Silicon Graphics International Corp
Form 10-Q
May 05, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 26, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number: 0-51333

SILICON GRAPHICS INTERNATIONAL CORP.

(Exact name of registrant as specified in its charter)

Delaware	**32-0047154**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

46600 Landing Parkway

Fremont, California 94538

(Address of principal executive offices including zip code)

(510) 933-8300

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of April 30, 2010, there were 30,674,095 shares outstanding of the Registrant s Common Stock, $0.001 par value per share.

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PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	March 26, 2010	June 26, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 143,248	$ 128,714
Current portion of restricted cash and cash equivalents	601	1,119
Accounts receivable, net of allowance for doubtful accounts of $1,224 and $859 at March 26, 2010 and June 26, 2009, respectively	81,843	64,810
Inventories	76,215	117,790
Current portion of deferred cost of revenue	33,912	5,505
Prepaid expenses and other current assets	25,426	25,757
Total current assets	361,245	343,695
Non-current portion of restricted cash and cash equivalents	3,594	2,294
Long-term investments	7,391	7,416
Property and equipment, net	30,045	33,124
Intangible assets, net	17,985	21,521
Non-current portion of deferred cost of revenue	44,490	339
Other assets	33,520	33,247
Total assets	$ 498,270	$ 441,636
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 39,943	$ 52,618
Accrued compensation	18,643	20,855
Other current liabilities	31,890	31,880
Current portion of deferred revenue	129,251	69,655
Total current liabilities	219,727	175,008
Non-current portion of deferred revenue	79,737	14,635
Long-term income taxes payable	21,714	18,948
Other non-current liabilities	15,214	14,946
Total liabilities	336,392	223,537
Commitments and contingencies (Note 15)		
Stockholders equity:		
Preferred stock, $0.001 par value; 12,000 shares authorized; none outstanding		

Common stock, $0.001 par value; 120,000 shares authorized; 30,674 shares issued and outstanding at March 26, 2009; 30,171 shares issued and outstanding at June 26, 2009	30	30
Additional paid-in capital	458,266	453,730
Treasury stock, at cost (244 shares at March 26, 2010 and June 26, 2009)	(1,022)	(1,022)
Accumulated other comprehensive loss	(1,486)	(1,575)
Accumulated deficit	(293,910)	(233,064)
Total stockholders equity	161,878	218,099
Total liabilities and stockholders equity	$ 498,270	$ 441,636

See notes to these condensed consolidated financial statements.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 26, 2010	April 4, 2009	March 26, 2010	April 4, 2009
Revenue	$ 107,820	$ 44,358	$ 302,080	$ 148,219
Cost of revenue	78,900	41,659	232,106	140,492
Gross profit	28,920	2,699	69,974	7,727
Operating expenses:				
Research and development	14,730	3,154	37,873	10,779
Sales and marketing	16,731	4,233	50,924	15,449
General and administrative	13,270	6,011	40,056	16,747
Acquisition-related		2,962	(557)	2,962
Restructuring	1,434		3,652	
Total operating expenses	46,165	16,360	131,948	45,937
Loss from operations	(17,245)	(13,661)	(61,974)	(38,210)
Interest and other income (expense), net:				
Interest income, net	105	118	332	1,345
Other expense, net	(2,566)	(16)	(3,480)	(981)
Total interest and other income (expense), net	(2,461)	102	(3,148)	364
Loss from continuing operations before income taxes	(19,706)	(13,559)	(65,122)	(37,846)
Income tax provision (benefit)	556	35	(3,930)	(1,115)
Loss from continuing operations	(20,262)	(13,594)	(61,192)	(36,731)
Discontinued operations (Note 11):				
Income (loss) from discontinued operations	82	197	346	(2,212)
Income tax benefit				(14)
Income (loss) from discontinued operations, net of tax	82	197	346	(2,198)
Net loss	$ (20,180)	$ (13,397)	$ (60,846)	$ (38,929)
Basic and diluted net income (loss) per share:				
Continuing operations	$ (0.67)	$ (0.46)	$ (2.04)	$ (1.24)
Discontinued operations		0.01	0.01	(0.07)
Basic and diluted net loss per share	$ (0.67)	$ (0.45)	$ (2.03)	$ (1.31)

Shares used in computing basic and diluted net loss per share	30,097	29,787	30,041	29,748

See notes to these condensed consolidated financial statements.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	March 26, 2010	April 4, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (60,846)	$ (38,929)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	13,725	2,931
Share-based compensation	3,584	3,998
Impairment of long-lived assets		663
Impairment of cost method investment		350
Provision for doubtful accounts receivable	430	1
Deferred income taxes	(87)	(14)
Loss on disposal of property and equipment	395	217
Changes in operating assets and liabilities:		
Accounts receivable	(17,463)	36,512
Inventories	41,981	9,913
Deferred cost of revenue	(72,558)	146
Prepaid expenses and other assets	220	7,686
Other long term assets	(273)	928
Accounts payable	(12,932)	(42,598)
Accrued compensation	(2,212)	290
Other liabilities	2,703	(1,942)
Deferred revenue	124,698	(590)
Net cash provided by (used in) operating activities	21,365	(20,438)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(5,287)	(1,301)
Increase in restricted cash and cash equivalents	(782)	(25)
Proceeds from sales and maturities of short-term investments		6,771
Proceeds from maturities of long-term investments	225	
Cash used in acquisition	(1,983)	
Escrow payment for the acquisiton of Legacy SGI		(1,000)
Cash paid for intangible assets		(48)
Net cash (used in) provided by investing activities	(7,827)	4,397
CASH FLOWS FROM FINANCING ACTIVITIES:		
Restricted stock retired to cover taxes	(766)	(941)
Proceeds from issuance of common stock upon exercise of stock options	860	15
Purchase of treasury stock		(1,022)
Proceeds from sales of common stock under ESPP plan	902	992
Net cash provided by (used in) financing activities	996	(956)

Effect of exchange rate changes on cash and cash equivalents		65
Net increase (decrease) in cash and cash equivalents	14,534	(16,932)
Cash and cash equivalents beginning of period	128,714	190,778
Cash and cash equivalents end of period	$ 143,248	$ 173,846
NON CASH INVESTING AND FINANCING ACTIVITIES:		
Property and equipment purchases in accounts payable	$ 257	$ 13
Unrealized gain (loss) on investments	$ 90	$ (1,286)
SUPPLEMENTAL DISCLOSURE OF OTHER CASH FLOW INFORMATION:		
Cash paid for income taxes	$ 1,293	$ 59

See notes to these condensed consolidated financial statements.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BUSINESS

Silicon Graphics International Corp. (SGI or the Company) was originally incorporated as Rackable Corporation and later changed its name to Rackable Systems, Inc. (Rackable Systems or Legacy Rackable). Rackable Systems was incorporated in the state of Delaware in December 2002 in connection with the acquisition of substantially all of the assets and liabilities of Rackable Systems predecessor company referred to herein as Old Rackable. On May 8, 2009, Rackable Systems completed the acquisition of substantially all of the assets, excluding certain assets unrelated to the ongoing business, and assumed certain liabilities of Silicon Graphics, Inc. (Legacy SGI) (see Note 3). This acquisition was consummated pursuant to the terms of an Asset Purchase Agreement dated March 31, 2009, as amended on April 30, 2009, which was approved by the United States Bankruptcy Court for the Southern District of New York for Silicon Graphics, Inc. Effective May 18, 2009, Rackable Systems changed its name to Silicon Graphics International Corp.

The Company s headquarters is located in Fremont, California. Following the acquisition of Legacy SGI assets, the Company now operates in 25 countries, with its primary manufacturing facilities located in Chippewa Falls, Wisconsin. The principal business of the Company has been and continues to be the design, manufacture and implementation of highly scalable compute servers and high-capacity storage systems, which are sold to customers such as large internet businesses, and companies in vertical markets such as semiconductor design, enterprise software, the federal government, entertainment, financial services, oil and gas, biotechnology and pharmaceuticals. Following the acquisition of Legacy SGI, the Company is also a leader in high-performance computing and data management. The Legacy SGI acquisition adds a broad line of mid-range to high-end computing servers, data storage and visualization systems, and provides customer support and professional services related to these products. Consequently, the Company is now a leading developer of enterprise-class, high performance features for Linux operating systems. The Company s products are used by the scientific, technical and business communities to solve challenging data intensive computing, data management and visualization problems.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal, recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations for the periods presented. These unaudited condensed consolidated financial statements also have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) applicable to interim financial information. The results for the interim periods are not necessarily indicative of results for the entire year or any future periods. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements for the fiscal year ended January 3, 2009, which are included in the Company s Annual Report on Form 10-K filed with the SEC on March 18, 2009, and the Company s unaudited financial information and notes thereto for the transition period from January 4, 2009 to June 26, 2009, included in the Company s transition report on Form 10-Q filed with the SEC on August 10, 2009 (the Transition Report).

Fiscal Year. The Company has a 52-week fiscal year ending on the last Friday in June with 13 week quarters ending on the last Friday of the respective period. On June 19, 2009, the Company s Board of Directors approved a change in the Company s fiscal year end from the Saturday closest to December 31st of each year to the last Friday in June of each year. As a result of this change, the Company s prior fiscal year, which began on January 4, 2009, ended on June 26, 2009. Accordingly, the Company s fiscal year 2010 began on June 27, 2009 following a transition period that ended June 26, 2009.

Basis of Consolidation. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of financial statements in accordance with generally accepted accounting principles in the United States of America (US GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses as presented in the unaudited condensed consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management s best knowledge of current events and actions that may impact the Company in the future, actual results may be different from the estimates. The Company s critical accounting policies are those that affect the Company s financial statements materially and involve difficult, subjective or complex judgments by management and include revenue recognition, allowance for doubtful accounts, inventory valuation, valuation of intangible assets, warranty reserve, share-based compensation, restructuring expense, and accounting for income taxes.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Discontinued Operations. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 420-20, *Discontinued Operation (ASC 420-20)*, the Company has accounted for the Rapidscale product line as a discontinued operation. The results of operations of the Rapidscale product line have been reclassified and presented as discontinued operations, net of tax, for all periods presented. The cash flows of the Rapidscale product line have not been reported separately within the unaudited condensed consolidated statement of cash flows based upon materiality (see Note 11).

***Cash and Cash Equivalents*.** The Company classifies highly liquid investments with remaining contractual maturity at date of purchase of three months or less as cash equivalents.

Restricted Cash and Cash Equivalents. *S*hort-term and long-term restricted cash and cash equivalents consist primarily of cash deposits with banks. The cash deposits are pledged as collateral for various guarantees issued to cover rent on leased facilities and equipment, to government authorities for value-added (VAT) and other taxes, and certain vendors to support payments in advance of delivery of goods and services. The deposits are classified as short-term or long-term depending on the nature of the period of guarantee (see Note 14).

Investments. The Company classifies its investments as available-for-sale at the time of purchase. The Company s investments include auction rate securities (ARS). ARS are structured with short-term interest rate reset dates, generally less than ninety days, but with contractual maturities that can be well in excess of ten years.

Investments are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), net of income taxes, in the condensed consolidated balance sheets. Realized gains or losses on the sale of investments are determined using the specific-identification method. The Company evaluates its investments periodically for other-than-temporary impairments by reviewing factors such as the length of time and extent to which fair value has been below amortized cost, the financial condition of the issuer and the Company s ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery of market value. The Company records an impairment charge to the extent the carrying value of available-for-sale securities exceeds the estimated fair market value of the securities and the decline in value is determined to be other-than-temporary.

The Company complies with the provisions of ASC 820-10, *Fair Value Measurements and Disclosures (ASC 820-10)*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. In February 2008, the FASB issued ASC 820-10-15, *Application of ASC 820-10 to ASC 840-*10 *and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under* ASC 840-10, and removed leasing transactions accounted for under ASC 840-10 and related guidance from the scope of ASC 820-10. ASC 820-10-15, *Effective Date of* ASC 820-10, deferred the effective date of ASC 820-10 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008.

ASC 820-10 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. ASC 820-10 also requires that fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available. Assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and/or the risks inherent in the inputs to the model. The adoption of ASC 820-10 did not have a significant impact on financial statements.

ASC 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820-10 are described below:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly; and

Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Accounts Receivable. Accounts receivable are recorded at the invoiced amount and do not bear interest. Accounts receivable have been reduced by an estimated allowance for doubtful accounts, which is management s best estimate of the amount of probable credit losses in existing accounts receivable. Among other factors, management determines the allowance based on customer specific experience and the aging of the receivables.

Concentration of Credit Risk. Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents, restricted cash and cash equivalents, long-term investments, and accounts receivable. The Company maintains cash and cash equivalents with high credit quality financial institutions. The Company derives a significant portion of its revenue from a large number of individual customers spread globally. The Company also derives revenue from several large customers. If the financial condition or results of operations of any one of the large customers deteriorates substantially, the Company s operating results could be adversely affected. To reduce credit risk, management performs ongoing credit evaluations of the financial condition of significant customers. The Company generally does not require collateral and maintains reserves for probable credit losses on customer accounts when considered necessary.

Inventories. Inventories, consisting primarily of server chassis, hard drives, microprocessors, memory chips, cooling fans, and other equipment used in the manufacture of Company products, are stated at the lower of cost or market. Cost components include materials, labor, and manufacturing overhead costs.

The Company assesses the value of inventory, on a quarterly basis based upon estimates about future demand and actual usage. To the extent that the Company determines that it is holding excess or obsolete inventory, it writes down the value of its inventory to its net realizable value. Such write-downs are reflected in cost of revenue.

The Company maintains a long-term inventory of parts to support maintenance arrangements. This parts inventory is valued based on assumptions about product life cycles, historical usage, current production status and installed base, and is periodically tested for impairment. The parts inventory is included in other assets in the unaudited condensed consolidated balance sheets.

Deferred Cost of Revenue. Deferred cost of revenue primarily consists of product costs related to revenue deferred in accordance with the Company s revenue recognition policy.

Property and Equipment. Property and equipment is stated at cost, net of accumulated depreciation and amortization. Property, equipment and capitalized software are depreciated on a straight-line basis over their estimated useful lives, generally two to 32 years. Leasehold improvements and assets acquired under capital leases are amortized using the straight-line method over the shorter of the estimated useful lives of the respective assets, or the lease term. When assets are retired or disposed of, the cost and related accumulated depreciation and amortization are removed from the Company s accounts and the resulting gain or loss is reflected in the condensed consolidated statements of operations.

Repairs and maintenance are charged to expense as incurred and significant improvements and betterments that substantially enhance the life of an asset are capitalized.

Intangible Assets. Intangible assets consist of customer relationships and backlog, purchased technology, trademarks and trade names, and in-process research and development costs, acquired in business combinations. Intangible assets are carried at cost, less accumulated amortization. Amortization is computed using the straight-line method over the estimated useful lives of the respective assets, generally one to five years, except for the customer backlog intangible asset, which is amortized as acceptance is received for a particular customer order, reflecting the use of the asset.

Equity Investments. The cost-method is used to account for equity investments in companies in which the Company holds less than a 20 percent voting interest, does not exercise significant influence, and the related securities do not have a quoted market price. In accordance with ASC Topic 325, *Investments-Other*, the Company monitors these investments for impairment and recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is determined to be other-than-temporary.

Impairment or Disposal of Long-Lived Assets. The Company reviews its long-lived assets in accordance with ASC 360-10 *Property Plant and Equipment*, for indicators of impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is measured by a comparison of the carrying amount of the assets to the estimated undiscounted future cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value calculated based on the principles in ASC 820-10.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Warranty Reserve. The warranty period for the Company s products is generally one to three years. The warranty accrual is based upon historical experience and product life and is affected by actual product failure rates, material usage, and service delivery costs incurred in correcting the product failure. The warranty reserve is included in other current liabilities and non-current liabilities in the condensed consolidated balance sheets.

Deferred Revenue. Deferred revenue is primarily comprised of revenue deferred for installations yet to be completed, advance billings and customer deposits for service, support and maintenance agreements and product revenue for which performance obligations or customer acceptance is required. Deferred revenue is recorded when products or services provided are invoiced prior to completion of the related performance obligations or customer acceptance and is recognized as revenue upon the completion of those performance and acceptance criteria. Extended warranty, service, support, and maintenance deferrals are recognized ratably over the service period.

Comprehensive Loss. Comprehensive loss for the three and nine months ended March 26, 2010 and April 4, 2009 consists of unrealized gain (loss) on investments classified as available-for-sale, unrecognized loss related to defined benefit pension plans and change in cumulative translation adjustment. The tax effect of unrealized gain (loss) on available-for-sale investments and unrecognized loss on pension assets has been taken into account, if applicable.

Comprehensive loss is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	March 26, 2010	**April 4, 2009**	**March 26, 2010**	**April 4, 2009**
Net loss	$ (20,180)	$ (13,397)	$ (60,846)	$ (38,929)
Unrealized gain (loss) on investments	102	(1,263)	90	(1,266)
Unrecognized loss on pension assets	58		(1)	
Change in cumulative translation adjustment		(115)		66
Total comprehensive loss	$ (20,020)	$ (14,775)	$ (60,757)	$ (40,129)

Revenue Recognition. The Company accounts for revenue under the provisions of ASC 605-10, *Revenue Recognition (ASC 605-10)*, ASC 605-20, *Separately Priced Extended Warranty and Product Maintenance Contracts (ASC 605-20),* ASC 985-605 *Software Revenue Recognition (ASC 985-605)*, ASC 605-25, *Multiple-Element Arrangements (ASC 605-25),* and *ASC 605-50 Customer Payments and Incentives*.

The Company enters into revenue arrangements to sell products and services for which the Company is obligated to deliver multiple products and/or services. A typical multiple-element arrangement includes product, third-party product or services, consulting services, and maintenance. Under the provisions of ASC 605-10, the Company recognizes revenue from sales of products when persuasive evidence of an arrangement exists, shipment has occurred and title has transferred, the sales price is fixed or determinable, and collection of the resulting receivable is reasonably assured. In customer arrangements with substantive performance obligations, revenue is recognized when formal customer acceptance is received, unless acceptance is deemed to be perfunctory.

Service revenue includes hardware, maintenance and installation services. Pursuant to ASC 605-10, the Company recognizes revenue from the sale of its products prior to completion of these services, as product sales are not dependent on these services to be functional. Under ASC 605-20, revenue from hardware maintenance contracts, which are expressly priced separately from the hardware, is recognized ratably over the contract term, generally one to three years. Where software is integrated with hardware and sold as a hardware appliance, the Company provides unspecified software updates and enhancements to the software through service contracts. As a result, the Company accounts for these arrangements in accordance with ASC 985-605 where software is determined to be more than incidental to the product. Revenue earned on software arrangements involving multiple-elements are allocated to each element based on Vendor Specific Objective Evidence (VSOE) of fair value. The undelivered element is generally post contract customer support (PCS) for which VSOE of fair value is determined based on the price charged for the PCS when sold separately. The Company has not established VSOE of fair value on its PCS arrangements for certain of its products and therefore revenue from these arrangements is deferred and recognized ratably over the PCS period.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Under ASC 605-25, multiple-element arrangements are assessed to determine whether they can be separated into more than one unit of accounting. In performing the assessment, the Company first applies the separation criteria within ASC 605-20 to separate the

deliverables that fall within the scope of ASC 605-20. Multiple-element arrangements are separated into more than one element if all of the following are met:

- The delivered item(s) has value to the customer on a standalone basis.
- There is objective and reliable evidence of the fair value of the undelivered item(s).
- If the arrangement includes a general right of return relative to the delivered item and delivery or performance of the undelivered item(s) is considered probable and substantially within the Company s control.

If all of the above criteria are not met, revenue associated with the arrangement is deferred until the entire arrangement has been delivered.

Royalty Revenue. The Company recognizes royalty revenue under fixed fee arrangements in the quarter in which the revenue is earned in accordance with the contractual terms and conditions. Under volume-based technology agreements, where the Company is unable to reliably estimate license volume, revenue is recognized in the quarter in which reports are received from licensees detailing the shipments of products incorporating the Company s intellectual property. The reports are generally received on a one-quarter lag basis from when the royalty revenue is earned. Royalty revenue was not material for any of the periods presented.

Engineering Service Revenue. The Company recognizes engineering services revenue when services are rendered, no significant post-delivery obligations exist, and collectability is reasonably assured. Engineering service revenue was not material for any periods presented.

Accounting for Taxes Collected from Customers. The Company collects various types of taxes from its customers that are assessed by governmental authorities, which are imposed on and concurrent with revenue-producing transactions. Such taxes are recorded on a net basis and are not included in revenue in any of the periods presented.

Research and Development. Costs related to research, design and development of Company products are charged to research and development expense as incurred. Software development costs are required to be capitalized when a product s technological feasibility has been established through the date the product is available for general release to customers. The Company has not capitalized any software development costs, as technological feasibility is generally not established until a working model is completed, at which time substantially all development is complete.

Share-Based Compensation. The Company accounts for employee stock purchase and stock incentive plans under the provisions of ASC 718-10 (revised 2004), *Compensation Stock Compensation (ASC 718-10).* ASC 718-10 requires the recognition of the fair value of share-based compensation expense in the Company s condensed statements of operations. The fair values of stock options and employee stock purchase plan awards are estimated using the Black-Scholes option-pricing model. Under ASC 718-10, compensation expense for those options granted prior to the adoption of ASC 718-10 continue to be expensed on the same basis as they were prior to its adoption, reduced for estimated forfeitures.

Defined Benefit Pension Plans. The Company accounts for its defined benefit pension plans in accordance with ASC 715-30, *Compensation Retirement Benefits Defined Benefit Plans Pensions*. The Company recognizes the funded status of its defined benefits plans as the difference between the fair value of restricted plan assets and the projected benefit obligation.

Restructuring Expense. The Company recognizes restructuring expense resulting from excess manufacturing or administrative facilities that the Company chooses to close, or consolidate, reduction in headcount, and from other exit activities. In connection with exit activities, the Company records restructuring charges for employee termination costs, long-lived asset impairments, costs related to leased facilities to be abandoned or subleased, and other exit-related costs. These charges are incurred pursuant to formal plans developed and approved by management and accounted for in accordance with ASC 420-10, *Exit or Disposal Cost Obligations (ASC 420-10)*. The recognition of restructuring expense requires management to make judgments and estimates regarding the nature, timing, and amount of costs associated with the planned exit activity, including estimating sublease income and the fair value, less selling costs, of property and equipment to be disposed of. Estimates of future liabilities may change, requiring the Company to record additional restructuring expense or to reduce the amount of liabilities previously recorded. At the end of each reporting period, the Company evaluates the remaining accrued balances to ensure their adequacy, that no excess accruals are retained and that the utilization of the provisions is for the intended purpose in accordance with developed exit plans. In the event circumstances change and the provision is no longer required, the provision is reversed.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Foreign Currency Transactions. The financial statements of the Company s foreign subsidiaries are re-measured in accordance with ASC 830-10, 30 *Foreign Currency Matters* . The functional currency of the Company s foreign subsidiaries is the U.S. dollar. Accordingly, all monetary assets and liabilities of the foreign subsidiaries are re-measured into U.S. dollars at the exchange rates in effect at the reporting date, nonmonetary assets and liabilities are translated at historical rates, and revenue and expenses are translated at average exchange rates in effect during each reporting period. Accordingly, transaction gains and losses are included as a component of interest and other income, net in the Company s unaudited condensed consolidated statements of operations. In the three months ended March 26, 2010 and April 4, 2009, the Company recognized losses of $2.6 million and $0.1 million respectively. In the nine months ended March 26, 2010 and April 4, 2009, the Company recognized losses of $3.5 million and $0.7 million, respectively.

Accounting for Income Taxes. The Company computes income taxes using the asset and liability method, under which deferred income taxes are provided for temporary differences between financial reporting basis and tax basis of assets and liabilities and operating loss and tax credit carry forwards. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized. Deferred tax assets and liabilities and operating loss and tax credit carry forwards are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and operating loss and tax credit carry forwards are expected to be recovered or settled.

The Company is subject to audits and examinations of tax returns by tax authorities in various jurisdictions, including the Internal Revenue Service. Management regularly assesses the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of the provision for income taxes.

Recently Issued Accounting Pronouncements**.** In June 2009, the FASB issued ASC 105-10, *Generally Accepted Accounting Principles (ASC 105-10).* ASC 105-10 establishes the FASB Accounting Standards Codification ™ *(Codification)* as the single source of authoritative U.S. Generally Accepted Accounting Principles recognized by the FASB for non-governmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative US GAAP for SEC registrants. The Company adopted ASC 105-10 in the three months ended September 25, 2009, which supersedes all existing non-SEC accounting and reporting standards, and all corresponding changes in the Company s notes to the unaudited condensed consolidated financial statements reflect the adoption of this standard.

In June 2009, the FASB issued ASC 810-10, *Consolidations (ASC 810-10).* ASC 810-10 provides (*a*) guidance on identifying variable interest entities and determining whether such entities should be consolidated; (*b*) general consolidation guidance; and (*c*) guidance on the consolidation of entities controlled by contract. ASC 810-10 will become effective for the Company beginning June 26, 2010. Early application is not permitted. The Company is evaluating the future effect, if any, of this standard on its results of operations or financial position.

In October 2009, the FASB issued ASC 985-605, *Software Revenue Recognition (ASC 985-605),* that will become effective for the Company beginning June 26, 2010, with earlier adoption permitted. In accordance with this standard, arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of ASC 985-605, and software-enabled products will now be subject to other relevant revenue recognition guidance. The Company believes that the adoption of this new standard will have a material effect on its financial position and results of operations. However, the Company is assessing the impact of this standard and accordingly is not able to estimate the effect on its financial position and results of operations.

In October 2009, the FASB issued ASC 605-25, *Multiple-Element Arrangements (ASC 605-25)*, for revenue arrangements with multiple deliverables that are outside the scope of ASC 985-605. In accordance with ASC 985-605, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. This standard includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. The Company believes that the adoption of this new standard will have a material effect on its financial position and results of operations. However, the Company is assessing the impact of this standard and accordingly is not able to estimate the effect on its financial position and results of operations.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

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3. ACQUISITION

Acquisition of Silicon Graphics, Inc.

On May 8, 2009 (the Closing Date), the Company completed the acquisition of substantially all of the assets of Legacy SGI, excluding certain assets unrelated to the ongoing business, including certain of Legacy SGI s non-U.S. subsidiaries and operations and assumed certain liabilities. The acquisition was consummated pursuant to the terms of an Asset Purchase Agreement (the Agreement) dated as of March 31, 2009 and as amended on April 30, 2009 (as amended, the Agreement). As Legacy SGI and certain of its affiliates had filed bankruptcy petitions and motions for voluntary Chapter 11 reorganization, the Purchase Agreement was subject to the approval of the United States Bankruptcy Court for the Southern District of New York (the Bankruptcy Court). On April 30, 2009, the Agreement and the transactions contemplated thereby were approved by the Bankruptcy Court, allowing the Company to complete the Acquisition under Section 363 of the U.S. Bankruptcy Code. Under the terms of the Agreement, the Company acquired the net assets for a purchase price of approximately $42.5 million in cash.

The transaction was accounted for in accordance with the provisions of ASC 805-10, *Business Combinations*. The Company retained independent appraisers to advise management in the preliminary determination of the fair value of the various assets acquired and liabilities assumed. The values assigned in these financial statements are preliminary and represent management s best estimate of fair values as of the Closing Date. In accordance with ASC 805-30, *Goodwill or Gain from Bargain Purchase, Including Consideration Transferred,* the estimated fair value of the acquired net assets of $62.3 million, including assumed liabilities, exceeds

the $42.5 million cash consideration paid by the Company resulting in a gain of $19.8 million. Accordingly, the Company recorded a gain on acquisition in the unaudited condensed consolidated statement of operations during the three months ended June 26, 2009.

As required by ASC 805-20, *Business Combinations Identifiable Assets and Liabilities, and Any Noncontrolling Interest*, the Company conducted a review to reassess whether it identified all the assets acquired and all the liabilities assumed, and followed ASC 805-20 s measurement procedures for Closing Date recognition of the fair value of net assets acquired. The review confirmed the calculation of the gain on acquisition, which is consistent with a distressed sale of assets in bankruptcy, as well as the depressed market capitalization of Legacy SGI prior to its acquisition.

The following are the estimated fair value of assets acquired and liabilities assumed as of the Closing Date (in thousands):

Cash and short-term investments	$ 33,018
Deferred cost of revenue	1,821
Other tangible assets	163,150
Deferred revenue	(76,265)
Deferred income tax liabilities	(1,818)
Other liabilities assumed	(79,275)
Net tangible assets	40,631
Intangible assets	21,700
Net assets acquired	62,331
Gain on acquisition	19,831
Cash paid	$ 42,500

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The fair value of the major components of the intangibles assets acquired and their estimated useful lives is as follows (dollars in thousands):

	Preliminary Fair Value	Weighted Average Useful Life (in Years)
Customer relationships	$ 6,900	5
Customer backlog	5,100	(a)
Purchased technology	5,000	4
Trademark/ trade name portfolio	2,600	5
In-process research and development costs	2,100	
Total	$ 21,700	

(a) The customer backlog intangible asset is amortized as all revenue recognition criteria is accomplished for a particular customer order, reflecting the use of the asset.

Under ASC 805-10, acquisition-related costs (i.e., advisory, legal, valuation and other professional fees) are not included as a component of consideration transferred, but are accounted for as expenses in the periods in which the costs are incurred. Acquisition-related costs were immaterial and $0.4 million in the three and nine months ended March 26, 2010.

The Company has included the operating results of Legacy SGI in its unaudited condensed consolidated financial statements since the Closing Date.

The following unaudited pro forma condensed financial information presents the combined results of operations of the Company and Legacy SGI as if the acquisition had occurred as of the beginning of the period presented (in thousands except per share amounts):

	Pro Forma Combined Three Months Ended April 4, 2009	Pro Forma Combined Nine Months Ended April 4, 2009
Revenue	$ 137,493	$ 416,889
Loss from continuing operations	(60,683)	(168,540)
Loss from discontinued operations, net of tax	197	(2,198)
Net loss	$ (60,486)	$ (170,738)
Net loss per share, basic and diluted:		
Continuing operations	$ (2.04)	$ (5.67)
Discontinued operations	0.01	(0.07)

Basic and diluted net loss per share	$	(2.03)	$	(5.74)
Shares used in computing basic and diluted net loss per share		29,787		29,748

The unaudited pro forma condensed financial information is not intended to represent or be indicative of the consolidated results of operations of the Company that would have been reported had the acquisition been completed as of the beginning of the period presented, and should not be taken as being representative of the future consolidated results of operations of the Company. For example, the unaudited pro forma condensed financial information does not take into account revenue and cost of revenue, which is deferred in accordance with ASC 985-605, as it is eliminated in purchase accounting.

The pro forma adjustments are based upon available information and certain assumptions that the Company believes are reasonable. The pro forma results of operations do not include the potential post-acquisition effects of any restructuring, impairment or integration costs related to the combined operations nor of any revenue opportunities, operating synergies or cost savings anticipated as eventual benefits of the acquisition.

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(UNAUDITED)

Acquisition of Copan Systems, Inc.

On February 23, 2010, the Company completed the acquisition of substantially all the assets of Copan Systems, Inc. (Copan) and assumed certain liabilties. The purchase price of $2.0 million was allocated to Copan s tangible and identifiable intangible assets acquired and liabilities assumed based on their fair market values as of the acquisition date. The purchase price allocation resulted in purchased net tangible assets of $1.0 million, consisting primarily of inventories and fixed assets, and purchased identifiable intangible assets of $1.0 million.

The transaction was accounted for in accordance with the provisions of ASC 805-10, *Business Combinations*. The Company retained independent appraisers to advise management in the determination of the fair value of the various assets acquired and liabilities assumed. As required by ASC 805-20, *Business Combinations Identifiable Assets and Liabilities, and Any Noncontrolling Interest*, the Company conducted a review to reassess whether it identified all the assets acquired and all the liabilities assumed, and followed ASC 805-20 s measurement procedures for recognition of the fair value of net assets acquired.

The fair value of the intangible assets acquired and their estimated useful lives are as follows (dollars in thousands):

	Fair Value	Useful Life (in Years)
Purchased technology	$ 300	2
Patents and core technology	200	2
Trademark/ trade name portfolio	100	2
In-process research and development costs	400	
Total	$ 1,000	

The financial results of this acquisition are not considered significant for purposes of pro forma financial disclosures.

4. BALANCE SHEET

Long-term Investments

Long-term investments consist of ARS, which are investments with contractual maturities generally between zero and 40 years. Beginning in February 2008, certain ARS failed auction due to sell orders exceeding buy orders. The Company s ARS consist of investments that are backed by pools of student loans, the majority of which are ultimately guaranteed by the U.S. Department of Education. Based on an analysis of impairment factors related to the ARS, the Company has recorded a temporary impairment loss in accumulated other comprehensive loss of $1.4 million at March 26, 2010. Given the recent disruptions in the credit markets and the fact that the liquidity for these types of securities remains uncertain, the Company has classified all of the ARS ($7.4 million, net of unrealized losses) as long-term investments in the unaudited condensed consolidated balance sheets as the Company s ability to liquidate such securities in the next 12 months is uncertain.

Realized gains or losses on sales of long-term investments were insignificant in all periods presented.

Fair Value of Investments

The Company utilized the guidance and procedures in ASC 820-10 and ASC 820-10-15 to determine the fair value of financial instruments. Such guidance confirms the unchanged measurement objective to determine the exit price at the balance sheet date for an orderly transaction that is not a forced liquidation or distressed sale. As required, measurement included appropriate risk adjustments that market participants would make for nonperformance and liquidity risks. The Company determined that this decline and duration represents a temporary impairment based on the guidance in ASC 320-10-35-18 through 35-34E, Investments Debt and Equity Securities, Recognition and Measurement, Impairment. ASC 320-10-53-33A through 35-33I provide three conditions for evaluating whether an impairment of a debt security is other than temporary each reporting period:

If management intends to sell an impaired debt security, the impairment is considered other than temporary. If the entity does not intend to sell the impaired debt security, it must still assess whether it is more likely than not that it will be required to sell the security.

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If management determines that it is more likely than not that it will be required to sell the security before recovery of the amortized cost basis of the security, the impairment is considered other than temporary.

If management determines that it does not intend to sell an impaired debt security and, that it is not more likely than not that it will be required to sell such a security before recovery of the security s amortized cost basis, the entity must assess whether it expects to recover the entire amortized cost basis of the security.

The Company has the intent and ability to hold these securities until their value recovers, and have not sold any at a loss. The valuation model assumes that a liquidity event will occur within the next 36 months. Long-term investments at March 26, 2010 consist of the following (in thousands):

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
March 26, 2010				
Long-term investments-ARS	$ 8,825	$	$ (1,434)	$ 7,391
Total investments	$ 8,825	$	$ (1,434)	$ 7,391
June 26, 2009				
Long-term investments-ARS	$ 9,056	$	$ (1,640)	$ 7,416
Total long-term investments	$ 9,056	$	$ (1,640)	$ 7,416

Fair Value Measurement

The financial assets of the Company measured at fair value on a recurring basis are cash and cash equivalents, restricted cash and cash equivalents, and long-term investments. The Company s cash equivalents are generally classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Company s long-term investments are classified within Level 3 of the fair value hierarchy because they are valued using unobservable inputs, due to the fact that observable inputs are not available, or situations in which there is little, if any, market activity for the asset or liability at the measurement date.

The following table sets forth investments as of March 26, 2010, which are measured at fair value on a recurring basis by level within the fair value hierarchy and are classified based on the lowest level of input that is significant to the fair value measurement (in thousands):

	Level 1	Level 2	Level 3	Assets at fair value
Cash and cash equivalents	$ 143,248	$	$	$ 143,248
Current portion of restricted cash and cash equivalents	601			601
Non-current portion of restricted cash and cash equivalents	3,594			3,594
Long-term investments-ARS			7,391	7,391

Total	$ 147,443	$	$ 7,391	$	154,834

Level 3 assets consist of ARS, which are valued based on a discounted cash flow model.

The changes in Level 3 assets measured at fair value on a recurring basis for the three months ended March 26, 2010 were as follows:

		Long-term investments ARS
Balance at December 25, 2009	$	7,437
Total unrealized gains included in other comprehensive income		129
Purchases, sales, and settlements, net		(175)
Balance at March 26, 2010	$	7,391

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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The changes in Level 3 assets measured at fair value on a recurring basis for the nine months ended March 26, 2010 were as follows:

	Long-term investments ARS
Balance at June 26, 2009	$ 7,416
Total unrealized gains included in other comprehensive income	200
Purchases, sales, and settlements, net	(225)
Balance at March 26, 2010	$ 7,391

ASC 825, *Financial Instruments*, requires disclosure of the estimated fair value of certain financial instruments and the methods and significant assumptions used to estimate their fair values. The fair values of cash and cash equivalents, accounts receivable and accounts payable approximated their carrying values because of the short-term nature of these instruments. The fair value of investment in SGI Japan is valued based on a combination of discounted cash flows and market transactions. As of March 26, 2010 and June 26, 2009, the fair value of investment in SGI Japan was $5.0 million.

Inventories

Inventories consist of the following (in thousands):

	March 26, 2010	June 26, 2009
Finished goods	$ 35,111	$ 56,343
Work in process	11,023	21,347
Raw materials	30,081	40,100
Total inventories	$ 76,215	$ 117,790

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following (in thousands):

	March 26, 2010	June 26, 2009
Non-trade receivable	$ 3,155	$ 7,534
Prepaid income taxes	6,561	4,099
Value-added tax receivable	7,288	2,659
Deferred income taxes	2,511	2,511

Other current assets	5,911	8,954
Total prepaid expenses and other current assets	$ 25,426	$ 25,757

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Property and Equipment, Net

Property and equipment, net consist of the following (in thousands):

	March 26, 2010	June 26, 2009
Land and building	$ 11,812	$ 11,503
Computer equipment and software	20,963	16,855
Manufacturing equipment	6,649	6,741
Leasehold improvements	7,392	5,564
Furniture and fixtures	1,663	1,648
Vehicles	104	104
Construction in progress	489	1,216
	49,072	43,631
Less accumulated depreciation and amortization	(19,027)	(10,507)
Total property and equipment, net	$ 30,045	$ 33,124

Depreciation and amortization expense for the three months ended March 26, 2010 and April 4, 2009 was $3.1 million and $0.8 million, respectively. Depreciation and amortization expense for the nine months ended March 26, 2010 and April 4, 2009 were $9.2 million and $2.2 million, respectively.

Intangible Assets, Net

	Weighted Average Useful Life (in Years)	Gross Carrying Amount Cost	Accumulated Amortization	Net
Customer relationships	5	$ 6,900	$ (1,235)	$ 5,665
Purchased technology	4	5,300	(1,075)	4,225
Patents	2	200	(8)	192
Customer backlog	(a)	5,100	(2,721)	2,379
Trademark/trade name portfolio	5	3,667	(643)	3,024
Subtotal		21,167	(5,682)	15,485
In-process research & development costs not subject to amortization		2,500		2,500
Total		$ 23,667	$ (5,682)	$ 17,985

(a) The customer backlog intangible asset is amortized as all revenue recognition criteria is accomplished for a particular customer order, reflecting the use of the asset.

In December 2002, as a part of the acquisition of Old Rackable, a trade name intangible asset valued at $3.5 million was recorded. In connection with the acquisition of Legacy SGI and the change in name to Silicon Graphics International Corp., it was determined that the capitalized trade name, which was historically classified as an indefinite life asset, has a finite life of five years.

Intangible assets amortization expense for the three months ended March 26, 2010 and April 4, 2009 was $0.8 million and immaterial, respectively. Intangible assets amortization expense for the nine months ended March 26, 2010 and April 4, 2009 was $4.5 million and $0.7 million, respectively.

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As of March 26, 2010, estimated future amortization expense for intangible assets, subject to amortization, is as follows (in thousands):

Fiscal Year	Amortization Expense
2010 (remaining three months)	$ 2,236
2011	4,684
2012	3,403
2013	2,813
2014	2,349
	$ 15,485

Other Assets

Other assets consist of the following (in thousands):

	March 26, 2010	June 26, 2009
Long-term inventory	$ 16,106	$ 14,332
Restricted pension plan assets	7,636	8,152
Investment in SGI Japan	5,000	5,000
Residual value of leased equipment	1,087	1,476
Long-term refundable deposits	1,419	1,416
Lease payments receivable	522	986
Long-term prepaid expenses	800	910
Other assets	950	975
Total other assets	$ 33,520	$ 33,247

Other Current Liabilities

Other current liabilities consist of the following (in thousands):

	March 26, 2010	June 26, 2009
Accrued value-added tax payable	$ 10,134	$ 3,061
Accrued warranty, current portion	3,744	5,920
Accrued sales and use tax payable	2,322	501
Income taxes payable	1,066	1,256
Other	14,624	21,142

Total other current liabilities	$ 31,890	$ 31,880

Warranty Reserve

Activity in the warranty reserve is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	March 26, 2010	**April 4, 2009**	**March 26, 2010**	**April 4, 2009**
Balance at beginning of period	$ 7,352	$ 2,789	$ 8,572	$ 3,683
Current period accrual	363	363	1,245	(770)
Warranty expenditures charged to reserve	(1,832)	(514)	(3,934)	(275)
Balance at end of period	$ 5,883	$ 2,638	$ 5,883	$ 2,638

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Other Non-current Liabilities

Other non-current liabilities consist of the following (in thousands):

	March 26, 2010	June 26, 2009
Deferred income taxes	$ 2,966	$ 2,966
Accrued warranty, non-current portion	2,139	2,652
Deferred rent, non-current portion	1,045	1,082
Other	9,064	8,246
Total other non-current liabilities	$ 15,214	$ 14,946

5. STOCK REPURCHASE

In February 2009, the Company s Board of Directors authorized a share repurchase program of up to $40.0 million of its common stock. Under the program, the Company was able to purchase shares of common stock through open market transactions and privately negotiated purchases at prices deemed appropriate by management. During the quarter ended April 4, 2009, the Company repurchased and held in treasury 243,695 shares of outstanding common stock for a total of $1.0 million including expenses. Such repurchases were accounted for at cost and reflected as treasury stock in the accompanying balance sheet. The program was discontinued in April 2009 and no shares of outstanding common stock were repurchased during the three and nine months ended March 26, 2010

6. SHARE-BASED COMPENSATION

Share-Based Benefit Plans

In 2005, the Company s Board of Directors adopted and its stockholders approved the Company s 2005 Equity Incentive Plan (2005 Plan), 2005 Non-Employee Directors Stock Option Plan and 2005 Employee Stock Purchase Plan (2005 ESPP Plan).

The Company s Board of Directors adopted the 2006 New Recruit Equity Incentive Plan (New Recruit Plan) in January 2006 which allows the Company to grant non-statutory stock awards to newly hired employees as an inducement to join the Company. No grants may be made under the New Recruit Plan to persons who are continuing employees or directors. The New Recruit Plan provides for the grant of the following stock awards: (i) non-statutory stock options, (ii) stock purchase awards, (iii) stock bonus awards, (iv) stock appreciation rights, (v) stock unit awards, and (vi) other stock awards.

Determining Fair Value

The fair value of share-based awards was estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions for the following periods:

	Three Months Ended	Nine Months Ended

	March 26, 2010	April 4, 2009	March 26, 2010	April 4, 2009
Option Plans Shares				
Risk-free interest rate	2.3%	1.8%	2.6%	2.5%
Volatility	59.8%	63.5%	61.7%	60.2%
Weighted average expected life (in years)	5.0	5.0	5.0	5.1
Weighted average fair value	$ 4.89	$ 2.10	$ 2.99	$ 4.27
ESPP Plan shares				
Risk-free interest rate	0.4%	0.7%	0.6%	1.4%
Volatility	55.0%	68.0%	58.0%	60.0%
Weighted average expected life (in years)	1.25	1.25	1.25	1.25
Weighted average fair value	$ 3.59	$ 1.66	$ 2.55	$ 2.91

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The computation of expected life is based on an analysis of the relevant industry sector post-vest termination rates and exercise factors. In the three and nine months ended March 26, 2010, expected volatility is based on the implied and historical volatility for the Company. In the three and nine months ended April 4, 2009, expected volatility is based on a combination of the implied and historical volatility for both the company and its peer group. The interest rate is based on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term. Where the expected term of the Company s share-based awards do not correspond with the terms for which interest rates are quoted, the Company performs a straight-line interpolation to determine the rate from the available term maturities. The expected term of the options represent the estimated period of time until exercise and is based on our historical experience adjusted for the exercise patterns of a group of similar entities in our industry, giving consideration to the contractual terms, vesting schedules, and expectations of future employee behavior. The expected term for the ESPP is based on the term of the purchase period. The Company has not paid and does not expect to pay dividends. As share-based compensation expense recognized in the consolidated statements of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. ASC 718-10 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimated. In accordance with ASC 718-10, management made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

Share-Based Compensation Expense

Total share-based compensation expense is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	March 26, 2010	April 4, 2009	March 26, 2010	April 4, 2009
Cost of revenue	$ 155	$ 117	$ 565	$ 567
Research and development	169	294	554	750
Sales and marketing	143	369	264	610
General and administrative	694	904	2,307	2,084
Continuing operations	1,161	1,684	3,690	4,011
Discontinued operations		(58)	(106)	(13)
Total share-based compensation expense	$ 1,161	$ 1,626	$ 3,584	$ 3,998

Stock Options and Restricted Stock Awards Activity

Summary of stock option activity is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual term in years	Aggregate Intrinsic Value
Balance at June 26, 2009	2,886,160	$ 11.98		

Options granted	1,521,500	5.59		
Options exercised	(145,749)	5.90		
Options cancelled	(471,460)	9.68		
Balance at March 26, 2010	3,790,451	$ 9.94	7.8	$ 8,827,713
Vested and expected to vest at March 26, 2010	3,297,024	$ 10.38	7.7	$ 6,817,289
Exercisable at March 26, 2010	1,732,152	$ 12.41	6.7	$ 1,602,140

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Performance-based option grant

On August 11, 2009, the Company s CEO was granted a non-qualified stock option, with performance-based metrics, to purchase 40,000 shares of the Company s common stock. The stock option, which has a grant date fair value of approximately $0.1 million, was valued using the Black-Scholes option-pricing model. The stock option has an exercise price of $5.34 per share, a contractual term of ten years and a maximum of 10,000 shares vesting per annum depending on the attainment of performance-based metrics. Compensation expense for this award is recognized when it is determined that it is probable that the performance metrics will be achieved. Compensation expense related to this award was immaterial in the three and nine months ended March 26, 2010.

The total intrinsic value of options exercised in the nine months ended March 26, 2010 and April 4, 2009 was $0.5 million and $0.1 million, respectively.

As of March 26, 2010, there was $3.3 million of total unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a weighted average period of 1.6 years.

Summary of restricted stock awards (RSA) activity is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Balance at June 26, 2009	100,940	$ 14.69
Released	(40,782)	14.95
Balance at March 26, 2010	60,158	$ 14.52

As of March 26, 2010, there was $0.9 million of total unrecognized compensation cost related to RSA, which is expected to be recognized over a weighted average period of 1.0 years.

Summary of restricted stock units (RSU) activity is as follows:

	Number of Shares
Balance at June 26, 2009	702,650
Awarded	
Released	(210,447)
Forfeited	(92,058)
Balance at March 26, 2010	400,145
Vested and expected to vest at March 26, 2010	333,511

As of March 26, 2010, there was $3.3 million of total unrecognized compensation cost related to RSU, which is expected to be recognized over a weighted average period of 1.8 years.

During the nine months ended March 26, 2010 and April 4, 2009, 91,737 and 134,601 of shares of common stock were delivered to the Company in payment of $0.6 million and $0.9 million of withholding tax obligations arising from the release of RSA and RSU. The withholding tax obligations were based upon the fair market value of the Company s common stock on the vesting date.

At March 26, 2010, the total compensation cost related to options to purchase the Company s common stock under the 2005 ESPP Plan not yet recognized was approximately $0.8 million. This cost will be amortized on a straight-line basis over approximately 2 years. The following table shows the shares issued, and their respective weighted-average purchase price per share, pursuant to the 2005 ESPP Plan during the nine months ended March 26, 2010 and April 4, 2009:

	March 26, 2010	**April 4, 2009**
Shares issued	238,889	176,993
Weighted-average purchase price per share	$ 3.78	$ 5.59

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

7. RESTRUCTURING ACTIVITY

In the nine months ended March 26, 2010, management approved restructuring actions to reduce the Company s European and U.S workforce and vacate certain facilities in Europe. The expense for the nine months ended March 26, 2010 related to these actions was $3.3 million for severance and $0.3 million for vacating facilities.

During the nine months ended March 26, 2010, the Company made $4.2 million in payments related to all restructuring actions, including $3.8 million for severance and $0.4 million for vacated facilities, primarily rent. The restructuring liability balance of $1.1 million outstanding as of March 26, 2010 includes $0.9 million recorded in other current liabilities and $0.2 million recorded in other non-current liabilities in the Company s unaudited condensed consolidated balance sheets.

Activity in the restructuring reserve is as follows (in thousands):

	Employee Terminations	Facilities Exit Costs	Total
Balance at June 26, 2009	$ 1,496	$ 199	$ 1,695
Costs incurred	339	164	503
Cash payments	(1,414)	(189)	(1,603)
Balance at September 25, 2009	$ 421	$ 174	$ 595
Costs incurred	1,612	103	1,715
Cash payments	(1,223)	(112)	(1,335)
Balance at December 25, 2009	$ 810	$ 165	$ 975
Costs incurred	1,378	64	1,442
Cash payments	(1,205)	(67)	(1,272)
Balance at March 26, 2010	$ 983	$ 162	$ 1,145

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

8. EARNINGS PER SHARE

Basic and diluted net loss per share is presented in accordance with ASC 260-10, *Earnings per Share.* Basic and diluted net loss per common share is computed by dividing consolidated net loss by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing consolidated net income by the weighted average number of common shares outstanding and dilutive common stock equivalent shares outstanding during the period. For the three and nine months ended March 26, 2010 and April 4, 2009, potentially dilutive shares, which include outstanding common stock options and restricted stock units, were not included in the computation of diluted net loss per common share as the result would be anti-dilutive. Such potentially dilutive shares are excluded when the effect would be to reduce a net loss per share. As the Company had a net loss in each of the periods presented, basic and diluted net loss per share are the same for each period presented.

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except share and per share data):

	Three Months Ended		Nine Months Ended	
	March 26, 2010	April 4, 2009	March 26, 2010	April 4, 2009
Numerators:				
Loss from continuing operations	$ (20,262)	$ (13,594)	$ (61,192)	$ (36,731)
Income (loss) from discontinued operations, net of tax	82	197	346	(2,198)
Net loss	$ (20,180)	$ (13,397)	$ (60,846)	$ (38,929)
Denominator:				
Shares used in computing basic and diluted net loss per share	30,097	29,787	30,041	29,748
Net loss per share, basic and diluted:				
Continuing operations	$ (0.67)	$ (0.46)	$ (2.04)	$ (1.24)
Discontinued operations		0.01	0.01	(0.07)
Basic and diluted net loss per share	$ (0.67)	$ (0.45)	$ (2.03)	$ (1.31)

The following table sets forth potential shares of common stock, which are excluded from the calculation of diluted net loss per share, as the result would be anti-dilutive (in thousands):

	At period end	
	March 26, 2010	April 4, 2009
Potentially dilutive securities	4,190	3,156

9. EMPLOYEE BENEFIT PLANS

Defined Benefit Plans

In Germany and the United Kingdom, the Company provides certain current and former employees with pension benefits under defined benefit plans. These defined benefit plans were acquired as part of the acquisition of Legacy SGI in May 2009. No new employees are eligible to join these plans.

The projected benefit obligation (PBO) and the assets of the United Kingdom plan have been transferred to an insurance company and the Company is not responsible for any additional contributions to the plan to fund the benefit payments to the employees. However, the Company continues to pay the annual administrative costs of the plan.

The Company carries the interest and service cost of the German plan. The Company has a life insurance policy with a cash surrender value that has been earmarked by the Company to partly cover the under-funded element of the German plan.

SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The cost of the German plan for the three and nine months ended March 26, 2010 is comprised of the following (in thousands):

	Three Months Ended March 26, 2010	Nine Months Ended March 26, 2010
Service cost	$ 32	$ 98
Interest expense	141	433
Expected return on plan assets	(24)	(75)
Net periodic pension cost	$ 149	$ 456

The cash surrender value of the life insurance policy that has been earmarked by the Company to partly cover the under-funded status of the German plan of $7.9 million, as of March 26, 2010, is included in other assets in the unaudited condensed consolidated balance sheets. The projected benefit obligation of $7.2 million, as of March 26, 2010, is included in accrued compensation and other non-current liabilities in the unaudited condensed consolidated balance sheets.

Defined Contribution Plan

Effective September 1, 2003, the Company established a 401(k) retirement plan covering substantially all U.S. employees. The plan provides for voluntary salary reduction contributions up to the maximum allowed under Internal Revenue Service rules. The Company can make annual contributions to the plan at the discretion of the Board of Directors. There was no contribution for the nine months ended March 26, 2010. The Company contributed $0.1 million for the nine months ended April 4, 2009.

10. INCOME TAXES

The Company recorded a tax expense of $0.6 million and tax benefit of $3.9 million for the three and nine months ended March 26, 2010. The tax expense was computed based on the Company s projected financial results for the fiscal year ending June 25, 2010. Additionally, the income tax expense includes a discrete tax benefit of $4.9 million resulting from the November 6, 2009 enactment of the Worker, Homeownership, and Business Assistance Act of 2009 (the Act). The Act provides an election for federal taxpayers to increase the carry back period for an applicable net operating loss to three to five years from two years. Additional amounts recorded include a discrete tax benefit of $0.3 million related to a research and development credit claim for fiscal 2006, net of unrecognized tax benefits, and tax expense of $0.6 million for unrecognized tax benefits and related interest. The effective tax rate used to record the tax expense differed from the combined federal and net state statutory income tax rate for the three and nine months ended March 26, 2010 primarily due to the tax benefit attributable to the utilization of tax attributes in the prior years and operating losses generated during the period from which the Company does not benefit.

The Company recorded a tax expense of $0.1 million and a tax benefit of $1.1 million for the three and nine months ended April 4, 2009, respectively. The effective tax rate used to record the tax expense differed from the combined federal and net state statutory income tax rate for the three and nine months ended April 4, 2009 primarily due to decreases in the valuation allowances for deferred tax assets related to the net operating loss carry back to fiscal 2006.

As of December 25, 2009, the Company has provided a full valuation allowance against net deferred tax assets. Management continues to evaluate the realizability of deferred tax assets and related valuation allowance. If management s assessment of the deferred tax assets or the corresponding valuation allowance were to change, the Company would record the related adjustment to income during the period in which management makes the determination.

The Company had approximately $9.3 million of gross unrecognized tax benefit as of March 26, 2010, primarily due to the recognition of tax benefits as a result of Legacy SGI s tax contingency recorded in the acquisition, of which $8.8 million, when recognized, will impact the effective tax rate. During the nine months ended March 26, 2010, the Company recorded a net increase of $2.8 million in taxes, accrued interest, penalties and foreign currency associated with unrecognized tax benefits.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

11. DISCONTINUED OPERATIONS

In October 2008, the Company committed to a formal plan to abandon the Rapidscale product line, which was reviewed and approved by management with appropriate authority, and was communicated to the affected employees. The Company will continue to honor service contracts with existing Rapidscale customers, but had no other significant continuing involvement in the operations of the Rapidscale product line subsequent to the abandonment.

In accordance with ASC 420-20, the abandonment of the Rapidscale product line qualifies as a discontinued operation. Accordingly, the results of operations of the Rapidscale product line were reclassified and included in discontinued operations, net of tax, within the unaudited condensed consolidated statements of operations for the three months and nine months ended March 26, 2010 and the three and nine months April 4, 2009, respectively.

The following summarizes the results of discontinued operations (in thousands):

	Three Months Ended		Nine Months Ended	
	March 26, 2010	April 4, 2009	March 26, 2010	April 4, 2009
Revenue	$ 85	$ 174	$ 290	$ 544
Cost of revenue	9	70	60	141
Gross profit	76	104	230	403
Operating expenses:				
Research and development		4	(105)	1,707
Sales and marketing			(14)	
General and administrative	(6)	15	9	130
Impairment of long-lived assets				663
Total operating expenses	(6)	19	(110)	2,500
Income (loss) from discontinued operations	82	85	340	(2,097)
Other income (expense), net		112	6	(115)
Income (loss) from discontinued operations before taxes	82	197	346	(2,212)
Income tax provision (benefit)				(14)
Net income (loss) from discontinued operations	$ 82	$ 197	$ 346	$ (2,198)

12. SEGMENT INFORMATION

As a result of the acquisition of the Legacy SGI assets, the Company reassessed its segment reporting based on the operating and reporting structure of the combined company, in accordance with the provisions of ASC 280-10, *Segment Reporting* (*ASC 280-10*). Historically, the Company concluded that it operated in a single operating segment. In connection with the acquisition of Legacy SGI, the Company changed its operating and reporting structure to operate in two operating segments, products and services. Commencing with the quarter ended September 25, 2009, the Company has reflected segment information on the new basis. The three and nine month periods ended April 4, 2009 have not been restated to reflect the new operating segments as service revenue was immaterial in those periods.

The Company s operating segments are determined after assessment of factors such as quantitative thresholds of business components to be included into reportable segments, economic characteristics, and homogeneity of products, which are aligned with the process by which the chief operating decision maker (CODM) (our Chief Executive Officer) makes operating decisions and evaluates performance. The CODM looks at products and services metrics, which are derived on a contractual basis.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Segment Results

The following table presents revenues and gross margin for the Company s products and services segments for the three and nine months ended March 26, 2010 (dollars in thousands):

	Three Months Ended March 26, 2010	Nine Months Ended March 26, 2010
Revenue:		
Products	$ 69,652	$ 189,350
Services	38,168	112,730
Total	107,820	302,080
Cost of revenue:		
Products	57,576	168,564
Services	21,324	63,542
Total	78,900	232,106
Gross profit:		
Products	12,076	20,786
Services	16,844	49,188
Total	$ 28,920	$ 69,974
Gross margin:		
Products	17.3%	11.0%
Services	44.1%	43.6%
Total	26.8%	23.2%

Sales and cost of sales is the only discrete financial information we have available for our operating segments. For this reason, we are not able to provide other financial results or assets by operating segment (e.g. operating expenses, net income, long-lived assets, etc.).

Operating segments do not sell products to each other, and accordingly, there is no inter-segment revenue to be reported.

The Company does not assess the performance of its geographic regions on other measures of income or expense, such as depreciation and amortization, operating income or net income. In addition, the Company s assets are located primarily in the United States and are not allocated to any specific region. The Company does not produce reports for, or measure the performance of, its geographic regions on any asset-based metrics. Therefore, geographic information is presented only for revenues.

Customer information

For the three and nine months ended March 26, 2010, Amazon accounted for approximately 19% and 22% of the Company s revenues, respectively. For the three months ended April 4, 2009, Amazon and Microsoft accounted for approximately 34% and 29% of the Company s revenues, respectively. For the nine months ended April 4, 2009, Amazon and Microsoft accounted for approximately 43% and 17% of the Company s revenues, respectively. No other single customer accounted for more than 10% of the Company s revenues for any period presented.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Geographic Information

Revenue from both domestic and international customers (based on the address of the customer on the invoice) was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	March 26, 2010	April 4, 2009	March 26, 2010	April 4, 2009
Domestic revenue	$ 83,735	$ 36,376	$ 236,232	$ 125,664
International revenue	24,085	7,982	65,848	22,555
Total revenue	$ 107,820	$ 44,358	$ 302,080	$ 148,219

Approximately 92% and 90% of the Company s property and equipment was located in the United States as of March 26, 2010 and June 26, 2009, respectively.

13. RELATED PARTY TRANSACTIONS

The Company owns approximately 10% of the outstanding stock of SGI Japan, which was acquired in the acquisition of Legacy SGI, and the Company s Chief Executive Officer is a member of SGI Japan s Board of Directors. We account for this investment under the cost method of accounting in accordance with ASC 325-20, *Cost Method Investments*. The Company records revenue for products sold to SGI Japan when evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectibility is reasonably assured as prescribed by ASC 605-10. Revenues and cost of revenues from sales to SGI Japan are as follows (in thousands):

	Three Months Ended	Nine Months Ended
	March 26, 2010	March 26, 2010
Product revenue	$ 1,222	$ 7,592
Cost of product revenue	$ 758	$ 4,681

Amounts receivable from and payable to SGI Japan were $0.8 million and zero, respectively, at March 26, 2010.

14. FINANCIAL GUARANTEES

The Company has issued financial guarantees to cover inventory purchases and rent on leased facilities and equipment; to government authorities for VAT and other taxes; and to various other parties to support payments in advance of future delivery on goods and services. The majority of the Company s financial guarantees have terms of one year or more. The maximum potential obligation under financial guarantees at March 26, 2010 was $4.6 million for which the Company has $4.2 million of assets held as collateral. The full amount of the assets held as collateral are included in short-term and long-term restricted cash and cash equivalents in the condensed consolidated balance sheets.

15. COMMITMENTS AND CONTINGENCIES

Leases

The Company leases its facilities and office buildings under operating leases that expire at various dates through March 2017. Certain leases also contain escalation and renewal option clauses calling for increased rents. Where a lease contains an escalation clause or a concession such as a rent holiday, rent expense is recognized in accordance with ASC 840-20, *Operating Leases*, using the straight line method over the term of the lease. In addition to the minimum future lease commitments presented below, the leases generally require that the Company pay property taxes, insurance, maintenance and repair costs. Also, under certain leases, the Company is granted an option to early terminate the lease by providing an advance notice and paying an early termination fee. The Company does not intend early termination of the leases and hence the future minimum operating lease commitments disclosed herein consist of the total lease payments through the end of the initial lease terms.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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Future minimum lease payments under operating leases are as follows (in thousands):

Fiscal Year	
2010 (remaining three months)	$ 2,053
2011	6,817
2012	5,218
2013	4,011
2014	2,064
Thereafter	456
Total	$ 20,619

Rent expense for the three months ended March 26, 2010 and April 4, 2009 was approximately $1.6 million and $0.6 million, respectively. Rent expense for the nine months ended March 26, 2010 and April 4, 2009 was approximately $4.9 million and $1.8 million, respectively.

Purchase Commitments

In connection with supplier agreements, the Company has agreements to purchase certain units of inventory and non-inventory items through 2010. As of March 26, 2010, these remaining non-cancelable commitments were approximately $15.5 million, of which $13.1 million will be paid in the next 12 months.

Indemnification Agreements

The Company enters into standard indemnification agreements with its customers and certain other business partners in the ordinary course of business. These agreements include provisions for indemnifying the customer against any claim brought by a third party to the extent any such claim alleges that the Company s product infringes a patent, copyright or trademark, or misappropriates a trade secret, of that third party. The agreements generally limit the scope of the available remedies in a variety of industry-standard methods, including, but not limited to, product usage and geography-based limitations, a right to control the defense or settlement of any claim, and a right to replace or modify the infringing products to make them non-infringing. The Company has not incurred significant expenses related to these indemnification agreements and no material claims for such indemnifications were outstanding as of March 26, 2010. As a result, the Company believes the estimated fair value of these indemnification agreements, if any, to be de minimus; accordingly, no liability has been recorded with respect to such indemnifications as of March 26, 2010.

Contingencies

The Company may, from time to time, be involved in lawsuits, claims, investigations and proceedings that arise in the ordinary course of business. In accordance with ASC 450-10, *Contingencies*, (ASC 450-10), the Company records a provision for a liability when management believes that it is both probable that a liability has been incurred and it can reasonably estimate the amount of the loss. The Company believes it has adequate provisions for any such matters. The Company reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case.

In fiscal 2005, as a result of anonymous allegations and allegations by an ex-employee, Legacy SGI conducted an internal investigation into whether certain systems were delivered to an entity in China in possible violation of U.S. export laws. Legacy SGI voluntarily shared information with respect to the investigation with the U.S. Department of Commerce. The Company cannot be assured that the Department or other agencies of the U.S. government will not institute any proceedings against it in the future. In addition, from time to time, the Company receives inquiries from regulatory agencies informally requesting information or documentation. There can be no assurance in any given case that such informal review will not lead to further proceedings involving the Company in the future.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

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(UNAUDITED)

On May 1, 2007, Legacy SGI received a legal notice from counsel to Bharat Heavy Electricals Ltd. (BHEL), located in India, alleging delay in and failure to deliver products and technical problems with its hardware and software in relation to the establishment of a facility in Hyderabad. The Company is currently engaged in arbitration. On January 21, 2008, BHEL filed its statement of claim against Silicon Graphics Systems (India) Pvt. Ltd. for a sum of Indian Rupee (INR) 78,478,200 ($1.7 million based on the conversion rate on March 26, 2010) plus interest and costs. On February 29, 2008, Legacy SGI filed its reply as well as a counter claim for a sum of INR 27,453,007 ($0.6 million based on the conversion rate on March 26, 2010) plus interest and costs. The proceeding has commenced and the arbitration proceedings were then held on February 28,. The matter has now been posted to June 12-13, 2010. We cannot currently predict the outcome of this dispute.

On January 16, 2009, the Company and certain of its former officers were sued in the United States District Court for the Northern District of California, in a matter captioned *In Re Rackable Systems, Inc. Securities Litigation*, Case No. C-09-0222-CW. On April 16, 2009, the Court appointed Elroy Whittaker as Lead Plaintiff and the Law Firm of Glancy Binkow & Goldberg LLP as Lead Plaintiff s Counsel. Lead Plaintiff filed a consolidated amended complaint (the Amended Complaint) on June 15, 2009. The Amended Complaint asserts claims for violations of (i) Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and (ii) Section 20(a) of the Exchange Act. The allegations relate to the drops in the Company s share price in early 2007 relating to its earnings reports for 2006 and Q4 2006. On August 13, 2009, the Company and its former officers filed a Motion to Dismiss the Amended Complaint (the Motion to Dismiss), which Lead Plaintiff opposed. On January 13, 2010, the Court entered an order granting the Motion to Dismiss, which dismissed the Amended Complaint with leave to amend. On February 3, 2010, Lead Plaintiff filed a second amended complaint asserting the same claims as the amended complaint. On April 2, 2010, Lead Plaintiff filed a stipulated proposed order requesting leave to file a supplemental second amended complaint, which substituted new Lead Plaintiffs into the action but otherwise did not change the allegations of the second amended complaint. On April 5, 2010, the Court granted the stipulated order and entered the supplemental second amended complaint. On April 9, 2010, the Company and its former officers filed a Motion to Dismiss the Supplemental Second Amended Complaint. The hearing on the Motion to Dismiss the Supplemental Second Amended Complaint is scheduled for June 3, 2010. The Company cannot currently predict the outcome of this dispute.

On March 10, 2009, the Company and certain of its present and former directors and officers were sued in the Superior Court of the State of California for Alameda County, in a shareholder derivative lawsuit captioned *Milo v. Barton, et al, Case No. R30944-0474*. The complaint alleges that the defendants engaged in various acts and omissions that resulted in the drops of the Company s share price in early 2007, and asserts claims for alleged breaches of defendants fiduciary duties, waste of corporate assets, and unjust enrichment. The complaint seeks compensatory damages in an unspecified amount, unspecified equitable or injunctive relief, disgorgement of unspecified compensation earned by the defendants, and an award of an unspecified amount for plaintiff s costs and attorneys fees. By stipulated order dated April 13, 2009, this action has been stayed pending resolution of the pleadings in the federal class action. The Company cannot currently predict the outcome of this dispute.

Third parties in the past have asserted, and may in the future assert, intellectual property infringement claims against the Company, and such future claims, if proved, could require the Company to pay substantial damages or to redesign its existing products or pay fees to obtain cross-license agreements. Litigation may be necessary in the future to enforce or defend the Company s intellectual property rights, to protect the Company s trade secrets or to determine the validity and scope of its proprietary rights or the proprietary rights of others. Any such litigation could result in substantial costs and diversion of management resources, either of which could harm the Company s business, operating results and financial condition. Further, many of the Company s current and potential competitors have the ability to dedicate substantially greater resources to enforcing and defending their intellectual property rights than the Company.

The Company is not aware of any pending disputes, including those disputes and settlements described above, that would be likely to have a material adverse effect on its consolidated financial condition, results of operations or liquidity. However, litigation is subject to inherent uncertainties and costs and unfavorable outcomes could occur. An unfavorable outcome could include the payment of monetary damages, cash or other settlement, or an injunction prohibiting it from selling one or more products. If an unfavorable resolution were to occur, there exists the possibility of a material adverse impact on the Company s consolidated financial condition, results of operations or cash flows of the period in which the resolution occurs or on future periods.

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SILICON GRAPHICS INTERNATIONAL CORP. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

16. SUBSEQUENT EVENT

On August 9, 2005, the Legacy SGI German subsidiary, Silicon Graphics GmbH, filed a lawsuit with the District Court of Munich I (Landericht München I), a Regional Court in Germany, against Media Broadcast GmbH (formerly T-Systems International GmbH), a systems integrator, relating to a dispute regarding whether acceptance criteria were met with regard to a Legacy SGI system delivered in the spring of 2003. On April 16, 2010, the Company settled its dispute with Media Broadcast GmbH. Under the settlement agreement, Media Broadcast GmbH will pay the Company €1.9 million ($2.5 million based on conversion rate on March 26, 2010) plus value-added tax. The Company expects to receive the settlement amount from Media Broadcast GmbH in May 2010. The Company will record a benefit from this transaction in the quarter ending June 25, 2010 of approximately $2.5 million as a result of this settlement.

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ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements included or incorporated by reference in this Form 10-Q other than statements of historical fact, are forward-looking statements. Investors can identify these and other forward-looking statements by the use of words such as estimate, may, will, could, anticipate, expect, intend, believe, continue or the negative of such terms, or other similar expressions. Forward-looking statements also include the assumptions underlying or relating to such statements.

Our actual results could differ materially from those projected in the forward-looking statements included herein as a result of a number of factors, risks and uncertainties, including, among others, the effect that the current economic and credit crises may continue to have on our business, the risk factors set forth in, Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations, Part II, Item 1A Risk Factors, and elsewhere in this Form 10-Q and the risks detailed from time to time in our future U.S. Securities and Exchange Commission reports. The information included in this Form 10-Q is as of the filing date with the Securities and Exchange Commission and future events or circumstances could differ materially from the forward-looking statements included herein. We assume no duty to update any of the forward-looking statements after the date of this report or to conform these statements to actual results except as required by law. Accordingly, we caution readers not to place undue reliance on such statements. We expressly disclaim any obligation to update or alter our forward-looking statements, whether, as a result of new information, future events or otherwise.

The following discussion and analysis should be read in conjunction with the condensed financial statements and notes thereto in Item 1 in this Form 10-Q and with our financial statements and notes thereto for the year ended January 3, 2009, contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 19, 2009 and the Transition Report on Form 10-Q (the Transition Report) filed with the Securities and Exchange Commission on August 10, 2009.

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Overview

We are a global leader in large-scale clustered computing and storage, high-performance compute and storage, and data center technologies. We also provide world-wide professional services as they relate to our products and relevant third party products. We are dedicated to solving the IT industry s most demanding business and technology challenges by delivering clustered computing and storage solutions, high performance computing and storage solutions, Eco-Logical datacenter solutions, software and services. We develop, market, and sell a broad line of low cost, mid-range and high-end computing servers, data storage and visualization systems as well as differentiating software. We sell data center infrastructure products purpose-built for large-scale data center deployments. In addition, we provide global customer support and professional services related to our products. We enable enterprises to meet their computing and storage requirements at a lower total cost of ownership and provide them greater flexibility and scalability. We are also a leading developer of enterprise class, high-performance features for the Linux operating system that provide our customers with a standard Linux operating environment combined with our differentiated yet un-intrusive Linux extensions that improve performance, simplify system management, and provide a more robust development environment.

We pioneered Eco-Logical data center design with innovative technologies in the areas of chassis and cabinet design, power distribution techniques, cooling techniques, and hardware-based remote management capabilities. We offer compute servers using our half-depth design, enabling back-to-back mounting for higher server density and improved thermal management. Data center products include ICE Cube a modular data center which augments or replaces traditional brick-and-mortar facilities, CloudRack C2 for breakthrough density and configurability for cluster computing, and MobiRack for mobile, all-in-one data center capabilities for field deployments.

Our products and services are used by the scientific, technical, and business communities to solve challenging data-intensive computing, data storage and management and visualization problems. These problems typically require large amounts of computing power and fast and efficient data movement both within the computing system and to and from large-scale data storage installations. Enterprises have also begun to deploy large-scale computing and storage farms by aggregating large numbers of relatively inexpensive, open-standard modular computing and storage systems. Our end users employ our systems to access, analyze, transform, manage, visualize and store very large amounts of data in real time or near real time running low-cost operating systems such as Linux and Windows and, we believe, enable enterprises to meet their computing and storage requirements at a lower total cost of ownership and provide enterprises with greater flexibility and scalability. The vertical markets we serve include defense and strategic systems, weather and climate, physical sciences, life sciences, energy (including oil and gas), aerospace and automotive, media and entertainment, semiconductor design, manufacturing, financial services, data centers, and business intelligence and data analytics.

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Applications for our systems within these vertical markets include simulating global climate changes, accelerating engineering of new automotive designs, supporting homeland security initiatives, real-time fraud detection, streaming media from Internet-video to film, and gaining business intelligence through data-mining. Our services facilitate rapid installation and implementation of our products, optimizing their use, maintaining their availability and educating customers to increase productivity.

From developing custom chips to datacenter solutions, we differentiate by scaling for compute and data intensive workloads of our customers most demanding applications. We have over 1,300 employees worldwide and we sell and market our systems, technologies, software, and services to enterprises in 25 countries through our direct and indirect sales force including original equipment manufacturers, system integrators and value added resellers. In the nine months ended March 26, 2010 and April 4, 2009, international sales were approximately 22% and 15%, respectively, of our total revenue.

Significant events

Our financial results during the three and nine months ended March 26, 2010 were affected by certain significant events that should be considered in comparing the periods presented.

Acquisition of Silicon Graphics, Inc.

On May 8, 2009, we acquired substantially all of the assets, excluding certain assets unrelated to the ongoing business and assumed certain liabilities of Silicon Graphics, Inc. (an entity in Chapter 11 of the U.S. Bankruptcy code) (Legacy SGI) for approximately $42.5 million in cash.

Change in Corporate Name and Trading Symbol

On May 18, 2009, we changed our name to Silicon Graphics International Corp. (SGI) and changed our NASDAQ stock ticker symbol from RACK to SGI.

Change in fiscal year

On June 19, 2009, our Board of Directors approved a change in our fiscal year-end from the Saturday closest to December 31st of each year to the last Friday in June of each year. As a result of this change, our prior fiscal year, which began on January 4, 2009, ended on June 26, 2009. Accordingly, our fiscal year 2010 began on June 27, 2009 following a transition period that ended June 26, 2009. The change in fiscal year-end was made to facilitate the integration and consolidated reporting of the businesses and other related assets acquired and liabilities assumed from Legacy SGI.

Critical Accounting Policies and Estimates

The preparation of financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. We base our estimates on historical expenses and various other assumptions that we believe to be reasonable at the time the estimates are made. Actual results could differ from those estimates. Our critical accounting policies and estimates are as follows:

- Revenue recognition;
- Allowance for doubtful accounts;
- Inventory valuation;
- Valuation of intangible assets;

Impairment of long-lived assets;

Warranty reserve;

Share-based compensation;

Restructuring expense; and

Accounting for income taxes

Revenue Recognition. We account for revenue under the provisions of ASC 605-10, *Revenue Recognition (ASC 605-10)*, ASC 605-20, *Separately Priced Extended Warranty and Product Maintenance Contracts (ASC 605-20)*, ASC 985-605*, Software Revenue Recognition (ASC 985-605)*, ASC 605-25, *Multiple-Element Arrangements (ASC 605-25),* and *ASC 605-50 Customer Payments and Incentives*.

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We enter into revenue arrangements to sell products and services for which we are obligated to deliver multiple products and/or services. A typical multiple-element arrangement includes product, third-party product or services, consulting services, and maintenance. Under the provisions of ASC 605-10, we recognize revenue from sales of products when persuasive evidence of an arrangement exists, shipment has occurred and title has transferred, the sales price is fixed and determinable and, collection of the resulting receivable is reasonably assured. Nevertheless, due to substantive performance obligations, revenue is only recognized when formal customer acceptance is received, unless acceptance is deemed to be perfunctory.

Service revenue includes hardware maintenance and installation services. Pursuant to ASC 605-10, we recognize revenue from the sale of our products prior to completion of these services, as product sales are not dependent on these services to be functional. Under ASC 605-20, revenue from hardware maintenance contracts, which are expressly priced separately from the hardware, is recognized ratably over the contract term, generally one to three years. Where software is integrated with hardware and sold as a hardware appliance we provide unspecified software updates and enhancements to the software through service contracts. As a result, we account for these arrangements in accordance with ASC 985-605 where software is determined to be more than incidental to the product. Revenue earned on software arrangements involving multiple-elements are allocated to each element based on Vendor Specific Objective Evidence (VSOE) of fair value. The undelivered element is generally post contract customer support (PCS) for which VSOE of fair value is determined based on the price charged for the PCS when sold separately. We have not established VSOE of fair value on our PCS arrangements for certain of our products and therefore revenue from these arrangements is deferred and recognized ratably over the PCS period.

Under ASC 605-25, multiple-element arrangements are assessed to determine whether they can be separated into more than one unit of accounting. In performing the assessment, we first apply the separation criteria within ASC 605-20 to separate the deliverables that fall within the scope of ASC 605-20. Multiple-element arrangements are separated into more than one element if all of the following are met:

- The delivered item(s) has value to the customer on a standalone basis.
- There is objective and reliable evidence of the fair value of the undelivered item(s).
- If the arrangement includes a general right of return relative to the delivered item and delivery or performance of the undelivered item(s) is considered probable and substantially within our control.

Royalty Revenue. We recognize royalty revenue under fixed fee arrangements in the quarter in which the revenue is earned in accordance with the contractual terms and conditions. Under volume-based technology agreements, where we are unable to reliably estimate license volume, we recognize revenue in the quarter in which we receive reports from licensees detailing the shipments of products incorporating our intellectual property components. The reports are generally received on a one-quarter lag basis from when the royalty revenues are earned. Royalty revenue was not material for any of the periods presented.

Engineering Service Revenue. We recognize engineering services revenue when services are rendered, or when an identifiable portion of the contract is completed, no significant post-delivery obligations exist, and collectability is reasonably assured. Engineering service revenue was not material for any periods presented.

Allowance for Doubtful Accounts. We provide an allowance for uncollectible accounts receivable as part of our general and administrative expenses based on our assessment of the collectability of specific customer accounts and an analysis of the remaining accounts receivable. We also analyze historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customer payment terms, when evaluating the adequacy of the allowance for doubtful accounts. Credit evaluations are undertaken for all major sale transactions before shipment is authorized. In the future, if our actual collections differ significantly from our estimates it may result in additional charges to or decreases in our general and administrative expenses.

Inventory Valuation. We value our inventories at the lower of cost or market with cost determined on a first-in, first-out basis. We assess the valuation of all inventories, including raw materials, work-in-process, finished goods and long-term inventory, on a periodic basis. We write down obsolete inventory or inventory in excess of our estimated usage to its estimated market value less cost to sell, if less than its cost. Inventory write-downs are included in cost of revenue in our consolidated statements of operations. Inherent in our estimates of market value in determining inventory valuation are estimates related to future demand and technological obsolescence of our products. Long-term inventory is valued based on assumptions about product life cycles, historical usage, current production status, and installed base and is periodically tested for impairment. If actual market conditions are less favorable than our projections, additional inventory write-downs may be required.

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Valuation of Intangible Assets. We periodically evaluate our intangible assets in accordance with ASC 360-10. *Property, Plant and Equipment (ASC 360-10)*, for indicators of impairment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Our intangible assets include customer relationships, purchased technology, customer backlog, a trade mark and a trade name and, in-process research and development. Factors that can trigger an impairment review include significant under-performance relative to historical or projected future operating results, significant changes in the manner that we use the acquired assets or the strategy for our overall business, or significant negative industry or economic trends. In-process research and development is evaluated at the completion or abandonment of related development projects.

Intangible assets are assessed for impairment whenever events or changes in circumstances indicate that an asset s carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. Cash flow assumptions used in calculating the fair value are based on historical and forecasted revenue, operating costs, and other relevant factors. If our estimate of future operating results changes, or if there are changes to other assumptions, the estimate of the fair value of our intangible assets could change significantly. Such change could result in impairment charges in future periods, which could have a significant negative impact on our unaudited condensed consolidated financial statements.

Impairment of Long-Lived Assets. We assess the carrying values of long-lived assets for possible impairment in accordance with the requirements of ASC 360-10. We conduct impairment tests when we identify events or when we believe that circumstances may have changed to indicate that the carrying amount of a long-lived asset may not be recoverable. Such events or changes in circumstances may include the discontinuation of a product or product line, a sudden or consistent decline in the forecast for a product, changes in technology or in the way an asset is being used, or an adverse change in legal factors or in the business climate. Our impairment review, to determine if a potential impairment charge is required, is based on an undiscounted cash flow analysis. This analysis requires judgment with respect to many factors, including future cash flows, changes in technology, the continued success of product lines and future volume and revenue and expense growth rates. It is possible that our estimates of these assumptions may change in the future, resulting in the need to reassess the carrying value of our long-lived assets for impairment.

Warranty Reserve. We provide for estimated cost to warrant our products against defects in materials and workmanship at the time revenue is recognized. We net any cost recoveries from warranties offered to us by our suppliers against the warranty expense. Warranty costs include labor to repair faulty systems and replacement parts for defective items, as well as other costs incidental to warranty repairs. We estimate our warranty obligation based on factors such as product life cycle analysis and historical experience, and our estimate is affected by data such as product failure rates, material usage and service delivery costs incurred in correcting a product failure. Our standard warranty ranges from one to three years. Should actual product failure rates, material usage or service delivery costs differ from our estimates, revisions to the estimated warranty liability would be required which could have a significant impact on our unaudited condensed consolidated financial statements.

Share-Based Compensation. We account for our employee stock purchase and stock incentive plans under the provisions of ASC 718-10, which requires the recognition of the fair value of share-based compensation expense in our unaudited condensed statement of operations. The fair values of our unvested stock units are calculated based on the fair value of our common stock at the dates of grant, using the Black-Scholes option-pricing model, which requires the input of subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them, the estimated volatility of our common stock over the expected term and the number of options that will ultimately not vest (i.e. forfeitures). Changes to any of these assumptions can have a significant effect on our reported share-based compensation expense.

Restructuring Expense. In recent years, we have recorded accruals in connection with our restructuring programs. These accruals include estimates of employee separation costs and the settlements of contractual obligations, including lease terminations resulting from our actions. Accruals associated with employee termination costs are estimated in accordance with ASC 450-10, *Contingencies (ASC 450-10)* and ASC 420-10*, Exit and Disposal Costs (ASC 420-10)*. Accruals associated with vacated facilities and related asset impairments are estimated in accordance with ASC 740-10, *Income Taxes Recognition (ASC 740-10)* and ASC 360-10-05, respectively. Our estimates may need to be adjusted upon the occurrence of future events, which include, but are not limited to, changes in the estimated time to enter into a sublease, the sublease terms and the sublease rates. Due to the extended contractual obligations of certain of these leases and the inherent volatility of the commercial real estate markets, we expect to make future adjustments to these vacated facilities accruals that could have a significant effect on our condensed consolidated financial statements.

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Accounting for Income Taxes. The determination of our tax provision is subject to judgments and estimates. The carrying value of our net deferred tax assets, which is comprised primarily of future tax deductions, is subject to significant judgment as to whether it is more likely than not our deferred tax assets will be realized. In determining whether the realization of these deferred tax assets may be impaired, we evaluate both positive and negative evidence as required in accordance with ASC 740-10, previously discussed in Statement of Financial Accounting Standards *(SFAS)* SFAS No. 109, *Accounting for Income Taxes*. As of December 25, 2009, we have concluded that it is more likely than not that our U.S. and international deferred tax assets, in excess of recoverable income taxes and certain deferred tax liabilities, are not probable of realization. Therefore, we recorded a valuation allowance for such excess deferred tax assets.

In 2007, we adopted the provisions under paragraphs 25-17 and 30-17 of ASC 740-10, *Basic Recognition Threshold,* previously discussed under FIN 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB No. 109,* and related guidance and as a result, we recognize liabilities for uncertain tax positions based on the two-step process prescribed in the provision. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement with the taxing authorities. We reevaluate these uncertain tax positions on a quarterly basis, based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, new audit activity and lapses in the statutes of limitations on assessment. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period that such event occurs and can have a significant effect on our unaudited condensed consolidated financial statements.

Results of Operations

We have included the operating results associated with the acquisition of Legacy SGI assets in our consolidated financial statements only for the periods since the date of the acquisition in May 2009, which has significantly affected our revenues, results of operations and financial position. Accordingly, the results of operations for the three and nine months ended March 26, 2010 presented below are not comparable to the results for the three and nine months ended April 4, 2009.

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As a result of the acquisition of Legacy SGI assets, we reassessed our segment reporting based on the operating and reporting structure of the combined company, in accordance with the provisions of ASC 280-10, *Segment Reporting (ASC 280-10).* Historically, we considered ourselves to operate in a single operating segment. In connection with the acquisition of Legacy SGI assets, we changed our operating and reporting structure to operate in two operating segments, products and services. Commencing with the quarter ended September 26, 2009, we have reflected segment information on the new basis. The three and nine month periods ended April 4, 2009 have not been restated to reflect the new operating segments as service revenue was immaterial in those periods. The following table sets forth our financial results for the three and nine months ended March 26, 2010 and April 4, 2009, as a percentage of revenue:

	Three Months Ended		Nine Months Ended	
	March 26, 2010	April 4, 2009	March 26, 2010	April 4, 2009
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	73.2%	93.9%	76.8%	94.8%
Gross profit	26.8%	6.1%	23.2%	5.2%
Operating expenses:				
Research and development	13.7%	7.1%	12.5%	7.3%
Sales and marketing	15.5%	9.5%	16.9%	10.4%
General and administrative	12.3%	13.6%	13.3%	11.3%
Acquisition-related	0.0%	6.7%	-0.2%	2.0%
Restructuring	1.3%	0.0%	1.2%	0.0%
Total operating expenses	42.8%	36.9%	43.7%	31.0%
Loss from operations	-16.0%	-30.8%	-20.5%	-25.8%
Interest and other income (expense), net:				
Interest income, net	0.1%	0.3%	0.1%	0.9%
Other expense, net	-2.4%	0.0%	-1.2%	-0.7%
Total interest and other income (expense), net	-2.3%	0.3%	-1.1%	0.2%
Loss from continuing operations before income taxes	-18.3%	-30.5%	-21.6%	-25.6%
Income tax provision (benefit)	0.5%	0.1%	-1.3%	-0.8%
Loss from continuing operations	-18.8%	-30.6%	-20.3%	-24.8%
Discontinued operations (Note 11):				
Income (loss) from discontinued operations	0.1%	0.4%	0.1%	-1.5%
Income tax benefit	0.0%	0.0%	0.0%	0.0%
Income (loss) from discontinued operations, net of tax	0.1%	0.4%	0.1%	-1.5%
Net loss	-18.7%	-30.2%	-20.1%	-26.3%

Comparison of the three and nine months ended March 26, 2010 and April 4, 2009

Financial Highlights

Our higher revenue and gross margin in the three and nine months ended March 26, 2010 was a result of including high performance compute server and storage products which are typically sold at higher margins and the related service revenue associated with our acquisition of Legacy SGI.

We experienced a significant increase in our operating expenses due to including the results of operations of the Legacy SGI acquisition in the three and nine months ended March 26, 2010.

Revenue

We derive revenue from the sale of products and services directly to end users as well as through resellers and system integrators. Product revenue is derived from the sale of mid-range to high-end computing servers, data storage systems, and visualization systems as well as software. Service revenue is generated from the sale of standard maintenance contracts as well as custom maintenance contracts that are tailored to individual customer s needs. We recognize service revenue ratably over the service periods. Maintenance contracts are typically between one to three years in length, and we actively pursue renewals of these contracts. We also generate professional services revenue related to implementation of and training on our products.

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The following table presents revenue:

	Three Months Ended March 26, 2010	Three Months Ended April 4, 2009	Change $	Change %	Nine Months Ended March 26, 2010	Nine Months Ended April 4, 2009	Change $	Change %
	(in thousands, except percentages)							
Product revenue	$ 69,652	$ 44,358	$ 25,294	57%	$ 189,350	$ 148,219	$ 41,131	28%
Service revenue	38,168		38,168	100%	112,730		112,730	100%
Total revenue	$ 107,820	$ 44,358	$ 63,462	143%	$ 302,080	$ 148,219	$ 153,861	104%

Revenue increased $63.5 million or 143% to $107.8 million in the three months ended March 26, 2010 from $44.4 million in the three months ended April 4, 2009. The increase in revenue was primarily due to the addition of product revenue from high performance compute server and storage products and related service revenue associated with our acquisition of Legacy SGI, which contributed $60.6 million of revenue during the three months ended March 26, 2010. Product revenue from the sale of data center products and services of $47.2 million increased $2.9 million or 6.5% in the three months ended March 26, 2010 as compared with the prior year period.

Revenue increased $153.9 million or 104% to $302.1 million in the nine months ended March 26, 2010 from $148.2 million in the nine months ended April 4, 2009. The increase in revenue was primarily due to the addition of product revenue from high performance compute server and storage products and related service revenue associated with our acquisition of Legacy SGI, which contributed $168.8 million of revenue during the nine months ended March 26, 2010. Product revenue from the sale of data center products and services of $133.3 million decreased $14.9 million or 10.1% in the nine months ended March 26, 2010 as compared with the prior year period. The decline in data center revenue reflects the economic downturn, which we believe has impacted the timing of our customers buying decisions and our average sales prices. We expect average selling prices for data center products to decline over time as competitive pricing pressure increases, and our products mature in the market and are replaced with new products with increased performance and superior features.

Cost of revenue and gross profit

Cost of revenue consists of costs associated with direct material, labor, manufacturing overhead, shipment of products, inventory write downs and share-based compensation. Cost of revenue also includes personnel costs for providing maintenance and professional services. Our manufacturing overhead and professional services personnel costs are fixed or semi-variable. Additionally, changes in customer and product mix, pricing actions by our competitors and commodity prices that comprise a significant portion of cost of revenue, significantly impact gross margin from period to period.

The following table presents cost of revenue, gross profit, and gross margin:

	Three Months Ended March 26, 2010	Three Months Ended April 4, 2009	Change $	Change %	Nine Months Ended March 26, 2010	Nine Months Ended April 4, 2009	Change $	Change %
	(in thousands, except percentages)							
Cost of product revenue	$ 57,576	$ 41,659	$ 15,917	38%	$ 168,564	$ 140,492	$ 28,072	20%
Cost of service revenue	21,324		21,324	100%	63,542		63,542	100%
Total cost of revenue	$ 78,900	$ 41,659	$ 37,241	89%	$ 232,106	$ 140,492	$ 91,614	65%
Product gross profit	$ 12,076	$ 2,699	$ 9,377	347%	$ 20,786	$ 7,727	$ 13,059	169%
Service gross profit	16,844		16,844	100%	49,188		49,188	100%
Total gross profit	$ 28,920	$ 2,699	$ 26,221	972%	$ 69,974	$ 7,727	$ 62,247	806%
Product gross margin	17.3%	6.1%			11.0%	5.2%		
Service gross margin	44.1%	N/A			43.6%	N/A		
Total gross margin	26.8%	6.1%			23.2%	5.2%		

The increase in our cost of revenue is primarily a result of the increase in revenue. Additionally, with the acquisition of Legacy SGI, we added facilities and personnel that contribute to an increase in our cost of revenue. Cost of revenue increased by a lower percentage than revenue due to a shift in mix towards a greater percentage of higher margin service offerings and high performance compute server and storage products associated with our acquisition of Legacy SGI.

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Gross profit increased $26.2 million to $28.9 million in the three months ended March 26, 2010 from $2.7 million in the three months ended April 4, 2009. The increase in gross profit and gross margin was primarily attributable to higher margin high performance compute server and storage product revenue and related service revenue associated with our acquisition of Legacy SGI, which contributed $21.6 million of gross profit in the three months ended March 26, 2010. Gross profit from the sale of data center products and services increased $4.6 million to $7.3 million in the three months ended March 26, 2010 from $2.7 million in the three months ended April 4, 2009.

Gross profit increased $62.2 million or 806% to $70.0 million in the nine months ended March 26, 2010 from $7.7 million in the nine months ended April 4, 2009. Our increase in gross profit and gross margin was primarily attributable to higher margin high performance compute server and storage product revenue and related service revenue associated with our acquisition of Legacy SGI, which contributed $57.2 million of gross profit in the nine months ended March 26, 2010. Gross profit from the sale of data center products and services increased $5.0 million or 65% to $12.7 million in the nine months ended March 26, 2010 from $7.7 million in the nine months ended April 4, 2009.

Operating Expenses

Research and development

Research and development expense consists primarily of personnel and related costs, contractor fees, new component testing and evaluation, test equipment, new product design and testing, other product development activities, share-based compensation, and facilities and information technology costs. Research and development expense and period-over-period changes are as follows:

	Three Months Ended		Change		Nine Months Ended		Change	
	March 26, 2010	April 4, 2009	$	%	March 26, 2010	April 4, 2009	$	%
	(in thousands, except percentages)							
Research and development	$ 14,730	$ 3,154	$ 11,576	367%	$ 37,873	$ 10,779	$ 27,094	251%

Research and development expense increased $11.6 million or 367% to $14.7 million in the three months ended March 26, 2010 from $3.2 million in the three months ended April 4, 2009. The increase in research and development costs was primarily due to higher compensation and related expenses of $5.9 million associated with increased headcount, which resulted from our acquisition of Legacy SGI, an increase in materials and supplies of $2.7 million, higher consulting fees of $1.2 million, an increase in facilities costs of $0.9 million, and an increase in depreciation expense of $0.7 million.

Research and development expense increased $27.1 million or 251% to $37.9 million in the nine months ended March 26, 2010 from $10.8 million in the nine months ended April 4, 2009. The increase in research and development costs was primarily due to higher compensation and related expenses of $16.6 million associated with increased headcount, which resulted from our acquisition of Legacy SGI, higher consulting fees of $2.0 million, an increase in materials and supplies of $4.9 million, an increase in facilities costs of $2.3 million, an increase in depreciation expense of $2.0 million and an increase of $0.7 million of share based compensation expense. These increases were partially offset by Legacy SGI research and development reimbursement arrangements of $2.1 million with our business partners.

Sales and marketing

Sales and marketing expense consists primarily of salaries, bonuses and commissions paid to our sales and marketing employees, amortization of intangible assets, share-based compensation, and facilities and information technology costs. We also incur marketing expenses for activities such as trade shows, direct mail, and print advertising. Sales and marketing expense and period-over-period changes are as follows:

	Three Months Ended		Change		Nine Months Ended		Change	
	March 26, 2010	April 4, 2009	$	%	March 26, 2010	April 4, 2009	$	%
	(in thousands, except percentages)							
Sales and marketing	$ 16,731	$ 4,233	$ 12,498	295%	$ 50,924	$ 15,449	$ 35,475	230%

Sales and marketing expenses increased $12.5 million or 295% to $16.7 million in the three months ended March 26, 2010 from $4.2 million in the three months ended April 4, 2009. The increase in sales and marketing expense was primarily due to higher compensation and related expenses of $7.3 million associated with increased headcount, which resulted from our acquisition of Legacy SGI, as well as higher commission and sales bonus of $2.1million, higher travel and related expenses of $0.5 million, higher facilities costs of $2.0 million as we have facilities in more locations following the acquisition of Legacy SGI. We also recorded intangible assets amortization expense of $0.5 million in the three months ended March 26, 2010 related to intangible assets acquired as part of our acquisition of Legacy SGI.

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Sales and marketing expenses increased $35.5 million or 230% to $50.9 million in the nine months ended March 26, 2010 from $15.4 million in the nine months ended April 4, 2009. The increase in sales and marketing expense was primarily due to higher compensation and related expenses of $20.2 million associated with increased headcount as well as higher commission and sales bonus of $4.8 million, which resulted from our acquisition of Legacy SGI, and higher facilities costs of $5.8 million as we have facilities in more locations following the acquisition of Legacy SGI. We also recorded intangible assets amortization expense of $3.5 million in the nine months ended March 26, 2010 related to intangible assets acquired as part of our acquisition of Legacy SGI.

We will continue to deploy our sales and support organizations to focus on key vertical markets such as federal, oil and gas, media and entertainment, financial services and geographic markets, as well as the markets presented by the Legacy SGI acquisition.

General and administrative

General and administrative expense consists primarily of personnel costs, legal and professional service costs, depreciation, share-based compensation, and facilities and information technology costs. General and administrative expense and period-over-period changes are as follows:

	Three Months Ended		Change		Nine Months Ended		Change	
	March 26, 2010	April 4, 2009	$	%	March 26, 2010	April 4, 2009	$	%
	(in thousands, except percentages)							
General and administrative	$ 13,270	$ 6,011	$ 7,259	121%	$ 40,056	$ 16,747	$ 23,309	139%

General and administrative expenses increased $7.3 million or 121% to $13.3 million in the three months ended March 26, 2010 from $6.0 million in the three months ended April 4, 2009. The increase in general and administrative expense was primarily due to higher compensation and related expenses of $4.1 million associated with increased headcount, which resulted from our acquisition of Legacy SGI, higher professional fees of $1.9 million, and higher facilities costs of $1.3 million.

General and administrative expenses increased $23.3 million or 139% to $40.1 million in the nine months ended March 26, 2010 from $16.7 million in the nine months ended April 4, 2009. The increase in general and administrative expense was primarily due to higher compensation and related expenses of $12.0 million associated with increased headcount, which resulted from our acquisition of Legacy SGI, higher professional fees of $7.5 million, and higher facilities costs of $3.6 million.

Acquisition-related

	Three Months Ended		Change		Nine Months Ended		Change	
	March 26, 2010	April 4, 2009	$	%	March 26, 2010	April 4, 2009	$	%
	(in thousands, except percentages)							
Acquisition-related	$	$ 2,962	$ (2,962)	N/A	$ (557)	$ 2,962	$ (3,519)	N/A

In the three and nine months ended March 26, 2010, we recorded a net gain of zero and $0.6 million, respectively, related to our acquisition of Legacy SGI. During the three months ended December 25, 2009, we received a $1.0 million payment from Legacy SGI related to potential liabilities of Legacy SGI, which pursuant to the Agreement were to be remitted to the Company if not paid to a third party. At the Closing Date, we assessed whether it was more likely than not that a contingent asset existed and based on all available information concluded that no asset existed. Accordingly, we have recorded the $1.0 million payment as a gain in our statement of operations in the nine month period results. This was partially offset by $0.4 million in expenses related to the acquisition of legacy SGI. The $3.0 million in acquisition related charges for the three and nine months ended April 4, 2009 relate to professional fees incurred related to the purchase of Legacy SGI.

Restructuring

	Three Months Ended		Change		Nine Months Ended		Change	
	March 26, 2010	April 4, 2009	$	%	March 26, 2010	April 4, 2009	$	%
	(in thousands, except percentages)							
Restructuring	$ 1,434	$	$ 1,434	100%	$ 3,652	$	$ 3,652	100%

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In the three and nine months ended March 26, 2010, management approved restructuring actions to reduce the Company s European and US workforces and vacate certain facilities in Europe. The expense for the three and nine months ended March 26, 2010 related to these actions was $1.4 million and $3.7 million, respectively. As a result of the restructuring actions undertaken, the Company anticipates cash outflows of $1.1 million, primarily during the next twelve months.

Total interest and other income, net

Interest and other income, net was a net expense of $2.5 million and $3.1 million in the three and nine months ended March 26, 2010, respectively, primarily due to foreign exchange losses attributable to the strengthening of the U.S. dollar.

Interest and other income, net was $0.1 million in the three months ended April 4, 2009, primarily due to foreign exchange losses, partially offset by interest income earned on our investment portfolio. Interest and other income, net was $0.4 million in the nine months ended April 4, 2009, primarily due to interest income, partially offset by foreign exchange losses.

Provision for income taxes

We recorded a net tax expense of $0.6 million and a net tax benefit of $3.9 million for the three and nine months ended March 26, 2010. Tax expense was computed based on our projected financial results for the fiscal year ending June 25, 2010. Additionally, the net income tax benefit includes a discrete tax benefit of $4.9 million resulting from the November 6, 2009 enactment of the Worker, Homeownership, and Business Assistance Act of 2009 (the Act). The Act provides an election for federal taxpayers to increase the carry back period for an applicable net operating loss to three to five years from two years. Additional amounts recorded include a discrete tax benefit of $0.3 million related to a research and development credit claim for fiscal 2006, net of unrecognized tax benefits, and tax expense of $0.6 million for unrecognized tax benefits and related interest. The effective tax rate used to record the tax expense differed from the combined federal and net state statutory income tax rate for the three and nine months ended March 26, 2010 primarily due to the tax benefit attributable to the utilization of tax attributes in the prior years and operating losses generated during the period from which we do not benefit.

We recorded a tax provision of $0.1 million and $1.1 million for the three and nine months ended April 4, 2009, respectively. The effective tax rate used to record the tax expense differed from the combined federal and net state statutory income tax rate for the three and nine months ended April 4, 2009 primarily due to decreases in the valuation allowances for deferred tax assets related to the net operating loss carry back to fiscal 2006.

As of March 26, 2010, we have provided a full valuation allowance against net deferred tax assets. Management continues to evaluate the realizability of deferred tax assets and related valuation allowance. If management s assessment of the deferred tax assets or the corresponding valuation allowance were to change, we would record the related adjustment to income during the period in which management makes the determination.

Income (Loss) from discontinued operations

During fiscal 2008, we classified our Rapidscale product line as a discontinued operation as a result of discontinuing this product line. Our decision was a result of a change in strategic direction, as well as an inability to license certain third party software on reasonable commercial terms.

We do not believe this discontinued operation will have a significant negative impact on our future results of operations. The revenue contribution from this product line was not significant for the three and nine months ended March 26, 2010. The revenue contribution from this product line was $0.2 million and $0.5 million for the three and nine months ended April 4, 2009.

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Liquidity and Capital Resources

Liquidity

We had $143.2 million of cash and cash equivalents at March 26, 2010 as compared to $128.7 million in cash and cash equivalents at June 26, 2009. Historically, we have required capital principally to fund our working capital needs and, during the three months ended June 26, 2009, we used $42.5 million of cash to acquire substantially all of the assets and certain liabilities of Legacy SGI. At March 26, 2010, we had short-term and long-term restricted cash and cash equivalents of $4.2 million that are pledged as collateral for various guarantees issued to cover rent on leased facilities and equipment, to government authorities for value-added (VAT) and other taxes, and certain vendors to support payments in advance of delivery of goods and services. At March 26, 2010, we held $7.4 million of long-term investments consisting of auction rate securities (ARS). The majority of these securities are collateralized by guaranteed student loans and insured or reinsured by the Department of Education. The credit markets continue to experience significant uncertainty, and some of this uncertainty has impacted the markets where our auction rate securities would be offered. For additional information related to our investments in ARS investments see Note 4 to our unaudited condensed consolidated financial statements in this Form 10-Q.

The adequacy of these resources to meet our liquidity needs beyond the next 12 months will depend on our growth, operating results and capital expenditures required to meet our business needs. If we fail to generate cash from operations, or generate additional cash from our operations on a timely basis, we may not have the cash resources required to run our business and we may need to seek additional sources of funds to meet our needs. Cash flows from our discontinued operations have been included in our consolidated statement of cash flows with continuing operations within each cash flow category. The absence of cash flows from discontinued operations is not expected to affect our future liquidity or capital resources. At March 26, 2010, we believe our current cash and cash equivalents will be sufficient to fund working capital requirements, capital expenditures, and operations for at least the next twelve months. We intend to retain any future earnings to support operations and to finance the growth and development of our business, and we do not anticipate paying any dividends in the foreseeable future. At the present time, we have no material commitments for capital expenditures.

The following is a summary of cash activity (in thousands):

	Nine Months Ended	
	March 26, 2010	**April 4, 2009**
Condensed consolidated statements of cash flows data:		
Net cash provided by (used in) operating activities	$ 21,365	$ (20,438)
Net cash (used in) provided by investing activities	(7,827)	4,397
Net cash provided by (used in) financing activities	996	(956)
Effect of exchange rate changes on cash and cash equivalents		65
Net increase (decrease) in cash and cash equivalents	14,534	(16,932)
Cash and cash equivalents - beginning of period	128,714	190,778
Cash and cash equivalents - end of period	$ 143,248	$ 173,846

Operating Activities

Cash provided by operating activities of $21.4 million for the nine months ended March 26, 2010 reflected cash provided by changes in working capital of $64.2 million, offset by our net loss of $60.8 million, net of adjustments for non-cash expenses. The primary working capital sources of cash were an increase in deferred revenue and a decrease in inventories. The primary working capital uses of cash were increases in deferred cost of revenue and accounts receivable and a decrease in accounts payable. Non-cash expenses consisted primarily of depreciation and amortization of $13.7 million and share-based compensation of $3.6 million.

Deferred revenue increased $124.7 million, primarily due to the timing of revenue recognition on sales transactions associated with sales accounted for under ASC 985-605. Inventory decreased $42.0 million. These sources of cash were offset by an increase in deferred cost of revenue of $72.6 million related to the increase in deferred revenue. Additionally, accounts receivable increased $17.5 million, reflecting an increase in shipments and the timing of sales. Accounts payable decreased $12.9 million, primarily due to the timing of payments.

Cash used in operating activities of $20.4 million for the nine months ended April 4, 2009, reflected our net loss of $38.9 million, offset by adjustments for non-cash expenses consisting primarily of depreciation and amortization of $2.9 million and share-based compensation of $4.0 million. Cash used for working capital was approximately $10.3 million, which resulted primarily from a decrease in accounts payable and an increase in deferred cost of revenue, partially offset by a decrease in accounts receivable and an increase in deferred revenue.

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Investing Activities

Cash used in investing activities was $7.8 million in the nine months ended March 26, 2010, primarily due to the purchases of property and equipment of $5.3 million and the acquisition of Copan Systems, Inc. of $2.0 million.

Cash provided by investing activities was $4.4 million in the nine months ended April 4, 2009, primarily due to the sales and maturities of short-term investments of $6.8 million, partially offset by purchases of property and equipment of $1.3 million and escrow payment for the acquisition of Legacy SGI of $1.0 million.

Financing Activities

Cash provided by financing activities was $1.0 million in the nine months ended March 26, 2010, primarily due to proceeds from the sale of stock under the employee stock purchase plan and stock options of $1.8 million, partially offset by the restricted stock retired to cover taxes of $0.8 million.

Cash used in financing activities was $1.0 million in the nine months ended April 4, 2009, primarily due to restricted stock retired to cover taxes of $1.0 million and purchase of treasury stock of $1.0 million, partially offset by proceeds from the sale of stock under the employee stock purchase plan of $1.0 million.

We expect to continue to invest in our business, which includes expenditures for working capital, capital expenditures and operating expenses. We intend to fund these activities with our cash reserves and cash generated from operations, if any. Increases in operating expenses may not result in an increase in our revenue and our anticipated revenue may not be sufficient to support these increased expenditures. We anticipate that operating expenses and working capital will constitute a material use of our cash resources.

Contractual Obligations and Contingent Liabilities and Commitments

Off-Balance Sheet Arrangements

At March 26, 2010, we did not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Contractual Obligations

There have been no material changes to the contractual obligations during the three and nine months ended March 26, 2010, outside of the ordinary course of business, from those disclosed in our quarterly report on Form 10-Q for the period ended December 25, 2009.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

In the normal course of business, our financial position is routinely subject to a variety of risks, including market risk for investments associated with interest rate movements, liquidity risks, and credit risks, and foreign exchange market risk associated with currency rate movements on non-U.S. dollar denominated assets and liabilities. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of these and other potential exposures. As a result, we do not anticipate material losses in these areas.

Investment Risk

The primary objective of our investment activities is to preserve principal while maximizing the income we receive from our investments without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash, cash equivalents, and investments in a variety of high credit quality, readily liquid securities which may include U.S. treasuries and government agencies, corporate debt, money market funds and commercial paper. Our exposure to market risks for changes in interest rates relates primarily to our investment portfolio. As of March 26, 2010, our cash and cash equivalents of $143.2 million consisted primarily of cash, money market funds, and U.S. Treasury notes. Due to the short term nature of our investment portfolio, we believe that the exposure of our principal to interest rate risk is minimal, although our future interest income is subject to reinvestment risk.

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There has been significant deterioration and instability in the financial markets since 2008. The extraordinary disruption and readjustment in the financial markets exposes us to additional investment risk. The value and liquidity of the securities in which we invest could deteriorate rapidly and the issuers of such securities could be subject to credit rating downgrades. In light of the current market conditions and these additional risks, we actively monitor market conditions and developments specific to the securities and security classes in which we invest. We believe that we take a conservative approach to investing our funds in that we invest only in highly-rated securities with relatively short maturities and do not invest in securities we believe involve a higher degree of risk. While we believe we take prudent measures to mitigate investment related risks, such risks cannot be fully eliminated as there are circumstances outside of our control. We currently believe that the current credit market difficulties do not have a material impact on our investment portfolio. However, future degradation in credit market conditions could have a material adverse affect on our financial position.

At March 26, 2010, we held auction rate securities (ARS) with a fair value of $7.4 million and amortized cost of $8.8 million as compared to $7.4 million and amortized cost of $9.1 million at June 26, 2009. ARS are securities that are structured with short-term interest rate reset dates of generally less than 90 days but with contractual maturities that can be well in excess of ten years. At the end of each reset period, which occurs every seven to 35 days, investors can sell or continue to hold the securities at par subject to a successful interest rate reset. In the first and second quarters of calendar year 2008, certain auction rate securities failed auction due to sell orders exceeding buy orders. Our ARS consist of investments that are backed by pools of student loans, the majority of which are ultimately guaranteed by the Department of Education. Based on our discounted cash flow model, we have recorded a temporary impairment within accumulated other comprehensive loss of approximately $1.4 million at March 26, 2010 related to the $8.8 million cost of these auction rate securities. We currently intend and have the ability to hold these securities until the value of such securities recovers. The funds associated with failed auctions will not be accessible until a successful auction occurs, a buyer is found outside of the auction process, the underlying securities have matured or the securities are recalled by the issuer. Given the recent disruptions in the credit markets and the fact that the liquidity for these types of securities remains uncertain, we have classified all of these auction rate securities as long-term investments in our unaudited condensed consolidated balance sheets, as our ability to liquidate such securities in the next 12 months is uncertain.

Foreign Exchange Risk

Prior to the May 8, 2009 acquisition of Legacy SGI, we did not make material sales or have material purchase obligations outside of the United States. As of March 26, 2010 and June 26, 2009, foreign currency cash accounts totaled $23.7 million and $18.0 million, respectively (primarily in Euros, British pound and Canadian dollars.).

With the acquisition of Legacy SGI and its multinational operations, we have increased foreign currency risks associated with cash and cash equivalents, investments, receivables, and payables denominated in foreign currencies. Fluctuations in exchange rates will result in foreign exchange gains and losses on these foreign currency assets and liabilities, which are included in interest and other income, net in our unaudited condensed consolidated statements of operations. Our exposure to foreign currency exchange rate risk relates to sales commitments, anticipated sales, purchases and other expenses, and assets and liabilities denominated in foreign currencies. For most currencies, we are a net receiver of the foreign currency and are adversely affected by a stronger U.S. dollar relative to the foreign currency.

At March 26, 2010, we had no foreign currency forward contracts or option contracts.

Sensitivity Analysis

For purposes of specific risk analysis, we use a sensitivity analysis to determine the impact that market risk exposures may have on the fair values of financial instruments. The financial instruments included in the sensitivity analysis consist of all of our cash and cash equivalents, short and long term investments.

To perform the sensitivity analysis, we assess the risk of loss in fair values from the impact of hypothetical changes in interest rates and foreign currency exchange rates on market sensitive instruments. Given the short term nature of our cash, cash equivalents, and short term investments, a sensitivity analysis was not performed as the risk of loss in fair value was deemed immaterial.

For the long-term investment in ARS, the sensitivity of fair value was tested assuming either a 100 basis point increase or a 100 basis point decrease in the market-required return, holding the interest income from the auction rate securities constant. A full 1% increase in required return would reduce the long term investments by $0.2 million, or 2.9%. A full 1% decrease in required return would increase the long term investments by $0.2 million, or 3.0%.

For foreign currency exchange rate risk, a 10% increase or decrease of foreign currency exchange rates against the U.S. dollar with all other variables held constant would have resulted in a $2.4 million change in the value of our financial instruments.

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ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, including our chief executive officer and chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures that are designed to ensure that the information included in reports we file under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is processed and reported within the appropriate time periods. As discussed in more detail below, our management, including our chief executive officer and chief financial officer, has concluded that these disclosure controls and procedures were ineffective as of March 26, 2010 due to a material weakness that we identified in our internal control over financial reporting, specifically related to inventory valuation.

As reported in our Annual Report on Form 10-K for our fiscal year ended January 3, 2009, our management identified a material weakness in internal control over financial reporting as of January 3, 2009 related to inventory valuation which is discussed below:

Inventory Valuation

During the year ended January 3, 2009, the Company did not perform certain of its designed controls over the period-end accounting process related to inventory valuation with sufficient precision, as evidenced by misstatements that were detected after management had completed its financial closing and reporting process related to the quarterly financial statements. Although the misstatements were not deemed to be individually material, their occurrence is indicative that the controls related to the inventory accounting process were not operating in an effective manner. Because the Company s controls over the inventory accounting process had not operated consistently for a sufficient period of time, management could not conclude as to the effectiveness of the related controls. Therefore, as of January 3, 2009 and continuing as of March 26, 2010, management has concluded that these internal control deficiencies constitute a material weakness in our internal control over financial reporting because there is a reasonable possibility that a material misstatement of the financial statements would not have been prevented or detected on a timely basis.

Changes in Internal Control over Financial Reporting

We commenced a number of efforts to remediate the material weakness related to inventory valuation noted above. These efforts will continue throughout fiscal year 2010 and include the following:

- We are automating the key components of our calculation for the provision for excess and obsolete inventory and purchase price variances;
- We are enhancing the training and education of our inventory and cost accounting personnel; and
- We are improving our review processes for various calculations relating to inventory valuation.

In addition, following our acquisition of the Legacy SGI assets and businesses, we are in the process of integrating and harmonizing Legacy SGI financial reporting and information technology systems with our own, including those that pertain to our internal controls over financial reporting. This process is complex, covers operations that are significantly larger and more international in scope than prior to the acquisition. The integration process is ongoing and is expected to place additional stress on our internal controls.

Inherent Limitation on the Effectiveness of Internal Controls

The effectiveness of any system of internal control over financial reporting, including ours, is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting, including ours, no matter how well designed and operated, can only provide reasonable, not absolute assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We intend to continue to monitor and upgrade our internal controls as necessary or appropriate for our business, but cannot assure you that such improvements will be sufficient to provide us with effective internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

We are involved in various legal proceedings and disputes that arise in the normal course of business. These matters include product liability actions, patent infringement actions, contract disputes, and other matters. We do not know whether we will prevail in these matters nor can we assure that any remedy could be reached on commercially viable terms, if at all. Based on currently available information, we believe that we have meritorious defenses to these actions and that the resolution of these cases is not likely to have a material adverse effect on our business, financial position or future results of operations. In accordance with the Financial Accounting Standards Board s, Accounting Standards Codification, ASC 450-10, Contingencies, (ASC 450-10), we record a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case.

Please refer to the section titled Legal Proceedings in our Annual Report on Form 10-K for the year ended January 3, 2009, as updated by our subsequent Quarterly Reports on Form 10-Q, which the information provided below updates and supplements.

On August 9, 2005, our German subsidiary, Silicon Graphics GmbH, which we acquired as part of our acquisition of Legacy SGI assets, filed a lawsuit with the District Court of Munich I (*Landgericht München I*), a Regional Court in Germany, against Media Broadcast GmbH (formerly T-Systems International GmbH), a systems integrator, relating to a dispute regarding whether acceptance criteria were met with regard to a Legacy SGI system delivered in the spring of 2003. We sought full payment for the system in an amount equal to 4.6 million ($6.1 million based on the conversion rate on March 26, 2010). On September 21, 2005, Media Broadcast filed a counterclaim contesting our claim and alleging damages of 9.1 million ($12.1 million based on the conversion rate on March 26, 2010) plus interest since April 2004, which exceeds our contractual limit of liability of 2.0 million ($2.7 million based on the conversion rate on March, 26, 2010). On December 12, 2005, we responded to Media Broadcast s counterclaim and filed a motion seeking an additional 3.8 million ($5.1 million based on the conversion rate on March 26, 2010) mainly for lost profit relating to maintenance services. On April 16, 2010, the parties have agreed to a final and unconditional settlement of the matter during a court directed settlement hearing whereby Media Broadcast will pay us 1.9 million ($2.5 million based on the conversion rate on March 26, 2010) plus value-added tax.

On May 1, 2007, SGI received a legal notice from counsel to Bharat Heavy Electricals Ltd. (BHEL), located in India, alleging delay in and failure to deliver products and technical problems with our hardware and software in relation to the establishment of a facility in Hyderabad. We assumed this claim in connection with our acquisition of Legacy SGI assets, and are currently engaged in arbitration. On January 21, 2008, BHEL filed its statement of claim against Silicon Graphics Systems (India) Pvt. Ltd. for a sum of Indian Rupee (INR) 78,478,200 ($1.7 million based on the conversion rate on March 26, 2010) plus interest and costs. On February 29, 2008, we filed our reply as well as a counter claim for a sum of INR 27,453,007 ($0.6 million based on the conversion rate on March 26, 2010) plus interest and costs. The proceeding has commenced and the arbitration proceedings were then held on February 28, 2010. The matter has now been posted to June 12-13, 2010 for cross -examination of SGI s witnesses. We cannot currently predict the outcome of this dispute.

On January 16, 2009, the Company and certain of its former officers were sued in the United States District Court for the Northern District of California, in a matter captioned *In Re Rackable Systems, Inc. Securities Litigation, Case No. C-09-0222-CW*. On April 16, 2009, the Court appointed Elroy Whittaker as Lead Plaintiff and the Law Firm of Glancy Binkow & Goldberg LLP as Lead Plaintiff s Counsel. Lead Plaintiff filed a consolidated amended complaint (the Amended Complaint) on June 15, 2009. The Amended Complaint asserts claims for violations of (i) Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and (ii) Section 20(a) of the Exchange Act. The allegations relate to the drops in the Company s share price in early 2007 relating to its earnings reports for 2006 and Q4 2006. On August 13, 2009, the Company and its former officers filed a Motion to Dismiss the Amended Complaint (the Motion to Dismiss), which Lead Plaintiff opposed. On January 13, 2010, the Court entered an order granting the Motion to Dismiss, which dismissed the Amended Complaint with leave to amend. On February 3, 2010, Lead Plaintiff filed a second amended complaint asserting the same claims as the amended complaint. On April 2, 2010, Lead Plaintiff filed a stipulated proposed order requesting leave to file a supplemental second amended complaint, which substituted new Lead Plaintiffs into the action but otherwise did not change the allegations of the second amended complaint. On April 5, 2010, the Court granted the stipulated order and entered the supplemental second amended complaint. On April 9, 2010, the Company and its former officers filed a Motion to Dismiss the Supplemental Second Amended Complaint. The hearing on the Motion to Dismiss the Supplemental Second Amended Complaint is scheduled for June 3, 2010. We cannot currently predict the outcome of this dispute.

On December 3, 2009, the Company initiated an arbitration proceeding captioned *Silicon Graphics Intl. Corp., f/k/a Rackable Systems, Inc. v. Thomas Weisel Partners Group, Inc., et al. , FINRA Arb. No. 09-06849*, against its former investment advisor Thomas Weisel Partners LLC (TWP), as well as TWP s parent company Thomas Wiesel Partners Group, Inc., to remedy TWP s alleged mismanagement and wrongful advice pertaining to Rackable Systems investments in allegedly unsuitable and illiquid investments called auction rate securities (ARS). Due to market conditions, the ARS at issue are still held by the Company, as described elsewhere herein. The Company filed its arbitration claim with the Financial Industry Regulatory Authority (FINRA), and asserts various causes of action including breach of fiduciary duty, unsuitability, and breach of contract. The Company seeks remedies including rescission; restitution; disgorgement; and compensatory, consequential, and punitive damages, and requests a damages award in excess of $9 million, exclusive of punitive damages and other potential relief. TWP filed its Answer on February 4, 2010, the parties have commenced the discovery process, and an initial Pre-hearing Conference currently is set for May 10, 2010. No date has yet been set for an arbitration hearing on the merits of the case. We cannot currently predict the outcome of this dispute.

ITEM 1A. Risk Factors

We have updated the risk factors appearing under the caption Risks Relating to our Business and Industry set forth in our Annual Report on Form 10-K for the year ended January 3, 2009. These updated risk factors are set forth below. We have designated with an asterisk (*) those risk factors that have changed substantively from those set forth in our Annual Report on Form 10-K.

Risks Related To Our Business and Industry

*If we cannot successfully integrate the Legacy SGI businesses or realize any benefits from the acquisition, our business will be harmed.**

Achieving the benefits of our acquisition of substantially all of Legacy SGI s assets excluding certain assets unrelated to the ongoing business will depend in part on the successful integration in a timely and efficient manner of the Legacy SGI technical and business operations that we acquired and the former employees of Legacy SGI and its subsidiaries that are now employed by us or our subsidiaries. As a result of the acquisition, the number of personnel employed by us and our subsidiaries has increased from approximately 234 to over 1,300 as of March 26, 2010 and the number of countries in which we conduct operations has increased from three to 25.

The integration process requires coordination of and with personnel that joined our organization as a result of the acquisition, involves the integration of systems, applications, policies, procedures, business processes and operations and is a complex, costly and time-consuming process. The difficulties and risks of combining our historic operations and the acquired Legacy SGI assets include, among others:

- failure of our customers and Legacy SGI s former customers to accept new products or to continue as our customers following the acquisition;
- failure to successfully manage relationships with manufacturers, end-users, distributors and suppliers;
- failure to successfully relocate and integrate our own manufacturing, research and development and sales operations as well as those acquired in the acquisition of Legacy SGI assets;
- failure to effectively coordinate sales and marketing efforts to communicate our capabilities following the acquisition;
- failure to successfully develop new products and services on a timely basis that address our market opportunities following the acquisition;
- failure to compete effectively against companies already serving the broader market opportunities expected to be available to us following the acquisition;

retaining key employees;

managing a significantly larger operation, both in terms of international scope and number of employees;

consolidating corporate and administrative infrastructures;

preserving the research and development and other important relationships acquired from Legacy SGI;

integrating and managing the acquired Legacy SGI technology with our existing technology;

using our liquid capital and other assets after the acquisition to efficiently develop our business;

appropriately managing the liabilities we assumed in connection with the acquisition;

failure to successfully consolidate third-party contract manufacturing, streamline our supply chain, and reduce product costs;

failure to successfully integrate and harmonize financial reporting and information technology systems; including internal controls over financial reporting and

diverting management s attention from ongoing business concerns.

We cannot provide assurance that we will receive any benefits of these acquisitions, or that any of the difficulties described above will not adversely affect us. The integration process may be difficult and unpredictable because of possible conflicts and differing opinions on business and technical matters. If we cannot successfully integrate the technical and business operations and personnel that we acquired from Legacy SGI, we may not realize the expected benefits of the acquisitions.

*We expect to incur significant costs integrating the acquired assets of Legacy SGI into our business.**

We expect to incur significant costs integrating the technical and business operations and personnel of Legacy SGI, which may include costs for employee redeployment, relocation or severance, conversion of information systems, reorganization of facilities, disposition of excess facilities and relocation or disposition of excess equipment. The benefits of the acquisition of the Legacy SGI assets may not be sufficient to justify these integration costs.

*Integrating the acquired assets of Legacy SGI may divert the attention of our management away from our operations.**

Our successful integration of the acquired Legacy SGI technical and business operations and personnel into our organization may place a significant burden on our management and internal resources. The diversion of management s attention and any difficulties encountered in the transition and integration process could result in harming our business, financial condition and operating results.

*As a result of the Legacy SGI acquisition we now have extensive international operations, which subjects us to additional business risks.**

Following our recent acquisition of substantially all the assets of Legacy SGI, a significant portion of our sales occur and are expected to occur in international jurisdictions, including countries outside of Europe, Middle East, and Africa where we have no operating experience. International operations involve inherent risks that we may not be able to control, and risks of which we may not be aware, including:

supporting multiple languages;

recruiting sales and technical support personnel internationally with the skills to design, manufacture, sell and support our products;

complying with governmental regulation of encryption technology and regulation of imports and exports, including obtaining required import or export approval for our products;

increased complexity and costs of managing international operations;

increased exposure to foreign currency exchange rate fluctuations;

commercial laws and business practices that favor local competition;

multiple, potentially conflicting, and changing governmental laws, regulations and practices, including differing export, import, tax, labor, anti-bribery and employment laws;

longer sales cycles and manufacturing lead times;

difficulties in collecting accounts receivable;

reduced or limited protection of intellectual property rights; and

more complicated logistics and distribution arrangements.

International political instability may halt or hinder our ability to do business and may increase our costs. Various events, including the occurrence or threat of terrorist attacks, increased national security measures in the United States and other countries, and military action and armed conflicts, may suddenly increase international tensions. In addition, concerns about other international crises, such as potential pandemics, may have an adverse effect on the world economy and could adversely affect our business operations or the operations of our contract manufacturers and suppliers.

We invoice substantially all of our international revenue in foreign currencies and substantially all our operating expenses incurred in our foreign subsidiaries are denominated in foreign currencies. For the three and nine months ended March 26, 2010, our international revenue was $24.1 million and $65.8 million, respectively, and as of March 26, 2010, the balance in our foreign currency cash accounts is $23.7 million. At March 26, 2010, we had no foreign currency forward contracts or option contracts. As a result, an increase in the value of the United States dollar relative to foreign currencies could make our products more expensive and, thus, not competitively priced in foreign markets. Additionally, a decrease in the value of the United States dollar relative to foreign currencies could increase our operating costs in foreign locations. In the future, a larger portion of our international revenue may be denominated in foreign currencies, which will subject us to additional risks associated with fluctuations in those foreign currencies. In addition, we may be unable to successfully hedge against any such fluctuations.

*Our international sales may require export licenses and expose us to additional risks. **

Our sales to customers outside the United States are subject to U.S. export regulations. Under these regulations, sales of many of our high-end products require clearance and export licenses from the U.S. Department of Commerce. Our international sales would be adversely affected if these regulations were tightened, or if they are not modified over time to reflect the increasing performance of our products. Delay or denial in the granting of any required licenses could make it more difficult to make sales to non-U.S. customers. In addition, we could be subject to regulations, fines and penalties for violations of import and export regulations if we were found in violation of these regulations. End users could circumvent end-user documentation requirements that are intended to aid in our compliance with export regulations, potentially causing us to violate these regulations. These violations could result in penalties, including prohibitions on us from exporting our products to one or more countries, and could materially harm our business, including our sales to the U.S. government.

*Following our acquisition of the Legacy SGI assets, we rely on sales to U.S. government entities. We have limited experience dealing with the U.S. government as a customer, and a loss of contracts, a failure to obtain new contracts or a reduction of sales under existing contracts with the U.S. government could adversely affect our operating performance.**

Following our acquisition of substantially all of the Legacy SGI s assets, we expect to derive a significant portion of our revenue directly from U.S. government entities and research institutions funded by the U.S. government. In addition, many of our scientific and research customers depend on U.S. government funding for their information technology budgets. As a result, a significant portion of our revenue depends on sales to or funded by the U.S. government. Sales to or funded by the government present risks in addition to those involved in sales to commercial customers, including potential disruptions and delays due to changes in appropriation and spending patterns. Our government business is also highly sensitive to changes in the U.S. government s national and international priorities and budgeting. Changes in the continuing war on terrorism may affect funding for our programs or result in changes in government programs or spending priorities that may harm our business. In addition, the U.S. government can typically terminate or modify its contracts with us at any time for its convenience. Our U.S. government business is also subject to specific procurement regulations and a variety of other requirements. Failure to comply with these or other applicable regulations and requirements could lead to suspension or debarment from government contracting or subcontracting for a period of time. Any disruption or limitation in our ability to do business with the U.S. government or entities funded by the U.S. government would materially and adversely affect our revenue and operating results.

Prior to our acquisition of the Legacy SGI assets, sales to U.S. Government entities were not a significant part of our business, and we have limited experience in dealing with the U.S. government as a customer. In addition, we have not historically required government security clearances which are necessary in some cases to do business with the U.S. government, and have limited experience in obtaining or maintaining these security clearances for us or our employees. Failure to retain necessary security clearances could negatively impact our business with the U.S. Government.

Our quarterly operating results have fluctuated significantly in the past and will continue to fluctuate in the future, which could cause our stock price to decline.

Our quarterly operating results have fluctuated significantly in the past, and we believe that they will continue to fluctuate in the future, due to a number of factors, many of which are beyond our control. We expect that our revenue, gross margin, and earnings per share will fluctuate on a quarterly basis in future periods. If in future periods our operating results do not meet the expectations of investors or analysts who choose to follow our company, our stock price may fall. Factors that may affect our quarterly operating results include the following:

- fluctuations in the buying patterns and sizes of customer orders from one quarter to the next;

increased competition causing us to sell our products or services at decreasing margins;

location and timing requirements for the delivery of our products and services;

addition of new customers or loss of existing customers, especially involving our largest customers;

gross margin obtained on the sales of products and services, especially to our largest customers;

write-off of excess and obsolete inventory;

impairment and shortening of the useful life of components from our suppliers;

unexpected changes in the price for, and the availability of, components from our suppliers;

our ability to enhance our products with new and better designs and functionality;

costs associated with obtaining components to satisfy customer demand;

productivity and growth of our sales force;

actions taken by our competitors, such as new product announcements or introductions or changes in pricing;

revenue and gross margin disparity among our lines of server product and storage product lines;

market acceptance of our newer products, such as ICE Cube and CloudRack, or our future products, such as Altix UV;

technology regulatory compliance, certification and intellectual property issues associated with our products;

the payment of unexpected legal fees and potential damages or settlements resulting from protecting or defending our intellectual property or other matters;

the payment of significant damages or settlements resulting from faulty or malfunctioning products or the provision of services unsatisfactory to our customers;

the market down turn and delay in orders of our products;

the departure and acquisition of key management and other personnel; and general economic trends, including changes in information technology spending or geopolitical events such as war or incidents of terrorism.

We have been substantially dependent on a concentrated number of customers, including Internet companies that purchase in large quantities. If we are unable to maintain or replace our relationships with concentrated customers and/or diversify our customer base, our revenue may fluctuate and our growth may be limited.

Historically, a significant portion of our revenue has come from a limited number of customers. There can be no guarantee that we will be able to sustain our revenue levels from this type of customer. For example, our revenue has largely been generated in connection with these customers decisions to deploy large-scale server and storage farms and their capacity requirements may become fulfilled. In 2007, our three largest customers accounted for 64% of our revenue. In 2008, our three largest customers accounted for 56% of our revenue. During the three and nine months ended March 26, 2010, our largest customer accounted for 19% and 22% of our revenue, respectively. Moreover, the proportion of our revenue derived from a limited number of customers may be even higher in future quarters. If we cannot maintain or replace the customers that purchase large amounts of our products, or if they do not purchase products at the levels or at the times that we anticipate, our ability to maintain or grow our revenue will be adversely affected. To maintain our relationships with our largest customers, and to continue to win their business, we may from time to time sell products to them at less than optimal gross margins. For example, in the second quarter of 2008 our gross margin was negatively impacted by an order shipped in the quarter to a significant customer priced at unfavorable gross margins with the intent of preserving an existing and significant customer relationship. In addition, customer concentration may expose us to credit risk, as a large portion of our accounts receivable may be from a small number of customers. For example, as of January 3, 2009, 77% of our accounts receivable were owed to us from our three largest customers. As of March 26, 2010, 13% of our accounts receivable was owed to us from our largest customer.

In the three months and nine months ended March 2008 and 2009, a substantial majority of our revenue was generated from companies that compete in the Internet market. A significant part of our growth has been due to the fact that these companies are doing well and, in many cases, expanding and, as a result, have been purchasing large quantities of products from us. If economic factors change for these Internet companies, as they have before, our ability to maintain or grow our revenue will be adversely affected. The current economic downturn, volatile business environment and continued unpredictable and unstable market conditions adversely impact the internet sector and our key customers, negatively affecting our business and outlook.

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We face intense competition from the leading enterprise computing companies in the world as well as from emerging companies. If we are unable to compete effectively, we might not be able to achieve sufficient market penetration, revenue growth or profitability.

The markets for compute server products and storage products are highly competitive. In addition to intensely competitive smaller companies, we face challenges from some of the most established companies in the computer industry, such as Dell Inc., Hewlett-Packard Company (HP), International Business Machines Corporation and Oracle Corporation in the computer server market. In the storage market, we compete primarily with EMC Corporation, HP, Hitachi Data Systems, Inc, and NetApp, Inc. These larger competitors have at least the following advantages over us:

- substantially greater market presence and greater name recognition;
- substantially greater financial, technical, research and development, sales and marketing, manufacturing, distribution and other resources;
- longer operating histories;
- a broader offering of products and services;
- more established relationships with customers, suppliers and other technology companies; and
- the ability to acquire technologies or consolidate with other companies in the industry to compete more effectively.

Because these competitors may have greater financial strength than we do and are able to offer a more diversified bundle of products and services, they may have the ability to severely undercut the pricing of our products or provide additional products or servicing at little or no cost, which would make us less competitive or force us to reduce our average selling prices, negatively impacting our margins. In the past, we have had transactions where one or more competitors undercut our prices causing us to reduce our price, which negatively impacted our gross margin on that transaction and our overall gross margin. In addition, we have on occasion lost sales opportunities due to a competitor undercutting the pricing of our products or maintaining superior brand recognition. These competitors may be able to develop products that are superior to the commercially available components that we incorporate into our products, or may be able to offer products that provide significant price advantages over those we offer. For instance, a competitor could use its resources to develop proprietary motherboards with specifications and performance that are superior in comparison with the platforms that are currently available to the marketplace, which could give that competitor a distinct technological advantage. In addition, if our competitors products become more accepted than our products, our competitive position will be impaired.

As the enterprise computing industry evolves, we expect to encounter additional competitors, including companies in adjacent technology businesses such as storage and networking infrastructure and management, companies providing technology that is complementary to ours in functionality, such as datacenter management software, contract manufacturers, and other emerging companies that may announce server product offerings. Moreover, our current and potential competitors, including companies with whom we currently have strategic alliances, may establish cooperative relationships among themselves or with other third parties. If this occurs, new competitors or alliances may emerge that could negatively impact our competitive position.

Our products have incorporated or have been dependent upon, open standards, commoditized components and materials that we obtain in spot markets, and, as a result, our cost structure and our ability to respond in a timely manner to customer demand are sensitive to volatility of the market prices for these components and materials.

A significant portion of our cost of revenue is directly related to the pricing of commoditized materials and components utilized in the manufacture of our products, such as memory, hard drives, central processing units (CPUs), or power supplies. As part of our procurement model, we generally do not enter into long-term supply contracts for these materials and components, but instead, purchase these materials and components in a competitive bid purchase order environment with suppliers or on the open market at spot prices. As a result, our cost structure is affected by the availability and price volatility in the marketplace for these components and materials, including new versions of hard drives and CPUs that are introduced by our suppliers. For example, in the fourth quarter of 2006, we experienced volatility in Dynamic Random Access Memory (DRAM) prices that caused us to procure DRAM at prices higher than anticipated, which negatively impacted our overall gross margin for the quarter. In 2008 and 2009, prices of DRAM decreased. This volatility makes it difficult to predict expense levels and operating results and may cause them to fluctuate significantly. In addition, if we are successful in growing our business, we may not be able to continue to procure components solely on the spot market, which would require us to enter into contracts with component suppliers to obtain these components. This could increase our costs and decrease our gross margin. Also, if we try to take advantage of favorable pricing of a particular component by purchasing a large quantity, there is the risk that a shift in our customers preferred components may render any stockpiled components of little value to us. For example, we recorded a $16.6 million expense related to the write down for excess and obsolete inventory during fiscal year 2007, contributed in part by customer driven technology platform shift from AMD to Intel, affecting demand for memory, motherboards, CPUs and chassis that we had previously purchased.

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In addition, because our procurement model involves our ability to maintain low inventory and to acquire materials and components as needed, and because we do not enter into long-term supply contracts for these materials and components, our ability to effectively and efficiently respond to customer orders may be constrained by the then-current availability or the terms and pricing of these materials and components. Our industry has experienced component shortages and delivery delays in the past, and in the future we may experience shortages or delays of critical components as a result of strong demand in the industry or other factors. As an example, CPUs can represent a significant portion of our cost of revenue, and both the price and availability of various kinds of CPUs are subject to substantial volatility in the spot market. The industry in the past has experienced a shortage of selected Intel chips, which caused some of our motherboard suppliers to reduce or suspend shipments of motherboards using these chips. This impacted our ability to ship selected configurations to some of our customers, and in some cases accelerated a transition to other platforms. If shortages or delays arise, the prices of these components may increase or the components may not be available at all. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products to meet customer demand, which could adversely affect our business and financial results. As another example, DRAM can also represent a significant portion of our cost of revenue, and both the price and availability of various kinds of DRAM are subject to substantial volatility in the spot market. In the fourth quarter of 2006 we encountered conditions where we were forced to pay higher prices than we anticipated for DRAM and we have encountered conditions where DRAM was in tight supply and we were unable to deliver customer orders on their anticipated delivery dates. In addition, if any of our suppliers, such as Intel or AMD for CPUs, were to increase the costs to us for components we use, we would either pass these price increases on to our customers, which could cause us to lose business from these customers, or we would need to absorb these price increases, which would cause our margins to decrease, either of which could adversely affect our business and financial results.

We intend to expand our operations and increase our expenditures in an effort to grow our business. If we are not able to manage this growth and expansion, or if our business does not grow as we expect, our operating results may suffer.

We intend to continue to grow our business by entering new markets, acquisitions, developing new product and service offerings and pursuing new customers. In connection with this growth, we expect that our annual operating expenses may increase over the next several years to the extent we expand our sales and marketing, research and development, manufacturing and production infrastructure, and our customer service and support efforts. Our failure to timely or efficiently expand operational and financial systems and to implement or maintain effective internal controls and procedures could result in additional operating inefficiencies that could increase our costs and expenses more than we had planned and might cause us to lose the ability to take advantage of market opportunities, enhance existing products, develop new products, satisfy customer requirements, respond to competitive pressures or otherwise execute our business plan. Additionally, if we do increase our operating expenses in anticipation of the growth of our business and this growth does not meet our expectations, our financial results could be negatively impacted.

If we acquire or invest in other companies, assets or technologies and we are not able to integrate them with our business, or we do not realize the anticipated financial and strategic goals for any of these existing or future transactions, our financial performance may be impaired.

If appropriate opportunities present themselves, as they have in the past, we may consider acquiring or making investments in companies, assets or technologies that we believe are strategic. We only have limited experience in doing so, and for any such company, asset or technology which we successfully acquire or invest in, we will be exposed to a number of risks, including:

- we may find that the acquired company, asset or technology does not further our business strategy, that we overpaid for the company, asset or technology or that the economic conditions underlying our acquisition decision have changed;
- we may have difficulty integrating the assets, technologies, operations or personnel of an acquired company, or retaining the key personnel of the acquired company;
- our ongoing business and management s attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically or culturally diverse enterprises;
- we may encounter difficulty entering and competing in new product or geographic markets or increased competition, including price competition or intellectual property litigation; and

we may experience significant problems or liabilities associated with product quality, technology and legal contingencies relating to the acquired business or technology, such as intellectual property or employment matters.

For example, in connection with our acquisition of Terrascale Technologies, Inc., we expended a great deal of effort and resources, but were unable to generate revenue, increase gross profit or contribute positive cash flow into our business, sufficient to realize our investment, causing us to exit this product line. This resulted in an impairment charge of $17.5 million during the year ended January 3, 2009. We have shown the results of this product line as discontinued operation in our unaudited condensed consolidated financial statements.

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If we were to proceed with one or more significant acquisitions or investments in which the consideration included cash, we could be required to use a substantial portion of our available cash. To the extent we issue shares of capital stock or other rights to purchase capital stock, including options and warrants, existing stockholders might be diluted and earnings per share might decrease. In addition, acquisitions and investments may result in the incurrence of debt, large one-time write-offs, such as acquired in-process research and development costs and restructuring charges.

Our business depends on decisions by potential customers to adopt our modular, open standard-based products and to replace their legacy server systems with our products, and they may be reluctant to do so, which would limit our growth.

Our business depends on companies moving away from large proprietary RISC/UNIX servers to standardized servers that utilize commercially available x86 processor architectures and can deploy a variety of operating systems, including Linux and Microsoft Windows. Excluding sales to Microsoft Corporation, we believe that a majority of the server systems that we sold in 2008, 2007 and 2006 ran on the Linux operating system and are subject to the GNU General Public License. While litigation involving the SCO Group s claim against IBM that Linux is an unauthorized derivative work of the UNIX ® operating system has been stayed due to SCO s bankruptcy filing, if it ultimately results in a ruling that users of Linux must pay royalties to SCO or others, that could impede broader Linux adoption and could materially harm our ability to sell our products based on the Linux operating system. In addition, Microsoft has publicly claimed that Linux infringes 235 or more of Microsoft s patents and has entered into transactions with Novell, Inc. and other Linux distributors under which the parties reportedly agree, among other things, not to sue each other s customers for potential patent infringements related to Linux. It is possible that a party (including Microsoft) could prove a claim for proprietary rights in the Linux operating system or other programs developed and distributed under the GNU General Public License. In addition, the GNU General Public License is a subject of litigation, and it is possible that a court could hold these licenses to be unenforceable in that litigation. Any ruling by a court that the Linux operating system or significant portions of it may not be copied, modified or distributed subject only to the minimal restrictions contained in these licenses, that users or distributors of Linux must pay royalties to Microsoft or others or that these licenses are not enforceable could also impede broader Linux adoption and materially harm our ability to sell our products based on the Linux operating system. Further, because potential customers have often invested significant capital and other resources in existing systems, many of which run mission-critical applications, customers may be hesitant to make dramatic changes to their datacenter systems. The failure of our customers and potential customers to replace their legacy server systems and adopt open standard-based modular technologies could have a material adverse impact on our ability to maintain or generate additional revenue.

We rely primarily on our direct sales force to generate revenue, and may be unable to hire additional qualified sales personnel in a timely manner or retain our existing sales representatives.

To date, we have relied primarily on our direct sales force to sell our products in the United States. Because we are looking to expand our customer base and grow our sales to existing customers, we will need to continue to hire qualified sales personnel, both in the United States and abroad, if we are to achieve our business objectives. The competition for qualified sales personnel in our industry is very intense. If we are unable to hire, train, deploy and manage qualified sales personnel in a timely manner, our ability to grow our business will be impaired. For example, in the past it has taken us up to six months to hire a qualified sales executive and it may take a newly-hired sales executive up to nine months after hiring to become productive, resulting in aggregate lag time between the commencements of the search to productivity, in excess of one year. In addition, if we are unable to retain our existing sales personnel, or if our sales personal are ineffective, our ability to maintain or grow our current level of revenue will be adversely affected. In addition, a large percentage of our revenue has been historically generated from a small number of customers. If we are unable to retain the sales personnel who are responsible for those customer accounts, our business could be negatively impacted.

We are continuing to develop and execute upon a channel strategy to generate additional sales and revenue, and the failure to successfully expand channel sales might affect our ability to sustain revenue growth and may harm our business and operations.

An increasing portion of our sales strategy is to develop our sales efforts through the use of resellers and other third parties to sell our systems. We may not be successful in building or expanding relationships with these third parties. Further, even if we do develop and expand these relationships, they may conflict with our direct sales efforts in some territories. Ineffective marketing of our products by our resellers or disruptions in our distribution channels could lead to decreased sales or slower than expected growth in revenue and might harm our business and operations.

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Our sales cycle requires us to expend a significant amount of resources, and could have an adverse effect on the amount, timing and predictability of future revenue.

The sales cycle of our products, beginning from our first customer contact to closing of the sale, often ranges from three to six months. We may expend significant resources during the sales cycle and ultimately fail to close the sale. The success of our product sales process is subject to factors, over which we have little or no control, including:

- the timing of our customers budget cycles and approval processes;
- our customers existing use of, or willingness to adopt, open standard server products, or to replace their existing servers or expand their processing capacity with our products;
- the announcement or introduction of competing products; and
- established relationships between our competitors and our potential customers.

We expend substantial time, effort and money educating our current and prospective customers as to the value of our products. Even if we are successful in persuading lower-level decision makers within our customers organizations of the benefits of our products, senior management might nonetheless elect not to buy our products after months of sales efforts by our employees or resellers. If we were unsuccessful in closing sales, after expending significant resources, our revenue and operating expenses will be adversely affected.

If we are unable to protect our intellectual property adequately, we may not be able to compete effectively.

Our intellectual property is critical to our success and our ability to compete. If we fail to protect our intellectual property rights adequately, our competitors might gain access to our technology. Unauthorized parties may attempt to copy or otherwise obtain and use our proprietary technology despite our efforts to protect our intellectual property. In addition, we license our technology and intellectual property to third parties, including in some cases, our competitors, which could under some circumstances make our patent rights more difficult enforce.

However, litigation is inherently uncertain, and there is no assurance that any litigation we initiate will have a successful outcome. Monitoring unauthorized use of our technology is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as the laws of the United States. Any claims or litigation that we have initiated or that we may initiate in the future to protect our proprietary technology could be time consuming and expensive and divert the attention of our technical and management resources whether or not the claims or litigation are decided in our favor. We currently have numerous patents issued in the United States and a number of utility patent applications pending in the United States and other countries. These patents may be limited in value in asserting our intellectual property rights against more established companies in the computer technology sector that have sizeable patent portfolios and greater capital resources. In addition, patents may not be issued from these patent applications, and even if patents are issued, they may not benefit us or give us adequate protection from competing products. For example, issued patents might be circumvented or challenged, and could be declared invalid or unenforceable. Moreover, if other companies develop unpatented proprietary technology similar to ours or competing technologies, our competitive position will be weakened.

If we are found to have violated the intellectual property rights of others, we could be required to indemnify our customers, resellers or suppliers, redesign our products, pay significant royalties and enter into license agreements with third parties.

Our industry is characterized by a large number of patents, copyrights, trade secrets and trademarks and by frequent litigation based on allegations of infringement or other violation of intellectual property rights. As we continue our business, expand our product lines and our product functionality, and expand into new jurisdictions around the world, third parties may assert that our technology or products violate their intellectual property rights. Any claim, regardless of its merits, could be expensive and time consuming to defend against. It would also divert the attention of our technical and management resources. Successful intellectual property claims against us could result in significant financial liability, impair our ability to compete effectively, or prevent us from operating our business or portions of our business. In addition, resolution of claims may require us to redesign our technology, to obtain licenses to use intellectual property belonging to third parties, which we may not be able to obtain on reasonable terms, to cease using the technology covered by those rights, and to indemnify our customers, resellers or suppliers. Any of these events could negatively affect our competitive position and materially harm our business, financial condition and results of operations.

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If we lose the services of one or more members of our current executive management team or other key employees, or if we are unable to attract additional executives or key employees, we may not be able to execute on our business strategy.

Our future success depends in large part upon the continued service and enhancement of our executive management team and other key employees, including, for example, Mark Barrenechea, who joined our company as our chief executive officer, at the end of April 2007. Changes in management can be disruptive within a company, which could negatively affect our operations, our culture and our strategic direction. Our employees may terminate their employment with us at any time. Our U.S. employees are at will, while outside of the U.S., notice or severance may be required if we wish to terminate an employee. The failure of our management team to seamlessly manage employee transitions, or the loss of services of any of these executives or of one or more other members of our executive management or sales team or other key employees could seriously harm our business. Competition for qualified executives is intense, particularly in Silicon Valley, and if we are unable to continue expanding our management team, or successfully integrate new additions to our management team in a manner that enables us to scale our business and operations effectively, our ability to operate effectively and efficiently could be limited or negatively impacted. In addition, in January 2009 we reduced our workforce by approximately 15% as part of our efforts to reduce costs and improve the efficiency and profitability of our business. Also, we commenced the transition of a significant number of new employees in connection with our acquisition of Legacy SGI assets in May 2009. These reductions and transitions in our workforce may impair our ability to recruit and retain qualified employees. If we need to rehire terminated individuals or hire individuals with similar skills, we may be unable to do so.

If we fail to maintain or expand our relationships with our suppliers, in some cases single-source suppliers, we may not have adequate access to new or key technology necessary for our products, and, as a result, our ability to deliver leading-edge products may be impaired.

In addition to the technologies we develop, our suppliers develop product innovations at our direction that are requested by our customers. In many cases, we retain the ownership of the intellectual property developed by these suppliers. In addition, we rely heavily on our component suppliers, such as Intel and AMD, to provide us with leading-edge components. If we are not able to maintain or expand our relationships with our suppliers or continue to leverage their research and development capabilities to develop new technologies desired by our customers, our ability to deliver leading-edge products may be impaired and we could be required to incur additional research and development expenses.

We historically have depended on our compute server products for the majority of our revenue. If market acceptance of our compute server products does not continue, we may not be able to achieve growth.

Sales of our compute server products accounted for 85% of our revenue during fiscal 2008, 92% of revenue in fiscal 2007 and 91% in fiscal 2006. Despite our acquisition of Legacy SGI assets, if our compute server products fail to maintain market acceptance, or if we are unsuccessful in developing improved products or products to replace or supplement our current server product lines, we may not be able to achieve expected financial results. Further, because some of our customers are engaged in large-scale data center implementations, if customers believe that new generations of our compute server products will become available in the near future, this perception may cause customers to delay or cancel existing orders, which would affect our ability to generate revenue in accordance with forecasted levels.

We rely on contract manufacturers to manufacture our products, and our failure to successfully manage our relationships with these contract manufacturers could impair our ability to deliver our systems in a manner consistent with required volumes or delivery schedules, which could damage our relationships with our customers and decrease our revenue.

We rely on a very small number of contract manufacturers to assemble and test a majority of our products. None of these third party contract manufacturers are obligated to perform services or supply products to us for any specific period, or in any specific quantities, except as may be provided in a particular purchase order. Moreover, none of our contract manufacturers has provided contractual assurances to us that adequate capacity will be available to us to meet future demand for our products. If our contract manufacturers are not able to maintain our high standards of quality, are not able to increase capacity as needed, or are forced to shut down a factory, our ability to deliver quality products to our customers on a timely basis may decline, which would damage our relationships with customers, decrease our revenue and negatively impact our growth.

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Our customers require a high degree of reliability in our products and services, and if we cannot meet their expectations our relationships with our customers could be damaged and demand for our products and services will decline.

Because our customers rely on our products and services for their enterprise or mission critical applications, any failure to provide high quality products and reliable services, whether caused by our own failure or failures by our suppliers or contract manufacturers, could damage our reputation and reduce demand for our products and services. Some of our products, such as our ICE cube line, are particularly complex and carry a higher per unit price. A failure of products in our ICE cube line would therefore potentially be more costly to us, with the risk and potential cost to us increasing proportionately with the number of products we sell products in this line. Most of our customers use our systems for applications that are critical to their organization; as a result system reliability is critical to the success of our products. In addition, delays in our ability to fill product orders as a result of quality control issues, such as an increase in failure rates or the rate of product returns, may negatively impact our relationships with our customers and harm our revenue and growth.

Unstable market and economic conditions may have serious adverse consequences on our business.

Our general business strategy may be adversely affected by the current economic downturn and volatile business environment and continued unpredictable and unstable market conditions. If the current equity and credit markets deteriorate further, or do not improve, it may make any necessary debt or equity financing more difficult, more costly, and more dilutive. We believe we are well positioned with significant capital resources to meet our current working capital and capital expenditure requirements. However, a prolonged or profound economic downturn may result in adverse changes to demand for our products, or our customers ability to pay for our products, which would harm our operating results. There is also a risk that one or more of our current service providers, manufacturers and other partners may not survive these difficult economic times, which would directly affect our ability to attain our operating goals on schedule and on budget. Failure to secure any necessary financing in a timely manner and on favorable terms could have a material adverse effect on our financial performance and stock price and could require us to change our business plans.

Uncertainty in the credit market may negatively affect the value of auction rate securities owned by us and our ability to liquidate these securities.

Our long-term investments as of March 26, 2010 are comprised of various ARS. ARS are variable-rate debt securities that have a long-term maturity. The interest rate on ARS resets through Dutch auctions that are held at pre-determined intervals, usually every 28 days, providing liquidity by allowing investors to roll over their holdings or obtain immediate liquidity by selling. Recent uncertainty in the credit market has negatively affected these auctions as they have not had sufficient bidders to allow investors to complete a sale. In February 2008, auctions of ARS that we continue to hold failed. Due to the uncertainty of liquidity, we have classified these investments as long-term and have included them in long-term investments. As of March 26, 2010 we have recorded an unrealized loss of $1.4 million on these investments in other comprehensive loss, reducing their value to $7.4 million. In the future, failed auctions may affect our ability to liquidate these ARS until a future auction is successful, a buyer is found outside of the auction process, the underlying securities have matured or the securities are recalled by the issuer. In addition, failed auctions may affect the fair value of our ARS and may result in an impairment charge.

Maintaining and improving our financial controls, particularly in light of recent acquisition of the Legacy SGI business and the requirements of being a public company may strain our resources and divert management s attention.

We are subject to the reporting requirements of the Securities Exchange Act of 1934 or the Exchange Act, the Sarbanes-Oxley Act of 2002 and The NASDAQ Stock Market Rules. The requirements of these rules and regulations have increased our legal and financial compliance costs, make some activities more difficult, time-consuming or costly and may also place undue strain on our personnel, systems and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. This can be difficult to do. In particular, we acquired substantially all the assets of Legacy SGI and are in the process of integrating and harmonizing Legacy SGI financial reporting and information technology systems, including internal control over financial reporting, with our own. As a result of this and similar activities, management s attention may be diverted from other business concerns, which could have a material adverse effect on our business, financial condition and results of operations. We may not be able to meet the requirements needed to prevent additional material weaknesses. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on the NASDAQ Global Select Market.

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We have a material weakness in our internal control over financial reporting, and this material weakness creates a reasonable possibility of material misstatements in our financial statements.

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports and effectively prevent fraud. As a publicly traded company we must maintain effective disclosure controls and procedures and internal control over financial reporting. This can be difficult to do. A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that:

pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company s annual or interim financial statements will not be prevented or detected on a timely basis. In connection with the preparation of our financial statements for the year ended January 3, 2009, we determined that we had a material weakness, and therefore determined that our internal control over financial reporting was not effective, and therefore created a reasonable possibility of material misstatements in our financial statements. This material weakness related to our accounting for inventory valuation as more fully explained in Part II Item 9A. Controls and Procedures in our Annual Report on Form 10-K for the year ended January 3, 2009 and has not yet been remediated.

In order to improve and to maintain the effectiveness of our internal control over financial reporting and disclosure controls and procedures, significant resources and management oversight will be required. We began the process of remediating this material weakness when first identified in connection with the preparation of our financial statements for the fiscal year ended December 29, 2007, but this process takes time, and we will not be able to assert that we have remediated this material weakness until the procedures that we put in place have been working for a sufficient period of time for us to determine that they are effective. As a result of this and similar activities, management s attention may be diverted from other business concerns, which could have a material adverse effect on our business, financial condition and results of operations. If we are unable to remediate this material weakness, or in a future report one or more additional material weaknesses, there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

Even after corrective actions are implemented, the effectiveness of our controls and procedures may be limited by a variety of risks including:

faulty human judgment and simple errors, omissions or mistakes;

collusion of two or more people;

inappropriate management override of procedures; and

the risk that enhanced controls and procedures may still not be adequate to assure timely and reliable financial information.

A failure to have effective internal controls and procedures for financial reporting in place could result in a restatement of our financial statements, as it did in our Form 10-Q for the quarterly period ended March 29, 2008, or impact our ability to accurately report financial information on a timely basis, which could adversely affect our stock price.

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Risk Related to Owning Our Stock

*Our stock price in the past has been volatile, and may continue to be volatile or may decline regardless of our operating performance, and investors may not be able to resell shares at or above the price at which they purchased the shares.**

Our stock has been publicly traded for a relatively short period of time, having first begun trading in June 2005. During that time our stock price has fluctuated significantly, from a high of approximately $56.00 per share to a low of approximately $3.43 per share. At times the stock price has changed very quickly. For example, most recently, our stock has dropped from a high of more than $9.89 per share in September 2008 to a low of approximately $3.43 per share in March 2009. During the three months ended March 26, 2010, our stock price has fluctuated from a high of approximately $12.62 to a low of approximately $7.01. If investors purchase shares of our common stock, they may not be able to resell those shares at or above the price at which they purchase them. The market price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control including:

- price and volume fluctuations in the overall stock market;
- purchases of shares of our common stock pursuant to our share repurchase program;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- actual or anticipated fluctuations in our operating results;
- changes in operating performance and stock market valuations of other technology companies generally, or those that sell enterprise computing products in particular;
- changes in financial estimates by any securities analysts who follow our company, our failure to meet these estimates or failure of those analysts to initiate or maintain coverage of our stock;
- ratings downgrades by any securities analysts who follow our company;
- the public s response to our press releases or other public announcements, including our filings with the SEC;
- announcements by us or our competitors of significant technical innovations, customer wins or losses, acquisitions, strategic partnerships, joint ventures or capital commitments;
- introduction of technologies or product enhancements that reduce the need for our products;
- market conditions or trends in our industry or the economy as a whole;
- the loss of one or more key customers;

the loss of key personnel;

the development and sustainability of an active trading market for our common stock;

lawsuits threatened or filed against us;

future sales of our common stock by our officers, directors and significant stockholders; and

other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

In addition, the stock markets, and in particular the NASDAQ Stock Market, have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. We are currently involved in securities litigation, and could become involved in additional securities litigation in the future, either of which could have substantial costs and divert resources and the attention of management from our business. For additional information regarding our securities litigation, please see the section of this report titled *Legal Proceedings.*

Due to these factors, sales of a substantial number of shares of our common stock in the public market could occur at any time. These sales, or the perception in the market that the holders of a large number of shares intend to sell shares, could reduce the market price of our common stock.

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Some provisions in our certificate of incorporation and bylaws may deter third parties from acquiring us.

Our certificate of incorporation and bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

- limitations on persons authorized to call a special meeting of stockholders;
- our stockholders may take action only at a meeting of stockholders and not by written consent;
- our certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and
- advance notice procedures required for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for stockholders to elect directors of their choosing and cause us to take other corporate actions they desire.

We do not expect to pay any cash dividends for the foreseeable future.

We do not anticipate that we will pay any cash dividends to holders of our common stock in the foreseeable future. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends in the foreseeable future should not purchase our common stock.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. (Removed and Reserved)

ITEM 5. Other Information

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ITEM 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Ex. No.	File No.	Filing Date	Filed Herewith
2.1	Asset Acquisition Agreement, dated December 23, 2002, by and between GNJ, Inc. (f.k.a. Rackable Systems, Inc.) and Registrant	S-1	2.1	333-122576	2/4/2005	
2.2	Share Purchase Agreement dated as of August 29, 2006, by and among Rackable Systems, Inc., Rackable Systems Canada Acquisition ULC, Terrascale Technologies Inc. and the other parties identified on Schedule A thereto	8-K	2.1	000-51333	8/30/2006	
2.3	Asset Purchase Agreement dated as of March 31, 2009, by and among Silicon Graphics, Inc., the subsidiaries of Silicon Graphics, Inc. listed on Schedule I thereto, and Rackable Systems, Inc.	8-K	2.1	000-51333	4/1/2009	
2.4	Amendment to Asset Purchase Agreement dated as of March 31, 2009, by and among Silicon Graphics, Inc., the subsidiaries of Silicon Graphics, Inc. listed on Schedule I thereto, and Rackable Systems, Inc., dated as of April 30, 2009.	8-K	2.1	000-51333	5/5/2009	
2.5	Secured Creditor Asset Purchase Agreement dated as of February 23, 2010, by and between Silicon Valley Bank and Silicon Graphics International Corp.	8-K	2.5	000-51333	3/1/2010	
3.1	Amended and Restated Certificate of Incorporation	10-Q	3.1	000-51333	8/12/2005	
3.2	Amended and Restated Bylaws	8-K	3.2	000-51333	3/7/2008	
3.3	Certificate of Ownership and Merger	8-K	3.3	000-51333	5/21/2009	
4.1	Reference is made to Exhibits 3.1, 3.2 and 3.3					
4.2	Form of Specimen Stock Certificate	8-K	4.2	000-51333	5/21/2009	
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a)					X
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a)					X
32.1	Certifications required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350)					X

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SILICON GRAPHICS INTERNATIONAL CORP.

By: /s/ JAMES D. WHEAT
Chief Financial Officer

(Duly authorized and principal financial officer)

Dated: May 5, 2010