

## STEC Inc. (STEC)

### Checks Indicate Q3 Beat Likely in Cards; but Expect Changing Competitive Landscape to Pressure Shares Downward

September 17, 2009

Price (close 9/16/09)  
**\$37.90**

Rating  
**OUTPERFORM**

12- Month Price Target  
**\$39 (from \$45)**

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- While we maintain our Outperform rating on STEC, we are reducing our PT to \$39 (from \$45) following our recent round of industry channel checks that indicate the competitive landscape in SATA/SAS enterprise SSD market is intensifying above our previous expectations. Although our checks also indicate a possible Q3 beat and potential raise to Q4 above the Str. and our estimates is likely in the cards driven by higher than expected ZeusIOPs shipments, we believe the stock could continue to face downward pressure. We are concerned STEC's "window of opportunity" to maintain a market leadership position and secure design wins at Tier I OEMs in the SATA/SAS SSD enterprise market ahead of the competition may be closing.
- Checks indicate Q3 is tracking ahead of Str. and our estimates driven by continued strength in ZeusIOPs. Although we recently increased our Q3 estimates primarily due to higher than expected shipments of Mach8 to IBM, our recent checks suggest that Q3 is tracking ahead of the Str. and our pro forma EPS and revenue estimates of \$0.47 and \$97MM, respectively, driven by strong demand for ZeusIOPs.
- Our industry checks indicate that one of STEC's Tier I OEM enterprise customers is in final qualification stages with Toshiba for its Single Level Cell (SLC) NAND-based serial attached SCSI (SAS) interface SSD. While we had expected STEC's competitors to gain design wins at its OEMs, we believed this would likely not occur until 1H:10E.
- Industry checks lead us to believe a leading Hard Disk Drive (HDD) OEM is likely set to introduce a SLC SATA/SAS SSD and possibly a Multi-Level-Cell (MLC) SSD drive in Q4. Although to date the competition in the enterprise SATA/SAS SSD market has largely been from primary NAND flash suppliers: Micron Technology (MU, Outperform), Samsung, Toshiba, and Intel (INTC, Outperform), our industry checks indicate one of the leading HDD OEMs will likely introduce a SATA/SAS SLC and potentially a MLC NAND based SSD in Q4. While the exact timing of the release of this product is unclear, we believe the addition of a HDD supplier to the competitive landscape places increased pressure on STEC's ability to gain design wins in the enterprise SSD market.
- Unexpected Changes to Competitive Landscape Alters our Risk/Reward Assumptions; Lowering Price Target to \$39 (from \$45). We think given the unexpected changes to the competitive landscape and our increasing concerns for potential price increases and supply constraints of SLC NAND that the stock should trade at a greater discounted multiple to its peer group, as a result, we are reducing our PT to \$39 (from \$45). Our PT is based upon 17x our 2010E pro forma EPS estimate of \$2.29, about a 25% (up from 10%) discount to the blended peer group median multiple (23x).
- Risks to attainment of our price target include: delayed production ramp at customers, supply constraints for NAND flash, greater than expected ASP declines in NAND flash and a change to the competitive landscape for fibre channel SSDs.

#### Company Information

52-Week Range	\$3.42 - 42.50
Shares Outstand.	50.7 Million
Insider/Institutional	48.0% / 63.5%
Public Float	31 Million
Market Cap.	\$1,921.6 Million
LT Debt	\$0.0
Debt/Capital	0.0%
Cash	\$88.5
Cash/Share	\$1.75
Book Value/Share	\$3.78
Enterprise Value	\$1,833.1 Million

#### Company Description

STEC is a leading developer, designer and manufacturer of solid state storage drives (SSDs) and memory solutions for the enterprise server, personal computer, router, switch, medical, military and industrial end markets.

FYE DEC	2008A		2009E			2010E		
REV. (\$m)	ACTUAL	CURR.	PREV.	CONS.	CURR.	PREV.	CONS.	
Q1 Mar	\$50.7	\$63.5A			\$103.9		\$106.0	
Q2 Jun	56.2	86.4A			114.0		117.0	
Q3 Sep	63.7	96.8E		96.5E	127.2		127.5	
Q4 Dec	56.9	106.8E		105.9E	145.4		136.6	
Year**	\$227.4	\$353.5E		\$352.3E	\$490.6		\$487.0	
Change	21%	55%		55%	39%		38%	

	2008A		2009E			2010E		
EPS <sup>(1)</sup>	ACTUAL	CURR.	PREV.	CONS.	CURR.	PREV.	CONS.	
Q1 Mar	\$0.07	\$0.17A			\$0.49		\$0.51	
Q2 Jun	0.09	0.42A			0.53		0.57	
Q3 Sep	0.10	0.47E		0.47E	0.59		0.62	
Q4 Dec	0.05	0.52E		0.52E	0.68		0.65	
Year**	\$0.30	\$1.59E		\$1.59E	\$2.29		\$2.35	
P/E	NM	23.8x		23.8x	16.5x		16.1x	
Change	48%	423%		423%	44%		48%	

Consensus estimates are from Thomson First Call.

\* Numbers may not add up due to rounding.

<sup>(1)</sup> Pro forma EPS excludes amortization, stock option expenses, and non-recurring investment gains and losses.



Source: NASDAQ.com

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**Exhibit 1: Valuation Comparables for Semiconductor Industry**

US\$ in millions, except per share data		Price 9/16/2009	Rating <sup>(1)</sup>	QTD Price 6/18/2009	QTD % 6/18/2009	LTM Price 9/16/2008	LTM % 9/16/2008	Performance (LTM) vs. S&P 500 vs. SOX		52 Week		Market Cap. <sup>(2)</sup>	Ent. Value <sup>(3)</sup>	Revenue		Price/Revenue		EV/Revenue		EPS <sup>(4)</sup>		P/E	Price/ Book	Y/Y % Rev Growth	Y/Y % EPS Growth		
								High	Low	High	Low			CY09E	CY10E	CY09E	CY10E	CY09E	CY10E	CY09E	CY10E	CY09E	CY10E				
<b>Analog</b>																											
Advanced Analogic Technologies I	AATI	\$4.50	Neutral*	\$4.59	-2.0%	\$4.10	9.5%	21.7%	6.4%	\$5.59	\$1.83	\$193.7	\$89.0	\$89.3	\$103.5	2.2 x	1.9 x	1.0 x	0.9 x	-\$0.14	\$0.04	nm	116.7 x	1.5 x	16%	NA	
Analog Devices Inc	ADI	27.66	NR*	24.78	11.6%	26.23	5.8%	17.4%	2.1%	30.68	15.29	8,323.7	6,974.2	2,020.8	2,204.5	4.1 x	3.8 x	3.5 x	3.2 x	0.97	1.30	28.6 x	21.2 x	3.4 x	9%	35%	
Fairchild Semicon. Int	FCS	11.02	NR*	6.99	57.7%	9.95	10.8%	22.7%	7.4%	11.39	2.17	1,369.2	1,502.7	1,147.6	1,324.1	1.2 x	1.0 x	1.3 x	1.1 x	-0.21	0.48	nm	22.8 x	1.4 x	15%	NA	
International Rectifier Corp	IRF	20.16	NR*	14.81	36.1%	21.28	-5.3%	6.7%	-8.6%	22.00	9.27	1,428.1	945.2	656.8	775.0	2.2 x	1.8 x	1.4 x	1.2 x	-1.31	-0.13	nm	1.3 x	18%	NA		
Intersemi Corporation	ISIL	16.07	Outperform*	12.57	27.8%	17.50	-8.2%	3.8%	-11.5%	19.16	7.18	1,986.5	1,662.3	592.0	668.4	3.4 x	3.0 x	2.8 x	2.5 x	0.29	0.54	55.1 x	29.9 x	1.9 x	13%	85%	
Linear Technology Cp	LLTC	27.14	NR*	23.35	16.2%	29.38	-7.6%	4.3%	-10.9%	32.70	17.69	6,077.5	6,814.4	846.9	973.6	7.2 x	6.2 x	7.8 x	6.8 x	1.00	1.19	27.1 x	22.8 x	nm	15%	19%	
Microchip Technology Inc	MCHP	27.40	NR*	22.55	21.5%	28.64	-4.3%	7.6%	-7.6%	32.37	16.23	5,027.5	3,955.6	808.8	964.5	6.2 x	5.2 x	4.9 x	4.1 x	0.71	1.16	38.7 x	23.7 x	3.5 x	19%	63%	
Micrel Inc	MRCL	8.32	NR*	7.32	13.2%	8.79	-5.3%	6.6%	-8.7%	9.50	5.78	518.5	473.6	205.5	239.6	2.5 x	2.2 x	2.3 x	2.0 x	0.22	0.47	37.3 x	17.9 x	2.9 x	17%	109%	
Microsemi Corporation	MSCC	15.56	Outperform*	13.80	12.8%	24.79	-37.2%	-25.3%	-40.5%	27.75	7.06	1,263.0	1,119.4	434.5	464.8	2.9 x	2.7 x	2.6 x	2.4 x	0.87	-	17.9 x	nm	1.8 x	7%	NA	
Maxim Integrated Products	MXIM	19.31	NR*	15.69	23.1%	17.54	10.1%	22.0%	6.8%	19.56	10.72	5,885.9	4,972.5	1,613.7	1,854.0	3.6 x	3.2 x	3.1 x	2.7 x	0.14	0.62	138.9 x	31.4 x	2.3 x	15%	343%	
National Semiconductor Corp	NSM	15.11	NR*	12.55	20.4%	17.29	-12.6%	-0.7%	-15.9%	18.65	9.02	3,557.3	4,098.6	1,221.9	1,379.7	2.9 x	2.6 x	3.4 x	3.0 x	0.07	0.75	20.7 x	20.3 x	nm	13%	824%	
On Semiconductor Corp	ONNN	8.60	Outperform*	6.86	25.4%	7.19	19.6%	31.5%	16.3%	9.12	2.35	3,592.1	4,093.0	1,712.4	1,896.5	2.1 x	1.9 x	2.4 x	2.2 x	0.25	0.57	33.9 x	15.0 x	4.2 x	11%	126%	
Semtech Corporation	SMTC	18.06	NR*	15.91	13.5%	13.68	32.0%	44.0%	28.7%	19.16	8.80	1,117.0	849.4	271.6	308.0	4.1 x	3.6 x	3.1 x	2.8 x	0.71	0.91	25.6 x	19.8 x	2.8 x	13%	29%	
Superlux Inc	SUPX	27.60	NR*	25.11	9.9%	28.91	-4.5%	7.4%	-7.9%	35.03	17.31	350.6	287.7	60.0	73.6	5.8 x	4.8 x	4.8 x	3.9 x	0.37	0.71	73.9 x	38.9 x	2.0 x	22%	90%	
Texas Instruments Incorporated	TXN	24.13	Outperform*	21.30	13.3%	21.91	10.1%	22.1%	6.8%	25.35	13.38	31,321.2	28,764.2	10,119.6	10,920.3	3.1 x	2.9 x	2.8 x	2.6 x	1.00	1.55	24.1 x	15.6 x	3.4 x	8%	55%	
Vitesse Semiconductor Corp	VLTR	18.60	Neutral*	13.14	41.6%	13.53	37.5%	49.4%	34.2%	20.17	6.10	451.2	390.1	101.6	127.7	4.4 x	3.5 x	3.8 x	3.1 x	0.54	0.90	34.3 x	20.8 x	6.0 x	26%	65%	
<b>Average</b>																											
<b>Median</b>																											
<b>Communications/Storage</b>																											
Applied Micro Circuits Corp	AMCC	\$9.52	NR*	\$8.13	17.1%	\$6.65	43.2%	55.1%	39.8%	\$10.59	\$3.01	\$657.2	\$456.9	\$186.0	\$224.7	3.5 x	2.9 x	2.5 x	2.0 x	-\$0.11	\$0.29	nm	33.4 x	2.3 x	21%	NA	
Atheros Communications Inc.	ATHR	27.76	Neutral	19.24	44.3%	25.18	10.2%	22.2%	6.9%	31.35	11.26	1,749.5	1,458.7	498.8	606.2	3.5 x	2.9 x	2.9 x	2.4 x	1.00	1.37	27.6 x	20.3 x	3.6 x	22%	36%	
Broadcom Corp Cl A	BRCM	30.21	NR*	24.79	21.9%	21.37	41.4%	53.3%	38.1%	30.60	12.98	12,985.5	10,778.4	4,219.2	4,906.2	3.1 x	2.6 x	2.6 x	2.2 x	0.97	1.39	31.2 x	21.7 x	3.4 x	16%	44%	
Cypress Semiconductor Corp	CY	10.48	NR*	9.20	13.2%	24.86	-57.8%	45.9%	-61.2%	28.99	2.54	1,651.3	1,433.4	647.0	762.9	2.6 x	2.2 x	1.9 x	-0.09	0.42	nm	24.8 x	2.7 x	19%	NA		
CAVium Networks Inc	CAVM	21.80	NR*	16.81	29.7%	12.33	76.8%	88.7%	73.5%	21.85	7.14	891.3	828.0	95.5	127.9	9.3 x	7.0 x	8.7 x	6.5 x	-0.03	0.33	nm	66.6 x	7.3 x	34%	NA	
Conexant Systems Inc	CSXT	3.91	NR*	1.44	171.5%	4.80	-18.5%	-6.6%	-21.9%	4.95	0.26	178.2	462.4	235.5	-	0.8 x	nm	2.0 x	nm	-0.08	-	nm	nm	NA	NA	NA	NA
Exar Corporation	EXAR	28.38	NR*	21.19	33.6%	8.90	263.0%	113.9%	316.6%	21.19	3.16	423.0	113.9	148.5	148.5	1.2 x	1.2 x	1.2 x	1.2 x	0.91	1.07	0.4 x	184.5 x	1.1 x	1%	NA	
Lsi Corp	LSI	5.53	Outperform*	4.56	21.3%	6.07	-8.9%	3.0%	-12.2%	6.37	2.36	3,709.4	3,185.8	2,137.2	2,387.4	1.7 x	1.6 x	1.5 x	1.3 x	0.07	0.24	76.0 x	22.9 x	2.8 x	12%	233%	
Marvell Technology Group	MVVL	16.43	NR*	11.64	41.2%	10.80	52.1%	64.1%	48.8%	16.72	4.48	10,036.3	8,760.3	2,585.9	3,013.8	3.9 x	3.3 x	3.4 x	2.9 x	0.68	0.94	24.3 x	17.5 x	2.6 x	17%	39%	
Mellanox Technologies Ltd	MLNX	15.60	NR*	12.03	29.7%	11.27	38.4%	50.4%	35.1%	16.71	6.02	450.8	-307.7	107.5	133.2	4.2 x	3.4 x	nm	nm	0.62	0.78	25.3 x	20.0 x	0.5 x	24%	26%	
Neologic Microsystems Inc	NELT	43.58	Underperform*	36.46	19.5%	28.01	55.6%	67.5%	52.3%	44.83	14.42	977.9	894.2	172.2	277.6	5.7 x	3.5 x	6.2 x	3.2 x	1.33	1.65	32.8 x	26.4 x	4.7 x	61%	25%	
Qualcomm Inc	QCOM	45.71	NR*	45.20	1.1%	46.82	-2.4%	9.6%	-5.7%	49.25	20.63	76,500.7	66,341.7	10,823.8	12,229.1	7.0 x	6.2 x	6.1 x	5.4 x	2.05	2.44	22.3 x	18.7 x	4.1 x	13%	19%	
Pmc-Sierra Inc	PMCS	9.72	NR*	7.96	22.1%	7.84	24.0%	35.9%	20.7%	9.99	2.82	2,201.4	2,026.4	490.6	559.0	4.5 x	3.9 x	4.1 x	3.6 x	0.46	0.52	21.1 x	18.7 x	2.7 x	14%	13%	
Silicon Laboratories Inc	SLAB	47.54	NR*	37.98	25.2%	30.04	58.3%	70.2%	54.9%	49.08	17.05	2,151.3	1,838.6	426.2	499.7	5.0 x	4.3 x	4.3 x	3.7 x	1.70	2.12	28.0 x	22.4 x	4.1 x	17%	25%	
Sigma Designs Inc	SIGM	15.55	NR*	16.04	-3.1%	14.13	10.0%	22.0%	6.7%	17.84	6.93	409.5	217.3	201.0	211.4	2.8 x	1.6 x	2.0 x	1.0 x	1.07	1.07	14.6 x	14.5 x	nm	9%	0%	
Spectrum Communications Inc (Adr)	SPRD	3.27	NR*	2.83	15.5%	3.36	-2.7%	9.3%	-6.0%	3.74	0.63	148.2	-202.2	94.3	149.9	1.6 x	1.0 x	nm	nm	-0.60	-0.13	nm	nm	0.2 x	59%	NA	
Stec Inc	STEC	37.90	Outperform*	23.19	6.3%	8.60	34.1	3.53	3.37	42.50	3.42	1,921.61	1,833.10	353.49	490.57	5.44	3.92	5.19	3.74	1.59	2.29	23.84	16.53	8.96	0.39	0.44	
Semiconductors Nv (Adr)	STM	9.70	NR*	7.51	29.2%	12.23	-20.7%	-8.8%	-24.0%	12.55	3.73	8,820.9	9,035.9	8,130.7	9,041.4	1.3 x	1.0 x	1.1 x	1.0 x	-0.76	0.15	nm	63.7 x	1.2 x	11%	NA	
<b>Average</b>																											
<b>Median</b>																											
<b>Consumer</b>																											
Cypress Semiconductor Corp	CY	\$10.48	NR*	\$9.20	13.9%	\$24.86	-57.8%	45.9%	-61.2%	\$28.99	\$2.54	\$1,651.3	\$1,433.4	\$647.0	\$762.9	2.6 x	2.2 x	2.2 x	1.9 x	-\$0.09	\$0.42	nm	24.8 x	2.7 x	18%	NA	
OmniVision Technologies	OVTI	\$16.65	Outperform*	10.39	60.3%	12.07	37.9%	49.9%	34.6%	16.09	4.12	863.8	586.7	528.6	706.1	1.6 x	1.2 x	1.1 x	0.8 x	-0.02	0.92	nm	18.1 x	1.8 x	34%	NA	
Rf Micro Devices Inc	RFMD	\$5.66	NR*	3.76	50.5%	2.85	98.6%	110.5%	85.3%	5.74	0.70	1,522.5	1,715.4	859.0	953.4	1.8 x	1.6 x	2.0 x	1.6 x	0.15	0.36	37.7 x	3.4 x	11%	141%		
Micron Technology Inc	MU	\$8.50	Outperform*	5.06	68.0%	4.34	95.9%	107.8%	92.5%	8.22	1.59	6,578.2	8,024.2	4,624.1	5,359.9	1.4 x	1.2 x	1.7 x	1.5 x	-1.64	-0.41	nm	nm	1.4 x	16%	NA	
Integrated Device Tech Inc	IDTI	\$6.90	NR*	6.04	14.2%	8.71	-20.8%	-8.8%	-24.1%	9.47	2.03	1,142.4	836.5	488.7	560.1	2.3 x	2.0 x	1.7 x	1.5 x	0.07	0.26	100.2 x	26.3 x	2.1 x	15%	280%	
Silicon Image Inc	SIMG	\$3.35	NR*	2.29	46.3%	5.71	-41.3%	-29.4%	-44.6%	4.03	0.33	238.8	76.6	167.5	177.4	1.4 x	1.4 x	0.5 x	0.4 x	-0.12	-0.01	nm	1.0 x	6%	NA		
Silicon Laboratories Inc	SLAB																										

**Exhibit 2: STEC Historical and Projected Pro Forma Quarterly and Annual Income Statement**

FISCAL YEAR ENDS DECEMBER (\$MILLIONS, EXCEPT SHARE DATA)	Q1:08 MAR	Q2:08 JUN	Q3:08 SEP	Q4:08 DEC	Q1:09A MAR	Q2:09A JUN	Q3:09E SEP	Q4:09E DEC	Q1:10E MAR	Q2:10E JUN	Q3:10E SEP	Q4:10E DEC	2008A	2009E	2010E
<b>REVENUE</b>	<b>\$50.7</b>	<b>\$56.2</b>	<b>\$63.7</b>	<b>\$56.9</b>	<b>\$63.5</b>	<b>\$86.4</b>	<b>\$96.8</b>	<b>\$106.8</b>	<b>\$103.9</b>	<b>\$114.0</b>	<b>\$127.2</b>	<b>\$145.4</b>	<b>\$227.4</b>	<b>\$353.5</b>	<b>\$490.6</b>
<b>TOTAL COGS</b>	<b>33.1</b>	<b>36.4</b>	<b>42.0</b>	<b>38.5</b>	<b>38.2</b>	<b>43.1</b>	48.1	53.3	51.5	56.5	63.1	72.3	149.9	182.8	243.4
<b>GROSS PROFIT</b>	17.6	19.8	21.7	18.4	25.3	43.2	<b>48.7</b>	<b>53.5</b>	<b>52.4</b>	<b>57.6</b>	<b>64.1</b>	<b>73.1</b>	77.5	170.7	247.2
% Sales	34.7%	35.3%	34.1%	32.3%	39.8%	50.1%	50.3%	50.1%	50.5%	50.5%	50.4%	50.3%	34.1%	48.3%	50.4%
Incr. gm	-32.5%	40.8%	25.0%	48.8%	104.2%	78.6%	51.8%	48.4%	37.3%	50.7%	49.9%	49.2%	47.5%	73.9%	55.8%
<b>SALES &amp; MARKETING</b>	<b>4.40</b>	<b>4.67</b>	<b>4.74</b>	<b>4.50</b>	<b>4.52</b>	<b>4.83</b>	<b>5.30</b>	<b>5.80</b>	<b>5.50</b>	<b>6.50</b>	<b>7.40</b>	<b>8.00</b>	18.3	20.5	27.4
% Sales	8.7%	8.3%	7.4%	7.9%	7.1%	5.6%	5.5%	5.4%	5.3%	5.7%	5.8%	5.5%	8.1%	5.8%	5.6%
<b>GENERAL &amp; ADMINISTRATION</b>	<b>3.63</b>	<b>3.63</b>	<b>4.52</b>	<b>4.70</b>	<b>4.93</b>	<b>6.31</b>	<b>6.50</b>	<b>6.70</b>	<b>6.70</b>	<b>6.80</b>	<b>7.10</b>	<b>7.80</b>	16.5	24.4	28.4
% Sales	7.2%	6.5%	7.1%	8.3%	7.8%	7.3%	6.7%	6.3%	6.5%	6.0%	5.6%	5.4%	7.2%	6.9%	5.8%
<b>RESEARCH &amp; DEVELOPMENT</b>	<b>4.33</b>	<b>4.80</b>	<b>4.75</b>	<b>5.03</b>	<b>4.62</b>	<b>5.06</b>	<b>6.10</b>	<b>6.50</b>	<b>7.80</b>	<b>8.50</b>	<b>9.50</b>	<b>10.80</b>	18.9	22.3	36.6
% Sales	8.5%	8.5%	7.5%	8.8%	7.3%	5.9%	6.3%	6.1%	7.5%	7.5%	7.5%	7.4%	8.3%	6.3%	7.5%
<b>TOTAL OPERATING EXPENSES</b>	<b>12.4</b>	<b>13.1</b>	<b>14.0</b>	<b>14.2</b>	<b>14.1</b>	<b>16.2</b>	<b>17.9</b>	<b>19.0</b>	<b>20.0</b>	<b>21.8</b>	<b>24.0</b>	<b>26.6</b>	53.7	67.2	92.4
% Sales	24.4%	23.3%	22.0%	25.0%	22.1%	18.8%	18.5%	17.8%	19.3%	19.1%	18.9%	18.3%	23.6%	19.0%	18.8%
<b>OPERATING PROFIT (EBIT)</b>	<b>5.2</b>	<b>6.7</b>	<b>7.7</b>	<b>4.2</b>	<b>11.2</b>	<b>27.0</b>	<b>30.8</b>	<b>34.5</b>	<b>32.4</b>	<b>35.8</b>	<b>40.1</b>	<b>46.5</b>	23.8	103.5	154.8
% Sales	10.3%	12.0%	12.1%	7.3%	17.7%	31.3%	31.8%	32.3%	31.2%	31.4%	31.6%	32.0%	10.5%	29.3%	31.6%
Incr. gm	-29.9%	27.4%	12.8%	52.1%	106.6%	69.3%	35.6%	37.4%	71.4%	33.0%	33.2%	34.9%	34.1%	63.3%	37.4%
<b>INTEREST INCOME</b>	<b>0.69</b>	<b>0.40</b>	<b>0.24</b>	<b>(0.08)</b>	<b>(0.01)</b>	<b>0.05</b>	<b>0.25</b>	<b>0.25</b>	<b>0.25</b>	<b>0.25</b>	<b>0.25</b>	<b>0.25</b>	1.25	0.54	1.00
<b>PRETAX PROFIT</b>	<b>5.9</b>	<b>7.1</b>	<b>7.9</b>	<b>4.1</b>	<b>11.2</b>	<b>27.1</b>	<b>31.0</b>	<b>34.8</b>	<b>32.7</b>	<b>36.0</b>	<b>40.4</b>	<b>46.8</b>	25.1	104.1	155.8
% Sales	11.7%	12.7%	12.4%	7.2%	17.7%	31.4%	32.0%	32.5%	31.4%	31.6%	31.7%	32.1%	11.0%	29.4%	31.8%
<b>PROVISIONS (benefit) FOR TAXES</b>	<b>2.2</b>	<b>2.7</b>	<b>3.0</b>	<b>1.6</b>	<b>2.7</b>	<b>5.8</b>	<b>6.8</b>	<b>7.6</b>	<b>7.2</b>	<b>7.9</b>	<b>8.9</b>	<b>10.3</b>	9.5	23.0	34.3
Tax rate	37.7%	37.9%	37.7%	38.4%	24.4%	21.4%	<b>22.0%</b>	<b>22.0%</b>	<b>22.0%</b>	<b>22.0%</b>	<b>22.0%</b>	<b>22.0%</b>	37.9%	22.1%	22.0%
<b>LOSS FROM DISCONTINUED OPS</b>					-								0.00	0.00	0.00
<b>NET INCOME, PRO FORMA</b>	<b>3.7</b>	<b>4.4</b>	<b>4.9</b>	<b>2.5</b>	<b>8.5</b>	<b>21.3</b>	<b>24.2</b>	<b>27.1</b>	<b>25.5</b>	<b>28.1</b>	<b>31.5</b>	<b>36.5</b>	15.6	81.1	121.5
% Sales	7.3%	7.9%	7.8%	4.4%	13.4%	24.7%	25.0%	25.4%	24.5%	24.6%	24.8%	25.1%	6.8%	22.9%	24.8%
<b>AVG. SHARES - Diluted</b>	<b>51.3</b>	<b>51.2</b>	<b>51.4</b>	50.5	<b>49.1</b>	<b>50.7</b>	51.2	51.7	52.2	52.7	53.2	53.7	51.2	51.0	53.0
<b>EPS, PRO FORMA <sup>(1)</sup></b>	<b>\$0.07</b>	<b>\$0.09</b>	<b>\$0.10</b>	<b>\$0.05</b>	<b>\$0.17</b>	<b>\$0.42</b>	<b>\$0.47</b>	<b>\$0.52</b>	<b>\$0.49</b>	<b>\$0.53</b>	<b>\$0.59</b>	<b>\$0.68</b>	<b>\$0.30</b>	<b>\$1.59</b>	<b>\$2.29</b>
<b>EPS, GAAP</b>	<b>\$0.04</b>	<b>\$0.03</b>	<b>\$0.02</b>	<b>(\$0.00)</b>	<b>\$0.06</b>	<b>\$0.38</b>	<b>\$0.41</b>	<b>\$0.47</b>	<b>\$0.43</b>	<b>\$0.48</b>	<b>\$0.54</b>	<b>\$0.62</b>	<b>\$0.09</b>	<b>\$1.32</b>	<b>\$2.07</b>
<b>CFFO, Per Share</b>	<b>\$0.04</b>	<b>(\$0.33)</b>	<b>(\$0.58)</b>	<b>\$0.27</b>	<b>\$0.61</b>	<b>\$0.48</b>	<b>\$0.13</b>	<b>\$0.30</b>	<b>\$0.54</b>	<b>\$0.33</b>	<b>\$0.35</b>	<b>\$0.51</b>	<b>(\$0.61)</b>	<b>\$1.50</b>	<b>\$1.73</b>
<b>Y/Y % CHANGE</b>															
Revenue	7%	28%	42%	7%	25%	54%	52%	88%	63%	32%	31%	36%	21%	55%	39%
Gross profit	22%	43%	56%	9%	44%	118%	124%	191%	107%	33%	32%	37%	31%	120%	45%
Operating profit (EBIT)	112%	226%	405%	-8%	115%	302%	300%	726%	188%	32%	31%	35%	125%	335%	50%
Net income, pro forma <sup>(1)</sup>	79%	82%	84%	-26%	131%	381%	390%	976%	200%	32%	30%	35%	47%	421%	50%
EPS, pro forma <sup>(1)</sup>	81%	79%	85%	-24%	141%	386%	392%	952%	182%	27%	25%	30%	48%	423%	44%
<b>Q/Q % CHANGE</b>															
Revenue	-4%	11%	13%	-11%	12%	36%	12%	10%	-3%	10%	12%	14%			
Gross profit	4%	13%	9%	-15%	37%	71%	13%	10%	-2%	10%	11%	14%			
Operating profit (EBIT)	15%	29%	14%	-46%	169%	141%	14%	12%	-6%	10%	12%	16%			
Net income, pro forma <sup>(1)</sup>	8%	20%	11%	-49%	237%	151%	14%	12%	-6%	10%	12%	16%			
EPS, pro forma <sup>(1)</sup>	9%	21%	11%	-48%	247%	143%	12%	11%	-7%	9%	11%	15%			

<sup>(1)</sup> Pro forma EPS excludes amortization, stock option expenses, and non-recurring investment gains and losses.

Sources: Company reports and Wedbush Securities, Inc. research.

**Exhibit 3: STEC Historical & Projected Annual Balance Sheet & Ratio Analysis**

<b>FISCAL YEAR ENDS DECEMBER (\$000s)</b>	<b>2005A</b>	<b>2006A</b>	<b>2007A</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>
Cash and cash equivalents	60,006	40,907	94,326	33,379	112,121	197,060
Accounts receivable	38,630	68,726	34,288	43,516	65,267	88,868
Inventory, net	37,108	75,430	31,556	63,985	53,296	64,284
Deferred income taxes	1,410	2,535	1,241	1,302	3,701	5,039
Other assets	5,139	1,691	3,028	7,872	3,425	4,663
<b>TOTAL CURRENT ASSETS</b>	<b>\$142,293</b>	<b>\$189,289</b>	<b>\$164,439</b>	<b>\$150,054</b>	<b>\$237,809</b>	<b>\$359,914</b>
Property, plant and equipment, net	8,231	11,864	37,928	46,993	39,631	33,051
Long-term investments	333	423	1,060	2,720	3,544	3,544
Goodwill and purchased intangible assets	1,769	3,121	2,679	2,255	2,101	2,101
Deferred income taxes	2,515	1,959	3,578	4,407	5,125	6,979
<b>TOTAL ASSETS</b>	<b>\$155,141</b>	<b>\$206,656</b>	<b>\$209,684</b>	<b>\$206,429</b>	<b>\$288,210</b>	<b>\$405,589</b>
Account payable	20,565	28,546	16,638	13,097	14,804	24,106
Accrued expenses and other liabilities	7,195	12,096	6,169	10,339	17,161	23,367
Liabilities of discontinued operations	-	-	483	0	0	0
<b>TOTAL CURRENT LIABILITIES</b>	<b>\$27,760</b>	<b>\$40,642</b>	<b>\$23,290</b>	<b>\$23,436</b>	<b>\$31,965</b>	<b>\$47,473</b>
Long term income taxes payable	-	-	849	1,430	1,902	2,590
<b>TOTAL LIABILITIES</b>	<b>\$27,760</b>	<b>\$40,642</b>	<b>\$24,139</b>	<b>\$24,866</b>	<b>\$33,868</b>	<b>\$50,063</b>
<b>Stockholders' equity:</b>						
Common stock	45	49	50	48	-	-
Additional paid in capital	111,576	128,353	137,942	129,670	-	-
Unearned stock based compensation	-	-	-	-	-	-
Retained earnings	15,760	37,612	47,553	51,845	-	-
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>\$127,381</b>	<b>\$166,014</b>	<b>\$185,545</b>	<b>\$181,563</b>	<b>\$252,440</b>	<b>\$352,936</b>
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS EQUITY</b>	<b>\$155,141</b>	<b>\$206,656</b>	<b>\$209,684</b>	<b>\$206,429</b>	<b>\$288,210</b>	<b>\$405,589</b>
<b>FISCAL YEAR ENDS DECEMBER</b>	<b>2005A</b>	<b>2006A</b>	<b>2007A</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>
<b>PER SHARE:</b>						
Cash flow from operations	(\$0.14)	(\$0.59)	\$0.57	(\$0.61)	\$1.50	\$1.73
Depreciation and amortization	\$0.06	\$0.08	\$0.09	\$0.18	\$0.24	\$0.25
Cash <sup>(1)</sup>	\$1.29	\$0.84	\$1.84	\$0.65	\$2.20	\$3.72
Working capital	\$1.17	\$2.20	\$0.91	\$1.82	\$1.84	\$2.18
Book value	\$2.74	\$3.39	\$3.61	\$3.55	\$4.95	\$6.66
Tangible book value	\$2.70	\$3.33	\$3.56	\$3.50	\$4.91	\$6.62
<b>LIQUIDITY RATIOS</b>						
Current ratio	5.1x	4.7x	7.1x	6.4x	7.4x	7.6x
Quick ratio <sup>(2)</sup>	3.6x	2.7x	5.5x	3.3x	5.5x	6.0x
Cash ratio <sup>(3)</sup>	2.2x	1.0x	4.1x	1.4x	3.5x	4.2x
<b>LEVERAGE</b>						
Cash to equity	47.1%	24.6%	50.8%	18.4%	44.4%	55.8%
Assets to equity	121.8%	124.5%	113.0%	113.7%	114.2%	114.9%
Cash to assets	38.7%	19.8%	45.0%	16.2%	38.9%	48.6%
<b>TURNOVER RATIOS</b>						
Asset turnover	1.7x	1.7x	0.9x	1.1x	1.2x	1.2x
Asset turnover, excluding cash	2.8x	2.1x	1.6x	1.3x	2.0x	2.4x
Accounts receivable turnover	6.8x	5.1x	5.5x	5.2x	5.4x	5.5x
Inventory turnover	5.7x	3.6x	4.1x	2.3x	3.4x	3.8x
Fixed asset turnover	31.8x	29.7x	5.0x	4.8x	8.9x	14.8x
Accounts payable turnover	10.4x	9.4x	7.8x	11.4x	12.3x	10.1x
<b>CASH CONVERSION CYCLE</b>						
Days sales outstanding	54	71	66	70	67	66
Days inventory	64	103	89	156	106	96
Days payable	35	39	47	32	30	36
Cash conversion cycle (days)	82	135	108	194	144	126
<b>PRETAX RETURN ON ASSETS</b>						
Operating margin (EBIT/Sales)	2.2%	9.3%	5.6%	10.5%	29.3%	31.6%
Asset turnover (Sales/Assets)	1.7x	1.7x	0.9x	1.1x	1.2x	1.2x
<b>PRETAX ROA</b>	<b>3.6%</b>	<b>15.8%</b>	<b>5.0%</b>	<b>11.5%</b>	<b>35.9%</b>	<b>38.2%</b>
Tax burden (NI/EBT)	76.5%	63.6%	73.6%	62.1%	77.9%	78.0%
<b>RETURN ON ASSETS (ROA)</b>	<b>2.8%</b>	<b>10.0%</b>	<b>3.7%</b>	<b>7.2%</b>	<b>28.0%</b>	<b>29.8%</b>
<b>RETURN ON EQUITY (ROE)</b>	<b>4.4%</b>	<b>13.2%</b>	<b>5.7%</b>	<b>8.6%</b>	<b>32.1%</b>	<b>34.4%</b>

(1) Includes cash and short-term investments

(2) Defined as (cash + short-term investments + accounts receivable)/(current liabilities)

(3) Defined as (cash + short-term investments)/(current liabilities)

Sources: Company reports and Wedbush Securities, Inc. research.

**Exhibit 4: STEC Historical & Projected Annual Cash Flow Statement & Projected Assumptions**

<b>FISCAL YEAR ENDS DECEMBER</b>						
<b>(\$000s)</b>	<b>2005A</b>	<b>2006A</b>	<b>2007A</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>
<b>NET INCOME (LOSS)</b>	<b>\$5,573</b>	<b>\$21,851</b>	<b>\$10,014</b>	<b>\$4,292</b>	<b>\$67,638</b>	<b>\$109,542</b>
<b>Adjustments to cash provided by operating activities:</b>						
Depreciation and amortization	2,992	3,754	4,699	9,233	12,390	13,284
Loss from discontinued operations	-	-	-	-	215	-
Accounts receivable provisions	391	953	233	786	1,526	-
Stock based compensation expense	374	101	1,115	2,405	(4,302)	(12,000)
Inventory excess and obsolescence expense	622	2,145	2,515	3,827	-	-
Gain (loss) on sale of furniture, fixtures and equipment	75	72	(1)	(248)	40	-
Deferred income taxes	593	(569)	(325)	(890)	(2,136)	(1,338)
Income from discontinued operations	(1,430)	(665)	(4,204)	(141)	-	-
Restructuring and impairment charges	-	-	-	318	-	-
Net cash flow provided by discontinued operations	(8,077)	(14,789)	6,662	(145)	2,256	-
Changes in operating assets and liabilities:						
Accounts receivable	318	(20,398)	770	(10,014)	(23,277)	(23,601)
Inventories	(12,094)	(31,794)	17,382	(36,256)	10,689	(10,988)
Accounts payable	4,925	6,733	(5,433)	(3,890)	1,237	9,302
Accrued expenses and other current liabilities	71	2,789	(166)	3,405	6,541	6,206
Leasehold interest in land	-	(286)	(2,376)	78	25	-
Other current assets	(1,144)	1,412	(1,501)	(4,164)	3,545	1,238
<b>TOTAL OPERATING ACTIVITIES</b>	<b>(\$6,394)</b>	<b>(\$28,691)</b>	<b>\$29,384</b>	<b>(\$31,404)</b>	<b>\$76,389</b>	<b>\$91,644</b>
<b>Cash flow from investing activities:</b>						
Purchases of marketable securities	(395,761)	(234,767)	(496,288)	(47,770)	(5,200)	-
Proceeds from sales of property, plant and equipment	43	-	62	313	134	-
Purchases of property, plant and equipment	(4,989)	(5,901)	(27,622)	(19,177)	(6,607)	(6,705)
Sale of marketable securities	405,733	234,767	496,288	47,770	-	-
Proceeds from sale of consumer business	-	-	43,043	-	-	-
Acquisition of business	(1,561)	(1,187)	-	-	-	-
Net cash flows provided by discontinued operations	-	-	77	-	-	-
<b>TOTAL INVESTING ACTIVITIES</b>	<b>\$3,465</b>	<b>(\$7,088)</b>	<b>\$15,560</b>	<b>(\$18,864)</b>	<b>(\$11,673)</b>	<b>(\$6,705)</b>
<b>Cash flow from financing activities:</b>						
Repayment of line of credit, net	-	-	-	(35,000)	-	-
Stock buyback	(11,827)	-	(2,513)	(19,487)	-	-
Borrowing under credit line	-	-	-	35,000	-	-
Proceeds from issuance of common stock, net	238	-	-	-	-	-
Tax benefit of employee stock option exercises	-	3,834	2,876	2,883	3,459	-
Proceeds from exercise of stock options	1,178	12,846	8,112	5,925	5,367	-
<b>TOTAL FINANCING ACTIVITIES</b>	<b>(10,411)</b>	<b>\$16,680</b>	<b>\$8,475</b>	<b>(10,679)</b>	<b>\$8,826</b>	<b>\$0</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(\$13,340)</b>	<b>(\$19,099)</b>	<b>\$53,419</b>	<b>(\$60,947)</b>	<b>\$73,542</b>	<b>\$84,939</b>
<b>CASH FLOW SUMMARY AND ANALYSIS</b>	<b>2005A</b>	<b>2006A</b>	<b>2007A</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>
Cash flow from operations	(6,394)	(28,691)	29,384	(31,404)	76,389	91,644
Net capital expenditures	(4,989)	(5,901)	(27,622)	(19,177)	(6,607)	(6,705)
<b>FREE CASH FLOW</b>	<b>(\$11,383)</b>	<b>(\$34,592)</b>	<b>\$1,762</b>	<b>(\$50,581)</b>	<b>\$69,782</b>	<b>\$84,939</b>
Investment activity	8,454	(1,187)	62	313	(5,066)	-
Financing activity	(20,383)	16,680	51,595	(10,679)	14,026	-
Net change in cash and short-term investments	(23,312)	(19,099)	53,419	(60,947)	78,742	84,939
Beginning cash and short-term investments	83,318	60,006	40,907	94,326	33,379	112,121
<b>ENDING CASH AND SHORT-TERM INVESTMENTS</b>	<b>\$60,006</b>	<b>\$40,907</b>	<b>\$94,326</b>	<b>\$33,379</b>	<b>\$112,121</b>	<b>\$197,060</b>
	<b>2005A</b>	<b>2006A</b>	<b>2007A</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>
Accounts receivable turnover	6.8x	5.1x	5.5x	5.2x	5.4x	5.5x
Inventory turnover	5.7x	3.6x	4.1x	2.3x	3.4x	3.8x
Accounts payable turnover	10.4x	9.4x	7.8x	11.4x	12.3x	10.1x
Days sales outstanding	54	71	66	70	67	66
Days inventory	64	103	89	156	106	96
Days payable	35	39	47	32	30	36
Capital expenditures as a % of sales	-1.9%	-1.7%	-14.6%	-8.4%	-1.9%	-1.4%
Depreciation as a % of sales	1.1%	1.1%	2.5%	4.1%	3.5%	2.7%
<b>NET (INVESTMENTS)</b>	<b>-0.8%</b>	<b>-0.6%</b>	<b>-12.2%</b>	<b>-4.4%</b>	<b>1.6%</b>	<b>1.3%</b>

Sources: Company reports and Webush Securities, Inc. research.

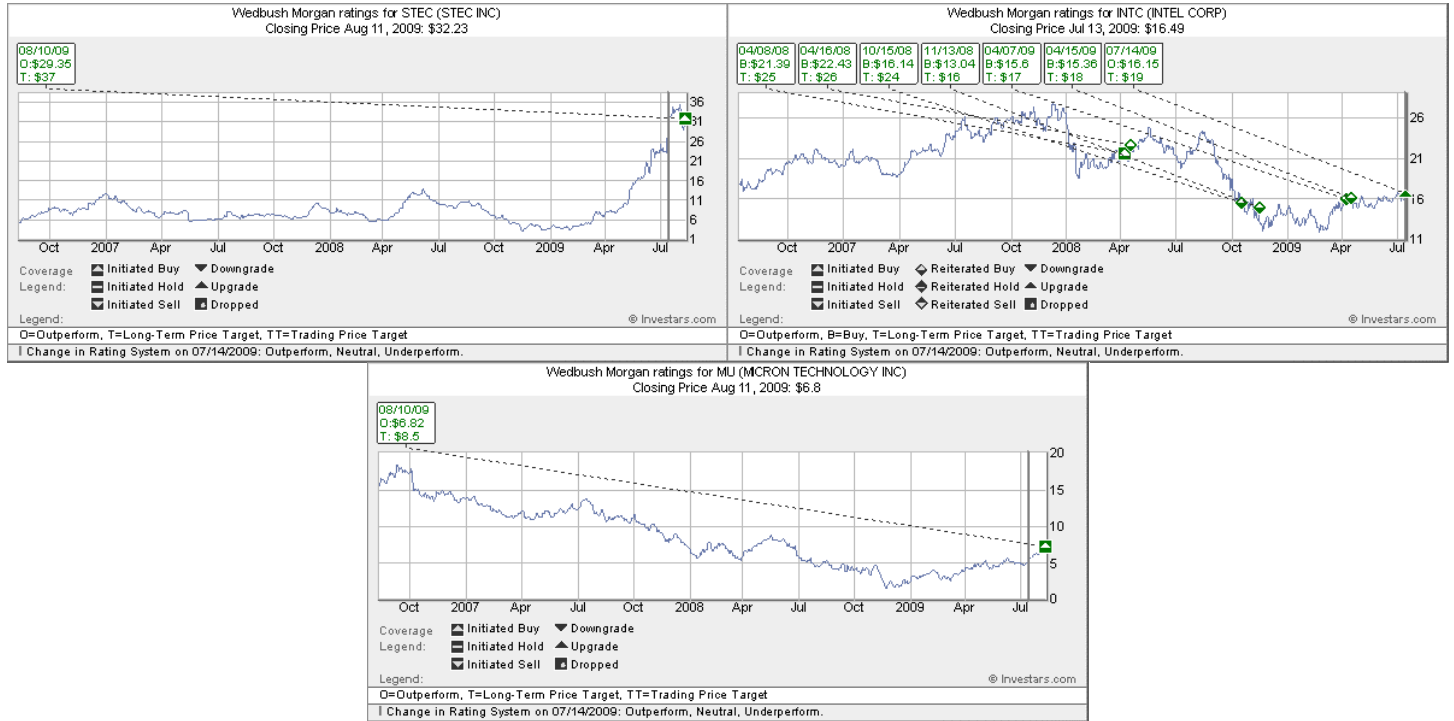
**Covered Public Companies Mentioned in this Report (close 09/16/09)**

COMPANY	TICKER	RATING	PRICE	TARGET
Intel Corporation	INTC	Outperform	\$19.65	\$24
Micron Technology, Inc.	MU	Outperform	\$8.50	\$8.50

**ANALYST CERTIFICATION**

I, Betsy Van Hees, certify that the views expressed in this report accurately reflect my personal opinion and that I have not and will not, directly or indirectly, receive compensation or other payments in connection with my specific recommendations or views contained in this report.

**IMPORTANT DISCLOSURES**



**INVESTMENT RATINGS**

**OUTPERFORM** – Expect the total return of the stock to outperform relative to the median total return of the analyst’s (or the analyst’s team) coverage universe over the next 6-12 months.

**NEUTRAL** – Expect the total return of the stock to perform in-line with the median total return of the analyst’s (or the analyst’s team) coverage universe over the next 6-12 months.

**UNDERPERFORM** – Expect the total return of the stock to underperform relative to the median total return of the analyst’s (or the analyst’s team) coverage universe over the next 6-12 months.

The Investment Ratings are based on the expected performance of a stock (based on anticipated total return to price target) relative to the other stocks in the analyst’s coverage universe (or the analyst’s team coverage).\*

**DISTRIBUTION OF RATINGS (as of June 30, 2009)**

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