

DISC Inc. (DCSR)



J. RICHARD ELLIS joined DISC Inc. in 1994 as President and Chief Operating Officer, before being promoted to Chairman and Chief Executive Officer in 1995. Prior to joining DISC, he spent over 25 years as an executive at a variety of high technology companies in Silicon Valley. Mr. Ellis has spent the last 12 years in the data storage sector with special focus on NearLine storage systems. Before coming to DISC, he was President and CEO of Cygnet Systems, a manufacturer of 12" optical library storage systems. Under his guidance, Cygnet was profitable and was the market leader in the 12" library market. Mr. Ellis' responsibilities included strategy, business development and strategic alliances. Mr. Ellis began his career at Hewlett-Packard in Operations and was involved in the introduction

of several new computer product lines. Mr. Ellis earned a Bachelor's degree in Electrical Engineering at New Mexico State University and a Master's degree in Management from Purdue.

SECTOR – DATA STORAGE

(MAY611) TWST: Could we start with a brief overview of the history of DISC Inc.?

Mr. Ellis: DISC historically has manufactured automated digital storage systems. We are headquartered in Milpitas, California, in the heart of the Silicon Valley. The company was founded in 1986, went public in 1991, at the very early stage of revenue development. We have been shipping product for nearly 10 years into niche markets within the imaging marketplace. In today's market, we are a leading manufacturer of automated library solutions, providing companies with storage devices that add capacity to networks for a fraction of the total cost of RAID. Our products range in capacity from about 500 gigabytes to 10 terabytes of storage.

TWST: Could you talk specifically about the products and services you provide and what is in the pipeline for the immediate future?

Mr. Ellis: If you look at storage of data on networks, it consists of active data which is used and updated on a frequent basis, and inactive data which is typically older, and therefore infrequently used or updated. The consensus among industry analysts is that of all the data existing on networks, only about 30% is active and the remaining 70% is inactive and infrequently used. To store all of this data, there are three distinct categories of storage solutions available in the market.

The most predominant category is online storage, or RAID (Redundant Array of Independent Discs) storage, which provides very fast access to data, but at a high total cost of ownership. Companies providing RAID are EMC, Network Appliance, Compaq and Sun Microsystems.

Automated tape libraries produced by StorageTek or Exabyte comprise the second category of storage and they are most effectively used to back up RAID data for disaster recovery. Their capabilities are, of course, to provide very fast data transfer from the RAID device into the backup storage device; however, tape library systems suffer from the inability to randomly access data, and the media is fragile and has a limited life.

The third category of storage is called NearLine storage and is the area that DISC serves. NearLine storage has the capability to store vast amounts of data at a significantly lower total cost of ownership than RAID. In addition, NearLine systems provide far superior random access to data and long term archival over tape libraries.

For the last 10 years, DISC has been delivering NearLine storage products to high profile accounts in niche markets such as banking, government and healthcare.

In the banking marketplace, the application is predominately the archival of check images on DISC NearLine libraries. DISC is a major player in this particular niche market with installations in many major banks including Federal Reserve Banks.

The second niche market that we serve is the medical marketplace. In the medical marketplace, the applications consist of archival of patient records, X-rays, and full-motion image procedures such as heart catheterization procedures.

Federal and state governments were early adopters of NearLine storage systems, which is a lucrative market for DISC. Currently, we have key installations in the Navy, the Veterans Administration, and NASA, with applications ranging from satellite data archival to land and personnel records.

Now what we see happening is that the exponential growth in data storage, fueled by rich media content and emerging broadband data transmission, is creating similar requirements in the broad-based storage market. Ten years ago IT managers were concerned with megabytes of storage, five years ago this became gigabytes, and today companies are faced with storing terabytes of data. This year the worldwide market will generate and need to store two exabytes of data. We believe this will further drive the demand for our products in the marketplace.

TWST: Do you believe you are pretty well positioned at this point to make sure that you are on the forefront as far as providing that much more storage space for people?

Mr. Ellis: Yes. The high rate of growth in the general-purpose storage market, coupled with the fact that 70% of this data is

inactive data, is creating a tremendous market for manufacturers of NearLine storage devices such as DISC. Remember, only the active data needs to be kept on the RAID device. The remainder of the data could be migrated off to a NearLine storage device, thereby eliminating the need for backup, and reducing the operating and administration costs that are associated with RAID. Again, our storage devices add capacity to networks for a fraction of the cost of RAID. We feel that the developments I just described in the market increase our total available market opportunity from about \$150 to \$200 million to 70% of the general-purpose storage market. In 2001 this market is estimated at somewhere around \$20 billion and by 2003 it is expected to be a \$40 billion market.

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To penetrate this emerging market, we are investing very heavily in two primary areas. First, in the sales and marketing arena, we are expanding our channels worldwide and adding storage system professionals who understand the benefits of NearLine solutions. Secondly, in the area of product development, we are developing and integrating features and capabilities in our products to offer complete storage solutions.

TWST: Do you have the balance sheet to support some of these developmental plans?

Mr. Ellis: We have done private placements to fund these channel and product developments. The investors behind these investments are very long-term oriented and convinced in the market direction, as well as our overall value proposition.

TWST: Will acquisitions or other partnerships possibly play a part in these developments?

Mr. Ellis: Absolutely. We realize that we cannot effect a market change as major as this alone, so we are actively seeking out partners who share this same vision. One such partnership just culminated in the acquisition of NSM storage in Bingen, Germany. By combining the two companies, we have been able to broaden our technology offering, increase our research and development resources, and increase our revenue base. It also provides us with a local manufacturing and sales presence in the European Community and expands our global sales channels. Additionally, the combined product lines of NSM and DISC will give us a range of storage solutions that can be tailored to satisfy the storage requirements of our customers. NSM is the European market leader in CD and DVD libraries and the technology and quality reputation that it has developed will allow us to grow as leaders in the United States and the European Community as well as the rest of the world.

We have partnerships with technology developers such as Sony Optical, a division of Sony Corporation, that provide the technology in our 5-1/4 magneto optical libraries. Because of their be-

lief in the vision and the opportunity in the NearLine market, they are investing heavily in new generations of optical drive and media products for our automated libraries. Within a couple of years we will have technology in our products that will handle 40 terabytes of storage in less than 12 square feet of floor space for well under half a cent per megabyte.

TWST: Are there any specific benchmarks or milestones people could keep an eye out for that would help them gauge your progress?

Mr. Ellis: I think you need to track our revenue growth on a year-to-year basis. We have been transitioning the company in 2000 and 2001. As we get traction selling into new markets with a broader base of storage products and on a more global basis, you will see our quarter-to-quarter growth rates increase.

TWST: As far as risks, what is out there that may be of concern to you?

Mr. Ellis: One of the factors generating significant requirements for storage has been, of course, the growth of the Internet. With the collapse of the Internet bubble, the growth has slowed significantly. Of course, this dynamic really hurt those that were heavily dependent on businesses in the infrastructure portion of that market. Fortunately, we are not dependent upon that market.

However, most experts are predicting a more sane recovery of this market with a focus on business fundamentals. If you take into account the dynamics that are emerging with the advent of broadband data transmission, what will emerge with this recovery is an even stronger thirst for data storage. The broadband rich media content will dwarf today's data storage needs. Here again, I think the same rule applies: 20% to 30% of this data will be active data and the other 70% to 80% is inactive data.

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TWST: Do you have the management team in place to help take advantage of some of that opportunity?

Mr. Ellis: Absolutely. We have an experienced senior management team with many years in the data storage market. In addition, we all have experience in large companies such as Hewlett-Packard, IBM, StorageTek, as well as experience in small and start-up companies. With this blend of large and small company experience, we understand what it takes to grow a small company into a successful large and profitable company. Our acquisition of NSM has added four more managers to our team with international experience in both small and large companies.

TWST: As CEO, what's demanding most of your time and attention internally?

Mr. Ellis: Normally, I spend about 75% of my time working on strategic partnerships and talking to end-users. Most recently,

however, the acquisition of NSM has been a major consumer of my time. With that now complete, my focus will turn back to building the consortium of companies that share the vision of the NearLine storage market.

'We are well positioned in a growing market. The stock is attractively valued and our growth potential is tremendous. I think investors need to take a long-term outlook to the investment; it is going to take a few years to get this market developed, but I think we will begin to see results as we carry forward our plans in the marketplace.'

TWST: Have you tried to develop a specific corporate culture during your tenure at DISC? If so, how successful have you been in attaining that?

Mr. Ellis: I think we have been very successful in building a culture similar to that of Hewlett-Packard in the early 1970s. When I began my career at HP in this timeframe, there was a relaxed atmosphere of empowerment and accountability. This made such an impression on me, as well as many others at the time. I have tried to create that special environment in the various companies I have been involved with in the ensuing years. The culture that we have created at DISC is this type of environment: very open, concern for the individual, process oriented, problem solving and focused on results. If a company can create and maintain this atmosphere, it is a powerful force to growing a profitable, competitive company where people want to work.

TWST: What would you suggest long-term investors sitting down with your financial report focus on the most?

Mr. Ellis: It is a simple formula. Grow the top-line revenue, improve the margins, and control the operating expenses. We have been able to control our operating expenses up to this point, but we have struggled with our revenue growth and this has affected our margins. Therefore, the real key for us is to be successful in our top-line revenue growth. Since Bob Riland, our VP of Sales and Marketing, joined us a little over a year ago, his main focus has been to build a sales force capable of selling NearLine storage systems to the broad-based storage market. Of course, we are also taking good care of our existing customer base in our niche markets that I mentioned earlier. However, the new customer development is targeted at the broad-based storage marketplace.

TWST: What are the prime factors that are helping or hurting your operating margin?

Mr. Ellis: Volume and product mix are the major factors affecting our margins. As we ramp up our revenues we should see the margins improve accordingly. In addition, as we sell a more complete system with higher software content, this will also help margins.

TWST: How do you feel about your stock valuation at this point?

Mr. Ellis: We have an attractive valuation for the long-term investor. The total available market that is emerging for us gives us a tremendous opportunity for growth. We are well positioned to take advantage of this growth with our products, our channel coverage, and our worldwide manufacturing and support presence.

TWST: Is there anything that investors do not quite understand about the company that you would want to enlighten them on?

Mr. Ellis: Yes. The storage model is changing and DISC has been positioned for the new model for quite some time. The existing model is breaking down; it is expensive when you consider the total cost of ownership, including not only acquisition cost, but also support, administration, backup and operating costs. We meet the needs of the new model which is just emerging in the market that promotes the migration of inactive data off the RAID. The experience that we gained over the last few years in meeting our customers' needs in our niche markets helps us to better understand how to fulfill customer needs in new markets.

TWST: What top two or three reasons would you give a long-term investor to buy-in today?

Mr. Ellis: We are well positioned in a growing market. The stock is attractively valued and our growth potential is tremendous. I think investors need to take a long-term outlook to the investment; it is going to take a few years to get this market developed, but I think we will begin to see results as we carry forward our plans in the marketplace.

TWST: Thank you. (AAM)

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