Silicon Graphics International Corp
Form 10-Q
October 31, 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 September 26, 2014
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	32-0047154
(State or Other Jurisdiction of Incorporation or Organization)	(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 October 28, 2014, there were 34,590,456 shares of the registrant's common stock outstanding.

SILICON GRAPHICS INTERNATIONAL CORP.
TABLE OF CONTENTS

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	
	September 26, 2014	September 27, 2013
Revenue		
Product	$75,002	$108,820
Service	36,699	38,699
Total revenue	111,701	147,519
Cost of revenue		
Product	58,893	88,692
Service	20,436	20,579
Total cost of revenue	79,329	109,271
Gross profit	32,372	38,248
Operating expenses:		
Research and development	13,200	14,834
Sales and marketing	15,861	17,596
General and administrative	13,305	12,482
Restructuring	116	526
Total operating expenses	42,482	45,438
Loss from operations	(10,110)	(7,190)
Total other income, net:		
Interest expense, net	(42)	(7)
Other income, net	143	303
Total other income, net	101	296
Loss before income taxes	(10,009)	(6,894)
Income tax provision (benefit)	324	(71)
Net loss	$(10,333)	$(6,823)
Basic and diluted net loss per share	$(0.30)	$(0.20)
Weighted average shares used in computing basic and diluted net loss per share	34,420	34,096

See accompanying notes.

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

	Three Months Ended	
	September 26, 2014	September 27, 2013
Net loss	$(10,333)	$(6,823)
Other comprehensive (loss) income:		
Unrecognized gain on defined benefit plans, net of zero tax	69	29
Unrealized gain (losses) on derivatives instruments, net of zero tax	583	(1,045)
Unrealized (gain) losses on derivative instruments reclassified into earnings, net of zero tax	(101)	86
Foreign currency translation adjustment, net of zero tax	(1,119)	(139)
Other comprehensive loss	(568)	(1,069)
Total comprehensive loss	$(10,901)	$(7,892)

See accompanying notes.

3

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

	September 26, 2014	June 27, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$89,492	$109,297
Current portion of restricted cash	2,398	2,273
Accounts receivable, net of allowance for doubtful accounts of $234 and $287 as of September 26, 2014 and June 27, 2014, respectively	76,691	72,076
Inventories	65,391	47,354
Current portion of deferred cost of revenue	11,539	12,180
Prepaid expenses and other current assets	10,273	19,802
Total current assets	255,784	262,982
Non-current portion of restricted cash	2,092	2,177
Property and equipment, net	34,563	34,584
Goodwill and intangible assets, net	12,981	13,207
Non-current portion of deferred cost of revenue	7,464	7,592
Other assets	43,145	44,396
Total assets	$356,029	$364,938
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$62,741	$53,128
Accrued compensation	18,420	20,049
Current portion of deferred tax liabilities	15,846	15,846
Current portion of deferred revenue	84,140	78,675
Other current liabilities	25,513	37,814
Total current liabilities	206,660	205,512
Non-current portion of deferred revenue	43,833	45,422
Long-term income taxes payable	9,980	10,114
Retirement benefit obligations	12,176	12,931
Other non-current liabilities	8,383	8,807
Total liabilities	281,032	282,786
Commitments and contingencies (Note 22)		
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; 36,524 shares and 36,173 shares issued at September 26, 2014 and June 27, 2014, respectively	36	36
Additional paid-in capital	532,372	527,525
Treasury stock, at cost (1,965 shares at September 26, 2014 and 1,844 shares at June 27, 2014)	(19,778)	(18,677)
Accumulated other comprehensive loss	(4,456)	(3,888)
Accumulated deficit	(433,177)	(422,844)

Total stockholders' equity	74,997	82,152
Total liabilities and stockholders' equity	$356,029	$364,938

See accompanying notes.

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

	Three Months Ended	
	September 26, 2014	September 27, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(10,333)	$(6,823)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,656	3,591
Share-based compensation	3,499	2,976
Other	117	285
Changes in operating assets and liabilities:		
Accounts receivable	(5,997)	(22,995)
Inventories	(19,321)	4,533
Deferred cost of revenue	258	5,608
Prepaid expenses and other assets	11,229	742
Accounts payable	10,049	4,442
Deferred revenue	5,762	2,047
Other liabilities	(15,277)	(7,334)
Net cash used in operating activities	(17,358)	(12,928)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,192)	(1,710)
Other	(39)	(1,269)
Net cash used in investing activities	(1,231)	(2,979)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Funding of restricted stock units withheld for taxes	(522)	(832)
Purchase of treasury stock	(1,101)	(3,056)
Proceeds from issuance of common stock upon exercise of stock options	298	2,846
Proceeds from issuance of common stock under employee stock purchase plan	1,572	1,996
Net cash provided by financing activities	247	954
Effect of exchange rate changes on cash	(1,463)	(170)
Net decrease in cash	(19,805)	(15,123)
Cash-beginning of period	109,297	175,181
Cash-end of period	$89,492	$160,058
SUPPLEMENTAL DISCLOSURE OF OTHER CASH FLOW INFORMATION:		
Income taxes (paid) refunded	$(251)	$237
Cash paid for interest	$39	$34
NON CASH INVESTING AND FINANCING ACTIVITIES:		
Property and equipment purchases in accounts payable	$125	$2,389
Inventory transfers to property and equipment	$849	$748

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 high performance computing and data analytics 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 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.

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 27, 2014, which are included in the Company's Annual Report on Form 10-K filed with the SEC on September 8, 2014.
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 2015 will be comprised of 52 weeks and will end on June 26, 2015. Fiscal year 2014 was comprised of 52 weeks and ended on June 27, 2014.
In fiscal year 2014, the Company's fiscal quarters ended on September 27, 2013 (first quarter), December 27, 2013 (second quarter), March 28, 2014 (third quarter) and June 27, 2014 (fourth quarter).
In fiscal year 2015, the Company's fiscal quarters end on September 26, 2014 (first quarter), December 26, 2014 (second quarter), March 27, 2015 (third quarter) and June 26, 2015 (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.

6

Revenue and Cost of Revenue for Product and Service. For arrangements which include software licenses and undelivered post contract customer support ("PCS"), where we have not established vendor-specific objective evidence ("VSOE") of fair value of the undelivered element, revenue and related cost of revenue from these arrangements have been deferred and recognized ratably over the PCS period and historically been classified as combined product and service revenue and cost of revenue in the consolidated statements of operations. Revenue and cost of revenue for these types of arrangement are no longer material, as such, amounts are reported as revenue and cost of revenue for product or service. Amounts previously reported as combined product and service revenue and cost of revenue for the three months ended September 27, 2013 have been reclassified to conform to the three months ended September 26, 2014.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no changes in the Company's significant accounting policies for the three months ended September 26, 2014 as compared to those disclosed in the Company's Annual Report on Form 10-K for the year ended June 27, 2014.

Recently Issued Accounting Standards.

Revenue from Contracts with Customers. In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers,” which supersedes the revenue recognition requirements in Topic 605, “Revenue Recognition” and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in ASU 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, with early application not permitted. This guidance will be effective for the Company in fiscal 2018. The Company is currently evaluating the effects, if any, which the adoption of this guidance will have on the Company’s financial position, results of operations and cash flows.

Reporting of Discontinued Operations and Disclosures of Disposals of Component of an Entity. In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2014-08, “Reporting of Discontinued Operations and Disclosures of Disposals of Components of an Entity,” which provides a narrower definition of discontinued operations than under existing U.S. GAAP. ASU 2014-08 requires that only a disposal of a component of an entity, or a group of components of an entity, that represents a strategic shift that has, or will have, a major effect on the reporting entity’s operations and financial results should be reported in the financial statements as discontinued operations. ASU 2014-08 also provides guidance on the financial statement presentations and disclosures of discontinued operations. The amendments in ASU 2014-08 are effective for all disposals of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015, with early application permitted. This guidance will be effective during the Company's third quarter of fiscal 2016. The adoption of this standard will not have a significant effect on the Company's condensed consolidated statements of operations.

4. 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.

7

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

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):

	September 26, 2014				
	Carrying	Fair Value Measured Using			Total
	Value	Level 1	Level 2	Level 3	Balance
Assets					
Money market funds	$130	$130	$—	$—	$130
Investments held by insurance companies	5,624	—	5,624	—	5,624
Derivative assets	1,772	—	1,772	—	1,772
Total assets measured at fair value	$7,526	$130	$7,396	$—	$7,526
Liabilities					
Derivative liabilities	$974	$—	$974	$—	$974
Total liabilities measured at fair value	$974	$—	$974	$—	$974

	June 27, 2014				
	Carrying	Fair Value Measured Using			Total
	Value	Level 1	Level 2	Level 3	Balance
Assets					
Money market funds	$130	$130	$—	$—	$130
Investments held by insurance companies	5,624	—	5,624	—	5,624
Derivatives assets	1,092	—	1,092	—	1,092
Total assets measured at fair value	$6,846	$130	$6,716	$—	$6,846
Liabilities					
Derivative liabilities	$3,019	$—	$3,019	$—	$3,019
Total liabilities measured at fair value	$3,019	$—	$3,019	$—	$3,019

There were no transfers between Level 1 and Level 2 of the fair value hierarchy during the three months ended September 26, 2014 and September 27, 2013. 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 investments 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.

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

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

The Company does not have any assets or liabilities measured at fair value on a non-recurring basis as of September 26, 2014 and June 27, 2014.

5. 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 September 26, 2014, the Company has 6 open hedges with the aggregate notional amount in USD equivalent to approximately $11.3 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.

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 September 26, 2014, the Company has 32 open non-designated hedges with the aggregate USD-equivalent notional amount of approximately $14.6 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 months ended September 26, 2014 and September 27, 2013 was as follows (in thousands):

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

	Location	Three Months Ended September 26, 2014	Three Months Ended September 27, 2013
Designated Derivatives			
Cash Flow Hedges:			
Foreign exchange contracts (Effective portion)	Amount recognized in AOCI	$583	$(1,045)
Foreign exchange contracts (Effective portion)	Net revenues	163	(155)
Foreign exchange contracts (Effective portion)	Operating expenses	(63)	68
Foreign exchange contracts (Effective portion)	Other income (expense), net	—	50
Total		$683	$(1,082)
Non-designated Derivatives			
Foreign exchange contracts	Other income (expense), net	$899	$556
Total		$899	$556

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 asset position as of September 26, 2014, was $0.8 million. The credit-risk-related contingent features underlying these agreements had not been triggered as of September 26, 2014.

As of September 26, 2014, the Company has designated derivatives with notional values of approximately $11.3 million and non-designated derivatives with notional values of approximately $14.6 million in Euro, British Pound, Canadian Dollar, Australian Dollar, Japanese Yen and other currencies.

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 September 26, 2014 and June 27, 2014, 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		
As of September 26, 2014	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	$1,772	$—	$—	$(974	) $—	$798
Total	$1,772	$—	$—	$(974	) $—	$798

10

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

Offsetting of Derivative Liabilities

	Gross Amount Offset In the Statement of Financial Position			Gross Amounts Not Offset in the Statement of Financial Position		
As of September 26, 2014	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	$(974)	$—	$—	$974	$—	$—
Total	$(974)	$—	$—	$974	$—	$—

Offsetting of Derivative Assets

	Gross Amount Offset In the Statement of Financial Position			Gross Amounts Not Offset in the Statement of Financial Position		
As of June 27, 2014	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	$1,092	$—	$—	$(1,092)	$—	$—
Total	$1,092	$—	$—	$(1,092)	$—	$—

Offsetting of Derivative Liabilities

	Gross Amount Offset In the Statement of Financial Position			Gross Amounts Not Offset in the Statement of Financial Position		
As of June 27, 2014	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	$(3,019)	$—	$—	$1,092	$—	$(1,927)
Total	$(3,019)	$—	$—	$1,092	$—	$(1,927)

The gross fair value and location of derivative instruments held in the condensed consolidated statement of financial position as of September 26, 2014 and June 27, 2014 were as follows (in thousands):

Fair Values of Derivative Instruments

Asset Derivatives			Liability Derivatives		
Location	September 26, 2014	June 27, 2014	Location	September 26, 2014	June 27, 2014
Designated Derivatives:					
Foreign exchange contracts			Foreign exchange contracts		
Other current assets	$ 886	$ 88	Other current liabilities	$ 508	$ 209
Non- designated Derivatives:					
Foreign exchange contracts			Foreign exchange contracts		
Other current assets	886	1,004	Other current liabilities	466	2,810
Total derivatives	$ 1,772	$ 1,092		$ 974	$ 3,019

11

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

The following table provides the balances and changes in the accumulated other comprehensive loss (income) related to derivative instruments during the three months ended September 26, 2014 (in thousands):

	Amount
AOCI - Beginning balance of losses	$87
Gain recognized in OCI on derivatives (effective portion) before reclassifications	(583)
Unrealized gain reclassified to income	101
AOCI - Ending balance of gain	$(395)

See Statement of Comprehensive Loss and Note 4 for more information regarding derivatives.

6. INVENTORIES
Inventories consist of the following (in thousands):

	September 26, 2014	June 27, 2014
Finished goods	$22,541	$13,700
Work in process	21,105	10,795
Raw materials	21,745	22,859
Total inventories	$65,391	$47,354

Finished goods include inventory in transit, at customer sites undergoing installation, or testing prior to customer acceptance; such amounts were $12.4 million at September 26, 2014 and $7.9 million at June 27, 2014.

7. PREPAID EXPENSES AND OTHER CURRENT ASSETS
Prepaid expenses and other current assets consist of the following (in thousands):

	September 26, 2014	June 27, 2014
Value-added tax receivable	$3,394	$9,611
Deferred tax assets	126	126
Prepaid taxes	890	1,011
Other prepaid and current assets	5,863	9,054
Total prepaid expenses and other current assets	$10,273	$19,802

8. GOODWILL AND INTANGIBLE ASSETS, NET
Goodwill was as follows (in thousands):

	Product	Service	Total
Goodwill as of June 27, 2014	$7,508	$1,076	$8,584
Goodwill arising from acquisitions	—	—	—
Goodwill as of September 26, 2014	$7,508	$1,076	$8,584

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

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

Intangible Asset Class	Weighted Average Useful Life (in Years)	September 26, 2014 Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	5	$7,300	$ (7,000)	$300
Purchased technology	5	12,200	(10,550)	1,650
Customer backlog	(a)	10,540	(10,265)	275
Trademark/trade name portfolio	5	3,767	(3,692)	75
Patents and other	2(b)	2,297	(200)	2,097
Total		$36,104	$ (31,707)	$4,397

Intangible Asset Class	Weighted Average Useful Life (in Years)	June 27, 2014 Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	5	$7,300	$(6,975)	$325
Purchased technology	5	12,200	(10,406)	1,794
Customer backlog	(a)	10,540	(10,215)	325
Trademark/trade name portfolio	5	3,767	(3,685)	82
Patents and other	2(b)	2,297	(200)	2,097
Total		$36,104	$(31,481)	$4,623

(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 $0.2 million and $0.8 million in the three months ended September 26, 2014 and September 27, 2013, respectively.
As of September 26, 2014, expected amortization expense for all intangible assets was as follows (in thousands):

Fiscal Year	Amortization Expense
2015 (remaining nine months)	$647
2016	793
2017	759
2018	100
	$2,299

9. OTHER ASSETS
Other assets consist of the following (in thousands):

	September 26, 2014	June 27, 2014
Long-term service inventory	$15,828	$15,969
Restricted pension plan assets	7,666	8,242
Deferred tax assets	16,663	16,663
Long-term refundable deposits	2,414	2,895
Other assets	574	627
Total other assets	$43,145	$44,396

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

10. OTHER CURRENT LIABILITIES

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

	September 26, 2014	June 27, 2014
Accrued sales and use tax payable	$5,742	$15,033
Accrued professional services fees	4,489	3,421
Accrued warranty, current portion	3,986	4,216
Accrued restructuring and severance	1,448	2,741
Derivatives	974	3,019
Other	8,874	9,384
Total other current liabilities	$25,513	$37,814

11. OTHER NON-CURRENT LIABILITIES

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

	September 26, 2014	June 27, 2014
Accrued warranty, non-current portion	$1,648	$1,828
Deferred rent	5,755	6,312
Other	980	667
Total other non-current liabilities	$8,383	$8,807

12. 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	
	September 26, 2014	September 27, 2013
Balance at beginning of period	$6,044	$5,622
Current period provision	673	672
Warranty expenditures incurred	(1,176)	(1,027)
Changes in accrual for pre-existing warranties	93	333
Balance at end of period	$5,634	$5,600

13. RESTRUCTURING ACTIVITY

The Company has implemented restructuring actions to streamline operations and reduce operating expenses. Total expense for all restructuring actions was $0.1 million and $0.5 million in the three months ended September 26, 2014 and September 27, 2013, respectively. The restructuring expense is included in operating expenses in the accompanying condensed consolidated statements of operations. The total restructuring liability was $0.1 million as of September 26, 2014, all of which is classified as current liabilities in the accompanying condensed consolidated balance sheet.

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

Fiscal 2012 Restructuring Action

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.

Total expense incurred in connection with this restructuring plan for actions taken through September 26, 2014 was $12.7 million. This restructuring action is substantially complete.

Activity in accrued restructuring for this restructuring action through September 26, 2014 was as follows (in thousands):

	Employee Terminations	
Balance at June 27, 2014	$269	
Costs incurred	116	
Cash payments	(274	)
Balance at September 26, 2014	$111	

14. CREDIT FACILITY

On December 5, 2011, the Company entered into a five-year senior secured credit facility with aggregate principal amount of $25.0 million, as amended. 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 $10.0 million letter of credit subfacility. See Note 22 "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 September 26, 2014, the Company had no outstanding balance owed on the credit facility. As of September 26, 2014, 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.

The Company was in compliance with all covenants under the credit facility, as of September 26, 2014.

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

15. SHARE-BASED COMPENSATION

During the three months ended September 26, 2014 and September 27, 2013, the Company granted 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 2015 Employee Stock Purchase Plan; however, there were no stock options granted during the respective periods. Total share-based compensation expense was as follows (in thousands):

	Three Months Ended	
	September 26, 2014	September 27, 2013
Cost of revenue	$466	$442
Research and development	559	507
Sales and marketing	801	579
General and administrative	1,673	1,448
Total share-based compensation expense	$3,499	$2,976

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	
	September 26, 2014	September 27, 2013
ESPP Plan shares		
Risk-free interest rate	0.2%	0.2%
Volatility	49.0%	60.9%
Weighted average expected life (in years)	1.25	1.25
Expected dividend yield	—	—
Weighted average fair value	$3.21	$6.08

Stock Option Activity

A summary of stock option activity for the three months ended September 26, 2014 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 27, 2014	1,608,436	$10.53		
Options granted	—	—		
Options exercised	(43,436)	5.87		
Options cancelled	(86,590)	14.59		
Balance at September 26, 2014	1,478,410	$10.43	5.64	$1,766
Vested and expected to vest at September 26, 2014	1,452,503	$10.46	5.61	$1,720
Exercisable at September 26, 2014	1,219,984	$10.66	5.27	$1,477

The total intrinsic value of options exercised in the three months ended September 26, 2014 and September 27, 2013 was $0.1 million and $3.0 million, respectively. The total fair value of shares vested during the three months ended

September 26, 2014 and September 27, 2013 was $0.3 million and $0.6 million, respectively.
As of September 26, 2014, there was $0.3 million of total unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a weighted average period of 0.72 years.

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

Restricted Stock Unit Activity

The following table summarizes the Company's activity with respect to restricted stock units (“RSUs”) for the three months ended September 26, 2014:

	Number of Shares
Balance at June 27, 2014	1,696,823
Awarded	1,164,813
Released	(158,550)
Forfeited	(243,959)
Balance at September 26, 2014	2,459,127
Vested and expected to vest at September 26, 2014	1,867,475

In August 2014, the Company granted time-based RSUs ("2014 executive time-based RSUs") and performance-based RSUs (“2014 executive PSUs”) to members of the Company's executive management team. The 2014 executive time-based RSUs vest quarterly over four years, subject to the recipient's continuous service through each vesting date. The performance-based awards initially vest as to one-fourth of their amount on the third business day following Compensation Committee review of the Company’s goal attainment for the fiscal year ending June 26, 2015, so long as (a) the Company’s total stockholder return meets the median total stockholder return of its peer group (50% weighting), and (b) the Company’s financial results meet targets established by the Board for certain product sales and bookings for fiscal 2015 (two goals with 25% weighting each). The performance-based awards may be increased or decreased depending on the level of attainment by the Company of the performance metrics established by the Board. Achievement of the aforementioned performance criteria will result in a vesting percentage determined in accordance with a vesting matrix. At attainment of 75% or below, vesting will be at 50%. At 100% attainment, vesting will be at 125%. At 125% attainment or above, vesting will be at 150%. If the conditions for initial vesting of the performance-based awards are met, the remaining portion of the performance-based awards will vest in twelve equal, successive quarterly installments over an additional three years, subject to continued service through each vesting date.

For purposes of reporting and determining the share-based compensation expense as of September 26, 2014, the company estimated that 257,500 PSUs will be awarded. The Company assesses the achievement of these performance metrics on a quarterly basis.

As of September 26, 2014, there was $13.9 million of total unrecognized compensation cost related to RSUs and PSUs, which is expected to be recognized over a weighted average period of 1.68 years.

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	
	September 26, 2014	September 27, 2013
RSUs shares withheld for taxes	58,610	55,930
RSUs amounts withheld for taxes	$545	$864

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

Employee Stock Purchase Plan

At September 26, 2014, the total unrecognized compensation cost related to options to purchase the Company's common stock under the employee stock purchase plan ("ESPP") was approximately $2.3 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 months ended September 26, 2014 and September 27, 2013.

	Three Months Ended	
	September 26, 2014	September 27, 2013
Shares issued	209,631	253,078
Weighted-average purchase price per share	$7.50	$7.89

16. 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 27, 2014	1,844	$18,677	$10.13
Repurchase of Treasury Stock:			
Three months ended September 26, 2014	121	1,101	9.08
Balance at September 26, 2014	1,965	$19,778	$10.07

Since the inception of the repurchase plan in January 2013, the Company has repurchased approximately 1,216,000 shares of its common stock for $14.9 million. As of September 26, 2014, the Company had a remaining authorization of $15.1 million for future share repurchases.

17. NET LOSS 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. For both of the three months ended September 26, 2014 and September 27, 2013, the effect of outstanding options and RSUs were anti-dilutive to loss per share and were therefore excluded from the calculation of diluted loss per share.

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. As the Company had a net loss in both the three months ended September 26, 2014 and September 27, 2013, basic and diluted net loss per share are the same for these periods.

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

The following table sets forth the computation of basic and diluted net loss per share for the three months ended September 26, 2014 and September 27, 2013 (in thousands, except per share amount):

	Three Months Ended	
	September 26, 2014	September 27, 2013
Numerator:		
Net loss	$(10,333)	$ (6,823)
Denominator:		
Weighted-average common shares used in computing basic and diluted net loss per share	34,420	34,096
Basic and diluted net loss per share	$(0.30)	$ (0.20)

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

	Three Months Ended	
	September 26, 2014	September 27, 2013
Options, RSUs, and ESPP	4,013	4,117

18. 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	
	September 26, 2014	September 27, 2013
Net periodic benefit cost		
Service cost	$89	$109
Interest expense	110	129
Expected return on plan assets	(36)	(41)
Amortization of actuarial losses	69	30
Net periodic benefit cost	$232	$227

19. INCOME TAXES

The Company recorded tax expense of approximately $0.3 million for the three months ended September 26, 2014. The tax expense primarily was comprised of tax liability computed based on the Company’s projected full-year foreign taxes, state taxes and interest for unrecognized tax benefits, partially offset by a refund of taxes in Korea. The effective tax rate differed from the combined federal and net state statutory income tax rate for the three months ended September 26, 2014 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 $0.1 million for the three months ended September 27, 2013. The tax benefit primarily was comprised of a refund of provincial taxes in Canada of $0.6 million, partially offset by tax liability computed based on the Company’s projected foreign financial results for the year ending June 27, 2014, state taxes, and interest for unrecognized tax benefits. The provincial refund received by the Company was the result of the conclusion of an income tax audit for fiscal years 1996 to 2004 by the Canada Revenue Agency. The effective tax rate differed from the combined federal

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

and net state statutory income tax rate for the three months ended September 27, 2013 primarily due to the tax rate differential of the Company's foreign operations and utilization of net operating losses not previously recognized.
As of September 26, 2014, 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 $5.9 million of gross unrecognized tax benefit as of September 26, 2014, of which $2.1 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 September 26, 2014, 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.

20. SEGMENT INFORMATION
Commencing in the first quarter of fiscal 2015, the Company started managing its business primarily as two separate business units, Products and Service. The Company has combined both the Compute and Storage solutions into a single Product Business Unit. 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 two reportable segments is as follows:
Product—The Product segment is comprised of our Compute and Storage solutions. Compute solutions 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 solutions 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.
All historical segment numbers for the three months ended September 27, 2013 have been recast to conform to the three months ended September 26, 2014.
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.

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

Segment Results

Summary information by operating segment for the three months ended September 26, 2014 and September 27, 2013 is as follows (in thousands):

	Three Months Ended	
	September 26, 2014	September 27, 2013
Total net revenue		
Product	$75,002	$ 108,820
Service	36,699	38,699
Total net revenue	$111,701	$ 147,519
Operating profit from reportable segments		
Product	$391	$ 4,223
Service	14,698	15,075
Total operating profit from reportable segments (1)	$15,089	$ 19,298

(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.

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

	Three Months Ended	
	September 26, 2014	September 27, 2013
	(in thousands)	
Total reportable segments' operating profit	$15,089	$19,298
All other corporate charges:		
Unallocated operating expenses	19,843	17,770
Restructuring and severance	1,092	929
Amortization of intangibles	215	835
Share based compensation	3,499	2,976
Excess and obsolescence inventory charges	—	3,242
Other	550	736
Total all other corporate charges	25,199	26,488
Loss from operations, as reported	$(10,110)	$(7,190)

The segment information is presented on the basis which the Company's CODM evaluates the performance of its operating segments.

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 September 26, 2014, various agencies of the United States government, excluding system integrators (collectively, U.S. government), accounted for approximately 21% of the Company's revenue. For the three months ended September 27, 2013, various agencies of the United States government (collectively, U.S. government) accounted for approximately 30% of the Company's revenue.

At September 26, 2014, two customers accounted for approximately 27% of the Company's accounts receivable. At June 27, 2014, two customer accounted for approximately 27% of the Company's accounts receivable.

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 months ended September 26, 2014 and September 27, 2013 (in thousands except percentages):

	Three Months Ended			
	September 26, 2014		September 27, 2013	
Americas	$67,670		$102,212	
As a percent of total net revenue	60.5	%	69.3	%
EMEA	17,613		21,041	
As a percent of total net revenue	15.8	%	14.3	%
APJ	26,418		24,266	
As a percent of total net revenue	23.7	%	16.4	%
Total revenue	$111,701		$147,519	

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 $20.1 million or 18% and $16.8 million or 11% for the three months ended September 26, 2014, and September 27, 2013, respectively. No other individual foreign country's revenue accounted for 10% or more of revenues in the three months ended September 26, 2014 and September 27, 2013.

21. 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 September 26, 2014 was $4.6 million for which the Company has $4.5 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.

22. COMMITMENTS AND CONTINGENCIES

Letter of Credit

The Company's credit facility includes a $10.0 million letter of credit subfacility. As of September 26, 2014, 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 14 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 September 26, 2014. 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 September 26, 2014.

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 24 of the Company's Annual Report on Form 10-K filed with the SEC on September 8, 2014.

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 27, 2014 filed with the Securities and Exchange Commission (the “SEC”) on September 8, 2014 (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 27, 2014 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 high performance computing and data analytics 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 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, and media and entertainment.

SGI expects market growth in our core markets of high performance computing and storage and real time analytic. 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 and will focus on winning large strategic projects. We have a strong suite of products and a go-to-market strategy aligned with these growing opportunities. During fiscal 2014, we have introduced new configurations for our Rackable®, SGI® ICE™ X, SGI® UV™ compute platforms. We recently launched our new SGI UV for SAP HANA® which will largely target commercial enterprise businesses and is designed to streamline database management for single large node environments, which require extremely high capacity and scale to meet the needs of in-memory databases. Our management continues to focus on opportunities to enhance operational efficiency and reduce costs. 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 41.3% and 34.1% of total revenue from sales outside of the U.S. in the three months ended September 26, 2014 and September 27, 2013, respectively. In addition, our customer base continues to expand in various sectors, including the public and manufacturing sectors.

Results of Operations

Summarized below are the results of our operations for the three months ended September 26, 2014 as compared to the three months ended September 27, 2013.

Financial Highlights

- Our total revenue for the three months ended September 26, 2014 was $111.7 million, a decrease of $35.8 million or 24.3%, from the comparable period in fiscal 2013. The decrease experienced was due primarily to lower sales for our legacy cloud products. 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. We also experienced a decline in revenue from the U.S. government compared to the first quarter of fiscal 2014; however, we are seeing an upward trend in revenue generated from the U.S. government compared to the low levels that we experienced after the government shutdown in the fall of 2013.
- Our overall gross margin increased by 3.1 percentage points from 25.9% in the three months ended September 27, 2013 to 29.0% in the three months ended September 26, 2014. The favorable change in the overall gross margin in the three months ended September 26, 2014 was primarily driven by a more profitable mix compared to the comparable quarter last year. As indicated above, we made a strategic decision to withdraw from low margin commodity service infrastructure business which generated lower margins and we also benefited from lower excess and obsolete inventory charges and decreases in compensation and related expenses due to the reductions in headcount.
- Our research and development and selling, general and administrative expenses were $42.4 million in the three months ended September 26, 2014 compared to $44.9 million in the prior year comparable quarter, a decrease of approximately $2.5 million. The decrease was primarily attributed to a decline in compensation and related expenses due to the reductions in headcount and lower spending due to tight expense controls.
- Total headcount as of September 26, 2014 was 1,107, which reflects a net reduction of 209 employees or approximately 16%, from 1,316 as of September 27, 2013 primarily due to the restructuring and cost reduction actions occurring over the last fiscal year. The savings from headcount reductions, along with lower bonus and commissions, contributed to the reduction in expenses.
- We recorded restructuring and severance expense of $0.1 million and $0.5 million in the three months ended September 26, 2014 and September 27, 2013, respectively.

We recognized a net loss of $10.3 million for the three months ended September 26, 2014 compared to a net loss of $6.8 million in the comparable quarter last year. The increase in net loss for the three months ended September 26, 2014 compared to the comparable period last year was primarily driven by lower sales for our products as previously discussed above, partially offset by reductions in operating expenses as a result of headcount reductions.

- We are continuing to streamline our operations and maintain tight controls over spending in order to help achieve our long-term operating targets and goals, as well as to enable increased new investment in new products and emerging technologies.

Net Revenue

	Three Months Ended		2014 over
	September 26, 2014	September 27, 2013	2013 Change
	($ in thousands)		
Net revenue from products:	75,002	108,820	(33,818)
As a percent of total net revenue	67.1 %	73.8 %	(6.7) ppts
Net revenue from services	36,699	38,699	(2,000)
As a percent of total net revenue	32.9 %	26.2 %	6.7 ppts
Total net revenue	$111,701	$ 147,519	$(35,818)

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 months ended September 26, 2014 and September 27, 2013 (in thousands except percentages):

	Three Months Ended		2014 over
	September 26, 2014	September 27, 2013	2013 Change
Americas	$67,670	$102,212	$(34,542)
As a percent of total net revenue	60.6 %	69.3 %	(8.7) ppts
EMEA	17,613	21,041	(3,428)
As a percent of total net revenue	15.8 %	14.3 %	1.5 ppts
APJ	26,418	24,266	2,152
As a percent of total net revenue	23.6 %	16.4 %	7.2 ppts
Total revenue	$111,701	$147,519	$(35,818)

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, New Zealand, Japan and all other Asian countries.

Revenue generated in the Americas represented 60.6% of total revenue during the first quarter of fiscal 2015, or a decrease of 8.7 percentage points, from 69.3% during the comparable quarter last year. The decrease in revenue was due primarily to lower sales for our legacy cloud products as well as lower revenue from U.S. government sales resulting from a reduction in federal spending after last fall's government shutdown.

Cost of revenue and gross profit

Cost of revenue and gross profit for the three months ended September 26, 2014 and September 27, 2013 were as follows (in thousands except percentages):

	Three Months Ended		Change	
	September 26, 2014	September 27, 2013	$	%
Total cost of revenue	$79,329	$ 109,271	$(29,942)	(27.4)%
Total gross profit	$32,372	$ 38,248	$(5,876)	(15.4)%
Total gross margin	29.0 %	25.9 %		3.1 ppts

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 $5.9 million to $32.4 million in the three months ended September 26, 2014 from $38.2 million in the three months ended September 27, 2013 due to a decrease in revenue primarily related to lower sales for our legacy cloud products and U.S. government-related business. However, our overall gross margin increased to 29.0% in the three months ended September 26, 2014 from 25.9% in the three months ended September 27, 2013. The increase in gross margin for the three months ended September 26, 2014 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 lower excess and obsolete charges. In addition, we benefited from the decrease in compensation and related expenses due to the reductions in headcount during the three months ended September 26, 2014 compared to the three months ended September 27, 2013.

Operating Expenses

Operating expenses for the three months ended September 26, 2014 and September 27, 2013 were as follows (in thousands except percentages):

	Three Months Ended		Change	
	September 26, 2014	September 27, 2013	$	%
Research and development	$13,200	$ 14,834	$(1,634)	(11.0)%
Sales and marketing	15,861	17,596	(1,735)	(9.9)%
General and administrative	13,305	12,482	823	6.6 %
Restructuring	116	526	(410)	(77.9)%
Total operating expense	$42,482	$ 45,438	$(2,956)	(6.5)%

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 $1.6 million or 11.0% to $13.2 million in the three months ended September 26, 2014 from $14.8 million in the three months ended September 27, 2013. The decrease in research and development expense was primarily due to lower compensation and related expenses of $1.7 million, as a result of the reductions in headcount. We also benefited from a reduction in severance, lower depreciation costs and facilities costs. This was partially offset by an increase in equipment and material costs of $0.5 million incurred to support new product introductions and lower third party funding of $0.6 million during the first quarter of fiscal 2015 compared to the same period last year.

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 $1.7 million or 9.9% to $15.9 million in the three months ended September 26, 2014 from $17.6 million in the three months ended September 27, 2013. This decrease was primarily due to decreases in our compensation and related expenses as a result of decreased headcount, as well as lower commissions expense reflecting lower than expected achievement of sales commission targets and performance metrics compared to last year. We also benefited from lower travel costs due to tight expense controls and an overall reduction in headcount.

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 $0.8 million or 6.6% to $13.3 million in the three months ended September 26, 2014 from $12.5 million in the three months ended September 27, 2013. The increase in general and administrative expense was primarily due to the fact that we received a $0.6 million property tax refund in the first quarter of fiscal 2014. We also recognized higher share-based compensation expense due to new grant awards and an increase in consulting fees associated with our plans to upgrade our enterprise resource planning systems. This was partially offset by lower compensation and related expenses as a result of decreased headcount as well as lower rent expense.

Restructuring. Total restructuring expense related to our fiscal 2012 restructuring action was $0.1 million during the three months ended September 26, 2014 and was $0.5 million for the three months ended September 27, 2013. As a result of the restructuring actions taken in Europe described above, we have incurred approximately $12.7 million of cumulative expense through September 26, 2014 (including fiscal 2012, fiscal 2013 and fiscal 2014). This restructuring action is substantially complete.

Total other income, net

Total other income, net for the three months ended September 26, 2014 and September 27, 2013 were as follows (in thousands except percentages):

	Three Months Ended		Change	
	September 26, 2014	September 27, 2013	$	%
Interest expense, net	$(42)	$ (7)	$(35)	(500.0)%
Other income, net	143	303	(160)	(52.8)%
Total other income, net	$101	$ 296	$(195)	(65.9)%

Interest expense, net. Interest expense, net primarily consists of interest earned on our interest-bearing investment accounts money market funds, as well as interest expense relating to our credit facility and to certain tax payments.

Other income, net. Other income, net during the three months ended September 26, 2014 consisted of foreign exchange gains (losses) as a result of the exchange rates primarily for the Euro, British Pound, Japanese Yen 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.

Income tax provision (benefit)

Income tax provision (benefit) for the three months ended September 26, 2014 and September 27, 2013 were as follows (in thousands except percentages):

	Three Months Ended		Change	
	September 26, 2014	September 27, 2013	$	%
Income tax provision (benefit)	$324	$(71)	$395	(556.3)%

We recorded a tax provision of $0.3 million for the three months ended September 26, 2014. The tax provision primarily was comprised of tax liability computed based on the Company's projected full-year foreign taxes, state taxes, and interest for unrecognized tax benefits, and partially offset by a refund of taxes in Korea. The effective tax rate differed from the combined federal and net state statutory income tax rate for the three months ended September 26, 2014 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 $0.1 million for the three months ended September 27, 2013. The net tax benefit was primarily comprised of a refund of provincial taxes in Canada of $0.6 million, partially offset by tax liability computed based on the Company's foreign projected financial results for the year ended June 27, 2014, state tax, and interest for unrecognized tax benefits. The provincial refund received by the Company was the result of the conclusion of an income tax audit for fiscal years 1996 to 2004 by the Canada Revenue Agency. The effective tax rate differed from the combined federal and net state statutory income tax rate for the three months ended September 27, 2013 primarily due to the tax rate differential of the Company's foreign operations and utilization of net operating losses not previously recognized.

As of September 26, 2014, we have provided a partial valuation allowance against our net deferred tax assets. 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 2015, the Company started managing its business primarily as two separate business units, Products and Service. The Company has combined both the Compute and Storage solutions into a single Product Business Unit. 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.

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 months ended September 27, 2013 have been recast to conform to the three months ended September 26, 2014.

Product:
Our product segment include our scale-out computing, scale-up computing, software and cloud/web solutions. Compute solutions 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. Our Storage solutions 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 product segment for the three months ended September 26, 2014 and September 27, 2013 were as follows (in thousands except percentage):

	Three Months Ended		Change	
	September 26, 2014	September 27, 2013	$	%
Net revenue	$75,002	$ 108,820	$(33,818)	(31.1)%
Operating profit	$391	$ 4,223	$(3,832)	(90.7)%
Operating margin	0.5 %	3.9 %		(3.4) ppts

Revenue for our product segment decreased $33.8 million or 31.1% to $75.0 million in the three months ended September 26, 2014 from $108.8 million during the three months ended September 27, 2013. 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. We also experienced a decline in revenue from the U.S. government compared to the first quarter of fiscal 2014. However, we are seeing an upward trend in revenue generated from the U.S. government compared to the low levels that we experienced after the government shutdown in the fall of 2013. We experienced lower volumes for our scale-out and scale-up compute products as well as in our storage solutions as we typically generate incremental revenue for storage products to provide our customers with a complete solution.
Overall operating profit for our product segment decreased by $3.8 million to an operating profit of $0.4 million in the three months ended September 26, 2014 from $4.2 million operating profit in the three months ended September 27, 2013. Despite the decrease in legacy cloud products, during the first quarter of fiscal 2015, gross margin remained flat as a result of an unfavorable product mix. The segment also incurred lower operating expenses due to reductions in headcount discussed above, resulting in lower compensation and related expenses, as well as lower commission. However the relative fixed costs on significantly lower revenue volume negatively impacted the segment results during the period. This was partially offset by an increase in research and development as we continue to invest in our next generation products and launch new product offerings.
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 months ended September 26, 2014 and September 27, 2013 were as follows (in thousands except percentage):

	Three Months Ended		Change	
	September 26, 2014	September 27, 2013	$	%
Net revenue	$36,699	$ 38,699	$(2,000)	(5.2)%
Operating profit	$14,698	$ 15,075	(377)	(2.5)%
Operating margin	40.1 %	39.0 %		1.1 ppts

30

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 $2.0 million or 5.2% to $36.7 million in the three months ended September 26, 2014 from $38.7 million in the three months ended September 27, 2013. The decrease was primarily due to timing of professional services provided as well as fewer customer service maintenance contracts. In addition, we experienced lower support revenue as our new products replaced our installed base of older generation products. Typically, we sell service contracts along with sales of our products. As such, the overall decrease in product sales have negatively impacted our service revenue.

Despite the decrease in revenue, overall operating profit decreased by only $0.4 million for our Service segment during the three months ended September 26, 2014 compared to the three months ended September 27, 2013. The Service segment benefited from the reductions in headcount discussed above resulting in lower compensation and related expenses, as well as lower commissions.

Liquidity and Capital Resources

We had $89.5 million of unrestricted cash and cash equivalents at September 26, 2014 and $109.3 million at June 27, 2014. As of September 26, 2014, $45.6 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 to 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 September 26, 2014 and June 27, 2014, we had short-term and long-term restricted cash of $4.5 million 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 with an aggregate principal amount of $25.0 million, as amended. 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 September 26, 2014 and June 27, 2014, we had no balance outstanding under the credit facility. The maximum amount available to be borrowed under the credit facility at September 26, 2014 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 September 26, 2014, 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.

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):

	Three Months Ended			
	September 26, 2014		September 27, 2013	
Consolidated statements of cash flows data:				
Net cash used in operating activities	$(17,358	)	$(12,928	)
Net cash used in investing activities	(1,231	)	(2,979	)
Net cash provided by financing activities	247		954	
Effect of exchange rate changes on cash and cash equivalents	(1,463	)	(170	)
Net decrease in cash	$(19,805	)	$(15,123	)

32

Operating Activities

Cash used in operating activities was $17.4 million for the three months ended September 26, 2014. Our net loss was $10.3 million for the three months ended September 26, 2014. Non-cash items included in net loss consisted primarily of depreciation and amortization expense of $2.7 million, share-based compensation expense of $3.5 million and $0.1 million of other items. Net change in operating assets and liabilities of $13.3 million contributed to the decrease in cash from operating activities. The primary uses of cash in operating activities were for increases in accounts receivable and inventory, and decreases in other operating liabilities. 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 prepaid and other asset and increase in accounts payables and deferred revenue.

For the three months ended September 26, 2014, accounts receivable increased $6.0 million reflecting the timing of revenue recognition and collections of the trade receivables, and inventory increased $19.3 million reflecting the timing of customer shipments and acceptance of sales contracts. Additionally, other liabilities decreased by $15.3 million primarily due to the timing of payments to our suppliers.

For the three months ended September 26, 2014, accounts payable increased $10.0 million primarily due to the timing of payments to our supplier, prepaid expenses and other assets decreased by $11.2 million and deferred cost decreased by $0.3 million. Deferred revenue increased by $5.8 million primarily due to the timing of revenue recognition on sales transactions that were required to be recognized in accordance with our revenue recognition policy.

Cash used in operating activities was $12.9 million for the three months ended September 27, 2013. Our net loss was $6.8 million for the three months ended September 27, 2013. Non-cash items included in net loss consisted primarily of depreciation and amortization expense of $3.6 million, share-based compensation expense of $3.0 million and $0.3 million of other items. Net change in operating assets and liabilities of $13.0 million contributed to the decrease in cash from operating activities. The primary uses of cash in operating activities were for increases in accounts receivable and decreases in other operating liabilities. The primary sources of cash in operating activities were decreases in deferred cost of revenue and inventory as we shipped and installed solutions for a number of large contracts during the period as well as a increases in accounts payable and deferred revenue.

For the three months ended September 27, 2013, accounts receivable increased $23.0 million reflecting the timing of revenue recognition and collections of the trade receivables. Additionally, other liabilities decreased by $7.3 million primarily due to the timing of payments.

For the three months ended September 27, 2013, inventory decreased $4.5 million reflecting timing of customer shipments and acceptance of sales contracts. Deferred cost also decreased by $5.6 million and deferred revenue increased by $2.0 million primarily due to the timing of revenue recognition on sales transactions that were required to be deferred in accordance with our revenue recognition policy. Additionally, accounts payable increased $4.4 million, primarily due to the timing of payments and our progress in effectively monitoring our working capital, and other prepaid expenses and other assets decreased $0.7 million.

Investing Activities

Cash used in investing activities was $1.2 million in the three months ended September 26, 2014, primarily due to purchases of property and equipment of $1.2 million.

Cash used in investing activities was $3.0 million in the three months ended September 27, 2013, primarily due to purchases of property and equipment of $1.7 million and a reduction of restricted cash of $1.3 million.

Financing Activities

Cash provided by financing activities was $0.2 million for the three months ended September 26, 2014, primarily due to the proceeds for the issuance of stock under our employee stock purchase plan and stock option exercises of $1.9 million. This was offset by the repurchase of shares of our common stock of $1.1 million and the funding of restricted stock units withheld for taxes of $0.5 million.

Cash provided by financing activities was $1.0 million for the three months ended September 27, 2013, primarily due to the proceeds for the issuance of stock under our employee stock purchase plan and stock option exercises of $4.9

million, which was offset by the repurchase of shares of our common stock of $3.1 million and the funding of restricted stock units withheld for taxes of $0.8 million.

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 September 26, 2014, we had total outstanding commitments on non-cancelable operating leases of our real properties of $36.0 million, of which $26.0 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 2015 through 2023. As of September 26, 2014, we had total outstanding commitments of $10.0 million in non-cancelable international real property operating leases. The total outstanding commitments included $7.0 million relating to our leased facilities in Japan including the recent four year renewal of our Tokyo office. Our major facility leases in our international locations are generally for terms of two to four years and generally do not provide renewal options.

As of September 26, 2014, personal property under operating lease was comprised primarily of automobiles and office equipment. Total outstanding commitments under such leases totaled approximately $1.1 million at September 26, 2014.

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 September 26, 2014, there were remaining commitments of approximately $13.0 million, of which $12.2 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 with an aggregate principal amount of $25.0 million, as amended. As of September 26, 2014 and June 27, 2014, we had no balance outstanding under the credit facility. 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 14 of our unaudited condensed consolidated financial statements in this Form 10-Q for further information on the credit facility.

Uncertain Tax Positions—As of September 26, 2014, the net recorded tax liability for uncertain tax positions was $14.0 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 September 26, 2014 was $4.6 million, for which we have $4.5 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 September 26, 2014. 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 September 26, 2014.
Off-Balance Sheet Arrangements—Our credit facility includes a $10.0 million letter of credit subfacility. As of September 26, 2014, 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 September 26, 2014.

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;
- Retirement benefit obligations; and
- Accounting for income taxes.

There have been no significant changes in the Company's significant accounting policies for the three months ended September 26, 2014 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.

35

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

We invest our excess cash in various fixed-income securities and money market funds. The primary objectives of our investment activities are to preserve principal and maintain short-term liquidity while maximizing the income we receive from our investments. The market value of these securities can vary depending upon prevailing interest rates, and if we were forced to liquidate our position in a security before its maturity date we could suffer loss of principal. We also are exposed to credit and liquidity risk related to these securities. If the issuer of a security were to default on its obligations, we would suffer loss of principal. If there were disruptions in the pricing and trading of securities in the financial markets, it is possible that there would not be a liquid market for our securities, which could limit our ability to meet cash requirements. To preserve principal and maintain short-term liquidity, our investment policy dictates that we maintain our portfolio of cash, cash equivalents, and investments in high credit quality, readily liquid securities, of relatively short duration. Our portfolio of investments have a range of original maturities and typically have average remaining maturities of less than two years.

We actively monitor market conditions and developments specific to the securities and security classes in which we invest. We believe that we take a conservative approach to investing our funds in that we invest only in highly-rated securities with relatively short maturities. 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 that could have a material adverse affect 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. As of September 26, 2014, our cash and cash equivalents of $89.5 million consisted primarily of cash and money market funds. We believe that the exposure of our principal to interest rate risk is minimal, although our future interest income is subject to reinvestment risk.

Given the short term nature of our cash and cash equivalents, the risk of loss in fair value resulting from interest rate changes is minimal. At September 26, 2014, 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 September 26, 2014, we did not have any outstanding borrowings under our credit facility.

Foreign Exchange Risk

As of September 26, 2014, foreign currency cash accounts totaled $42.6 million, primarily in Japanese Yen, Euros, Canadian Dollar and Australian Dollar.

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. Our balance sheet hedging strategy 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 three 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. Additionally, our cash flow hedging strategy 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 $4.3 million change in the value of our foreign currency cash accounts as of September 26, 2014.

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer and chief 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 included 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 September 26, 2014.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended September 26, 2014, 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 September 26, 2014, our top five customers worldwide accounted for approximately 48% of our total revenues, with the U.S. government, excluding system integrators, accounting for approximately 21% 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 September 26, 2014, such sales represented approximately 54% 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 changes in appropriation and spending priorities 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.

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 we do. 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 revenue 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 strategy and have invested in sales and marketing personnel and programs to increase penetration of our HPC, Storage and High Performance Data Analytics 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 assets;
- 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 market opportunities;
- 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;
- 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. 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.

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 September 26, 2014, we derived approximately 41% 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;
- global 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.

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 September 26, 2014, our stock price fluctuated from a high of $10.15 to a low of $8.72. 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.

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.

If we fail to properly manage our relationships with 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.

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.

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 September 26, 2014, our revenue from our EMEA and APJ regions was $17.6 million and $26.4 million, respectively. As of September 26, 2014, the balance in our foreign currency cash accounts was $42.6 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.
Our balance sheet hedging strategy 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. Additionally, our cash flow hedging strategy uses 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.
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.
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.

43

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, such as Intel, or GPUs such as, NVIDIA 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 ASICs 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.

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.

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 with an aggregate principal amount of $25.0 million, as amended. 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, working capital and operating results. If any of the Company's indebtedness is accelerated, the Company may not have sufficient funds available to repay such indebtedness.

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.

Financial Reporting Risks-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 addition, changes in accounting standards could also adversely affect our reported operating results.

In connection with the preparation of our consolidated financial statements, we use certain estimates and assumptions based on 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.

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, the Financial Accounting Standards Board (FASB) and various other 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, revenue and expenses, and could cause unexpected financial reporting fluctuations.

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, interest and penalties.

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.

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.

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.

The global economy has 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. 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, if one or more of our current service providers, manufacturers and other partners go out of business, it could directly affect our ability to attain our operating goals on schedule and on budget.

If the global economy experiences 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.

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 ("AIA"). As a result of the AIA, the United States is now a "first-to-file" system. For any patent applications that are filed on or after March 16, 2013 and that do not otherwise properly claim the benefit of an application filed before that March 16, 2013 date, said applications will be subject to the new "first-to-file" requirements versus the "first-to-invent" standard of law that existed prior to that date. 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 limit our sales and growth opportunities and impose unanticipated conditions or restrictions on our ability to commercialize our products.

We incorporate open source software into our products. A majority of our server systems run 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 purchase and adopt open standard-based technologies could have a material adverse impact on our ability to maintain or generate additional revenue.

In addition, 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 legal matters is discussed under "Legal Proceedings" in Part II, Item 1 of this Quarterly Report on Form 10-Q.

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

While we have undertaken restructuring efforts to streamline operations and reduce operating expenses, we may undertake additional restructuring efforts or other cost reduction measures in the future. Our ability to achieve the anticipated cost savings and other benefits from our restructuring efforts and costs reduction measures 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 and cost reduction measures. If our estimates and assumptions are incorrect or if other unforeseen events occur, we may not achieve the cost savings expected from such actions, and our business and results of operations could be adversely affected.

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.

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 FASB. 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. Our efforts to comply with 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.

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.

Conflict Minerals Risks—We are subject to the SEC's 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 in 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. 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 requires us to submit forms and reports to the SEC annually that disclose our determinations and due diligence measures. We are currently conducting conflict minerals due diligence with our supply chain partners. 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.

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 three months ended September 26, 2014:
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
Jun. 26, 2014 - Jul. 25, 2014	45	$9.17	45	$15,822
Jul. 26, 2014 - Aug. 22, 2014	39	$8.97	39	$15,471
Aug. 23, 2014 - Sept. 26, 2014	37	$9.10	37	$15,134
Total	121	$9.08	121	$15,134

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 September 26, 2014, the Company repurchased 121,000 shares of its common stock for approximately $1.1 million. Since the inception of the repurchase plan in January 2013, the Company has repurchased approximately 1,216,000 shares of its common stock for $14.9 million. As of September 26, 2014, the Company had a remaining authorization of $15.1 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.		
10.1*	Offer letter dated June 4, 2012 between the Registrant and Mekonnen Asrat					X
10.2*	First Amendment to Employment Letter Agreement dated December 17, 2012 between the Registrant and Mekonnen Asrat					X
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

* Indicates management contract or compensatory plan or arrangement.
** 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: October 31, 2014