Silicon Graphics International Corp
Form 10-Q
February 03, 2014

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 December 27, 2013
Or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 000-51333

SILICON GRAPHICS INTERNATIONAL CORP.
(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	32-0047154 (I.R.S. Employer Identification No.)

900 North McCarthy Blvd.
Milpitas, California 95035
(Address of principal executive offices, including zip code)
(669) 900-8000
(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 o

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 x No o

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. (Check one):

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of January 29, 2014, there were 34,166,153 shares of the registrant's common stock outstanding.

SILICON GRAPHICS INTERNATIONAL CORP.
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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

SILICON GRAPHICS INTERNATIONAL CORP.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Revenue				
Product	$71,130	$112,085	$170,349	$240,438
Service	38,529	42,159	76,605	87,567
Combined product and service	6,401	16,982	16,625	36,102
Total revenue	116,060	171,226	263,579	364,107
Cost of revenue				
Product	57,844	88,059	140,473	198,994
Service	21,126	25,478	41,374	52,555
Combined product and service	3,607	10,125	10,001	22,784
Total cost of revenue	82,577	123,662	191,848	274,333
Gross profit	33,483	47,564	71,731	89,774
Operating expenses:				
Research and development	14,902	15,530	29,736	29,499
Sales and marketing	18,815	19,664	36,411	39,235
General and administrative	14,547	12,383	27,029	26,572
Restructuring	111	2,867	637	4,341
Total operating expenses	48,375	50,444	93,813	99,647
Loss from operations	(14,892)	(2,880)	(22,082)	(9,873)
Total other income (expense), net:				
Interest income (expense), net	(46)	(112)	(53)	(267)
Other income (expense), net	1,685	213	1,988	(894)
Total other income (expense), net	1,639	101	1,935	(1,161)
Loss before income taxes	(13,253)	(2,779)	(20,147)	(11,034)
Income tax (benefit) provision	431	(3,880)	360	(3,455)
Net (loss) income	$(13,684)	$1,101	$(20,507)	$(7,579)
Basic and diluted net (loss) income per share				
Basic	$(0.40)	$0.03	$(0.60)	(0.23)
Diluted	$(0.40)	$0.03	$(0.60)	$(0.23)
Shares used in computing basic and diluted net (loss) income per share				
Basic	34,176	32,410	34,136	32,289
Diluted	34,176	32,778	34,136	32,289

See accompanying notes.

SILICON GRAPHICS INTERNATIONAL CORP.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(In thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Net (loss) income	$(13,684)	$1,101	$(20,507)	$(7,579)
Other comprehensive (loss) income:				
Unrecognized gain on defined benefit plans, net of zero tax	31	42	60	84
Unrealized losses on derivatives instruments, net of zero tax	(206)	—	(1,251)	—
Unrealized losses on derivative instruments reclassified into earnings, net of zero tax	140	—	226	—
Foreign currency translation adjustment, net of zero tax	(839)	(425)	(978)	(213)
Other comprehensive loss	(874)	(383)	(1,943)	(129)
Total comprehensive (loss) income	$(14,558)	$718	$(22,450)	$(7,708)

See accompanying notes.

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SILICON GRAPHICS INTERNATIONAL CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)
(Unaudited)

	December 27, 2013	June 28, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$113,441	$175,181
Current portion of restricted cash	2,411	531
Accounts receivable, net of allowance for doubtful accounts of $1,192 and $1,074 as of December 27, 2013 and June 28, 2013, respectively	71,716	59,842
Inventories	71,494	61,770
Current portion of deferred cost of revenue	14,152	21,204
Prepaid expenses and other current assets	20,570	14,094
Total current assets	293,784	332,622
Non-current portion of restricted cash	2,166	2,853
Property and equipment, net	27,698	26,170
Intangible assets, net	7,630	4,643
Non-current portion of deferred cost of revenue	6,695	7,281
Other assets	42,329	34,284
Total assets	$380,302	$407,853
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$56,789	$51,531
Accrued compensation	21,198	28,504
Current portion of deferred revenue	83,279	86,357
Other current liabilities	35,905	35,364
Total current liabilities	197,171	201,756
Non-current portion of deferred revenue	46,957	50,362
Long-term income taxes payable	10,360	10,149
Retirement benefit obligations	11,898	11,542
Other non-current liabilities	3,628	3,790
Total liabilities	270,014	277,599
Commitments and contingencies (Note 24)		
Stockholders' equity:		
Preferred stock, par value $0.001 per share; 12,000 shares authorized; none outstanding	—	—
Common stock, par value $0.001 per share; 120,000 shares authorized; 35,616 shares and 34,795 shares issued at December 27, 2013 and June 28, 2013, respectively	35	35
Additional paid-in capital	520,381	510,092
Treasury stock, at cost (1,506 shares at December 27, 2013 and 946 shares at June 28, 2013)	(15,497)	(7,692)
Accumulated other comprehensive loss	(4,094)	(2,151)
Accumulated deficit	(390,537)	(370,030)
Total stockholders' equity	110,288	130,254

Total liabilities and stockholders' equity	$380,302	$407,853

See accompanying notes.

SILICON GRAPHICS INTERNATIONAL CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended	
	December 27, 2013	December 28, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(20,507)	$(7,579)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	7,396	7,093
Share-based compensation	6,493	5,007
Release of liability for unrecognized tax benefits	—	(4,286)
Gain on investment	(1,717)	—
Assets impairment charges	890	—
Other	396	85
Changes in operating assets and liabilities:		
Accounts receivable	(13,056)	8,814
Inventories	(12,594)	(26,821)
Deferred cost of revenue	7,231	20,402
Prepaid expenses and other assets	(841)	139
Accounts payable	541	(10,801)
Deferred revenue	(8,180)	36,238
Other liabilities	(7,193)	6,105
Net cash (used in) provided by operating activities	(41,141)	34,396
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(6,735)	(2,012)
Proceeds on sales of investment	1,717	—
Net cash used in acquisition	(9,200)	—
Other	(1,193)	1,231
Net cash used in investing activities	(15,411)	(781)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of credit facility	—	(15,300)
Funding of restricted stock units withheld for taxes	(1,441)	(379)
Purchase of treasury stock	(7,805)	—
Proceeds from issuance of common stock upon exercise of stock options	3,242	749
Proceeds from issuance of common stock under employee stock purchase plan	1,995	1,736
Net cash used in financing activities	(4,009)	(13,194)
Effect of exchange rate changes on cash	(1,179)	(1,127)
Net (decrease) increase in cash	(61,740)	19,294
Cash-beginning of period	175,181	104,851
Cash-end of period	$113,441	$124,145
SUPPLEMENTAL DISCLOSURE OF OTHER CASH FLOW INFORMATION:		
Income taxes refunded	$134	$1,076
Cash paid for interest	$68	$562
NON CASH INVESTING AND FINANCING ACTIVITIES:		
Property and equipment purchases in accounts payable	$5,074	$112

See accompanying notes.

SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. DESCRIPTION OF BUSINESS
Silicon Graphics International Corp. ("SGI" or the "Company", "we", "us" or "our") is a global leader in high performance computing (HPC). We are focused on helping customers solve their most demanding business and technology challenges by delivering technical computing, Big Data and cloud computing solutions that accelerate time to discovery, innovation and profitability. We develop, market and sell a broad line of low cost, mid-range and high-end scale-out and scale-up servers, enterprise-class storage hardware, differentiating software and designed-to-order solutions for large-scale deployments, coupled with global support and highly experienced professional services. SGI solutions are designed to provide greater flexibility and scalability, with lower total cost of ownership.
The Company's solutions are utilized by scientific, business and government communities to fulfill highly data intensive application needs in petascale environments. Delivering industry-leading computing power and fast and efficient data movement, both within the computing system and to and from large-scale data storage installations, SGI systems enable customers to access, analyze, transform, manage and visualize information in real-time and near real-time. The vertical markets the Company serves include the federal government, defense and strategic systems, weather and climate, physical sciences, life sciences, energy (including oil and gas), aerospace and automotive, internet, financial services, media and entertainment and business intelligence and data analytics. The Company's headquarters is located in Milpitas, California and its primary manufacturing facility is located in Chippewa Falls, Wisconsin. See Note 5 for more information regarding the contract manufacturing transition.

2. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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 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 June 28, 2013, which are included in the Company's Annual Report on Form 10-K filed with the SEC on September 9, 2013.
The preparation of unaudited condensed consolidated financial statements in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses as presented in the accompanying unaudited condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.
Fiscal Year. The Company has a 52 or 53-week fiscal year ending on the last Friday in June. The current fiscal year 2014 will be comprised of 52 weeks and will end on June 27, 2014. Fiscal year 2013 was comprised of 52 weeks and ended on June 28, 2013.
In fiscal year 2013, the Company's fiscal quarters ended on September 28, 2012 (first quarter), December 28, 2012 (second quarter), March 29, 2013 (third quarter) and June 28, 2013 (fourth quarter).
In fiscal year 2014, the Company's fiscal quarters end on September 27, 2013 (first quarter), December 27, 2013 (second quarter), March 28, 2014 (third quarter) and June 27, 2014 (fourth quarter).
Principles of Consolidation. The unaudited condensed consolidated financial statements include the accounts of the Company and all of its subsidiaries. All intercompany accounts and transactions have been eliminated.

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SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no changes in the Company's significant accounting policies for the three months ended December 27, 2013 as compared to those disclosed in the Company's Annual Report on Form 10-K for the year ended June 28, 2013 except as summarized below.

Derivative Instruments. Derivatives that are not designated as hedges are adjusted to fair value through earnings. If the derivative is designated as a cash flow hedge, the effective portion of the contracts' gains and losses resulting from changes in fair value is recognized in accumulated other comprehensive income. Amounts associated with cash flow hedges are reclassified and recognized in income when the forecasted transaction occurs or it becomes probable the forecasted transaction will not occur. The ineffective portion of the hedge is recognized in earnings immediately.

As a result of our significant international operations, we are subject to risks associated with fluctuating exchange rates. We use derivative financial instruments, principally foreign currency exchange forward contracts, to attempt to minimize the impact of exchange rate movements on our subsidiaries' and consolidated balance sheets and operating results. Factors that could have an impact on the effectiveness of our hedging program include the accuracy of forecasts and the volatility of foreign currency markets. These programs reduce, but do not entirely eliminate, the impact of currency exchange movements. The maturities of these instruments are generally less than one year.

Recently Issued Accounting Standards.

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. In February 2013, the FASB issued guidance for reporting of amounts reclassified out of accumulated other comprehensive income. The revised guidance requires reporting the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures that provide additional detail about these amounts. This accounting standard was effective for the Company in its first quarter of fiscal 2014. The adoption of this standard had no effect on the Company's condensed consolidated statement of operations.

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. In July 2013, the FASB issued an amendment to the accounting guidance related to the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. The guidance requires an unrecognized tax benefit to be presented as a decrease in a deferred tax asset where a net operating loss, a similar tax loss, or a tax credit carryforward exists and certain criteria are met. This guidance is effective prospectively for annual and interim reporting periods beginning after December 15, 2013 and is consistent with our current practice. This accounting standard update will be effective for the Company beginning in the third quarter of fiscal 2014. We do not expect a material impact to our consolidated financial statements due to the adoption of this guidance.

4. ACQUISITION

On September 30, 2013 (the "Closing Date"), the Company acquired certain assets of FileTek, Inc. ("FileTek"), a global provider of Big Data storage virtualization, large-scale data management, and active archive solutions. Pursuant to the terms of the agreement, the total purchase price was approximately $9.2 million in cash. This acquisition expands the Company's storage solutions by enabling customers to manage data assets efficiently and lower the cost and administration of high-volume storage. Under the terms of the agreement, SGI acquired FileTek's StorHouse and Trusted Edge software, worldwide customers, engineering team, and services and support resources.

The acquired assets and assumed liabilities were recorded by the Company at their estimated fair values. The Company determined the estimated fair values using estimates made by management and valuations performed including discounted cash flow and cost approach analyses.

SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

The following table summarizes the allocation of the purchase price to the estimated fair values of the assets acquired and liabilities assumed as of the Closing Date (in thousands):

	Amount
Tangible assets acquired	$169
Tangible liabilities assumed	(3,119)
Net tangible liabilities	(2,950)
Intangible assets	4,900
Goodwill	7,250
Total net asset acquired	$9,200

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

Intangible Asset Class	Fair Value	Weighted Average Useful Life (in Years)
Purchased technology	$4,400	6.25
Maintenance and service agreements and related relationships	400	4
Trade name / trademarks	100	4
Total intangible assets	$4,900	

Acquisition and integration costs directly related to the acquisition were $0.2 million and were recorded in selling, general and administrative expenses. Such costs are expensed in accordance with the authoritative guidance.

Unaudited Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations for the Company and FileTek on a pro forma basis, as though the companies had been combined as of the beginning of fiscal 2014. The pro forma financial information is presented for informational purposes only and may not be indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of fiscal year 2014. The pro forma financial information for three and six months ended December 27, 2013 include the business combination accounting effect on historical FileTek revenue, amortization and development charges from acquired intangible assets and related tax effects.

	Six Months Ended December 27, 2013	December 28, 2012
	(In thousands, except per share amounts)	
Revenue	$265,079	$367,807
Net (loss) income	$(20,329)	$(6,823)
Net (loss) income per share - basic	$(0.60)	$(0.21)
Net (loss) income per share - diluted	$(0.60)	$(0.21)

5. CONTRACT MANUFACTURING TRANSITION

In July 2013, the Company selected Jabil Circuit, Inc. ("Jabil") as its primary global manufacturing services and supply chain management provider. The transition to Jabil will be implemented as a “manage in place” model, which utilizes existing SGI facilities and personnel to foster continuity of supply and best practices. On November 18, 2013, the Company signed an asset purchase agreement with Jabil, whereby Jabil will purchase SGI’s primary manufacturing facility, located in Chippewa Falls, Wisconsin and certain other manufacturing assets for $6.3 million in cash.

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SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

The total carrying of these assets held for sale were written down to their fair value of $6.3 million, resulting in an impairment charge of $0.9 million recorded in general and administrative expenses during the three and six months ended December 27, 2013.

In addition, SGI expects that approximately 130 of its manufacturing personnel in Chippewa Falls will transfer to Jabil. No other workforce transfers or reductions are contemplated at this time as a result of the transaction. As part of the employee transition, the Company accrued approximately $0.7 million of compensation costs associated with the transfer of these employees as part of the agreement with Jabil which was recorded within cost of revenue.

The final terms of the master service and transition agreements with Jabil are subject to execution of definitive contracts, which are expected to close in February 2014.

6. FINANCIAL INSTRUMENTS AND FAIR VALUE

The Company measures its assets and liabilities at fair value based upon the expected exit price, representing the amount that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value reflects 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 Company uses a three-level 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 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.

The Company's assessment of the hierarchy level of the assets or liabilities measured at fair value is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company considers an active market to be one in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis, and views an inactive market as one in which there are a few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers. Where appropriate, the Company or the counterparty's non-performance risk is considered in determining the fair values of liabilities and assets, respectively.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the Company's assets that are measured at fair value on a recurring basis (in thousands):

	December 27, 2013				
	Carrying	Fair Value Measured Using			Total
	Value	Level 1	Level 2	Level 3	Balance
Assets					
Money market funds	$20,022	$20,022	$—	$—	$20,022
Investments held by insurance companies	5,549	—	5,549	—	5,549
Derivative assets	1,342	—	1,342	—	1,342
Total assets measured at fair value	$26,913	$20,022	$6,891	$—	$26,913
Liabilities					
Derivative liabilities	$3,121	$—	$3,121	$—	$3,121
Total liabilities measured at fair value	$3,121	$—	$3,121	$—	$3,121

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SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

	June 28, 2013				
	Carrying	Fair Value Measured Using			Total
	Value	Level 1	Level 2	Level 3	Balance
Assets					
Money market funds	$20,015	$20,015	$—	$—	$20,015
Investments held by insurance companies	5,549	—	5,549	—	5,549
Derivatives assets	69	—	69	—	69
Total assets measured at fair value	$25,633	$20,015	$5,618	$—	$25,633
Liabilities					
Derivative liabilities	$208	$—	$208	$—	$208
Total liabilities measured at fair value	$208	$—	$208	$—	$208

There were no transfers between Level 1 and Level 2 of the fair value hierarchy during the three and six months ended December 27, 2013 and December 28, 2012. The Company's cash equivalents, consisting of money market funds, are classified within Level 1 of the fair value hierarchy as they were valued using quoted market prices of the identical underlying securities in active markets.

Level 2 assets include investments that are pooled with other investment held by insurance companies within their general funds for our pension plans. The investments held by the insurance companies are valued by taking the percentage owned by the plan in the underlying net asset value of the insurance company's general fund. The valuation of the underlying net assets of the insurance company's general fund is based on quoted market prices of the investments in active markets or for quoted market prices in active markets of similar assets. The market inputs used to value these instruments generally consist of market yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. Pricing sources include industry standard data providers, security master files from large financial institutions and other third party sources. Our derivative financial instruments are classified within Level 2, as there is not an active market for each hedge contract, but the inputs used to calculate the value of the instruments are tied to active markets.

The fair values of accounts receivable, accounts payable, and accrued liabilities, due within one year approximates their carrying values because of their short-term nature.

Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

Long-Lived Assets

Long-lived assets held for sale which had a carrying amount of $6.3 million, net of an impairment charge of $0.9 million which was included in net income for the three and six months ended December 27, 2013. The assets held for sale as of December 27, 2013, relate to assets that will be sold to Jabil to assist in the transition to Jabil to be our global manufacturing services and supply chain management provider. Fair values for the impaired long-lived assets were measured using Level 3 inputs. See Note 5 for more information regarding the contract manufacturing transition. As of June 28, 2013, the Company had no assets or liabilities measured at fair value on a non-recurring basis.

7. DERIVATIVES

The Company is exposed to foreign currency exchange rate fluctuations in the normal course of our business. As part of the Company's risk management strategy, we use derivative instruments, primarily forward contracts to hedge economic exposures resulting from changes in foreign currency exchange rates.

Cash Flow Hedges

Beginning in fiscal 2014, we implemented a cash flow hedging strategy to protect anticipated non-functional currency revenues and expenses. The Company uses forward contracts designated as cash flow hedges to hedge a portion of future forecasted non-U.S. Dollar ("USD") cash flows. In general, these foreign exchange contracts, carried at fair value, have maturities between one and twelve months. As of December 27, 2013, the Company has 21 open hedges with an average notional amount in USD equivalent to approximately $1.1 million. The Company currently designates hedges for the Euro, British Pound and the Australian Dollar. These derivative instruments are designated and qualify as cash flow hedges under the criteria prescribed in the authoritative guidance. All amounts related to gains / losses on designated hedges, currently in accumulated other comprehensive income ("AOCI") are expected to be reclassified into earnings over the next 12 months.

SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

For derivative instruments that are designated and qualify as cash flow hedges under Accounting Standards Codification ("ASC") No. 815-Derivatives and Hedging, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive loss and reclassified into earnings into the same financial statement line as the item being hedged. SGI assesses the prospective and retrospective effectiveness of its hedge programs using statistical analysis. The Company uses the spot-to-spot method to measure ineffectiveness in the hedge relationship. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net. For derivative instruments that are not designated as hedging instruments under ASC No. 815 or that have been de-designated following recognition of the hedge item, gains and losses are recognized in other income (expense), net.

Balance Sheet Hedges

Additionally, the Company enters into foreign exchange contracts to hedge monetary assets and liabilities that are denominated in currencies other than the functional currency of our subsidiaries. These foreign exchange contracts are carried at fair value and do not qualify for hedge accounting treatment and are not designated as hedging instruments. Changes in fair value of these derivatives are recognized in other income (expense), net in the condensed consolidated statement of operations, in the current period, along with the offsetting foreign currency gain or loss on the underlying assets or liabilities. As of December 27, 2013, the Company has 32 open non-designated hedges with an average USD-equivalent notional amount of approximately $0.9 million.

The before tax effect of derivative instruments for foreign exchange contracts designated as hedging instruments and non-designated hedging instruments in our condensed consolidated statement of operations during the three and six months ended December 27, 2013 and December 28, 2012 was as follows (in thousands):

	Location	Three Months Ended		Six Months Ended	
		December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Designated Derivatives					
Cash Flow Hedges:					
Foreign exchange contracts (Effective portion)	Amount recognized in AOCI	$(206)	$—	$(1,251)	$—
Foreign exchange contracts (Effective portion)	Net revenues	(493)	—	(648)	—
Foreign exchange contracts (Effective portion)	Operating expenses	354	—	422	—
Foreign exchange contracts (Effective portion)	Other income (expense), net	38	—	88	—
Total		$(307)	$—	$(1,389)	$—
Non-designated Derivatives					
Foreign exchange contracts	Other income (expense), net	$284	$566	$840	$1,122
Total		$284	$566	$840	$1,122

The Company's use of derivative instruments exposes it to non-performance risk to the extent that the counterparties may be unable to meet the terms of the agreement. The Company does, however, seek to mitigate such risks by limiting our counterparties to major financial institutions which are selected based on their credit ratings and other factors. The Company has established policies and procedures for mitigating non-performance risk that include establishing counterparty credit limits, monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Therefore the Company does not consider counterparty non-performance risk a material risk at this time.

A number of the Company's derivative agreements contain threshold limits to the net liability position with counterparties and are dependent on the Company's corporate credit rating determined by the major credit rating agencies. The counterparties to the derivative instruments may request collateralization, in accordance with derivative agreements, on derivative instruments in net liability positions.

The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a net liability position as of December 27, 2013, was $1.8 million. The credit-risk-related contingent features underlying these agreements had not been triggered as of December 27, 2013.

As of December 27, 2013, the Company has designated derivatives with notional values of approximately $48.6 million and non-designated derivatives with notional values of approximately $18.9 million in Euro, British Pound, Canadian Dollar, Australian Dollar, Japanese Yen and other currencies.

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Derivative instruments are subject to master netting arrangements and are disclosed gross in the statement of financial position. The gross fair values and location of derivative instruments included in the condensed consolidated statement of financial position as of December 27, 2013 were as follows (in thousands):

Offsetting of Derivative Assets

	Gross Amount Offset In the Statement of Financial Position			Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amount of Recognized Assets	Gross Amount Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives						
Foreign currency forward contracts	$1,342	$—	$—	$(1,342)	$—	$—
Total	$1,342	$—	$—	$(1,342)	$—	$—

Offsetting of Derivative Liabilities

	Gross Amount Offset In the Statement of Financial Position			Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Pledged	Net Amount
Derivatives						
Foreign currency forward contracts	$(3,121)	$—	$—	$1,342	$—	$(1,779)
Total	$(3,121)	$—	$—	$1,342	$—	$(1,779)

The gross fair value and location of derivative instruments held in the condensed consolidated statement of financial position as of December 27, 2013 and June 28, 2013 were as follows (in thousands):

Fair Values of Derivative Instruments

Asset Derivatives			Liability Derivatives		
Location	December 27, 2013	June 28, 2013	Location	December 27, 2013	June 28, 2013
Designated Derivatives:					
Foreign exchange contracts			Foreign exchange contracts		
Other current assets	$ 490	$—	Other current liabilities	$ 1,525	$—
Non- designated Derivatives:					
Foreign exchange contracts			Foreign exchange contracts		
Other current assets	852	69	Other current liabilities	1,596	208
Total derivatives	$ 1,342	$69		$ 3,121	$208

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The following table provides the balances and changes in the accumulated other comprehensive loss (income) related to derivative instruments during the six months ended December 27, 2013 (in thousands):

	Amount
AOCI - Beginning balance of losses or (gain)	$—
Loss recognized in OCI on derivatives (effective portion) before reclassifications	1,251
Loss reclassified to income	(226)
AOCI - Ending balance of losses	$1,025

See Statement of Comprehensive (Loss) Income and Note 6 for more information regarding derivatives.

8. INVENTORIES

Inventories consist of the following (in thousands):

	December 27, 2013	June 28, 2013
Finished goods	$27,717	$11,332
Work in process	18,088	20,716
Raw materials	25,689	29,722
Total inventories	$71,494	$61,770

Finished goods include inventory in transit, at customer sites undergoing installation, or testing prior to customer acceptance; such amounts were $12.8 million at December 27, 2013 and $2.6 million at June 28, 2013.

9. PREPAID EXPENSES AND OTHER CURRENT ASSETS

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

	December 27, 2013	June 28, 2013
Value-added tax receivable	$6,587	$5,626
Deferred tax assets	282	281
Prepaid taxes	1,390	1,229
Other prepaid and current assets	6,011	6,958
Assets held for sale	6,300	—
Total prepaid expenses and other current assets	$20,570	$14,094

Assets held for sale of $6.3 million relate to SGI’s primary manufacturing facility, located in Chippewa Falls, Wisconsin and certain other manufacturing assets that are being sold to Jabil as part of an asset purchase agreement as we transition manufacturing and supply chain management to Jabil. See Note 5 for additional information related to our contract manufacturing transition activities.

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10. INTANGIBLE ASSETS, NET

Intangible assets by major asset class consist of the following (in thousands):

Intangible Asset Class	Weighted Average Useful Life (in Years)	December 27, 2013 Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	5	$7,300	$ (6,465)	$835
Purchased technology	5	12,200	(6,697)	5,503
Customer backlog	(a)	10,540	(9,710)	830
Trademark/trade name portfolio	5	3,767	(3,435)	332
Patents and other	2(b)	330	(200)	130
Total		$34,137	$ (26,507)	$7,630

Intangible Asset Class	Weighted Average Useful Life (in Years)	June 28, 2013 Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	5	$6,900	$(5,750)	$1,150
Purchased technology	5	7,800	(6,000)	1,800
Customer backlog	(a)	10,540	(9,572)	968
Trademark/trade name portfolio	5	3,667	(3,072)	595
Patents and other	2(b)	330	(200)	130
Total		$29,237	$(24,594)	$4,643

(a) The customer backlog intangible asset is amortized as revenue recognition criteria is met for a particular customer order, reflecting the use of the asset.
(b) Includes other intangible asset with an indefinite life.

Intangible assets amortization expense was $1.1 million and $0.9 million in the three months ended December 27, 2013 and December 28, 2012, respectively. Intangible assets amortization expense was $2.0 million and $1.9 million in the six months ended December 27, 2013 and December 28, 2012, respectively.

As of December 27, 2013, expected amortization expense for all intangible assets was as follows (in thousands):

Fiscal Year	Amortization Expense
2014 (remaining six months)	$2,029
2015	1,345
2016	1,264
2017	1,230
2018	572
Thereafter	1,060
	$7,500

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11. OTHER ASSETS

Other assets consist of the following (in thousands):

	December 27, 2013	June 28, 2013
Long-term service inventory	$15,630	$15,045
Restricted pension plan assets	8,298	7,822
Deferred tax assets	5,764	5,764
Long-term refundable deposits	3,049	3,178
Goodwill	8,781	1,531
Other assets	807	944
Total other assets	$42,329	$34,284

12. OTHER CURRENT LIABILITIES

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

	December 27, 2013	June 28, 2013
Accrued sales and use tax payable	$8,618	$9,545
Deferred tax liabilities	5,292	5,292
Accrued professional services fees	3,914	3,635
Accrued warranty, current portion	3,768	3,303
Income taxes payable	787	491
Accrued restructuring and severance	2,808	3,965
Other	10,718	9,133
Total other current liabilities	$35,905	$35,364

13. OTHER NON-CURRENT LIABILITIES

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

	December 27, 2013	June 28, 2013
Accrued warranty, non-current portion	$2,344	$2,319
Other	1,284	1,471
Total other non-current liabilities	$3,628	$3,790

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14. WARRANTY RESERVE

Activity in the warranty reserve, which is included in other current and non-current liabilities, was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Balance at beginning of period	$5,600	$7,261	$5,622	$7,302
Current period accrual	470	1,054	1,111	2,254
Warranty expenditures charged to accrual	(901)	(1,133)	(1,721)	(2,400)
Changes in accrual for pre-existing warranties	943	(641)	1,100	(615)
Balance at end of period	$6,112	$6,541	$6,112	$6,541

15. RESTRUCTURING ACTIVITY

On March 16, 2012, the Company's Board of Directors approved a restructuring action to reduce approximately 25% of the Company's European workforce and close certain legal entities and offices in Europe.

In connection with the restructuring action, the Company expects to incur pre-tax cash charges (including charges recorded in fiscal 2012 and 2013) of approximately $13.0 million, consisting of charges of approximately $12.0 million for employee termination benefits and up to $1.0 million for the planned office and legal entity closures, including contract termination costs and other associated costs. Total expense incurred in connection with this restructuring plan for actions taken through December 27, 2013 was $12.0 million.

The restructuring expense is included in operating expenses in the accompanying condensed consolidated statements of operations. The total restructuring liability was $1.3 million as of December 27, 2013, all of which is classified as current liabilities in the accompanying condensed consolidated balance sheet.

Activity in accrued restructuring for this restructuring action through December 27, 2013 was as follows (in thousands):

	Employee Terminations
Balance at June 28, 2013	$2,417
Costs incurred	526
Cash payments	(1,176)
Balance at September 27, 2013	1,767
Costs incurred	111
Cash payments	(592)
Balance at December 27, 2013	$1,286

16. CREDIT FACILITY

On December 5, 2011, the Company entered into a five-year senior secured credit facility in the aggregate principal amount of $35.0 million. The availability under the credit facility is limited to a borrowing base, subject to meeting certain conditions set forth in the credit facility. The credit facility includes a feature that allows the Company to increase the revolver amount in the first 18 months. The Company exercised this feature, and on May 1, 2012, the revolver amount was increased by $5.0 million to an aggregate principal amount of $40.0 million. On February 25, 2013, the Company amended the agreement and reduced the revolver amount to $25.0 million. The credit facility includes a $10.0 million letter of credit subfacility. See Note 24 "Commitments and Contingencies" for more information regarding the letter of credit.

The availability of the aggregate principal amount under the credit facility will fluctuate, generally monthly, based on eligible domestic accounts receivable and inventory due to a variety of factors including the Company's overall mix of sales and resulting accounts receivable with international and domestic customers, United States governmental agencies and a few individual customer accounts which may result in high concentrations of accounts receivable as compared to the overall level of the Company's accounts receivable. The credit facility contains financial covenants including, under certain conditions, maintaining a minimum fixed charge coverage ratio, as well as other non-financial covenants, including restrictions on declaring and paying dividends, and is secured by substantially all of the Company's assets. The credit facility terminates on December 5, 2016. Borrowings under the credit facility bear interest based on a rate of the Company's choice equal to either: 1) the LIBOR plus a margin of 2.50 percent per annum or 2) the base rate plus a margin of 1.75 percent per annum. The base rate is the greater of (a) the Federal Funds rate plus 0.50 percent, (b) the LIBOR rate plus 1.00 percent or (c) the prime rate of the financial institution. The LIBOR rate and the base rate are determined at the specified date preceding or at the time of the borrowing in accordance with the terms of the credit facility. In addition, unused line fees are payable on the credit facility at rates of 0.25 percent per annum.

As of December 27, 2013, the Company had no outstanding balance owed on the credit facility. As of December 27, 2013, the maximum amount available to be borrowed under the credit facility was approximately $23.0 million, which takes into account a $2.0 million outstanding letter of credit to back the Company's obligation to pay for goods or services to a supplier.

On January 16, 2014, the Company amended the credit facility to revise certain defined terms, to obtain consent for the Company’s proposed sale of manufacturing operations assets to Jabil and to obtain a release of liens with respect to such assets. The amendment also provided a waiver for certain technical defaults under the credit facility created by the Company relocating to Milpitas, CA and entering into the asset purchase agreement with Jabil. As of the date of the amendment, the Company was in compliance with all covenants under the credit facility.

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17. SHARE-BASED COMPENSATION

During the three and six months ended December 27, 2013 and December 28, 2012, the Company granted stock options and restricted stock units to employees and non-employee directors under its 2005 Equity Incentive Plan and issued shares of the Company's common stock to participating employees under its 2005 Employee Stock Purchase Plan. During the three months ended December 28, 2012, the Company granted stock options to employees and non-employee directors under its 2005 Equity Incentive Plan; however, during the three months ended December 27, 2013, no stock options were granted. Total share-based compensation expense was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Cost of revenue	$459	$371	$901	$871
Research and development	706	588	1,213	1,127
Sales and marketing	748	423	1,327	809
General and administrative	1,604	1,114	3,052	2,200
Total share-based compensation expense	$3,517	$2,496	$6,493	$5,007

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		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Option Plan Shares				
Risk-free interest rate	N/A	0.7 %	N/A	0.7 %
Volatility	N/A	67.6 %	N/A	67.6 %
Weighted average expected life (in years)	N/A	5.00	N/A	5.00
Expected dividend yield	N/A	—	N/A	—
Weighted average fair value	N/A	$3.67	N/A	$3.67
ESPP Plan shares				
Risk-free interest rate	0.2 %	0.2 %	0.2 %	0.2 %
Volatility	60.9 %	83.0 %	60.9 %	83.0 %
Weighted average expected life (in years)	1.25	1.25	1.25	1.25
Expected dividend yield	—	—	—	—
Weighted average fair value	$6.08	$4.39	$6.08	$4.39

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Stock Option Activity

A summary of stock option activity for the six months ended December 27, 2013 was as follows:

	Options Outstanding			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual term in years	Aggregate Intrinsic Value
				(in thousands)
Balance at June 28, 2013	2,281,401	$10.56		
Options granted	—	—		
Options exercised	(404,110)	8.02		
Options cancelled	(107,003)	20.77		
Balance at December 27, 2013	1,770,288	$10.52	6.18	$6,338
Vested and expected to vest at December 27, 2013	1,703,953	$10.55	6.11	$6,028
Exercisable at December 27, 2013	1,303,005	$10.64	5.56	$4,704

The total intrinsic value of options exercised in the six months ended December 27, 2013 and December 28, 2012 was $3.3 million and $0.4 million, respectively. The total fair value of shares vested during the six months ended December 27, 2013 and December 28, 2012 was $1.5 million and $2.1 million, respectively.

As of December 27, 2013, there was $0.8 million of total unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a weighted average period of 1.02 years.

Restricted Stock Unit Activity

The following table summarizes the Company's activity with respect to restricted stock units (“RSUs”) for the six months ended December 27, 2013:

	Number of Shares
Balance at June 28, 2013	1,337,767
Awarded	876,479
Released	(266,196)
Forfeited	(94,439)
Balance at December 27, 2013	1,853,611
Vested and expected to vest at December 27, 2013	1,431,257

In August 2013, the Company granted time-based RSUs ("executive time-based RSUs") and performance-based RSUs (“executive PSUs”) to members of the Company's executive management team. The executive time-based RSUs vest quarterly over four years, subject to the recipient's continuous service through each vesting date. The executive PSUs are eligible to vest upon the achievement of certain financial performance criteria for the Company for fiscal 2014. If the performance criteria are not met, none of the executive PSUs will vest and will be forfeited. If the performance criteria are met, 25% of the executive PSUs would vest following the Company's public announcement of financial results for fiscal 2014 and the remaining 75% of the executive PSUs would vest in twelve quarterly installments thereafter, subject to the recipient's continued service through each vesting date. For purposes of reporting and determining the share-based compensation expense as of December 27, 2013, the Company estimated that none of the PSUs will be awarded. The Company assesses the achievement of these performance metrics on a quarterly basis.

As of December 27, 2013, there was $10.2 million of total unrecognized compensation cost related to RSUs, which is expected to be recognized over a weighted average period of 2.59 years.

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RSUs are converted into common stock upon vesting. Upon the vesting of restricted stock, the Company generally uses the net share settlement approach, which withholds a portion of the shares to cover the applicable taxes and decreases the shares issued to the employee by a corresponding value. The withholding tax obligations are based upon the fair market value of the Company's common stock on the vesting date. The number and the value of the shares netted for employee taxes are summarized in the table below (in thousands except share amounts):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
RSUs shares withheld for taxes	46,486	22,764	102,416	47,145
RSUs amounts withheld for taxes	$578	$188	$1,442	$375

Employee Stock Purchase Plan

At December 27, 2013, the total compensation cost related to options to purchase the Company's common stock under the employee stock purchase plan ("ESPP") was approximately $0.7 million. This cost will be amortized on a straight-line basis over approximately 1.9 years. The following table shows the shares issued and their respective weighted-average purchase price per share, pursuant to the ESPP, during the three and six months ended December 27, 2013 and December 28, 2012.

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Shares issued	253,078	256,972	253,078	256,972
Weighted-average purchase price per share	$7.89	$6.76	$7.89	$6.76

18. STOCK REPURCHASE PROGRAM

In January 2013, the Company's board of directors approved a plan for the Company to repurchase shares of its common stock with a market value of up to $15.0 million. In November 2013, the Company announced an increase in the authorized repurchased amount to $30.0 million. The Company's common stock may be repurchased in the open market or through negotiated transactions, including 10b5-1 trading plans that would enable the Company to repurchase its shares during periods outside of its normal trading windows. The repurchase program expires December 31, 2014. Purchases will cease if the authorized funds are spent or the program is discontinued. The Company is not obligated to acquire any particular amount of stock, and the program may be suspended or terminated at any time at the Company's discretion.

These repurchases are reflected in our balance sheet as treasury stock and are available for future issuance. The following table shows the total number of shares repurchased during the period (in thousands, except per share amount):

	Treasury Stock		
	Number of Shares	Amount	Average Purchase Price Per Share
Balance at June 28, 2013	946	$7,692	$8.13
Repurchase of Treasury Stock:			
Three months ended September 27, 2013	200	3,056	15.28
Three months ended December 27, 2013	360	4,749	13.19
Balance at December 27, 2013	1,506	$15,497	$10.29

Since the inception of the repurchase plan in January 2013, the Company has repurchased approximately 758,000 shares of its common stock for $10.6 million. As of December 27, 2013, the Company had a remaining authorization of $19.4 million for future share repurchases.

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19. EARNINGS PER SHARE

Basic net income (loss) per common share is computed by dividing unaudited consolidated net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing unaudited consolidated net income (loss) by the weighted average number of common shares outstanding and dilutive common shares outstanding during the period. The dilutive effect of outstanding options and RSUs is reflected in diluted net income per share, but not diluted loss per share, by application of the treasury stock method, which includes consideration of share-based compensation required by accounting principles generally accepted in the U.S.

The following table sets forth the computation of basic and diluted net (loss) income per share for the three and six months ended December 27, 2013 and December 28, 2012 (in thousands, except per share amount):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Numerator:				
Net (loss) income	$(13,684)	$ 1,101	$(20,507)	$(7,579)
Denominator:				
Weighted-average common shares - basic	34,176	32,410	34,136	32,289
Effect of dilutive potential common shares	—	368	—	—
Weighted-average common shares - diluted	34,176	32,778	34,136	32,289
Basic net (loss) income per share	$(0.40)	$ 0.03	$(0.60)	$(0.23)
Diluted net (loss) income per share	$(0.40)	$ 0.03	$(0.60)	$(0.23)

The following potential common shares have been excluded from the basic net loss per share calculations, as their effect would have been anti-dilutive (in thousands):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Options, RSUs, and ESPP	3,810	4,657	3,842	5,068

20. RETIREMENT BENEFIT PLAN

Defined Benefit Plans

The Company sponsors defined benefit plans covering certain of its employees in Germany ("German plan") and Japan ("Japan plan").

The net periodic benefit cost of the German and Japan plans were comprised of the following components (in thousands):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Net periodic benefit cost				
Service cost	$110	$185	$219	$354
Interest expense	75	143	204	282
Expected return on plan assets	(37)	(47)	(78)	(93)
Amortization of actuarial losses	22	85	52	85
Net periodic benefit cost	$170	$366	$397	$628

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21. INCOME TAXES

The Company recorded a tax provision of approximately $0.4 million each for the three and six months ended December 27, 2013. The tax provision primarily was comprised of tax liability computed based on the Company’s projected full-year foreign taxes, state taxes, and tax reserves and related interest, offset by tax benefits from the reversal of previously accrued interest and tax refund in foreign jurisdiction. The effective tax rate differed from the combined federal and net state statutory income tax rate for the three and six months ended December 27, 2013 primarily due to the tax rate differential of the Company's foreign operations and utilization of net operating losses not previously recognized

The Company recorded a tax benefit of $3.9 million and $3.5 million for the three and six months ended December 28, 2012. The tax benefit primarily was comprised of the reversal of previously recorded unrecognized tax benefits primarily in Canada, offset by tax liability computed based on the Company’s projected foreign financial results for the year ended June 28, 2013, state taxes, and tax and interest for unrecognized tax benefits. The reversal in Canada was the result of an abatement of interest granted by Canada Revenue Agency in connection with an audit, which concluded during fiscal year 2013. The effective tax rate differed from the combined federal and net state statutory income tax rate for the three and six months ended December 28, 2012 primarily due to the tax rate differential of the Company's foreign operations, utilization of net operating losses, audit settlements and reversals of previously accrued taxes in foreign jurisdictions.

As of December 27, 2013, the Company has provided a partial valuation allowance against its 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 $5.7 million of gross unrecognized tax benefit as of December 27, 2013, of which $2.4 million will impact the effective tax rate when recognized. The Company recognizes interest expense and penalties related to the unrecognized tax benefits within income tax expense. As of December 27, 2013, the Company also had approximately $8.1 million of interest and penalties attributable to the gross unrecognized tax benefits. It is reasonably possible that over the next twelve-month period the Company may experience an increase or decrease in its unrecognized tax benefits.

22. SEGMENT INFORMATION

Commencing in the first quarter of fiscal 2014, the Company started managing its business primarily on a business unit basis versus the geographic basis previously used by management. Accordingly, the Company has determined its operating and reporting segments, which is based on the business unit structure, to be Compute, Storage and Service. The Company's operating segments are determined based upon several criteria including: the Company's internal organizational structure; the manner in which the Company's operations are managed; the criteria used by the Company's Chief Executive Officer, the Chief Operating Decision Maker (“CODM”), to evaluate segment performance; and the Company's availability of separate financial information.

A description of Company's three reportable segments is as follows:

Compute—The Compute solutions segment include our scale-out computing, scale-up computing, software and cloud/web solutions. Compute solutions also include integrated third-party hardware and software products that we sell to provide a single source solution for our customers. Our compute solutions are designed to minimize the number and complexity of interconnects for power and data transfer to improve reliability, speed of implementation and serviceability.

Storage—The Storage solutions segment include both hardware and software offerings to address virtually every type of data storage and management requirement. Products range from entry-level disk arrays to complex storage systems, with innovative technology and hardware, to include the SGI Modular InfiniteStorage™ platform, SGI InfiniteStorage™

gateway and SGI CXFS™ file system. Our storage solutions are designed to provide extreme scale, broad flexibility, and to minimize the cost to store data.
Service—The Service segment is comprised of customer service support and professional services. Our customer support organization provides ongoing maintenance and technical support for our products and some third-party products, as well as contracted maintenance services, hardware deployment services (install and de-install), time and materials-based services and spare parts. Our professional services organization provides value added services associated with technology consulting, project management and customer education, all of which help our customers realize the full value of their information technology investments.

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All historical segment numbers for the three and six months ended December 28, 2012 have been recasted to conform to the three and six months ended December 27, 2013.

The Company's CODM evaluates the performance of its operating segments based on revenue and operating profit (loss). Revenues are generally allocated based on the type of products and service provided to our customers. Operating profit (loss) for each segment includes related cost of sales and operating expenses directly attributable to the segment. A portion of the segments' expenses arise from shared services and infrastructure that the Company provides to the segments in order to realize economies of scale and to efficiently use resources. These expenses, collectively called corporate charges, include costs of centralized research and development and other corporate infrastructure expenses. The corporate charges that are directly attributable to the segments are allocated and are reassessed on a periodic basis. The allocations have been determined on a basis that the Company considers to be a reasonable reflection of the utilization of services provided to or benefits received by the segments. The profitability of each of the segments is measured after excluding share based compensation expenses, amortization of intangibles, restructuring charges, manufacturing transition costs, general and administration charges, other unallocated corporate charges and other items as noted in the reconciliation below as management does not include this information in its measurement of the performance of the operating segments.

Segment Results

Summary information by operating segment for the three and six months ended December 27, 2013 and December 28, 2012 is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Total net revenue				
Compute	$60,418	$ 109,129	$149,260	$ 239,929
Storage	16,916	18,911	36,894	34,426
Service	38,726	43,186	77,425	89,752
Total net revenue	$116,060	$ 171,226	$263,579	$ 364,107
Operating profit from reportable segments				
Compute	$(2,784)	$ 7,175	$(583)	$ 10,976
Storage	(495)	618	1,527	(446)
Service	15,343	14,079	30,418	29,027
Total operating profit from reportable segments (1)	$12,064	$ 21,872	$31,362	$ 39,557

(1) The profitability of each of the segments is measured after excluding unallocated corporate charges, restructuring and severance, amortization of intangibles, share based compensation expenses, manufacturing transition costs, and other items as noted in the reconciliation below.

SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

The following table reconciles segment results to our total company results from operations before taxes:

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
	(in thousands)			
Total reportable segments' operating profit	$12,064	$21,872	$31,362	$39,557
All other corporate charges:				
Unallocated operating expenses	18,373	18,221	36,143	37,532
Restructuring and severance	1,136	3,529	2,065	5,413
Amortization of intangibles	1,051	944	1,886	1,916
Share based compensation	3,517	2,496	6,493	5,007
Manufacturing transition costs	2,206	—	2,206	—
Excess and obsolescence inventory charges	—	—	3,242	—
Other	673	(438)	1,409	(438)
Total all other corporate charges	26,956	24,752	53,444	49,430
Loss from operations, as reported	$(14,892)	$(2,880)	$(22,082)	$(9,873)

The Company derives the results of the business segments directly from its internal management reporting system. The presentation of our revenue for segment information purposes differs from the accompanying unaudited condensed consolidated statements of operations. The segment information is presented on the basis which the Company's CODM evaluates the performance of its operating segments. The combined product and service revenue is allocated to product and service revenue on a contractual basis for segment information purposes.

The Company's assets are located primarily in the United States and are not allocated to any specific region. The Company does not measure the performance of its business segments on any asset-based metrics. Therefore, reportable segment information is presented only for revenue and operating profit (loss).

Customer information

For the three months ended December 27, 2013, various agencies of the United States government, excluding system integrators (collectively, U.S. government), accounted for approximately 15% of the Company's revenue. For the three months ended December 28, 2012, one customer accounted for approximately 19% of the Company's revenue and various agencies of the United States government (collectively, U.S. government) accounted for approximately 11% of the Company's revenue.

At December 27, 2013, one customer accounted for approximately 10% of the Company's accounts receivable. At June 28, 2013, one customer accounted for approximately 20% of the Company's accounts receivable.

For the six months ended December 27, 2013, various agencies of the U.S. government, excluding system integrators, accounted for approximately 23% of the Company's revenue. For the six months ended December 28, 2012, one customer from the Americas segment accounted for approximately 18% of the Company's revenue and various agencies of the U.S. government, excluding system integrators, accounted for approximately 13% of the Company's revenue.

SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

Geographic Information

The following table presents revenue by geographic region for the three and six months ended December 27, 2013 and December 28, 2012 (in thousands except percentages):

	Three Months Ended			Six Months Ended		
	December 27, 2013	December 28, 2012	2014 over 2013 Change	December 27, 2013	December 28, 2012	2014 over 2013 Change
Americas	$62,648	$112,358	(49,710)	$164,860	$235,743	(70,883)
As a percent of total net revenue	54.0%	65.6%	(11.6)%	62.5%	64.8%	(2.3)%
EMEA	29,029	31,133	(2,104)	50,070	56,195	(6,125)
As a percent of total net revenue	25.0%	18.2%	6.8%	19.0%	15.4%	3.6%
APJ	24,383	27,735	(3,352)	48,649	72,169	(23,520)
As a percent of total net revenue	21.0%	16.2%	4.8%	18.5%	19.8%	(1.3)%
Total revenue	$116,060	$171,226	(55,166)	$263,579	$364,107	(100,528)

The Americas geographic region includes both North and South America. The Europe geographic region ("EMEA") includes European countries, as well as the Middle East and Africa. The Asia-Pacific geographic region ("APJ") includes Australia, Japan and all other Asian countries.

International sales to Japan, the only single foreign country which accounted for 10% or more of total revenue, were $18.1 million or 16% of revenue and $35.0 million or 13% of revenue for the three and six months ended December 27, 2013, respectively. For the three months and six ended December 28, 2012, our international sales to Japan, the only single foreign country which accounted for ten percent or more of revenues, were $18.6 million or 11% of revenue and $55.0 million or 15% of revenue, respectively. No other individual foreign country's revenue accounted for 10% or more of revenues in the three and six months ended December 27, 2013 and December 28, 2012.

SILICON GRAPHICS INTERNATIONAL CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

23. FINANCIAL GUARANTEES

The Company has issued financial guarantees to cover rent on leased facilities and equipment, to government authorities for value-added tax 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 December 27, 2013 was $4.8 million for which the Company has $4.6 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 in the accompanying unaudited condensed consolidated balance sheets.

24. COMMITMENTS AND CONTINGENCIES

Letter of Credit

The Company's credit facility includes a $10.0 million letter of credit subfacility. As of December 27, 2013, the Company has a $2.0 million outstanding letter of credit to back the Company's obligation to pay or perform when required to do so pursuant to the requirements of an underlying agreement or the provision of goods or services to a supplier. See Note 16 for more information regarding the credit facility.

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 December 27, 2013. As a result, the Company believes the estimated fair value of these indemnification agreements, if any, to be immaterial; accordingly, no liability has been recorded with respect to such indemnifications as of December 27, 2013.

Contingencies

The Company may, from time to time, be involved in legal proceedings and disputes that arise in the normal course of business. These matters include product liability actions, patent infringement actions, contract disputes, domestic and international federal, state and local tax reviews and audits and other matters. The Company also may be subject to litigation and/or adverse rulings or judgments as a result of certain contractual indemnification obligations. 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.

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 proven, 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.

Additionally, 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.

The Company is not aware of any pending disputes, including those outlined above, that would be likely to have a material adverse effect, either individually or in the aggregate, 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.

Other Commitments

For a description of significant leases and purchase commitments see Note 23 of the Company's Annual Report on Form 10-K filed with the SEC on September 9, 2013.

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. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. 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, changes in the anticipated amounts and timing of restructuring charges to be incurred and cost savings expected to be realized from our restructuring actions in Europe, our ability to successfully execute our strategies, the risks discussed in this Part I, Item 2 -"Management's Discussion and Analysis of Financial Condition and Results of Operations,” the risk factors set forth in Part II, Item 1A- "Risk Factors” and elsewhere in this Form 10-Q, the risk factors set forth in our Annual Report on Form 10-K for the year ended June 28, 2013 filed with the Securities and Exchange Commission (the “SEC”) on September 9, 2013 (our “Annual Report”), and the risks detailed from time to time in our future reports filed with the SEC. The information included herein is as of the filing date of this Form 10-Q with the SEC and future events or circumstances could differ materially from the forward-looking statements included herein. Accordingly, we caution readers not to place undue reliance on these forward-looking statements. Unless required by law, we expressly disclaim any obligation to update or alter our forward-looking statements, whether as a result of new information, future events or otherwise. All subsequent written or oral forward-looking statements attributable to SGI or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Readers are urged to carefully review and consider the various disclosures made in this report and other documents we file from time to time with the SEC to advise interested parties of the risks and factors that may affect our business.

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto in Part I, Item 1 in this Form 10-Q and with our financial statements and notes thereto for the year ended June 28, 2013 contained in our Annual Report.

Overview

SGI is a global leader in high performance computing ("HPC"). We are focused on helping customers solve their most demanding business and technology challenges by delivering technical computing, Big Data and cloud computing solutions that accelerate time to discovery, innovation and profitability.

We develop, market and sell a broad line of low cost, mid-range and high-end scale-out and scale-up servers, enterprise-class storage hardware, differentiating software and designed-to-order solutions for large-scale deployments, coupled with global support and highly experienced professional services. SGI solutions are designed to provide greater flexibility and scalability, with lower total cost of ownership.

SGI solutions are utilized by scientific, business and government communities to fulfill highly data intensive application needs in petascale environments. Delivering industry-leading computing power and fast and efficient data movement, both within the computing system and to and from large-scale data storage installations, SGI systems enable customers to access, analyze, transform, manage and visualize information in real-time and near real-time. Our goal is to accelerate time to results in key markets including federal government, defense and strategic systems, weather and climate, physical and life sciences, energy (including oil and gas), aerospace, automotive, internet, financial services, media and entertainment and cloud services.

Management has implemented a strategic plan which will drive changes in three major areas. First, we expect market growth in our core markets of high performance computing, storage and Big Data. We believe that these are the markets that will provide the biggest growth opportunity and where we expect to gain share. We are continuing to target our investments towards key vertical markets and horizontal solutions where we can provide the highest value to our customers and differentiate our offerings to gain both market share and margins in line with our business model. Second, we have a strong suite of products and go-to-market strategy aligned with these growing opportunities. We continue to introduce new products and new configurations and have increased our portfolio of software partners. Third, management continues to focus on opportunities to enhance operational efficiency and costs, most notably through our contract manufacturing initiative that we recently announced, but also through consolidation of additional legal entities and the realization of a full year of savings from our restructuring activities. We believe that this strategic plan will help create a strong foundation for our business results in the long-term.

Our revenue mix by geography shows that we continue to have strong international presence with 48.2% and 40.3% of total revenue from sales outside of the U.S. in the three and six months ended December 27, 2013, respectively. Total revenue from sales outside of the U.S. in both the three and six months ended December 28, 2012 was 38.0% of total revenue. In addition, our customer base continues to expand in various sectors, including the public, cloud and manufacturing sectors.

Significant Events

Our financial results during the three and six months ended December 27, 2013 were affected by certain significant events that should be considered in comparing the periods presented.

Acquisition of FileTek, Inc.

On September 30, 2013, we acquired certain assets of FileTek, Inc., a global provider of Big Data storage virtualization, large-scale data management, and active archive solutions for a purchase price of $9.2 million in cash. This acquisition expands our storage solutions by enabling customers to manage data assets efficiently and lower the cost and administration of high-volume storage. Under the terms of the agreement, we acquired FileTek's StorHouse and Trusted Edge software, worldwide customers, engineering team and services and support resources.

Contract Manufacturing Transition

In July 2013, we selected Jabil Circuit, Inc. ("Jabil") as our primary global manufacturing services and supply chain management provider. The transition to Jabil will be implemented as a “manage in place” model, which utilizes existing SGI facilities and personnel to foster continuity of supply and best practices. On November 18, 2013, we signed an asset purchase agreement with Jabil, whereby Jabil will purchase SGI’s primary manufacturing facility, located in Chippewa Falls, Wisconsin and certain other manufacturing assets for $6.3 million in cash. The total carrying of these assets held for sale were written down to their fair value of $6.3 million, resulting in an impairment charge of $0.9 million recorded in general and administrative expenses during the three and six months ended December 27, 2013.

In addition, we expect that approximately 130 of our manufacturing personnel in Chippewa Falls will transfer to Jabil. No other workforce transfers or reductions are contemplated as a result of the transactions. As part of the employee transition, we accrued approximately $0.7 million of compensation costs associated with the transfer of these employees as part of the agreement with Jabil which was recorded within cost of revenue.

The final terms of our master service agreement and transition arrangement with Jabil are subject to execution of definitive agreements, which are expected to close in February 2014.

Results of Operations

Summarized below are the results of our operations for the three and six months ended December 27, 2013 as compared to the three and six months ended December 28, 2012.

Financial Highlights

- On September 30, 2013 (the "Closing Date"), the Company acquired certain assets of FileTek, Inc., a global provider of Big Data storage virtualization, large-scale data management, and active archive solutions. Pursuant to the terms of the agreement, the total purchase price was approximately $9.2 million in cash. This acquisition expands the

Company's storage solutions by enabling customers to manage data assets efficiently and lower the cost and administration of high-volume storage. Under the terms of the agreement, SGI acquired FileTek's StorHouse and Trusted Edge software, worldwide customers, engineering team and services and support resources.

- Our total revenue for the three months ended December 27, 2013 was $116.1 million, a decrease of $55.2 million or 32.2%, from the comparable period in fiscal 2013. In addition, revenue decreased $100.5 million or 27.6% in the six months ended December 27, 2013 from $364.1 million in the six months ended December 28, 2012. The decrease experienced for both the three and six month periods was due primarily as a result of lower sales for our legacy cloud product. This is consistent with our strategic decision to withdraw from low margin commodity service infrastructure and to focus our investments in strategic areas of HPC, Big Data, storage and services. In addition, we were also negatively impacted by the spending freeze instituted by the federal government prior to its shutdown during the first fiscal quarter of 2014 and the after-effects which have delayed funding for certain federal programs.

- Our overall gross margin increased by 1.0 percentage points from 27.8% in the three months ended December 28, 2012 to 28.8% in the three months ended December 27, 2013. The favorable change in the overall gross margin in the three months ended December 27, 2013 was primarily driven by a more profitable mix compared to the comparable quarter last year as we have made a strategic decision to withdraw from low margin commodity service infrastructure, as well as a decrease in compensation and related expenses due to the reductions in headcount. This was off set by a $0.7 million accrual for compensation costs associated with the transfer of employees as part of the agreement with Jabil as discussed above. Our overall gross margin increased by 2.5 percentage points from 24.7% in the six months ended December 28, 2012 to 27.2% in the six months ended December 27, 2013. The favorable change in the overall gross margin in the six months ended December 27, 2013 was primarily driven by a more profitable mix compared to the comparable period last year, as we were impacted by a few significant low margin deals during the first quarter of fiscal 2013 in Europe and Japan and our strategic decision to withdraw from low margin commodity service infrastructure. We also benefited from a decrease in compensation and related expenses due to the reductions in headcount. This was partially offset by higher excess and obsolete inventory charges incurred during the first half of fiscal 2014 compared to the first half of fiscal 2013 for inventory primarily related to our withdrawal from the legacy cloud business and the $0.7 million accrual for compensation costs associated with the transfer of employees as part of the agreement with Jabil as discussed above.
- Our research and development and selling, general and administrative expenses were $48.3 million in the three months ended December 27, 2013 compared to $47.6 million in the prior year comparable quarter, a decrease of approximately $0.7 million. The decrease was attributed to the decline in compensation and related expenses due to the reductions in headcount, along with lower spending due to tight expense controls. This was partially offset by a $0.9 million asset impairment charge and other third party costs of $0.4 million associated with our plans to transition our contract manufacturing and supply chain management to Jabil, as well as higher costs relating to the relocation of our new headquarters located in Milpitas, California. Our research and development and selling, general and administrative expenses were $93.2 million in the six months ended December 27, 2013 compared to $95.3 million in the prior year comparable period, a decrease of $2.1 million. A primary driver of this decline was the decrease in compensation and related expenses due to reductions in headcount. This was also partially offset by the asset impairment charge, contract manufacturing transition costs and relocation costs referred to above.
- Total headcount as of December 27, 2013 was 1,325, which reflects a net reduction of 117 employees or approximately 8%, from 1,442 as of December 28, 2012 due to the restructuring actions and attrition that occurred over the last twelve months, partially offset by the additional headcount acquired as part of the FileTek acquisition discussed above. The savings from the headcount reductions, along with lower bonus and commissions, contributed to the reduction in expenses. We have been controlling our costs across all functions in order to streamline our operations and reduce operating expenses.
- As part of the fiscal 2012 restructuring action primarily focused on cost reductions in Europe, we incurred restructuring expense of $0.1 million and $0.6 million in the three and six months ended December 27, 2013, respectively, compared to $2.9 million and $4.3 million in the three and six months ended December 28, 2012, respectively.
- We recognized net loss for the three months ended December 27, 2013 of $13.7 million compared to net income of $1.1 million in the comparable quarter last year. Net loss for the six months ended December 27, 2013 of $20.5 million compared to net loss of $7.6 million in the six months ended December 28, 2012. The unfavorable reductions in net income for both the three months ended December 27, 2013 compared to the comparable periods last year was primarily driven by lower sales for our legacy cloud products and U.S. government-related contracts as previously

discussed above.

- We recognized approximately $1.7 million in other income associated with the sale of an investment.
- We are continuing to streamline our operations and maintain tight controls over our spending in order to help achieve our long-term operating target goals. We are accelerating our initiatives to further penetrate the enterprise market and expect to gain visibility of funding for mission-critical government programs over the next few quarters.

Revenue, cost of revenue, gross profit and margin

Net Revenue

	Three Months Ended December 27, 2013 ($ in thousands)	December 28, 2012	2014 over 2013 Change	Six Months Ended December 27, 2013 ($ in millions)	December 28, 2012	2014 over 2013 Change
Net revenue from products:						
Compute	$60,418	$109,129	$(48,711)	$149,260	$239,929	$(90,669)
As a percent of total net revenue	52.0 %	63.7 %	(11.7)%	56.6 %	65.9 %	(9.3)%
Storage	16,916	18,911	(1,995)	36,894	34,426	2,468
As a percent of total net revenue	14.6 %	11.1 %	3.5 %	14.0 %	9.5 %	4.5 %
Net revenue from products	77,334	128,040	(50,706)	186,154	274,355	(88,201)
Net revenue from services	38,726	43,186	(4,460)	77,425	89,752	(12,327)
As a percent of total net revenue	33.4 %	25.2 %	8.2 %	29.4 %	24.6 %	4.8 %
Total net revenue	$116,060	$171,226	$(55,166)	$263,579	$364,107	$(100,528)

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 and data storage systems as well as software. We enter into sales contracts to deliver multiple products and/or services. In accordance with our revenue recognition policy, certain sales contracts are deferred and recognized over the service period. Service revenue is generated from the sale of standard maintenance contracts as well as custom maintenance contracts that are tailored to individual customers' 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.

We continuously make revisions to our product offerings and improvements of our product's performance and data storage capacity. Accordingly, we are unable to directly compare our products from period to period, and are therefore unable to quantify the changes in pricing of our products from period to period. We believe that our on-going revisions to product offerings and product feature improvements help mitigate competitive pricing pressures by shifting the competitive landscape to differentiated value rather than price. Among other things, the timing of our revenue is primarily dependent upon the funding and implementation schedule of our customers. A significant portion of our revenue relates to large IT projects, which can have long sales cycles and long build-out and acceptance schedules.

The following table presents revenue by geographic region for the three and six months ended December 27, 2013 and December 28, 2012 (in thousands except percentages):

	Three Months Ended December 27, 2013	December 28, 2012	2014 over 2013 Change	Six Months Ended December 27, 2013	December 28, 2012	2014 over 2013 Change
Americas	$62,648	$112,358	$(49,710)	$164,860	$235,743	$(70,883)
As a percent of total net revenue	54.0 %	65.6 %	(11.6)%	62.5 %	64.8 %	(2.3)%
EMEA	29,029	31,133	(2,104)	50,070	56,195	(6,125)
	25.0 %	18.2 %	6.8 %	19.0 %	15.4 %	3.6 %

As a percent of total net revenue						
APJ	24,383	27,735	(3,352)	48,649	72,169	(23,520)
As a percent of total net revenue	21.0 %	16.2 %	4.8 %	18.5 %	19.8 %	(1.3)%
Total revenue	$116,060	$171,226	$(55,166)	$263,579	$364,107	$(100,528)

The Americas geographic region includes both North and South America. The Europe geographic region ("EMEA") includes European countries, as well as the Middle East and Africa. The Asia-Pacific geographic region ("APJ") includes Australia, Japan and all other Asian countries.

Revenue generated in the Americas represented 54.0% of total revenue during the second quarter of fiscal 2014, or a decrease of 11.6 percentage points, from 65.6% during the comparable quarter last year. Revenue generated in the Americas represented 62.5% of total revenue during the six months ended December 27, 2013, or a decrease of 2.3 percentage points, from 64.8% during the comparable period last year.

Cost of revenue and gross profit

Cost of revenue and gross profit for the three and six months ended December 27, 2013 and December 28, 2012 were as follows (in thousands except percentages):

	Three Months Ended		Change		Six Months Ended		Change	
	December 27, 2013	December 28, 2012	$	%	December 27, 2013	December 28, 2012	$	%
Total cost of revenue	$82,577	$123,662	$(41,085)	(33.2)%	$191,848	$274,333	$(82,485)	(30.1)%
Total gross profit	$33,483	$47,564	$(14,081)	(29.6)%	$71,731	$89,774	$(18,043)	(20.1)%
Total gross margin	28.8%	27.8%		1.0%	27.2%	24.7%		2.5%

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. Our gross margins are impacted by changes in customer and product mix, pricing actions by our competitors and commodity prices that comprise a significant portion of cost of revenue from period to period. In addition, when certain sales contracts are deferred in accordance with our revenue recognition policy, the related cost of revenue is deferred and recognized upon recognition of revenue.

Our cost of revenue and gross profit are impacted by price changes, product configuration, revenue mix and product material costs. Our service cost of revenue and gross margin are impacted by timing of support service initiations and renewals, and incremental investments in our customer support infrastructure.

Overall gross profit decreased by $14.1 million to $33.5 million in the three months ended December 27, 2013 from $47.6 million in the three months ended December 28, 2012 due to a decrease in revenue volume primarily related to lower sales for our legacy cloud products and U.S. government-related business. However, our overall gross margin increased to 28.8% in the three months ended December 27, 2013 from 27.8% in the three months ended December 28, 2012. The increase in gross margin for the three months ended December 28, 2012 was primarily driven by a more profitable mix compared to the comparable quarter last year due to a strategic decision to withdraw from low margin commodity service infrastructure and higher mix of service revenue which typically generates higher gross margins. In addition, we benefited from the decrease in compensation and related expenses due to the reductions in headcount. This was off set by a $0.7 million accrual for compensation costs associated with the transfer of employees as part of the agreement with Jabil as discussed above.

Overall gross profit decreased by $18.0 million to $71.7 million in the six months ended December 27, 2013 from $89.8 million in the six months ended December 28, 2012 due to a decrease in revenue volume primarily related to lower sales for our legacy cloud products and U.S. government-related business. However, our overall gross margin increased to 27.2% in the six months ended December 27, 2013 from 24.7% in the six months ended December 28, 2012. The increase in gross margins for the six months ended December 27, 2013 was primarily driven by more favorable product mix due to our strategic decision to withdraw from low margin commodity server infrastructure and to focus our investments in strategic areas of HPC, Big Data, storage and services as well as a higher mix of service revenue which typically generates higher gross margins. We also benefited from the decrease in compensation and related expenses due to the reductions in headcount. This was slightly offset by higher excess and obsolete inventory charges during the six months ended December 27, 2013 compared to the six months ended December 28, 2012 as a result of our strategic withdrawal from the legacy cloud business. In addition, during the first six months of fiscal

2013, our gross margins were negatively impacted as a result of the low margin deals in Japan and Europe, impacting both our product and service margins.

Operating Expenses

Operating expenses for the three and six months ended December 27, 2013 and December 28, 2012 were as follows (in thousands except percentages):

	Three Months Ended		Change		Six Months Ended		Change	
	December 27, 2013	December 28, 2012	$	%	December 27, 2013	December 28, 2012	$	%
Research and development	$14,902	$ 15,530	$(628)	(4.0)%	$29,736	$ 29,499	$237	0.8%
Sales and marketing	18,815	19,664	(849)	(4.3)%	36,411	39,235	(2,824)	(7.2)%
General and administrative	14,547	12,383	2,164	17.5 %	27,029	26,572	457	1.7%
Restructuring	111	2,867	(2,756)	(96.1)%	637	4,341	(3,704)	(85.3)%
Total operating expense	$48,375	$ 50,444	$(2,069)	(4.1)%	$93,813	$ 99,647	$(5,834)	(5.9)%

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 decreased $0.6 million or 4.0% to $14.9 million in the three months ended December 27, 2013 from $15.5 million in the three months ended December 28, 2012. The decrease in research and development expense was primarily due to a decrease in third party provider and non-recurring engineering costs of approximately $0.9 million due to the timing of investment in new product introductions and development activities. We also experienced lower compensation and related expenses as a result of decreased headcount as well as lower bonus expense reflecting lower than expected achievement of performance metrics compared to last year. However, these reductions were offset by a reduction in third-party funding received during the second quarter of fiscal 2014 compared to the same time last year as well as higher share-based compensation expenses.

Research and development expense was $29.7 million during the six months ended December 27, 2013 or about flat compared to the six months ended December 28, 2012. We experienced lower compensation and related expenses as a result of decreased headcount as well as lower bonus expense reflecting lower than expected achievement of performance metrics compared to last year. However, these reductions were offset by higher depreciation, as we continue to invest in new product introductions and development activities, and higher share-based compensation expenses.

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 advertising.

Sales and marketing expense decreased $0.8 million or 4.3% to $18.8 million in the three months ended December 27, 2013 from $19.7 million in the three months ended December 28, 2012. This decrease was primarily due to a decrease in our compensation and related expenses as a result of decreased headcount as well as lower commissions and bonus expense reflecting lower than expected achievement of sales commission targets and performance metrics compared to last year. In addition, we incurred lower discretionary spending for travel and conferences. These reductions were slightly offset by higher share-based compensation expenses.

Sales and marketing expense decreased $2.8 million or 7.2% to $36.4 million in the six months ended December 27, 2013 from $39.2 million in the six months ended December 28, 2012. This decrease was primarily due to a decrease in our compensation and related expenses as a result of decreased headcount as well as lower commissions and bonus expense reflecting lower than expected achievement of sales commission targets and performance metrics compared to last year. This decrease was slightly offset by higher discretionary spending for travel and conferences, as well as higher share-based compensation expense.

General and administrative. General and administrative expense consists primarily of personnel costs, legal and professional service costs, depreciation, bad debt expense, share-based compensation, and facilities and information technology costs.

General and administrative expense increased $2.2 million or 17.5% to $14.5 million in the three months ended December 27, 2013 from $12.4 million in the three months ended December 28, 2012. This increase was primarily due to the $0.9 million asset impairment charge and other third party costs of $0.4 million associated with our plans to transition our contract manufacturing and supply management to Jabil. We also incurred higher costs relating to the relocation of our new headquarters to Milpitas, California and recorded higher share-based compensation expenses compared to the same period a year ago. This was partially offset by a decrease in our compensation and related expenses as a result of decreased headcount, as well as lower bonus expense reflecting lower than expected achievement of performance metrics compared to last year as well as reductions in third party professional fees due to tighter control measures.

General and administrative expense increased $0.5 million or 1.7% to $27.0 million in the six months ended December 27, 2013 from $26.6 million in the six months ended December 28, 2012. This increase was primarily due to the $0.9 million asset impairment charge and other third party costs of $0.4 million associated with our plans to transition our contract manufacturing and supply chain management to Jabil. We also incurred higher costs relating to the relocation of our new headquarters to Milpitas, California and recorded higher share-based compensation compared to the same period a year ago. This was offset by decreases in our compensation and related expenses as a result of decreased headcount as well as lower bonus expense reflecting lower than expected achievement of performance metrics compared to last year and a reduction in third party professional fees due to tight control measures.

Restructuring. Total restructuring expense related to our restructuring action in fiscal 2012 was approximately $0.1 million and $0.6 million for the three and six months ended December 27, 2013, respectively and $2.9 million and $4.3 million for the three and six months ended December 28, 2012, respectively. As a result of the restructuring actions taken in Europe described above, we have incurred approximately $12.0 million of cumulative expense through December 27, 2013. We estimate that we will incur total pre-tax cash charges (including charges recorded in fiscal 2012 and 2013) of approximately $13.0 million consisting of charges of approximately $12.0 million for employee termination benefits and up to $1.0 million for the planned office and legal entity closures, including contract termination costs and other associated costs.

Total other income (expense), net

Total other income (expense), net for the three and six months ended December 27, 2013 and December 28, 2012 were as follows (in thousands except percentages):

	Three Months Ended		Change		Six Months Ended		Change	
	December 27, 2013	December 28, 2012	$	%	December 27, 2013	December 28, 2012	$	%
Interest income (expense), net	$(46)	$ (112)	$66	58.9 %	$(53)	$ (267)	$214	80.1%
Other income (expense), net	1,685	213	1,472	691.1 %	1,988	(894)	2,882	322.4%
Total other income (expense), net	$1,639	$ 101	$1,538	1,522.8 %	$1,935	$ (1,161)	$3,096	266.7%

Interest income (expense), net. Interest income (expense), net primarily consists of interest earned on our interest-bearing investment accounts which include money market funds and U.S. treasury bills, as well as interest expense relating to our credit facility and to certain tax payments.

Other income (expense), net. Other income (expense), net during the three and six months ended December 27, 2013 consisted of foreign exchange gains (losses) as a result of the exchange rates primarily for the Euro, British Pound and Canadian dollar against the U.S. Dollar. We have a hedging strategy that is intended to mitigate the effect of exchange rate fluctuations on certain foreign currency balance sheet accounts and cash flows. In addition, during the three and the six months ended December 27, 2013, we also recorded $1.7 million of other income associated with a sale of an investment.

Income tax (benefit) provision

Income tax (benefit) provision for the three and six months ended December 27, 2013 and December 28, 2012 were as follows (in thousands except percentages):

	Three Months Ended		Change		Six Months Ended		Change	
	December 27, 2013	December 28, 2012	$	%	December 27, 2013	December 28, 2012	$	%
Income tax (benefit) provision	$431	$ (3,880)	$4,311	(111.1)%	$360	$ (3,455)	$3,815	(110.4)%

We recorded a tax provision of $0.4 million each for the three and six months ended December 27, 2013. The tax provision primarily was comprised of tax liability computed based on the Company’s projected full-year foreign taxes, state taxes, and tax reserves and related interest, offset by tax benefits from the reversal of previously accrued interest and tax refund in foreign jurisdiction. The effective tax rate differed from the combined federal and net state statutory income tax rate for the three and six months ended December 27, 2013 primarily due to the tax rate differential of the Company's foreign operations and utilization of net operating losses not previously recognized.

We recorded a tax benefit of $3.9 million and $3.5 million for the three and six months ended December 28, 2012. The net tax benefit was primarily comprised of the reversal of previously recorded unrecognized tax benefits primarily in Canada, offset by tax liability computed based on the Company’s foreign projected financial results for the year ended June 28, 2013, state tax, and tax and interest for unrecognized tax benefits. The reversal in Canada was the result of an abatement of interest granted by the Canada Revenue Agency in connection with an audit, which concluded during fiscal 2013. The effective tax rate differed from the combined federal and net state statutory income tax rate for the three and six months ended December 28, 2012 primarily due to tax expense incurred by the Company's foreign subsidiaries with operating income, offset by the release of the unrecognized tax benefits due to lapse of statute of limitations, benefits from reversals of previously accrued taxes in foreign jurisdictions and benefit from utilization of net operating losses not previously recognized.

As of December 27, 2013, we have provided a partial valuation allowance against our net deferred tax assets. Based on all available evidence, on a jurisdictional basis, including our historical operating results, and the uncertainty of predicting our future income, the valuation allowance reduces the majority of our deferred tax assets to an amount that is more likely than not to be realized. The amount of the valuation allowance is attributable to U.S. federal, state and certain foreign deferred tax assets primarily consisting of net operating loss carryovers, tax credit carryovers, accrued expenses, and other temporary differences. We continue to evaluate the realizability of deferred tax assets and related valuation allowance. If our 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.

Segment Operating Performance

Commencing in the first quarter of fiscal 2014, the Company started managing its business primarily on a business unit basis versus the geographic basis previously used by management. Accordingly, the Company has determined its operating and reporting segments, which is based on the business unit structure, to be Compute, Storage and Service. The Company's operating segments are determined based upon several criteria including: the Company's internal organizational structure; the manner in which the Company's operations are managed; the criteria used by the Company's Chief Executive Officer, the Chief Operating Decision Maker (“CODM”), to evaluate segment performance; and the availability of separate financial information.

The Company's CODM evaluates the performance of its operating segments based on revenue and operating profit (loss). Revenues are generally allocated based on the type of products and service provided to our customers. Operating profit (loss) for each segment includes related cost of sales and operating expenses directly attributable to the segment. A portion of the segments' expenses arise from shared services and infrastructure that the Company provides to the segments in order to realize economies of scale and to efficiently use resources. These expenses, collectively called corporate charges, include costs of centralized research and development and other corporate infrastructure expenses. These corporate charges are allocated to the segments and are reassessed on a periodic basis. The allocations have been determined on a basis that the Company considers to be a reasonable reflection of the utilization of services provided to or benefits received by the segments. The profitability of each of the segments is measured after excluding share based compensation expenses, amortization of intangibles, restructuring charges, general and administration charges, other unallocated corporate charges and other items as management does not include this information in its measurement of the performance of the operating segments.

All historical segment numbers for the three and six months ended December 28, 2012 have been recasted to conform to the three months ended December 27, 2013.

Compute:
Our compute solutions segment include our scale-out computing, scale-up computing, software and cloud/web solutions. Compute solutions also include integrated third-party hardware and software products that we sell to provide a single source solution for our customers. Our compute solutions are designed to minimize the number and complexity of interconnects for power and data transfer to improve reliability, speed of implementation and serviceability.
Operating results for our Compute segment for the three and six months ended December 27, 2013 and December 28, 2012 were as follow (in thousands except percentage):

	Three Months Ended		Change		Six Months Ended		Change	
	December 27, 2013	December 28, 2012	$	%	December 27, 2013	December 28, 2012	$	%
Net revenue	$60,418	$109,129	$(48,711)	(44.6)%	$149,260	$239,929	$(90,669)	(37.8)%
Operating (loss) profit	$(2,784)	$7,175	(9,959)	(138.8)%	(583)	$10,976	(11,559)	(105.3)%
Operating margin	(4.6)%	6.6%		(11.2)%	(0.4)%	4.6%		(5.0)%

Revenue for our Compute segment decreased $48.7 million or 44.6% to $60.4 million in the three months ended December 27, 2013 from $109.1 million during the three months ended December 28, 2012. Revenue for our Compute segment decreased $90.7 million or 37.8% in the six months ended December 27, 2013 compared to $239.9 million in the six months ended December 28, 2012. These decreases were due primarily as a result of lower sales for our legacy cloud products. This is consistent with our strategic decision to withdraw from low margin commodity server infrastructure and to focus our investments in strategic areas of HPC, Big Data, storage and service. In addition, we were also negatively impacted by the spending freeze instituted by the federal government prior to its shutdown during the first fiscal quarter of 2014 and the after-effects which have delayed funding for certain federal programs. Overall operating profit for our Compute segment decreased by $10.0 million to an operating loss of $2.8 million in the three months ended December 27, 2013 from $7.2 million operating profit in the three months ended December 28, 2012. Over all operating profit for our Compute segment decreased by $11.6 million to $0.6 million operating loss in the six months ended December 27, 2013 from $11.0 million operating income in the same period ended December 28, 2012. Although, the Compute segment generated higher product margins as a result of the decrease in legacy cloud products which has historically been less profitable, the relative fixed costs on significantly lower revenue volume negatively impacted the segment results during these periods. This was slightly offset by lower operating expenses due to reductions in headcount discussed above resulting in lower compensation and related expenses, as well as lower bonuses and commissions.
Storage:
Our Storage solutions segment include both hardware and software offerings to address virtually every type of data storage and management requirement. Products range from entry-level disk arrays to complex storage systems, with innovative technology and hardware, to include the SGI Modular InfiniteStorage™ platform, SGI InfiniteStorage™ gateway and SGI CXFS™ file system. Our storage solutions are designed to provide extreme scale, broad flexibility, and to minimize the cost to store data.
Operating results for our Storage segment for the three and six months ended December 27, 2013 and December 28, 2012 were as follow (in thousands except percentage):

Three Months Ended		Change		Six Months Ended		Change	
December 27, 2013	December 28, 2012	$	%	December 27, 2013	December 28, 2012	$	%

Net revenue	$16,916	$18,911	$(1,995)	(10.5)%	$36,894	$34,426	$2,468	7.2%
Operating (loss) profit	$(495)	$618	$(1,113)	(180.1)%	$1,527	$(446)	$1,973	442.4%
Operating margin	(2.9)%	3.3%		(6.2)%	4.1%	(1.3)%		5.4%

Revenue for our Storage segment decreased $2.0 million or 10.5% to $16.9 million in the three months ended December 27, 2013 from $18.9 million in the three months ended December 28, 2012. Revenue for our storage segment during the three months ended December 27, 2013 was negatively impacted by the after-effects of the spending freeze instituted by the federal government which have delayed funding for certain federal programs.

For the six months ended December 27, 2013, our Storage segment's revenue increased $2.5 million or 7.2% to $36.9 million from $34.4 million in the six months ended December 28, 2012. This increase was due primarily as a result of higher revenue generated by increased demand in our storage infrastructure products compared to the same period a year ago offset slightly by the delayed funding for certain federal programs.

Overall operating profit for our Storage segment decreased by $1.1 million to $0.5 million operating loss in the three months ended December 27, 2013 from a $0.6 million operating income in the three months ended December 28, 2012. For the three months ended December 27, 2013, gross margins were about flat compared to the comparable period a year ago on lower revenue. In addition, the Storage segment incurred higher operating expenses due to increased development in research and development in order to capitalize on software acquired as part of the recent FileTek acquisition.

Overall operating profit for our Storage segment increased by $2.0 million to a $1.5 million operating income in the six months ended December 27, 2013 from a $0.4 million operating loss in the six months ended December 28, 2012. We benefited from the reductions in headcount discussed above resulting in lower compensation and related expenses, as well as lower bonuses and commissions expense; however this was offset by increased investment in research and development. We also experienced higher margins for some of our third party products that we sell to customers which also contributed to the higher profitability. In addition, during the three and six months ended December 28, 2012, our gross margin was negatively impacted by a few low margin deals that occurred in the first half of fiscal 2013 in Japan and Europe.

Service:

The Service segment is comprised of customer service support and professional services. Our customer service support organization provides ongoing maintenance and technical support for our products and some third-party products, as well as contracted maintenance services, hardware deployment services (install and de-install), time and materials-based services and spare parts. Our professional services organization provides value added services associated with technology consulting, project management and customer education, all of which help our customers realize the full value of their information technology investments.

Operating results for our Service segment for the three and six months ended December 27, 2013 and December 28, 2012 were as follow (in thousands except percentage):

	Three Months Ended		Change		Six Months Ended		Change	
	December 27, 2013	December 28, 2012	$	%	December 27, 2013	December 28, 2012	$	%
Net revenue	$38,726	$43,186	$(4,460)	(10.3)%	$77,425	$89,752	$(12,327)	(13.7)%
Operating profit	$15,343	$14,079	1,264	9.0%	$30,418	$29,027	$1,391	4.8%
Operating margin	39.6%	32.6%		7.0%	39.3%	32.3%		7.0%

Our service revenue will typically fluctuate due to timing of when services were performed on consulting and product integration services. Our service revenue is typically recognized ratably over the respective service periods. Revenue for our Service segment decreased $4.5 million or 10.3% to $38.7 million in the three months ended December 27, 2013 from $43.2 million in the three months ended December 28, 2012. Revenue for our Service segment decreased $12.3 million or 13.7% to $77.4 million in the six months ended December 27, 2013 from $89.8 million in the six months ended December 28, 2012. The decreases for both the three and the six month period December 27, 2013 compared to the comparable period a year ago was primarily due to timing of professional services provided as well as a deterioration in customer service maintenance contracts. In addition, we experienced lower support revenue as our new products replace our installed base of older generation products.

Despite the decrease in revenue, overall operating profit increased for our Service segment during both the three and six months ended December 27, 2013 compared to the three and six months ended December 28, 2012. The Service segment was more profitable on lower revenue as we benefited from the reductions in headcount discussed above resulting in lower compensation and related expenses, as well as lower bonuses and commissions. During the three and six months ended December 27, 2013, we generated higher gross margins due to lower material costs and utilization of third third party providers. In addition, during the six months ended December 28, 2012, our gross margin was negatively impacted by a few low margin deals that occurred in the first half of fiscal 2013 in Japan and Europe.

Liquidity and Capital Resources

We had $113.4 million of unrestricted cash and cash equivalents at December 27, 2013 and $175.2 million at June 28, 2013. As of December 27, 2013, $60.0 million of cash was held outside the United States. Historically, we have required capital principally to fund our working capital needs. If we invest any of our cash outside of non-interest-bearing operating accounts, it is our investment policy to invest in a manner that preserves capital, provides liquidity, maintains appropriate diversification and optimizes after-tax yield and return within our policy's framework and stipulated benchmarks. Adherence with our policy requires the assets to be liquid on and before their maturity dates. This liquidity requirement means that the holder of the assets must be able to pay us, upon our demand, the cash value of the assets invested.

At December 27, 2013, we had short-term and long-term restricted cash of $4.6 million that are pledged as collateral for various guarantees issued to cover rent on leased facilities and equipment, to government authorities for value-added tax (“VAT”) and other taxes, and to certain vendors to support payments in advance of delivery of goods and services.

As described further below under the section entitled "Contractual Obligations and Other Commitments," in December 2011, we entered into a five-year senior secured credit facility in the aggregate principal amount of $35.0 million, which was increased to $40.0 million on May 1, 2012. On February 25, 2013, the Company amended the agreement and reduced the revolver amount to $25.0 million. The credit facility is intended to be used primarily to fund working capital requirements, capital expenditures and operations to the extent that cash provided by operating activities is not sufficient to fund our cash needs. As of December 27, 2013 and June 28, 2013, we had no balance outstanding under the credit facility and the maximum amount available to be borrowed under the credit facility was approximately $23.0 million, taking into account a $2.0 million outstanding letter of credit backing the Company's obligations to a supplier.

At December 27, 2013, we believe our current cash and cash equivalents, in conjunction with the funds that may be drawn down under our credit facility, will be sufficient to fund working capital requirements, capital expenditures, stock repurchase, and operations for at least the next twelve months. We have implemented processes to more effectively monitor our working capital. We have intensified our cash management processes related to monitoring, projecting and controlling procedures to operate our business and are more broadly requiring advance and milestone payments for certain large projects that would otherwise involve a significant lag between our payments to vendors for equipment and materials and the installation, acceptance, billing and collection from the customer. We intend to retain any future earnings to support operations, to finance the growth and development of our business and to fund our stock repurchase program. We do not anticipate paying any dividends in the foreseeable future. In June 2013, we signed a lease for a new headquarters facility and expect to incur approximately $10.8 million for capital expenditures less approximately $5.8 million in lease incentives.

The adequacy of these resources to meet our liquidity needs beyond the next twelve months will depend on our growth, operating results and capital expenditures required to meet our business needs. If we fail to generate 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.

If we require additional capital resources to expand our business internally or to acquire complementary products, technologies and businesses at any time in the future, we may seek to sell additional equity or debt securities or obtain other debt financing. The sale of additional equity or debt securities could result in more dilution to our stockholders. Financing arrangements may not be available to us, or may not be available in amounts or on terms acceptable to us.

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

	Six Months Ended	
	December 27, 2013	December 28, 2012
Consolidated statements of cash flows data:		
Net cash (used in) provided by operating activities	$(41,141)	$34,396

Net cash used in investing activities	(15,411)	(781)
Net cash used in financing activities	(4,009)	(13,194)
Effect of exchange rate changes on cash and cash equivalents	(1,179)	$(1,127)
Net (decrease) increase in cash	$(61,740)	$19,294

Operating Activities

Cash used in operating activities was $41.1 million for the six months ended December 27, 2013. Our net loss was $20.5 million for the six months ended December 27, 2013. Non-cash items included in net loss consisted primarily of depreciation and amortization expense of $7.4 million, share-based compensation expense of $6.5 million, a gain on sale of investment of $1.7 million, asset impairment charges of $0.9 million and $0.4 million of other items. Net change in operating assets and liabilities of $34.1 million contributed to the decrease in cash from operating activities. The primary uses of cash in operating activities were for increases in accounts receivable, inventory and prepaid expenses and other assets, and decreases in other operating liabilities and deferred revenue.. The increase in inventory reflects the timing of purchases to meet demands of large sales contracts that we anticipate shipping over the next few quarters. The primary sources of cash in operating activities were decreases in deferred cost of revenue and an increase in accounts payable.

For the six months ended December 27, 2013, accounts receivable increased $13.1 million reflecting the timing of revenue recognition and collections of the trade receivables and inventory increased $12.6 million reflecting the timing of customer shipments and acceptance of sales contracts. Additionally, deferred revenue decreased by $8.2 million primarily due to the timing of revenue recognition on sales transactions which were required to be deferred in accordance with our revenue recognition policy, other liabilities decreased by $7.2 million primarily due to the timing of payments and prepaid expenses and other assets increased by $0.8 million.

For the six months ended December 27, 2013, deferred cost decreased by $7.2 million and accounts payable increased $0.5 million, primarily due to the timing of payments.

Cash provided in operating activities was $34.4 million for the six months ended December 28, 2012. Our net loss was $7.6 million for the six months ended December 28, 2012. Non-cash items included in net loss consisted primarily of depreciation and amortization expense of $7.1 million, share-based compensation expense of $5.0 million and a release of previously recorded unrecognized tax benefits of $4.3 million. Net change in operating assets and liabilities contributed to the decrease in cash from operating activities of $34.1 million. The primary sources of cash in operating activities were increases in deferred revenue and decreases in accounts receivable and deferred cost of revenue. The primary uses of cash in operating activities were for purchases of inventory as well as decreases in accounts payable.

For the six months ended December 28, 2012, accounts receivable decreased $8.8 million due to the timing of collections of the trade receivables as well as milestone payments. During the three months ended December 28, 2012, we received approximately $70.0 million of milestone payments from our customers. Deferred revenue increased by $36.2 million and deferred cost of revenue decreased by $20.4 million, primarily due to the timing of revenue recognition on sales transactions which were required to be deferred in accordance with our revenue recognition policy. Additionally, prepaid expenses and other assets decreased $0.1 million, and other liabilities increased $6.1 million primarily due to timing of payments.

Inventory increased $26.8 million to meet the demands of the large sales contracts that we anticipate shipping over the next few quarters, as well as due to timing of customer shipments and acceptance. A large portion of our inventory balance includes inventory at customer sites undergoing installation testing prior to customer acceptance. Accounts payable increased $10.8 million, primarily due to the timing of payments and our progress in effectively monitoring our working capital.

Investing Activities

Cash used in investing activities was $15.4 million in the six months ended December 27, 2013, primarily due to purchases of property and equipment of $6.7 million, cash used to acquire FileTek of $9.2 million and an increase in restricted cash of $1.2 million. This was offset by cash proceeds of $1.7 million for the sale of an investment.

Cash used by investing activities was $0.8 million in the six months ended December 28, 2012, primarily due to purchases of property and equipment of $2.0 million offset by proceeds from other individually immaterial investing activities of $1.2 million

Financing Activities

Cash used in financing activities was $4.0 million for the six months ended December 27, 2013, primarily due to the proceeds for the issuance of stock under our employee stock purchase plan and stock option exercises of $5.2 million. This was offset by the repurchase of shares of our common stock of $7.8 million and the funding of restricted stock units withheld for taxes of $1.4 million.

Cash used in financing activities was $13.2 million for the six months ended December 28, 2012, primarily due to the payment of our credit facility of $15.3 million, and repurchases of restricted stock units withheld for taxes of $0.4 million, which was offset by $2.5 million for the issuance of stock under our employee stock purchase plan and stock option exercises

We expect to continue to invest in the business including working capital, capital expenditures and operating expenses. We intend to fund these activities with our cash reserves, cash generated from operations, if any, and with the principal that is available for withdrawal on the credit facility to the extent that cash provided by operating activities is not sufficient to fund our cash needs. 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 Commitments

Operating Leases—We lease certain real and personal property under non-cancelable operating leases. Certain leases require us to pay property taxes, insurance and routine maintenance and include renewal options and escalation clauses.

As of December 27, 2013, we had total outstanding commitments on non-cancelable operating leases of our real properties of $30.0 million, of which $23.5 million relates to our domestic leases. These domestic leases include our headquarters in Milpitas, California and our warehouse facility in Chippewa Falls, Wisconsin. A significant portion of our domestic leases will expire in fiscal 2024. The remainder of our domestic leases will expire in fiscal 2014 through 2016. As of December 27, 2013, we had total outstanding commitments of $6.3 million in non-cancelable international real property operating leases. The total outstanding commitments included $2.1 million relating to our leased facility in Japan, which we assumed as part of our acquisition of SGI Japan in March 2011. Our major facility leases in our international locations are generally for terms of two to nine years, and generally do not provide renewal options, except for our leases in Japan, that generally provide for a two-year renewal option.

As of December 27, 2013, personal property under operating lease was comprised primarily of automobiles and office equipment. Total outstanding commitments under such leases totaled approximately $1.0 million at December 27, 2013.

Purchase Commitments—From time to time, we issue purchase orders to our contract manufacturers for the procurement of materials to be used for upcoming orders, particularly for those components that have long lead times. These purchase orders vary in size depending on our projected requirements. If we do not consume these materials on a timely basis or if our relationship with one of our contract manufacturers was to terminate, we could experience an abnormal increase to our inventory carrying amount and related accounts payable.

In connection with supplier agreements, we agreed to purchase certain units of inventory and non-inventory. As of December 27, 2013, there were remaining commitments of approximately $18.7 million, of which $17.6 million is expected to be paid in the next 12 months.

Other than the contractual obligations and commitments described above, we have no significant unconditional purchase obligations or similar instruments. We are not a guarantor of any other entities' debt or other financial obligations.

Credit Facility—On December 5, 2011, we entered into a five-year senior secured credit facility in the aggregate principal amount of $35.0 million. The availability under the credit facility is limited to a borrowing base, subject to meeting certain conditions set forth in the credit facility. The credit facility includes a feature that allows the Company to increase the revolver amount in the first 18 months. The Company exercised this feature, and on May 1, 2012, the revolver amount was increased by $5.0 million to an aggregate principal amount of $40.0 million. On February 25, 2013, the Company amended the agreement and reduced the revolver amount to $25.0 million. As of December 27, 2013, we had no outstanding balance owed on the credit facility. As of December 27, 2013 and June 28, 2013, we had no balance outstanding under the credit facility and the maximum amount available to be borrowed under the credit facility was approximately $23.0 million, taking into account a $2.0 million outstanding letter of credit backing the Company's obligations to a supplier. This availability will fluctuate over time, and generally monthly, due to a variety of factors including our overall mix of sales and resulting accounts receivable with international and domestic customers, U.S. governmental agencies and a few individual customer accounts which may result in high concentrations of accounts receivable as compared to the overall level of our accounts receivable. See Note 16 to our unaudited condensed consolidated financial statements in this Form 10-Q for further information on the credit facility.

Uncertain Tax Positions—As of December 27, 2013, the net recorded tax liability for uncertain tax positions was $13.8 million, including interest and penalty. We cannot conclude on the range of cash payments that will be made within the next twelve months associated with our uncertain tax positions.

Guarantees and Indemnifications—We have issued financial guarantees to cover 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 our financial guarantees have terms of one year or more. The maximum potential obligation under financial guarantees at December 27, 2013 was $4.8 million, for which we have $4.6 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 in the unaudited condensed consolidated balance sheets.

Additionally, we enter into standard indemnification agreements with our 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 our 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. We have not incurred significant expenses related to these indemnification agreements and no material claims for such indemnifications were outstanding as of December 27, 2013. As a result, we believe the estimated fair value of these indemnification agreements, if any, to be immaterial and, accordingly, no liability has been recorded with respect to such indemnifications as of December 27, 2013.

Off-Balance Sheet Arrangements—Our credit facility includes a $10.0 million letter of credit subfacility. As of December 27, 2013, we have a $2.0 million outstanding letter of credit to back our obligation to pay or perform when required to do so pursuant to the requirements of an underlying agreement for the provision of goods or services to a supplier.

We had no other off-balance sheet arrangements as of December 27, 2013.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of revenues and expenses during the reporting period and the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements. We periodically evaluate our material estimates and judgments based on the terms of underlying agreements, the expected course of development, historical experience and other factors that we believe are reasonable under the circumstances. However, actual future results may vary from our estimates.

We believe that the accounting policies discussed under Part I, Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report are significantly affected by critical accounting estimates and that they are both highly important to the portrayal of our financial condition and results and require difficult management judgments and assumptions about matters that are inherently uncertain. Certain of these significant accounting policies are considered to be critical accounting policies.

Our critical accounting policies and estimates are as follows:

- Revenue recognition;
- Share-based compensation;
- Restructuring reserve;
- Inventory valuation;
- Impairment of intangibles and long-lived assets;
- Warranty reserve;
- Retirement benefit obligations; and
- Accounting for income taxes.

There have been no significant changes in the Company's significant accounting policies for the six months ended December 27, 2013 as compared to those discussed under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report except as noted below.

Recent Accounting Pronouncements

See Note 3 to our unaudited condensed consolidated financial statements in this Form 10-Q for a description of recent accounting pronouncements, including our expected adoption dates and estimated effects on our results of operations, financial condition and cash flows.

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, 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.

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 high credit quality, readily liquid securities, primarily money market funds. Our portfolio of investments has original maturities of less than three months from date of purchase.

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 generally invest 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 effect on our financial position.

Interest Rate Risk

Our exposure to market risks for changes in interest rates relates primarily to our investment portfolio and our credit facility. We currently do not hedge our interest rate exposure.

As of December 27, 2013, we held an immaterial amount of cash equivalents and we have $113.4 million cash on hand. We believe that the exposure of our principal to interest rate risk is minimal, although our future interest income is subject to reinvestment risk. We believe that the current risk of loss in fair value resulting from interest rate changes is minimal. At December 27, 2013, we had no interest rate forward contracts or option contracts.

The interest expense on outstanding cash borrowings under our credit facility is based on variable interest rates and is therefore affected by changes in market interest rates. As of December 27, 2013, we did not have any outstanding borrowings under our credit facility.

Foreign Exchange Risk

As of December 27, 2013, foreign currency cash accounts totaled $54.8 million, primarily in Japanese Yen, Euros, and British Pounds.

Foreign currency risks are associated with our 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 other income, net in our 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. In fiscal 2013, we implemented a balance sheet hedging strategy that is intended to mitigate our currency exposures related to remeasuring monetary assets and liabilities by entering into foreign currency forward contracts that have maturities generally of one month or less. These contracts are used to reduce our risk associated with exchange rate movements, as gains and losses on these contracts are intended to mitigate the effect of exchange rate fluctuations on certain foreign currency denominated balance sheet accounts. In fiscal 2014, we implemented a cash flow hedging strategy and will use forward contracts designated as cash flow hedges to hedge a portion of future

forecasted non-USD cash flows to further mitigate the effect of exchange rate fluctuations for these currencies.
We assessed the risk of loss in fair values from the impact of hypothetical changes in foreign currency exchange rates. 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 $5.5 million change in the value of our foreign currency cash accounts.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer (principal executive officer) and chief financial officer (principal financial officer), we have evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"). The evaluation considered the procedures designed to ensure that the information required to be disclosed in reports we file under the Exchange Act, is recorded, processed, summarized and reported within the appropriate time periods and that information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures. Based on that evaluation, our management, including our chief executive officer and chief financial officer, has concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of December 27, 2013.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended December 27, 2013, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

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 we cannot assure that such improvements will be sufficient to provide us with effective internal control over financial reporting.

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, domestic and international federal, state and local tax reviews and audits and other matters. We may also be subject to litigation and/or adverse rulings or judgments as a result of certain contractual indemnification obligations. We do not know whether we will prevail in these matters, nor can we assure that any remedy or resolution will be reached on commercially reasonable terms, if at all. We intend to defend ourselves vigorously in these actions. Based on currently available information, we believe that we have meritorious defenses and that the resolution of these cases, individually or in the aggregate, is not likely to have a material adverse effect on our business, financial condition or future results of operations. 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.

From time to time, we may be involved in litigation or other legal proceedings relating to claims arising out of our day-to-day operations or otherwise. Litigation is inherently uncertain, and we could experience unfavorable judgments or rulings in the future. Should we experience an unfavorable judgment or ruling, there exists the possibility of a material adverse impact on our financial condition, results of operations, cash flows or on our business for the period in which the judgment or ruling occurs and/or future periods.

ITEM 1A. Risk Factors

The risk factors presented below update the risk factors previously disclosed in our Annual Report. The following factors, along with those in the Annual Report and those described above under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” should be reviewed carefully, in conjunction with the other information contained in this Form 10-Q and our financial statements. These factors, among others, could cause actual results to differ materially from those currently anticipated and contained in forward-looking statements made in this Form 10-Q and presented elsewhere by our management from time to time. See the discussion of forward-looking statements in "Part I, Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Customer Concentration-A relatively small number of customers that purchase our products in large quantities have historically accounted for a significant portion of our revenues. If we are unable to maintain or replace our relationships with such customers and/or diversify our customer base, our revenue may fluctuate or decline 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 these customers. For the three months ended December 27, 2013, our top five customers worldwide accounted for approximately 35% of our total revenues, with the U.S. government, excluding system integrators, accounting for approximately 15% of total revenue.

This customer concentration increases the risk of quarterly fluctuations in our revenues and operating results. The loss or reduction of business from one or a combination of our significant customers, for example as a result of a customer's capital expenditure budget reductions or U.S. Government spending reductions, could materially adversely affect our revenues, financial condition and results of operations.

U.S. Government Sales-We derive a significant portion of our revenue from customers who directly or indirectly receive funding from the U.S. government. If our U.S. government-related sales decrease, or our ability to do business with the U.S. government or entities funded by the U.S. government is disrupted or limited, our operating performance could be adversely affected.

We generally derive a significant portion of our revenue directly from U.S. government entities, from research institutions funded by the U.S. government, and from system integrators that sell to the U.S. government through our subsidiary, Silicon Graphics Federal, LLC. For the three months ended December 27, 2013, such sales represented approximately 38% of our total revenue. These sales present risks in addition to those involved in sales to commercial customers, including potential disruptions and delays due to shut downs or changes in appropriation, budgetary priorities and debt limits by the U.S. government. In addition, the U.S. government can terminate or modify its contracts with us at any time for its convenience. A significant reduction in such sales could adversely affect our operating performance.

Our U.S. government business is also subject to specific procurement regulations and a variety of other requirements applicable to companies doing business with the U.S government. Sales to the defense sector require us to comply with additional defense-specific regulations, including maintaining a compliant security program, obtaining security clearances for employees and passing various inspections. Failure to comply with applicable regulations and requirements could lead to our suspension or debarment from U.S. government contracting or subcontracting for a period of time as well as fines against the Company.
Any disruption or limitation in our ability to do business with the U.S. government or entities funded by the U.S. government could materially adversely affect our revenue and operating results and may also impact our ability to accurately forecast our revenue.
Contract Manufacturing-We are dependent on contract manufacturers and partners to assemble and test certain of our products, and our failure to successfully manage our relationships with these contract manufacturers and partners could impair our ability to deliver systems that meet our and/or our customers' expectations, which could damage our relationships with our customers and decrease our revenue.
We have historically relied on a small number of contract manufacturers and partners to assemble and test certain of our products. None of these third-party contract manufacturers or partners 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. For example, we design custom silicon chips for ASICs, but rely on a third-party to manufacture the ASICs for us. 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.
We also announced recently that we have selected Jabil as our primary global manufacturing services and supply chain management provider subject to the execution of definitive agreements. We anticipate that the transaction with Jabil will close in February 2014 and will further increase our reliance and dependence on contract manufacturing. Because our products are very complex to manufacture, transitioning manufacturing activities from one manufacturing partner to another is complicated. If we fail to properly manage our relationship with Jabil or our other contract manufacturers or partners, or if one or more of them are not able to meet our manufacturing or capacity requirements, maintain our high standards of quality or experience delays or disruptions in their service delivery, 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.
Strong Competition-We face competition from the leading enterprise computing companies in the world as well as from emerging companies. Some of our competitors have greater name recognition and capital resources than SGI. 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 server market, such as Dell Inc., Hewlett-Packard Company ("HP"), International Business Machines Corporation, Cray, Inc. and Oracle Corporation. In the storage market, we compete primarily with EMC Corporation, HP, Hitachi Data Systems, Inc. and NetApp, Inc. Our largest competitors have several advantages over us, such as:

- 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 selling prices, negatively impacting our margins. 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 widely accepted than our products, our competitive position will be impaired.

The intense competition we face in the sales of our products and services and general economic and business conditions can put pressure on us to change our prices. If our competitors offer deep discounts on certain products or services or develop products that the marketplace considers more valuable, we may need to lower prices or offer other favorable terms in order to compete successfully. Any such changes may reduce margins and could adversely affect operating results.

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 data center 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.

Unproven Go-to-Market Strategy-We lack experience in marketing solutions to large enterprise customers. If we are not successful in increasing sales of our solutions into enterprise customers, our growth opportunities will be limited.

Despite our historical success in growing our revenues from certain agencies of the U.S. government as well as higher education, we have had limited success in broadening our base of enterprise customers. We have modified our go-to-market (GTM) strategy and have invested in sales and marketing personnel and programs to increase penetration of our HPC, Storage and Big Data solutions among enterprise customers. If we are not successful in increasing sales of our solutions into enterprise customers, our growth opportunities may be limited.

Fluctuations in Operating Results-Among other things, the timing of our revenue is primarily dependent upon the funding and implementation schedules of our customers, particularly as it relates to large IT projects where we can have long sales cycles and long build-out and acceptance schedules. Our periodic 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 and annual periodic 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 periodic basis in future periods. Factors that may affect our periodic 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 low margins;
- location and timing requirements for the delivery of our products and services;
- lengthy acceptance cycles of our products by certain customers;
- development or product delivery delays, and delays in obtaining necessary components from our suppliers, contractual provisions or other reasons;
- addition of new customers or loss of existing customers;
- gross margin pressures from the sales of products and services due to discounted pricing, especially to our largest customers;
- lack of reliability of our estimates to forecast sales and trends in our business to generate a sales pipeline;
- uncertainty regarding our sales pipeline and resulting customer contracts; our ability to align our product and service offerings and cost structure with customer needs;
- our ability to reduce operating expenses and total costs in procurement, which may involve delays in the anticipated timing of activities related to our cost savings plans and higher than expected or unanticipated costs to implement the plans;
- changes in the mix of products sold due to differences in profitability among our products;
- 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;

- our ability to timely bring new capabilities to market combining our products and technologies with those produced by our strategic partners and OEMs to address new opportunities, such as in the “Big Data” or “Hadoop” markets;
- 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;
- market acceptance of newer products,
- 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, settlements or contractual penalties resulting from faulty or malfunctioning products or the provision of services unsatisfactory to our customers;
- compliance costs associated with new laws, rules and regulations, including environmental regulations;
- disruptions or limitations in our ability to do business with the U.S. government or entities funded by the U.S. government, including but not limited to shut downs and/or changes in appropriation, budgeting priorities and debt limits;
- the payment of unexpected intellectual property licensing royalties to third parties who successfully assert that our product(s) infringe their intellectual property rights;
- 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.

Lengthy Sales Cycle-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 and may extend even longer for sales to U.S. government entities and to third parties and educational institutions that receive funding from the U.S. Government, whose purchases may be impacted by the current lack of certainty in the U.S. Federal government budget and continuing debate regarding the U.S. Federal government debt limit. 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 essential 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 are unsuccessful in closing sales after expending significant resources, our revenue and operating expenses will be adversely affected.

Even if we are successful in closing sales, several large transactions that we have entered into require us to invest cash up front to fund working capital without collecting cash for several periods. If we are unable to negotiate for more favorable cash collection terms in the future, our liquidity and ability to fund our operations could be adversely affected.

Channel Sales-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.

Volatile Stock Price-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 price has experienced high volatility. For example, during the quarter ended December 27, 2013, our stock price fluctuated from a high of $16.35 to a low of $11.59. Investors may not be able to sell the 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, including without limitation:

- price and volume fluctuations in the overall stock market;
- 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;
- rating 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;
- increases in the total short position in our common stock;
- 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 could become involved in securities litigation in the future, which could have substantial costs and divert resources and the attention of management from our business.

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.

Acquisition Strategy-We may not be able to realize the potential financial or strategic benefits of acquisitions that we may complete in the future, or find suitable target businesses or technologies to acquire, which could impair our ability to grow our business, develop new products or sell our products.

If appropriate opportunities present themselves, we may consider acquiring or making investments in companies, assets or technologies that we believe are strategic. Acquisitions are difficult, time consuming and pose a number of risks, including:

- the acquired products may fail to achieve projected sales or operating margin targets;
- the acquired business, asset or technology may not further our business strategy or we may not realize expected synergies or cost savings;
- we might overpay for the acquired business, asset or technology;
- we might experience difficulties integrating the acquired assets, technologies, operations or personnel or retaining the key personnel of the acquired company;
- disruption of ongoing business, including diversion of management's attention;
- we might experience difficulties entering and competing in new product or geographic markets in which we are not experienced;
- assumption of unknown liabilities, including tax and litigation or problems with product quality, and the related expenses and diversion of resources;
- potential downward pressure on operating margins due to lower operating margins of acquired businesses, increased headcount costs and other expenses associated with adding and supporting new products;
- potential negative impact on our relationships with customers, distributors and business partners; and
- potential negative impact on our earnings per share/negative impact on our earnings resulting from the application of ASC 805, Business Combinations, which became applicable to us in January 2009.

In addition, 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.

If we do not appropriately manage these risks, any acquisitions that we complete may have an adverse effect on our business and financial condition. Additionally, if we determine that we cannot use or sell the acquired products or technology, we will be required to write down the associated intangible assets, which would negatively impact our operating results.

International Sales and Operations-The global nature of our operations exposes us to increased risks and compliance obligations, which may adversely affect our business.

During the three months ended December 27, 2013, we derived approximately 48% of our revenue from sales outside of the United States. Our international business operations require us to recruit and retain qualified technical and managerial employees, manage multiple, remote locations and ensure intellectual property protection outside of the United States. Our international operations subject us to increased risks, 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 regulations, 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;
- longer sales cycles and manufacturing lead times;
- financial risks such as longer payment cycles and difficulties in collecting accounts receivable;
- difficulties associated with repatriating cash generated or held abroad in a tax-efficient manner;
- ineffective legal protection of intellectual property rights;
- more complicated logistics and distribution arrangements;
- additional taxes and penalties;
- inadequate local infrastructure that could result in business disruptions;
- political and economic instability; and
- other factors beyond our control such as natural disasters, terrorism, civil unrest, war and infectious diseases.

If any of the foreign economies in which we do business deteriorate or if we fail to effectively manage our global operations, our business and results of operations would be harmed.

In addition, our global operations are subject to numerous U.S. and foreign laws and regulations, including those related to anti-corruption, tax, corporate governance, imports and exports, financial and other disclosures, privacy and labor relations. These laws and regulations are complex and may have differing or conflicting legal standards, making compliance difficult and costly. If we or our employees, contractors or agents violate these laws and regulations, we could be subject to fines, penalties or criminal sanctions, and may be prohibited from conducting business in one or more countries. Any violation individually or in the aggregate could have a material adverse effect on our operations and financial condition.

Foreign Currency Fluctuations-We may experience foreign currency gains and losses.

We have significant exposure to revenues, expenses and certain asset and liability balances denominated in currencies other than the U.S. Dollar. Changes in the exchange rates of major foreign currencies, particularly the Euro, Japanese Yen and British Pound, relative to the U.S. Dollar, can significantly affect revenues and our operating results. Our revenues and operating results are adversely affected when the U.S. Dollar strengthens relative to other currencies and are positively affected when the U.S. Dollar weakens. Although we have recently started to engage in foreign currency hedging activity, we may be unable to hedge all of our foreign currency risk, which could have a negative impact on our results of operations. For the three months ended December 27, 2013, our revenue from our EMEA and APJ regions was $24.4 million and $29.0 million, respectively. As of December 27, 2013, the balance in our foreign currency cash accounts was $54.8 million. An increase in the value of the U.S. Dollar relative to foreign currencies could make our products more expensive and, thus, not competitively priced in foreign markets. On the other hand, a decrease in the value of the U.S. 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.

In fiscal 2013, we implemented a balance sheet hedging strategy that is intended to mitigate our currency exposures related to remeasuring monetary assets and liabilities by entering into foreign currency forward contracts that have maturities generally of one month or less. These contracts are used to reduce our risk associated with exchange rate movements, as gains and losses on these contracts are intended to mitigate the effect of exchange rate fluctuations on certain foreign currency denominated balance sheet accounts. Beginning in fiscal 2014, we implemented a cash flow hedging strategy and will use forward contracts designated as cash flow hedges to hedge a portion of future forecasted non-USD cash flows to further mitigate the effect of exchange rate fluctuations for these currencies.

Export Controls-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 approval 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 adjusted over time, as technology changes, to reflect the increasing compute performance of our systems. Delay or denial in the approval of any required licenses could make it more difficult to sell 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 from exporting our products to one or more countries, and could materially harm our business, including our sales to the U.S. government.
Open Source Modular Technology-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. A majority of the server systems that we sold in fiscal 2013, 2012 and 2011 ran on the Linux® operating system. Products based on the Linux operating system and sold by other software vendors have been the subject of intellectual property infringement litigation, including litigation by Microsoft Corporation. It is possible that a party could prove a claim for proprietary rights in the Linux operating system or other programs developed and distributed under the GNU General Public License or other open source software licenses. In addition, the GNU General Public License has itself been, and may be in the future, 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, 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 data center 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.
Cost of Materials-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. This volatility makes it difficult to predict expense levels and operating results and may cause them to fluctuate significantly. Further, 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.
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, including a shortage for hard drives related to flooding in Southeast Asia in 2011, which affected hard drive manufacturing facilities. In the future, we may experience other shortages or delays of critical components as a result of strong demand, capacity constraints, supplier financial weaknesses, inability of suppliers to borrow funds in the credit markets, disputes with suppliers (some of whom are also customers), disruptions in the operations of component suppliers, natural disasters, other problems experienced by suppliers or problems faced during the transition to new suppliers.

The price of components may increase due to potential shortages or delays, and we may be exposed to quality issues or the components may not be available at all. We may therefore not be able to secure enough components at reasonable prices or of acceptable quality to build products or provide services in a timely manner in the quantities or according to the specifications needed. Accordingly, our revenue and gross margin could suffer as we could lose time-sensitive sales, incur additional freight costs or be unable to pass on price increases to our customers. If we cannot adequately address supply issues, we may have to reengineer some products or service offerings, resulting in further costs and delays.

In order to secure components for the provision of products or services, at times we may enter into non-cancelable commitments with vendors. In addition, we may purchase components strategically in advance of demand to take advantage of favorable pricing or to address concerns about the availability of future components. If we fail to anticipate customer demand properly, a temporary oversupply could result in excess or obsolete components. Further, we compete in an industry that is characterized by rapid technological advances in hardware with frequent introduction of new products. With new product introductions, we face risks in predicting customer demand for the new products as well as the transition from existing products. If we do not make an effective transition from existing products to future products, we could have an oversupply of components. For example, DRAM can 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. Additionally, if any of our suppliers of CPUs or graphic processing unit ("GPUs") 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.

In addition to the component parts, we currently integrate Application Specific Integrated Circuits (ASIC) in many of our products. The development of an ASIC is costly and may take up to many months to develop. These costs typically are expensed as incurred as research and development costs and will cause volatility in our operating results and may cause them to fluctuate significantly.

Supplier Relationships-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, which may impair our ability to deliver leading-edge products.

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. Further, we rely heavily on our component suppliers, such as Intel and NVIDIA, to provide us with leading-edge components on time and in accordance with a product roadmap. 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 in a timely manner may be impaired and we could be required to incur additional research and development expenses.

Environmental Laws and Liabilities-Unforeseen environmental costs could impact our future net earnings.

We are subject to various federal, state, local and foreign laws and regulations concerning environmental protection, including laws addressing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes, the cleanup of contaminated sites, the content of our products and the recycling, treatment and disposal of our products. In particular, we face increasing complexity in our product design and procurement operations as we adjust to new and future requirements relating to the chemical and materials composition of our products, their safe use, the energy consumption associated with those products, and climate change laws and regulations. We could incur substantial costs, our products could be restricted from entering certain jurisdictions, and we could face other sanctions, if we were to violate or become liable under environmental laws or if our products become non-compliant with environmental laws. Our potential exposure includes fines and civil or criminal sanctions, third-party property damage, personal injury claims, compliance-related costs and clean-up costs. Further, liability under some environmental laws relating to contaminated sites can be imposed retroactively, on a joint and several basis, and without any finding of noncompliance or fault. The amount and timing of costs under environmental laws are difficult to predict and such costs could have a negative effect on our profitability. If we are found to be in violation of any environmental laws, costs associated with such liability may have an adverse effect on our financial results.

Dependence on Key Personnel-If we are unable to retain and attract adequate qualified personnel, we may not be able to execute on our business strategy.

During the past few fiscal years, we have experienced significant changes in our management team in the roles of chief executive officer, chief financial officer, chief accounting officer, chief operating officer and head of sales. Our future success depends in large part upon the continued service and enhancement of our management team and our employees. If there are further changes in management, such changes could be disruptive and 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 one or more members of our executive management or sales team or other key employees could seriously harm our business. Competition for qualified executives is intense 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.

Additionally, to help attract, retain and motivate certain qualified employees, we use share-based incentive awards such as employee stock options and non-vested share units (restricted stock units). If the value of such stock awards does not appreciate as measured by the performance of the price of our common stock, or if our share-based compensation otherwise ceases to be viewed as a valuable benefit, our ability to attract, retain and motivate employees could be weakened, which could harm our results of operations.

Credit Facility Restrictions-We are subject to restrictions under our credit facility that may result in our inability to engage in favorable business activities or finance future operations or capital needs.

On December 5, 2011, we entered into a five-year senior secured credit facility in the aggregate principal amount of $35.0 million, which amount was increased to $40.0 million on May 1, 2012. On February 25, 2013, the Company amended the agreement and reduced the revolver amount to $25.0 million. The credit facility includes a $10.0 million letter of credit subfacility. The credit facility contains various financial and other covenants that, among other things:

- require us to maintain a fixed charge coverage ratio (applicable during certain periods);
- limit our ability to incur indebtedness, grant liens, or consign inventory; and
- require us to obtain the bank's consent prior to selling the Company via a consolidation, merger or transfer of substantially all of our assets.

Although we can terminate the facility for convenience at any time, such termination would require repayment of any outstanding indebtedness. If we were unable to repay such indebtedness, we could not terminate the facility and we would be subject to its covenants and conditions. As a result of these covenants we may be restricted in the manner in which we conduct our business. In addition, we may be unable to engage in favorable business activities or finance future operations or capital needs, including without limitation, funding acquisitions or repurchasing our stock. This indebtedness may also adversely affect our ability to access sources of capital or incur certain liens. Accordingly, these restrictions may limit our ability to successfully operate our business. A failure to comply with these restrictions could lead to an event of default, which could result in an acceleration of the indebtedness and could adversely affect our cash flow and operating results. If any of the Company's indebtedness is accelerated, the Company may not have sufficient funds available to repay such indebtedness.

Financial Estimates and Assumptions-We make estimates and assumptions in connection with the preparation of our consolidated financial statements, and any changes to those estimates and assumptions could have a material adverse effect on our results of operations.

In connection with the preparation of our consolidated financial statements, we use certain estimates and assumptions based on historical experience and other factors. Our most critical accounting estimates are described in “Management's Discussion and Analysis of Financial Condition and Results of Operations” in Part I, Item 2 of this Quarterly Report on Form 10-Q. While we believe that these estimates and assumptions are reasonable under the circumstances, they are subject to significant uncertainties, some of which are beyond our control. Should any of these estimates and assumptions change or prove to have been incorrect, it could have a material adverse effect on our results of operations, and we may be required to restate our financial results for prior periods which could cause our stock price to decline.

Internal Controls-If we are unable to maintain effective internal control over financial reporting in the future, the accuracy and timeliness of our financial reporting may be adversely affected.
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, which 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 failure to have effective internal controls and procedures for financial reporting in place could result in a restatement of our financial statements, impact our ability to accurately report financial information on a timely basis, make it difficult or impossible to obtain an audit of our financial statements or result in a qualification of any such audit. Any such event could lead to a loss of market confidence in our financial statements, delisting from the NASDAQ Global Select Market, loss of financing sources, and litigation, any of which could adversely affect our stock price.
Tax Exposure-Unanticipated changes in our tax provisions or exposure to additional income tax liabilities could affect our profitability.
We are subject to income taxes in the United States and numerous foreign jurisdictions. Our tax liabilities are affected by the amounts we charge for inventory, services, funding and other items in intercompany transactions. We are subject to ongoing tax audits in various jurisdictions. Tax authorities may disagree with our intercompany charges, cross-jurisdictional transfer pricing or other matters and assess additional taxes. For example, we were assessed tax and interest by the Canada Revenue Agency ("CRA") in connection with excess research credits claimed by our Canadian subsidiaries in prior periods. During fiscal 2013, the CRA reduced the tax and interest assessed which resulted in a tax benefit and a reduction of a tax liability.
We regularly assess the likely outcomes of these audits in order to determine the appropriateness of our tax provision. However, there can be no assurance that we will accurately predict the outcomes of these audits, and the amounts ultimately paid upon resolution of audits could be materially different from the amounts previously included in our income tax expense and therefore could have a material impact on our tax provision, net income and cash flows.
In addition, our effective tax rate in the future could be adversely affected by changes to our operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws and the discovery of new information in the course of our tax return preparation process.
IT Infrastructure-Unsuccessful deployment of new transaction processing applications and other systems integration issues could disrupt our internal operations and any such disruption could reduce our expected revenue, increase our expenses and damage our reputation.
Portions of our IT infrastructure may experience interruptions, delays or cessations of service or produce errors in connection with systems integration and implementation of new transaction processing applications, including accounting, manufacturing and sales system. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and be more expensive, time consuming, disruptive and resource-intensive to remediate. Such disruptions could adversely impact our ability to fulfill orders and negatively impact our business or interrupt other processes. Delayed sales, lower margins or lost customers resulting from these disruptions have adversely affected us in the past, and in the future could adversely affect our financial results, public disclosures and reputation.
Information Security-We maintain confidential and proprietary information on our computer networks and employ security measures designed to protect this information from unauthorized access. If our security measures are breached and unauthorized access is obtained, we may lose proprietary data and may suffer economic losses.
We maintain confidential information on our computer networks, including information and data that are proprietary to our customers and third parties, as well as to our company. Although we have designed and employed security

measures to protect this information from unauthorized access, our security measures may be breached as a result of third-party action, including computer hackers, employee error, malfeasance or otherwise, and result in someone obtaining unauthorized access to our customers' data or our data, including our intellectual property and other confidential business information. Because the techniques employed by hackers to obtain unauthorized access or to sabotage systems change frequently, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any security breach could result in disclosure of our trade secrets or disclosure of confidential customer, supplier or employee data. If this should happen, we could be exposed to potentially significant legal liability, harm to our reputation and other harm to our business.

Geographic Business Concentrations-Business disruptions could affect our operating results.

A significant portion of our manufacturing, research and development activities and certain other critical business operations is concentrated in a few geographic areas. We are a highly automated business and a disruption or failure of our systems could cause delays in completing sales and providing services. A major earthquake, fire, tornado or other catastrophic event that results in the destruction or disruption of any of our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be materially and adversely affected.

Further, we maintain a program of insurance coverage for various types of property, casualty and other risks. We place our insurance coverage with various carriers in numerous jurisdictions. However, there is a risk that a claim may go unpaid, such as in the event of a widespread catastrophic event that materially affects the resources of our insurer. The types and amounts of insurance that we obtain vary from time to time and from location to location, depending on availability, cost and our decisions with respect to risk retention. The policies are subject to deductibles and exclusions that result in our retention of a level of risk on a self-insurance basis. Losses not covered by insurance may be substantial and may increase our expenses, which could harm our results of operations and financial condition.

Weak Global Economy-Weak or unstable global market and economic conditions may have serious adverse consequences on our business.

As a result of the recent global recession, the global economy experienced significant uncertainty, stock market volatility, tightened credit markets, concerns about both deflation and inflation, reduced demand for products, lower consumer confidence, reduced capital spending, liquidity concerns and business insolvencies. Further declines and uncertainty about economic conditions could negatively impact our customers' businesses, causing our customers to postpone their decision-making or decrease their spending or affecting our customers' ability to pay for our products, which would harm our operating results. In addition, one or more of our current service providers, manufacturers and other partners may go out of business, which could directly affect our ability to attain our operating goals on schedule and on budget.

If the global economy continues to experience uncertainty, our ability to obtain credit on favorable terms could be jeopardized. 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. Furthermore, should any of our banking partners declare bankruptcy or otherwise default on their obligations, it could adversely affect our financial results and our business.

We cannot predict if or when global economic confidence will be restored. Accordingly, our future business and financial results are subject to considerable uncertainty, and our stock price is at risk of volatile change.

Intellectual Property Enforcement-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 to enforce. Third parties could also obtain licenses to some of our intellectual property as a consequence of a merger or acquisition. Also, our participation in standard setting organizations or industry initiatives may require us to license our patents to other companies that adopt certain standards or specifications. As a result of such licensing, our patents might not be enforceable against others who might otherwise be infringing those patents and the value of our intellectual property may be impaired.

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. Litigation is inherently uncertain, and there is no assurance that any litigation we initiate will have a successful outcome. Enforcing our rights could subject us to claims that the intellectual property right is invalid, is otherwise not enforceable, or is licensed to the party against whom we are asserting a claim. Also, assertion of our intellectual property rights could result in the other party seeking to assert alleged intellectual property rights of its own or assert other claims against us, which could harm our business.

We currently have numerous patents issued and a number of 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 sizable 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.

Intellectual Property Risks-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. Because of technological changes and the extent of issued patents in our industry, it is possible that certain components of our products and business methods may unknowingly infringe existing patents of others. Any claim, regardless of its merits, could be expensive and time consuming to defend against. Such claims 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 or at all, to cease using the technology covered by those rights, and to indemnify our customers, resellers or suppliers. Any of these events could result in unexpected expenses, negatively affect our competitive position and materially harm our business, financial condition and results of operations.

In addition, we are also subject to risks related to ownership of our patentable inventions as a result of recent changes in U.S. patent law under the America Invents Act, pursuant to which the United States is transitioning from a "first-to-invent" system to a "first-to-file" system for patent applications filed on or after March 16, 2013. Accordingly, with respect to patent applications filed on or after March 16, 2013, even if we are the first to invent, we will not obtain ownership of an invention unless we are the first to file a patent application or can establish that such an earlier filing is derived from a previous public disclosure of our inventive work. If we are the first to invent but not the first to file a patent application, we will not be able to fully protect our intellectual property rights and may be found to have violated the intellectual property rights of others if we continue to operate in the absence of a patent issued to us. If we are not the first to file one or more patent applications to protect our intellectual property rights when the new patent regime becomes effective, we may be required to redesign our technology, cease using the related technology or attempt to license rights from another party, any of which could materially harm our business, financial condition and results of operations.

Open Source Software-Our use of open source and third-party software could impose unanticipated conditions or restrictions on our ability to commercialize our products.

We incorporate open source software into our products. Open source software is made available to us and to the public by its authors or other third parties under licenses that impose certain obligations on licensees in the event those licensees re-distribute or make derivative works of the open source software. The terms of many open source licenses have not been interpreted by United States or other courts, and these licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our products. In this event, we could be required to seek licenses from third parties in order to continue offering our products, to make generally available, in source code form, proprietary code that links to certain open source modules, to re-engineer our products, or to discontinue the sale of our products if re-engineering could not be accomplished on a timely basis, any of which might harm our business, operating results and financial condition.

Litigation-Adverse litigation results could affect our business.

We may be subject to legal claims or regulatory matters involving consumer, stockholder, competition and other issues on a global basis. Litigation can be lengthy, expensive and disruptive to our operations, and results cannot be predicted with certainty. An adverse decision could include monetary damages or, in cases for which injunctive relief is sought, an injunction prohibiting us from manufacturing or selling one or more of our products. If we were to receive an unfavorable ruling on a matter, our business, operating results or financial condition could be materially harmed. Additional information regarding certain of the lawsuits we are involved in is discussed under "Legal Proceedings" in Part I, Item 3 of the Company's Annual Report on Form 10-K for the year ended June 28, 2013 which was filed with the SEC on September 9, 2013.

Global Restructuring-We may not fully realize the anticipated positive impacts to future financial results from our restructuring efforts.

While we have substantially completed restructuring efforts to streamline operations and reduce operating expenses in Europe, we may undetake additional restructuring efforts in the future. Our ability to achieve the anticipated cost savings and other benefits from our restructuring efforts within expected time frames is subject to many estimates and assumptions, and may vary materially based on factors such as negotiations with third parties. These estimates and assumptions are subject to significant economic, competitive and other uncertainties, some of which are beyond our control. There can be no assurance that we will fully realize the anticipated positive impacts to future financial results from our current or future restructuring efforts. If our estimates and assumptions are incorrect or if other unforeseen events occur, we may not achieve the cost savings expected from such restructurings, and our business and results of operations could be adversely affected.

Accounting Standards-Changes in accounting principles or standards, or in the way they are applied, could result in unfavorable accounting charges or effects and unexpected financial reporting fluctuations, and could adversely affect our reported operating results.

We prepare our consolidated financial statements in conformity with U.S. Generally Accepted Accounting Principles ("GAAP"). These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles and guidance. A change in existing principles or guidance can have a significant effect on our reported results and may retroactively affect previously reported results. Additionally, proposed accounting standards could have a significant impact on our operational processes, revenues and expenses, and could cause unexpected financial reporting fluctuations.

For example, the Financial Accounting Standards Board ("FASB") is currently working together with the International Accounting Standards Board ("IASB") to converge certain accounting principles and facilitate more comparable financial reporting between companies that are required to follow GAAP and those that are required to follow International Financial Reporting Standards ("IFRS"). These efforts may result in different accounting principles under GAAP, which may have a material impact on the way in which we report financial results in areas including, but not limited to, revenue recognition, lease accounting,and financial statement presentation. We expect the SEC to make a determination regarding the incorporation of IFRS into the financial reporting system for U.S. companies. A change in accounting principles from GAAP to IFRS may have a material impact on our financial statements and may retroactively adversely affect previously reported transactions.

Corporate Governance-We are subject to evolving corporate governance and public disclosure regulations that have increased both our compliance costs and the risk of noncompliance, which could have an adverse effect on our stock price.

We are subject to changing rules and regulations promulgated by a number of governmental and self-regulated organizations, including the SEC, the NASDAQ Global Select Market and the Financial Accounting Standards Board. These rules and regulations continue to evolve in scope and complexity and many new requirements have been created in response to laws enacted by Congress, making compliance more difficult and uncertain. For example, Congress recently passed the Dodd-Frank Wall Street Reform and Protection Act. Our efforts to comply with the Dodd-Frank Act and other new regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

Conflict Minerals Risks-We are subject to the SEC's new rules regarding the use and disclosure of conflict minerals, which we expect will increase our operating and compliance costs and could potentially harm our reputation, causing a decline in our stock price.

The SEC adopted its final rule implementing Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act concerning conflict minerals during August 2012. The objective of the rule is to reduce funding for armed groups that are abusing human rights in the "conflict region" as defined in the final rule. We are committed to compliance with the SEC's Conflict Minerals Rule and support its intended objective. This new rule requires us to: (1) determine whether conflict minerals (tin, tantalum, tungsten, gold or similar derivatives) are used in our products and, if so, determine if the minerals originated from the Democratic Republic of Congo (DRC) or its immediately adjoining countries; and (2), if so, conduct due diligence regarding the source and chain of custody of these conflict minerals to determine whether the conflict minerals financed or benefitted armed groups. The rule will require us to submit forms and reports to the SEC by May 31, 2014 and annually thereafter that disclose our determinations and due diligence measures. We are currently conducting conflict minerals due diligence with our supply chain partners and are working toward our May 31, 2014 deadline. Presently, we have not determined how many or if any of our supply chain partners use conflict minerals or how much expense our due diligence exercise will add to our operational cost. If we do not properly assess supply chain partners and appropriately control costs and budget for conflict minerals compliance, our results of operations and profitability in the future could suffer, our reputation could be harmed and our stock price could suffer as a result.

Anti-takeover Provisions-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.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds
Issuer Purchases of Equity Securities
The following table summarizes the activity related to stock repurchases during the there months ended December 27, 2013:
Issuers Repurchases of Equity Securities
(in thousands, except per share amounts)

	Total Number of Shares Purchased	Weighted Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Amount That May Yet Be Purchased Under the Plans or Programs
Sept. 28, 2013 - Oct. 25, 2013	95	$14.97	95	$7,742
Oct. 26, 2013 - Nov. 22, 2013	205	$12.52	205	$20,175
Nov. 23, 2013 - Dec. 27, 2013	60	$12.68	60	$19,415
Total	360	$13.94	360	$19,415

In January 2013, the Company's board of directors approved a plan for the Company to repurchase shares of its common stock with a market value of up to $15.0 million. In November 2013, the Company announced an increase in the authorized repurchase amount to $30.0 million. The Company's common stock may be repurchased in the open market or through negotiated transactions, including 10b5-1 trading plans that would enable the Company to repurchase its shares during periods outside of its normal trading windows. The repurchase program expires December 31, 2014. Purchases will cease if the authorized funds are spent or the program is discontinued. The Company is not obligated to acquire any particular amount of stock, and the program may be suspended or terminated at any time at the Company's discretion. These repurchases are reflected in our balance sheet as treasury stock and are available for future issuance.
During the three months ended December 27, 2013, the Company repurchased 360,000 shares of its common stock for approximately $4.7 million. Since the inception of the repurchase plan in January 2013, the Company has repurchased approximately 758,000 shares of its common stock for $10.6 million. As of December 27, 2013, the Company had a remaining authorization of $19.4 million for future share repurchases.

ITEM 3. Defaults Upon Senior Securities
None.

ITEM 4. Mine Safety Disclosures
Not applicable.

ITEM 5. Other Information
None.

ITEM 6. Exhibits

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date	Filed Herewith
		Form	Ex. No.	File No.		
31.1	Certification of Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a).					X
31.2	Certification of Principal Financial Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a).					X
32.1	Certifications of Principal Executive Officer and Principal Financial Officer furnished pursuant to 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
101.INS**	XBRL Instance Document					X
101.SCH**	XBRL Taxonomy Extension Schema Document					X
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document					X

** XBRL (eXtensible Business Reporting Language) information is furnished and not filed herewith, is not a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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/ ROBERT J. NIKL

Robert J. Nikl
Chief Financial Officer
(Principal Financial Officer)

Dated: January 31, 2014