15 Authorization Letter #1 pursuant to the MSA, dated April 1, 2002 (previously filed as Exhibit 10.34 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2002, filed on May 13, 2002, and incorporated herein by reference)

10.16 Authorization Letter #2 pursuant to the MSA, dated April 1, 2002 (previously filed as Exhibit 10.35 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2002, filed on May 13, 2002, and incorporated herein by reference)

10.17

Master Secondary Storage Services Agreement, between StorageTek and Electronic Data Systems Corporation, dated March 29, 2002 (previously filed as Exhibit 10.36 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2002, filed on May 13, 2002, and incorporated herein by reference)

10.18[1] Offer Letter, dated June 25, 2002, between StorageTek and Mark Roellig (previously filed as Exhibit 10.28 to our Quarterly Report on Form 10-Q for the fiscal quarter ended June 28, 2002, filed on August 12, 2002, and incorporated herein by reference)

10.19[1] Form of Indemnification Agreement, dated as of November 22, 2002, between StorageTek and each director (previously filed as Exhibit 10.31 to our Annual Report on Form 10-K for the fiscal year ended December 27, 2002, filed on March 7, 2003, and incorporated herein

10.20[1] Offer Letter, dated November 12, 2002, between StorageTek and Pierre Cousin (previously filed as Exhibit 10.33 to our Annual Report on Form 10-K for the fiscal year ended December 27, 2002, filed on March 7, 2003, and incorporated herein by reference)

10.21[1] Agreement, dated December 1, 2002, between StorageTek and Pierre Cousin (previously filed as Exhibit 10.34 to our Annual Report on Form 10-K for the fiscal year ended December 27, 2002, filed on March 7, 2003, and incorporated herein by reference)

10.22[1] Amended and Restated CEO Employment Agreement, dated March 27, 2003, between StorageTek and Patrick J. Martin (previously filed as Exhibit 10.36 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 28, 2003, filed on May 9, 2003, and incorporated herein by reference)

10.23[1] Form of Executive Agreement, dated as of February 12, 2003, between StorageTek and each executive officer (previously filed as Exhibit 10.37 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 28, 2003, filed on May 9, 2003, and incorporated herein by reference)

10.24 Letter, dated July 24, 2003, from StorageTek to Bank of America, N.A. (previously filed as Exhibit 10.32 to our Quarterly Report on Form 10-Q for the fiscal quarter ended June 27, 2003, filed on August 8, 2003, and incorporated herein by reference)

10.25[1] Offer Letter, dated December 12, 2003, between StorageTek and Mark Ward (previously filed as Exhibit 10.30 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 26, 2004, filed on May 5, 2004, and incorporated herein by reference)

10.26[1] Offer Letter, dated March 1, 2004, between StorageTek and Eula Adams (previously filed as Exhibit 10.31 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 26, 2004, filed on May 5, 2004, and incorporated herein by reference)

10.27[1] Credit Agreement, dated as of October 15, 2004, among StorageTek, the several financial institutions thereto, Bank of America, N.A., as L/C Issuer and Administrative Agent for the Banks, and Banc of America Securities LLC as Sole Lead Arranger and Sole Book Manager (previously filed in our Quarterly Report on Form 10-Q for the fiscal quarter ended September 24, 2004, filed on November 1, 2004 and incorporated herein by reference)

10.28[1] Amended and Restated form of Stock Option Agreement for use in connection with the Amended and Restated 1995 Equity Participation Plan (previously filed as Exhibit 10.1 to our Current Report on Form 8-K, filed on December 21, 2004 and incorporated herein by reference)

10.29[1] Amended and Restated form of Restricted Stock Agreement for use in connection with the Amended and Restated 1995 Equity Participation Plan (previously filed as Exhibit 10.2 to our Current Report on Form 8-K, filed on December 21, 2004 and incorporated herein by reference)

10.30[1] Amended and Restated form of Stock Option Agreement for use in connection with StorageTek s 2004 Long Term Incentive Plan (previously filed as Exhibit 10.3 to our Current Report on Form 8-K, filed on December 21, 2004 and incorporated herein by reference)

10.31[1] Amended and Restated form of Restricted Stock Agreement for use in connection with StorageTek s 2004 Long Term Incentive Plan (previously filed as Exhibit 10.4 to our Current Report on Form 8-K, filed on December 21, 2004 and incorporated herein by reference)

10.32[1] Amended and Restated form of the Restricted Stock Unit Agreement for use in connection with StorageTek s 2004 Long Term Incentive Plan (previously filed as Exhibit 10.5 to our Current Report on Form 8-K, filed on December 21, 2004 and incorporated herein by reference)

10.33[1] Offer Letter, dated January 27, 2005, between StorageTek and Brenda Zawatski (previously filed as Exhibit 10.1 to our Current Report on Form 8-K, filed on February 2, 2005, and incorporated herein by reference)

10.34[1] Amended and Restated form of Restricted Stock Agreement for use in connection with the Amended and Restated 1995 Equity Participation Plan (previously filed as Exhibit 10.1 to our Current Report on Form 8-K, filed on February 14, 2005, and incorporated herein by reference)

10.35[1] Amended and Restated form of Restricted Stock Agreement for use in connection with StorageTek s 2004 Long Term Incentive Plan (previously filed as Exhibit 10.2 to our Current Report on Form 8-K, filed on February 14, 2005, and incorporated herein by reference)

10.36[1] Transition Agreement, between StorageTek and certain executive officers of StorageTek (previously filed as Exhibit 10.1 to our Current Report on Fort 8-K, filed March 30, 2005, and incorporated herein by reference)

10.37[1] Offer Letter, dated March 14, 2005, between StorageTek and Nigel Dessau (previously filed as Exhibit 10.1 to our Current Report on Fort 8-K, filed April 4, 2005, and incorporated herein by reference)

31.1 [2] Certification Pursuant to Exchange Act Rules 13a-14 and 15d-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 [2] Certification Pursuant to Exchange Act Rules 13a-14 and 15d-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 [2] Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 [2] Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

SIGNATURES

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

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

STORAGE TECHNOLOGY CORPORATION
(Registrant)

May 10, 2005 /s/ ROBERT S. KOCOL

(Date)	Robert S. Kocol Corporate Vice President and Chief Financial Officer (Principal Financial Officer)
May 10, 2005	/s/ THOMAS G. ARNOLD
(Date)	Thomas G. Arnold Vice President and Corporate Controller (Principal Accounting Officer)