



Value Raider ALERT - Phoenix Technologies (PTEC) FQ1 Results - Turnaround on Track

January 25, 2007

Small cap core systems software name **Phoenix Technologies** ([PTEC](#)) reported its fiscal first quarter (quarter ended December 31) results before the bell this morning. PTEC is a holding in the [Value Raider Model Portfolio](#).

For FQ1, the first full quarter under the struggling company's new management team, PTEC posted revenue of \$9.7 million, up 17% sequentially, but just half of the \$18.6 million in revenue that PTEC posted in the year ago period. Keep in mind that a year ago PTEC was effectively aggressively "borrowing" from future revenue and driving down future margins by aggressively using "fully-paid-up" licensing. PTEC's new management, led by CEO **Woody Hobbs**, has eliminated this ill-advised pricing in a bid to improve PTEC's margins, build a more predictable revenue base and bring the name back to profitability. Longer term, PTEC hopes to grow the business through new products.

Hobbs & Co have also been aggressively cutting costs. Operating expenses were down - 27% sequentially to \$15.1 million (\$11.8 million after backing out restructuring charges and comp expense), while gross margin rose from 63% to 74% sequentially on the higher revenue and lower costs. On a non-GAAP basis, PTEC still posted an ugly loss of -\$4.7 million or -42 cents per share and cash declined roughly -\$10 million sequentially from \$60.3 million to \$50.6 million. While these latest results are certainly nothing to write home about, and PTEC has chewed through a frightening amount of cash in recent quarters, under the surface, the new management team is making good progress and is following through on their goal of driving the business back to profitability. PTEC is now sitting on executed sales agreements of nearly \$22 million

On this morning's earnings call, Hobbs and CFO **Rich Arnold** seemed confident about the company's turnaround plan and noted that FQ1 results were "in line to slightly better" than expectations. Hobbs said he is "more confident than ever" in the company's prospects of gaining significant new business in the second half of its fiscal year. In a sign of new PTEC management's growing comfort with the next few quarters, it offered up guidance for the first time. PTEC now expects greater than 10% sequential top-line growth in FQ2 (revenue of around \$10.7 million) and total annual revenue for the year in excess of \$50 million. PTEC also nudged up its expectations of hitting a break-even run rate from the end of FQ4 to during the quarter. We actually think PTEC could now reach pro forma operating profitability in FQ3 and definitely during FQ4 if things keep falling into place.

PTEC now expects total expenses (including COGS) to be less than \$15 million in FQ2. This numbers includes restructuring charges and compensation expense. Based on PTEC's new guidance, the name is indicating \$30 million in revenue in the back-half of the year with FQ4 expected to be higher than FQ3. Thus, one can see how, *if* PTEC can hit these targets, it will have clawed back to break-even levels in the coming months. PTEC indicated previously it expects its net cash balance at its low point to be around

\$45 million. Today's results and call indicate that our view, that PTEC shares *could* hit \$7 over the next year, remains on track and doable. It also indicates that PTEC's decision to reject the latest buyout offer by **Ramius Capital**, its largest shareholder (nearly 14% stake), at the \$5.25 level is correct. A bid at the \$6+ level we think is a different story and we still see value in adding more shareholder-representation at the board level.

So far on the day, PTEC shares are nudging up 1.8% to \$5.10, putting us up ~23% over our buy of the stock for the model portfolio at the \$4.12 level last November. At current price levels, the stock checks in at an enterprise value of around \$80 million, valuing the 70%+ gross margin BIOS name at a still modest 1.3x expected exit run-rate revenue for the year of ~\$60 million. The stock is no longer the "ultra-deep value" it looked like when we added it a few months ago, but we still see a favorable risk-reward outlook.

The next notable date for PTEC holders is the company's annual meeting on February 14. Ramius has nominated two of its representatives for PTEC's board and has said that these new directors, if elected, will push for a sale of the company. We still think the two sides could reach a settlement ahead of the meeting. We don't know which side **Special Situations Funds**, which holds a 13% stake in PTEC, comes down on in this argument, but we would note that the fund has recently added to its position around the \$5 level.

As for us, we plan to sit tight and let things play out. As always, we'll keep you posted.

Read our [PTEC post archive](#) for more information.

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