

After '90s plunge, Iomega rebuilds, posts modest profit

by Mike Freeman

Plenty of technology companies that were once household names have become industry footnotes - thanks to management missteps or new technology leapfrogging over their products. But few companies have had a more tumultuous, lingering fall than Iomega.

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COMEBACK AHEAD? - Iomega's Zip drives for backing up computer data were so popular that the company became a top name in the technology industry. At its zenith from 1996 to 1998, Iomega boasted \$1.7 billion in sales and more than 4,800 employees worldwide. Its shares soared above \$100 thanks to the enthusiastic response to its Zip external computer disk drives. A national magazine pegged the stock as the first to become the subject of full-blown Internet chat-room frenzy.

That crest was followed by a precipitous plunge in Iomega sales, share price and employees. Zip revenue tumbled faster than expected, and Iomega's new products have not generated enough sales to make up the difference.

But Iomega has failed to come up with a follow-up success, causing a steep slide in its sales and share price. Iomega is hoping that its REV desktop backup line will help it make a comeback. Iomega has undertaken several restructurings, including a major purge in July 2001, when it cut nearly 40 percent of its global work force and moved its corporate headquarters from Roy, Utah, to San Diego. Today, Iomega employs about 235 workers worldwide and posted sales of \$159 million through the first three quarters of the year.

Yet a funny thing happened on the road to obscurity. Iomega recently surprised Wall Street by posting its first third-quarter profit in more than three years. Iomega reported a quarterly net profit of \$900,000, or 2 cents a share, compared with a loss of \$12.3 million a year earlier. Analysts had expected a loss of 3 cents a share. It acquired a San Diego-based provider of network security services in August - the company's first attempt to expand beyond its core data storage roots. And its share price is up nearly 40 percent for the year, albeit from a low base.

While it's too early to call the improvement a turnaround, analysts say Iomega appears at least to have reached bottom and to be ahead of schedule in efforts to resurrect itself. "I think the bottom line is the company has lowered its operating expenses to a level that it's now profitable at its current run rate," said Bud Leedom, publisher of the California Stock Report and an owner of Iomega shares.

Leedom added that Iomega generally has strong fourth quarters thanks to holiday purchases of its removable data storage disks and drives aimed at home users. "Any incremental revenue gains and they can generate strong earnings per share for the quarter," Leedom said. The improved performance comes as chief executive Jonathan Huberman tries to put his stamp on the struggling company. Huberman joined Iomega in February after previous CEO Werner Heid resigned.

Huberman is an Iomega insider. He sat on the company's board for years and worked with San Diego's Idanta Partners, a venture capital firm that funded the company from its founding in 1980. Idanta sold its stake in Iomega about three years ago. Huberman's first step was to shed unprofitable products and further cut costs by laying off about 90 workers. He revamped the company's supply chain to get products from suppliers at lower costs.

"We had to stop losing money," said Huberman, who was managing director of a hedge fund that invests in small and medium-sized companies before joining Iomega. "It had been too long. We have much lower costs now. It's a sustainable business with our current products."

Huberman also is refocusing Iomega on small-business customers. While small businesses have long been a target for the company, Iomega also spends a lot of money and time fighting for shelf space at Best Buy and other electronics retailers to sell data storage to home users, analysts say. Iomega's previous management aimed to make it the data backup brand of choice for the digital home, pitching home computer users to buy its data storage products to back up their digital photos, digital music and other digital media. The much-ballyhooed digital home has been slow to catch on, however. Inexpensive thumb, or flash, drives and rewriteable compact discs are tough competitors in the consumer market, analysts say. And many consumers often don't bother to back up photos and music sitting on their home computer hard drives - at least not yet.

While he's not abandoning the home user, Huberman sees an opportunity with small businesses. Hence the August acquisition of San Diego-based CSCI. The company provides managed services surrounding network security with its OfficeScreen product. For a monthly fee, doctor groups, mortgage brokers, health clubs, real estate brokers and other small firms get security protection for all their remote offices that are linked via a network.

Once they've bought the data security, these small firms might also opt for Iomega's network attached data storage or other storage devices, Huberman said. At the time of the CSCI purchase, he said the deal was the first step toward Iomega becoming a managed services provider. Huberman thinks managed services for small business is a fragmented market with a lot of opportunity. Many small firms are too tiny to be bothered with the big players in the managed services business, such as IBM, he said. "Most go after whales. We can make money on sardines," he said. Small businesses face higher risks if their data is hacked, Huberman said, because they don't have the deep pockets to deal with the fallout.

Iomega brings a well-known brand name and a well-established sales channel, including value-added resellers that serve small businesses.

"The question for small businesses is 'Do I trust Iomega?' " Huberman said. "We're still a big business with a very strong balance sheet. There's no risk of us going anywhere." The 26-year-old Iomega had plenty of ups and downs in its early days, but it always managed to snap back with a new technology or innovative product.

Among its most innovative was the Zip product line - a removable drive and disk system for the computer market that caught on like wildfire when introduced in March 1995. Company sales soared from \$141 million in 1994 to a peak of \$1.7 billion in 1997 on the strength of the Zip line. Iomega has sold more than 50 million Zip drives and more than 280 million storage disks. At its peak, the company had more than \$400 million in the bank and no debt.

But internal computer hard drives grew in capacity and became less expensive. And external devices migrated from the pricey Zips to ultra cheap CDs and flash drives. Iomega tried introducing a slew of new products in hopes of finding another hit. None stuck.

"Zip came at the right place at the right time," Leedom said. "It is one of those situations where a company is lucky and has foresight. But today that space is vastly more competitive. The products that are serving that market have shrunk in size dramatically."

With its share price in shambles and little hope of stemming the tide of declining Zip sales, Iomega issued a \$5 per share dividend in October 2003, in part because it could think of nothing better to do with its stockpile of cash. Recently, the company's remaining products - particularly its REV products - have gotten good reviews in electronics industry magazines. REV drives are external data backup and recovery devices for desktop computers with 35 to 70 gigabytes of capacity. The target customers are small or medium-sized businesses and home users.

And Huberman still has a long runway - \$70 million in cash - to improve Iomega's prospects. He doesn't rule out further acquisitions.

"We've stopped the ship from sinking," Huberman said. "We have a solid core. It's too good a company, too good a brand, not to be turned around."

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