THREE'S A CHARM

OEMs Venture capitalists told S3’s founders to focus on what they did best: graphics accelerators. Luckily they did. Now the company’s sales have reached jackpot levels.

BY LAWRENCE ARAGON

Dado Banatao and Ron Yara wanted to build a lightning-fast PC. But when they pitched their concept to venture capitalists, the money men gave them two words of advice: Forget it. Instead, they were told to concentrate on their core technology—graphics acceleration. They did. And Banatao, Yara—and especially their shareholders—couldn't be happier.

After going public in March last year, shares in their company, S3 Inc., soared from $15 to $40—then split in December. The fuel for this rocket-ship performance: growth, and lots of it. In Broadview Associates’ most recent report of the nation’s fastest-growing high-tech companies, S3 ranked No. 1 among 15 chip makers for 1993’s third quarter (see PC Week/Inside, Feb. 14). And this wasn’t just a blip. S3’s 1993 sales of $113 million reflected a 269 percent increase over the previous year’s results. Securities analysts expect another strong showing this year—net income of $22.4 million on sales of $179.5 million.

In the five years since its founding, S3 has succeeded in claiming a 25 percent share of what is now a $450 million market. It’s second only to Cirras Logic Inc., with 40 percent. S3 has done so well by focusing on the middle to high end of the accelerator market, where premium prices have endowed it with 40 percent margins. Now, though, S3 is aiming some
of its older 32-bit products at the low end. It has prudent reasons. But the move isn't without risk. Its plans will put it nose-to-nose against older and larger Cirrus in yet another segment—and just as a low-end price war is expected to break out.

Banatao and Yara founded S3 (an abbreviation for start-up No. 3) after a rocky split from their second, Chips and Technologies. After the VCs shunned their original systems-building scheme, it didn't take the duo long to recover. They reedited their pitch in a weekend. Seven days later, they had tentative commitments from VCs—despite not having a formal business plan. Eventually, they raised more than $16 million in two rounds of venture funding. These early investors liked Banatao's and Yara's credentials: Banatao also held senior engineering management jobs at companies, including Seeq, and Yara worked at Intel as a product marketing manager.

Both are workaholics. Through three startups, "I've missed 10 years of my life," confesses Banatao, 47, who serves as company chairman. The rest of S3's 150-member staff isn't exactly laid back. Overtime is so institutionalized that S3 ships in catered meals at 7 p.m.—every night. "A lot of the startup feel is still here," says spokesman Andy Logan. Indeed, even Banatao's and Yara's offices are cubicles. S3's growth into a "corporation" hasn't stifled a sense of impromptu fun: Yara, 46, still shoots Nerf loops with the staff.

In the helter-skelter of such rapid growth, Banatao and Yara have managed to make good decisions. Analysts cite only one misstep: a local-bus chip-set line that S3 canceled in 1990, resulting in the layoff of half its staff. The company claims to be the first accelerator company to bet on Windows rather than IBM's once-touted XGA graphics standard. It was also first with a single-chip GUI accelerator, and the first out of the gate with an integrated 32-bit version.

What does S3 need to do to keep succeeding? Even though it recently introduced a line of 64-bit accelerators, S3 must continue to innovate. To supplement its R&D efforts, CEO Terry Holdt, 50, hasn't ruled out using some of S3's $45 million in cash to acquire new technologies or companies. It should help, too, that Yara, who was handling day-to-day marketing responsibilities, recently became a senior VP focusing on long-term planning with Banatao.

Another issue S3 must confront: keeping up with Cirrus. For example, Cirrus has already come to market with an integrated DAC (digital-to-analog converter). Integrated DACs are typically used in notebooks and low-end PCs. Within a year, S3 must have an integrated DAC, too, says Mike Feibus, a principal of Mercury Research.

What's more, Cirrus also recently announced plans to buy its own fabricating capacity. Will S3 follow? Not just yet. Yara says that Cirrus, at $600 million in sales, has reached a size where producing its own chips becomes cost-effective. S3 isn't there yet. For the moment, it has plenty of capacity through Hewlett-Packard, NEC, and Toshiba as well as four more foundries it has yet to announce. One option: Sometime between now and the middle of next year, S3 could wind up with an equity stake in a fab.

S3's move into the low end will come in an effort to milk some of its older products for all they're worth. The November introduction of its 64-bit accelerator means that it can steer its 32-bit version to cheaper desktop machines. One possible damper to the shift is a price war in low-end graphics chips expected to break out this year, Feibus says.

That prospect isn't causing any second thoughts at S3, though. The rapidly growing low end "is going to be a key element of the market for us," Holdt says. He contends that S3's high-performance 32-bit 895 chip will be "a tremendously powerful vehicle to capture share."

Besides, it doesn't have much to lose. Competition by the bigger Cirrus notwithstanding, the market for graphics accelerators will continue to grow like gangbusters. Thanks to the appetite for Windows, Dataquest Inc. estimates accelerator sales of 65 million units, valued at $1.4 billion, by 1997. S3 will grow right along with the market. And as long as it does, Banatao and Yara—and their shareholders—will continue to rejoice in that original piece of advice to just forget it.