Super Micro Computer, Inc.
Form 10-Q
November 08, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010

or

¨ **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 001-33383

Super Micro Computer, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**77-0353939**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification Number)**

980 Rock Avenue

San Jose, CA 95131

(Address of principal executive offices)

(408) 503-8000

(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 ¨

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

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

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

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

As of October 31, 2010 there were 37,456,669 shares of the registrant s common stock, $0.001 par value, outstanding, which is the only class of common or voting stock of the registrant issued.

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FORM 10-Q

SUPER MICRO COMPUTER, INC.

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PART I: FINANCIAL INFORMATION

Item 1.

SUPER MICRO COMPUTER, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

	September 30, 2010	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 83,519	$ 72,644
Short-term investments	59	845
Accounts receivable, net of allowances of $1,291 and $1,210 at September 30, 2010 and June 30, 2010, respectively (including amounts receivable from a related party of $355 and $1,201 at September 30, 2010 and June 30, 2010, respectively)	71,810	72,963
Inventory, net	151,510	135,584
Deferred income taxes-current	9,211	9,756
Prepaid income taxes	3,665	2,737
Prepaid expenses and other current assets	3,732	2,328
Total current assets	323,506	296,857
Long-term investments	5,788	5,901
Property, plant and equipment, net	68,736	62,691
Deferred income taxes-noncurrent	2,625	4,825
Restricted assets	363	286
Other assets	2,569	202
Total assets	$ 403,587	$ 370,762
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable (including amounts due to a related party of $30,496 and $19,464 at September 30, 2010 and June 30, 2010, respectively)	$ 113,067	$ 95,416
Accrued liabilities	23,683	19,432
Income taxes payable	4,151	3,219
Advances from receivable financing arrangements	1,110	1,193
Short-term debt	18,553	18,553
Current portion of capital lease obligations	49	62
Total current liabilities	160,613	137,875
Long-term capital lease obligations-net of current portion	41	46
Other long-term liabilities	8,363	8,140
Total liabilities	169,017	146,061
Commitments and contingencies (Note 14)		

Stockholders equity:		
Common stock and additional paid-in capital, $0.001 par value		
Authorized shares: 100,000,000		
Issued shares: 37,880,992 and 37,493,534 at September 30, 2010 and June 30, 2010, respectively	103,002	100,350
Treasury stock (at cost), 445,028 shares at September 30, 2010 and June 30, 2010	(2,030)	(2,030)
Accumulated other comprehensive loss	(204)	(204)
Retained earnings	133,802	126,585
Total stockholders equity	234,570	224,701
Total liabilities and stockholders equity	$ 403,587	$ 370,762

See accompanying notes to condensed consolidated financial statements.

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SUPER MICRO COMPUTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share amounts)

(unaudited)

	Three Months Ended September 30,	
	2010	2009
Net sales (including related party sales of $2,133 and $1,701 in the three months ended September 30, 2010 and 2009, respectively)	$ 207,178	$ 148,521
Cost of sales (including related party purchases of $36,418 and $27,262 in the three months ended September 30, 2010 and 2009, respectively)	174,141	124,012
Gross profit	33,037	24,509
Operating expenses:		
Research and development	10,446	8,627
Sales and marketing	6,208	4,534
General and administrative	4,374	3,799
Provision for litigation loss		1,089
Total operating expenses	21,028	18,049
Income from operations	12,009	6,460
Interest and other income, net	20	32
Interest expense	(159)	(133)
Income before income tax provision	11,870	6,359
Income tax provision	4,653	2,496
Net income	$ 7,217	$ 3,863
Net income per common share:		
Basic	$ 0.19	$ 0.11
Diluted	$ 0.17	$ 0.10
Weighted-average shares used in calculation of net income per common share:		
Basic	37,223,866	34,945,516
Diluted	41,431,066	39,207,218

See accompanying notes to condensed consolidated financial statements.

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SUPER MICRO COMPUTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended September 30,	
	2010	2009
OPERATING ACTIVITIES:		
Net income	$ 7,217	$ 3,863
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	1,282	1,121
Stock-based compensation expense	1,824	1,527
Excess tax benefits from stock-based compensation	(648)	
Allowance for doubtful accounts	161	41
Allowance for sales returns	1,280	931
Provision (benefit) for inventory	(90)	266
Deferred income taxes	2,745	(223)
Changes in operating assets and liabilities:		
Accounts receivable, net (including changes in related party balances of $846 and ($6) during the three months ended September 30, 2010 and 2009, respectively)	(288)	(5,365)
Inventory	(15,836)	(10,283)
Prepaid expenses and other assets	(3,772)	(156)
Accounts payable (including changes in related party balances of $11,032 and $8,427 during the three months ended September 30, 2010 and 2009, respectively)	17,574	12,876
Income taxes payable, net	1,000	2,150
Accrued liabilities	4,251	2,514
Other long-term liabilities	223	397
Net cash provided by operating activities	16,923	9,659
INVESTING ACTIVITIES:		
Restricted assets	(77)	(4)
Proceeds from investments	900	3,440
Purchases of property, plant and equipment	(7,250)	(672)
Net cash provided by (used in) investing activities	(6,427)	2,764
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	594	703
Excess tax benefits from stock-based compensation	648	
Repayment of long-term debt		(9,994)
Payment of obligations under capital leases	(18)	(10)
Advances (payment) under receivable financing arrangements	(83)	181
Minimum tax withholding paid on behalf of an employee for restricted stock awards	(762)	
Net cash provided by (used in) financing activities	379	(9,120)

Net increase in cash and cash equivalents	10,875	3,303
Cash and cash equivalents at beginning of period	72,644	70,295
Cash and cash equivalents at end of period	$ 83,519	$ 73,598
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 132	$ 133
Cash paid for taxes, net of refunds	$ 675	$ 413
Non-cash investing and financing activities:		
Accrued costs for property, plant and equipment purchases	$ 568	$ 379
Changes in fair values of investments	$	$ 339

See accompanying notes to condensed consolidated financial statements.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Organization

Super Micro Computer, Inc. (together with its subsidiaries, the Company) was incorporated in 1993. The Company is a global leader in server technology and green computing innovation. The Company develops and provides high performance server solutions based upon an innovative, modular and open-standard architecture. The Company has operations in San Jose, California, the Netherlands and Taiwan.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the United States Securities and Exchange Commission (SEC) and include the accounts of the Company and its wholly-owned subsidiaries. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements for the fiscal year ended June 30, 2010 included in its Annual Report on Form 10-K, as filed on September 7, 2010 with the SEC (the Annual Report).

The unaudited condensed consolidated financial statements included herein reflect all adjustments, including normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for the periods presented. The condensed consolidated results of operations for the three months ended September 30, 2010 and 2009 are not necessarily indicative of the results that may be expected for future quarters or for the year ending June 30, 2011.

Principles of Consolidation

The condensed consolidated financial statements reflect the condensed consolidated balance sheets, results of operations and cash flows of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Reclassification

The balance of accrued litigation loss in the prior period condensed consolidated statements of cash flows has been reclassified to be combined with accrued liabilities to conform with the current period presentation.

Fair Value Measurements

The Company accounts for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

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.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 3. Recently Issued Accounting Standards

In June 2009, the FASB issued authoritative guidance on the consolidation of variable interest entities, which is effective for fiscal years beginning after November 15, 2009 and interim periods therein and thereafter. The new guidance requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. This accounting guidance is effective for the Company beginning in the first quarter of fiscal year 2011. The adoption of this standard did not have a material impact on the Company s consolidated financial position and results of operations.

In October 2009, the FASB issued authoritative guidance on revenue recognition, which is effective prospectively for fiscal years beginning on or after June 15, 2010, with earlier adoption permitted. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB issued authoritative guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative fair value method. The new guidance includes new disclosure requirements on how the application of the relative fair value method affects the timing and amount of revenue recognition. The adoption of this standard did not have a material impact on the Company s consolidated financial position and results of operations.

In January 2010, the FASB issued authoritative guidance on Fair Value Measurements and Disclosures Improving Disclosures About Fair Value Measurements. The new guidance requires new disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. The new disclosures and clarifications of existing disclosures was effective in the Company s second quarter of fiscal year 2010, except for the disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements, which are effective for the Company s first quarter of fiscal year 2011. The Company has updated its disclosures to comply with this guidance, however, adoption of the updated guidance did not have an impact on the Company s consolidated results of operations or financial condition.

In April 2010, the FASB updated its guidance related to the milestone method of revenue recognition. The update provides guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. A vendor can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. The updated guidance is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years beginning on or after June 15, 2010, with early adoption permitted. The adoption of this standard did not have a material impact on the Company s consolidated financial position and results of operations.

Note 4. Stock-based Compensation and Stockholders Equity

Stock Option Plan

In August 2006, the Board of Directors approved the 2006 Equity Incentive Plan (the 2006 Plan) and reserved for issuance 4,000,000 shares of common stock for the granting of stock options, stock appreciation rights, restricted stock awards, restricted stock units and other equity-based awards. The number of shares reserved automatically increases on July 1 each year through 2016, by an amount equal to the smaller of (a) three percent of the number of shares of stock issued and outstanding on the immediately preceding June 30, or (b) a lesser amount determined by the Board of Directors. The 2006 Plan was approved by the stockholders of the Company in January 2007. The exercise price per share for incentive stock options granted to employees owning shares representing more than 10% of the Company at the time of grant cannot be less than 110% of the fair value. Nonqualified stock options and incentive stock options granted to all other persons shall be granted at a price not less than 100%

of the fair value. Options generally expire ten years after the date of grant and options vest over four years; 25% at the end of one year and one sixteenth per quarter thereafter. In the three months ended September 30, 2010 and 2009, the Company granted options for the purchase of 469,760 and 106,210 shares under the 2006 Plan, respectively. At September 30, 2010, 1,225,208 shares of common stock are available for future grant under the 2006 Plan.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Restricted Stock Awards

Restricted stock awards are share awards that provide the rights to a set number of shares of the Company s stock on the grant date. In August 2008, the Compensation Committee of the Board of Directors of the Company (the Committee) approved the terms of an agreement (the Option Exercise Agreement) with Charles Liang, a director and President and Chief Executive Officer of the Company, pursuant to which Mr. Liang exercised a fully vested option previously granted to him for the purchase of 925,000 shares. The option was exercised using a net-exercise procedure in which he was issued a number of shares representing the spread between the option exercise price and the then current market value of the shares subject to the option (898,205 shares based upon the market value as of the date of exercise). The shares issued upon exercise of the option are subject to vesting over a five-year vesting period. Vesting of the shares subject to the award may accelerate in certain circumstances pursuant to the terms of the applicable Option Exercise Agreement. The Company determined that there was no incremental fair value of the option exchanged for the award. 359,282 and 179,641 shares were vested as of September 30, 2010 and June 30, 2010, respectively.

In November 2008, the Committee approved the terms of an Option Exercise Agreement with Chiu-Chu Liang, a director and Vice President of Operations & Treasurer of the Company and Shiow-Meei Liaw, Senior Warehouse Manager of the Company, pursuant to which they exercised fully vested options previously granted to them for the purchase of 185,263 and 92,631 shares, respectively. They exercised the options using a net-exercise procedure in which they were issued a number of shares representing the spread between the option exercise price and the then current market value of the shares subject to the option (182,611 and 91,305 shares, respectively, based upon the market value as of the date of exercise). The shares issued upon exercise of the options are subject to vesting over a two-year vesting period. Vesting of the shares subject to the awards may accelerate in certain circumstances pursuant to the terms of the applicable Option Exercise Agreement. The Company determined that there was no incremental fair value of the option exchanged for the awards. 136,957 shares were vested as of both September 30, 2010 and June 30, 2010.

Determining Fair Value

Valuation and amortization method The Company estimates the fair value of stock options granted using the Black-Scholes-option-pricing formula and a single option award approach. This fair value is then amortized ratably over the requisite service periods of the awards, which is generally the vesting period.

Expected Term The Company s expected term represents the period that the Company s stock-based awards are expected to be outstanding and was determined based on an analysis of the relevant peer companies post-vest termination rates and the exercise factors.

Expected Volatility Expected volatility is based on a combination of the implied and historical volatility for its peer group and the Company s historical volatility for the stock options granted prior to September 30, 2009. For stock options granted after September 30, 2009, expected volatility is based solely on the Company s historical volatility.

Expected Dividend The Black-Scholes valuation model calls for a single expected dividend yield as an input and the Company has no plans to pay dividends.

Risk-Free Interest Rate The risk-free interest rate used in the Black-Scholes valuation method is based on the U.S. Treasury zero coupon issues in effect at the time of grant for periods corresponding with the expected term of option.

Estimated Forfeitures The estimated forfeiture rate is based on the Company s historical forfeiture rates and the estimate is revised in subsequent periods if actual forfeitures differ from the estimate.

The fair value of stock option grants for the three months ended September 30, 2010 and 2009 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended September 30,	
	2010	**2009**
Risk-free interest rate	1.40%	2.10%
Expected life	4.38 years	4.06 years
Dividend yield	0%	0%
Volatility	54.50%	55.01%
Weighted-average fair value	$ 6.11	$ 3.54

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table shows total stock-based compensation expense included in the condensed consolidated statements of operations for the three month periods ended September 30, 2010 and 2009 (in thousands).

	Three Months Ended September 30,	
	2010	2009
Cost of sales	$ 194	$ 144
Research and development	864	670
Sales and marketing	282	206
General and administrative	484	507
Stock-based compensation expense	$ 1,824	$ 1,527

The cash flows resulting from the tax benefits for tax deductions resulting from the exercise of stock options in excess of the compensation expense recorded for those options (excess tax benefits) issued or modified since July 1, 2006 are classified as cash from financing activities. Excess tax benefits for stock options issued prior to July 1, 2006 are classified as cash from operating activities.

Stock Option and Awards Activity

The following table summarizes stock option activity during the three months ended September 30, 2010 under all stock option plans:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at July 1, 2010	12,124,945	$ 6.34	5.94	$ 89,283
Granted	469,760	$ 13.61		
Exercised	(291,674)	$ 2.04		
Forfeited or cancelled	(51,261)	$ 10.46		
Outstanding at September 30, 2010	12,251,770	$ 6.71	5.92	$ 53,473
Vested and expected to vest at September 30, 2010	11,709,095	$ 6.53	5.81	$ 52,512
Exercisable at September 30, 2010	8,444,401	$ 5.30	4.66	$ 45,987

The total intrinsic value of options exercised was $2,201,000 and $1,648,000 for the three months ended September 30, 2010 and 2009, respectively. Stock-based compensation expense in the three months ended September 30, 2010 and 2009 was $1,824,000 and $1,527,000, respectively. As of September 30, 2010, the Company s total unrecognized compensation cost related to non-vested stock-based awards granted since July 1, 2006 to employees and non-employee directors was approximately $14,648,000, which will be recognized over a weighted-average vesting period of approximately 2.09 years.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the Company s restricted stock award activity for the three months ended September 30, 2010:

	Restricted Stock Awards	
	Number of Shares	Weighted Average Grant Date Fair Value Per Share
Nonvested stock at July 1, 2010	855,523	$ 9.79
Granted		
Vested	(179,641)	$ 10.66
Forfeited		
Nonvested stock at September 30, 2010	675,882	$ 9.56

The intrinsic value of restricted stock awards vested was $1,915,000 for both three months ended September 30, 2010 and 2009. The total intrinsic value of the outstanding restricted stock awards was $6,461,000 and $8,376,000 as of September 30, 2010 and June 30, 2010, respectively. There is no incremental fair value to be recognized as compensation expense in connection with the unvested restricted stock awards of 675,882 shares as of September 30, 2010.

Note 5. Comprehensive Income

The components of comprehensive income, net of taxes, are as follows (in thousands):

	Three Months Ended September 30,	
	2010	2009
Net income	$ 7,217	$ 3,863
Unrealized gains on investments, net of taxes		205
Total comprehensive income	$ 7,217	$ 4,068

Note 6. Net Income Per Common Share

The Company s restricted share awards subject to repurchase and settled in shares of common stock upon vesting have the nonforfeitable right to receive dividends on an equal basis with common stock and therefore are considered participating securities that must be included in the calculation of net income per share using the two-class method. Under the two-class method, basic and diluted net income per common share is determined by calculating net income per share for common stock and participating securities based on participation rights in undistributed earnings. Diluted net income per common share also considers the dilutive effect of in-the-money stock options, calculated using the treasury stock method. Under the treasury stock method, the amount of assumed proceeds from unexercised stock options includes the amount of compensation cost attributable to future services not yet recognized, assumed proceeds from the exercise of the options, and the incremental

income tax benefit or liability as if the options were exercised during the period.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The computation of basic and diluted net income per common share using the two-class method is as follows (in thousands, except per share amounts):

	Three Months Ended September 30,	
	2010	2009
Basic net income per common share calculation		
Net income	$ 7,217	$ 3,863
Less: Undistributed earnings allocated to participating securities	(149)	(118)
Net income attributable to common shares basic	$ 7,068	$ 3,745
Weighted-average number of common shares used to compute basic net income per common share	37,224	34,946
Basic net income per common share	$ 0.19	$ 0.11
Diluted net income per common share calculation		
Net income	$ 7,217	$ 3,863
Less: Undistributed earnings allocated to participating securities	(134)	(106)
Net income attributable to common shares diluted	$ 7,083	$ 3,757
Weighted-average number of common shares used to compute basic net income per common share	37,224	34,946
Dilutive effect of options to purchase common stock	4,207	4,261
Weighted-average number of common shares used to compute diluted net income per common share	41,431	39,207
Diluted net income per common share	$ 0.17	$ 0.10

For the three months ended September 30, 2010 and 2009, the Company had stock options outstanding that could potentially dilute basic earnings per common share in the future, but were excluded from the computation of diluted net income per common share in the periods presented, as their effect would have been anti-dilutive. The shares of common stock issuable upon exercise of such anti-dilutive outstanding stock options were 2,925,000 and 5,308,000 for the three months ended September 30, 2010 and 2009, respectively.

Note 7. Balance Sheet Components (in thousands)

Inventory:

	September 30, 2010	June 30, 2010
Finished goods	$ 97,427	$ 88,392
Work in process	16,011	8,540
Purchased parts and raw materials	38,072	38,652
Total inventory, net	$ 151,510	$ 135,584

The Company recorded a provision (benefit) for excess and obsolete inventory totaling ($90,000) and $266,000 in the three months ended September 30, 2010 and 2009, respectively.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Property, Plant and Equipment:

	September 30, 2010	June 30, 2010
Land	$ 34,896	$ 27,186
Buildings	28,071	29,645
Building and leasehold improvements	3,364	3,335
Machinery and equipment	13,673	12,689
Furniture and fixtures	2,935	2,882
Purchased software	2,220	2,107
	85,159	77,844
Accumulated depreciation and amortization	(16,423)	(15,153)
Property, plant and equipment, net	$ 68,736	$ 62,691

In June 2010, the Company purchased three buildings in San Jose, California. The preliminary values allocated to the land and buildings were $7,966,000 and $10,537,000, respectively, as of June 30, 2010 which were subject to the completion of a cost segregation study. Based on the cost segregation study completed in September 2010, the purchase values allocated to the land and buildings were $9,540,000 and $8,963,000, respectively. In August 2010, the Company purchased land in Taiwan, consisting of approximately 4.7 acres. The purchase price is $6,137,000 and the Company plans to develop the land for manufacturing and service operations through fiscal year 2012.

The cost of assets under capital leases was $176,000 as of both September 30, 2010 and June 30, 2010 and related accumulated amortization was $61,000 and $53,000, respectively.

Restricted Assets:

Restricted assets consist primarily of certificates of deposits pledged as security for one irrevocable letter of credit of $121,000, bank guarantee for duty import taxes of $127,000 and $62,000 and bank guarantees for office leases of $115,000 and $103,000 as of September 30, 2010 and June 30, 2010, respectively. In February 2008, the Company obtained an irrevocable standby letter of credit required by the landlord of its office lease totaling $121,000.

Product Warranties:

	Three Months Ended September 30,	
	2010	2009
Balance, beginning of period	$ 4,564	$ 3,579
Provision for warranty	2,605	1,560
Costs charged to accrual	(2,001)	(1,422)
Change in estimated liability for pre-existing warranties	(542)	(276)

Balance, end of period	$ 4,626	$ 3,441

Note 8. Short-term and Long-term Investments

As of September 30, 2010 and June 30, 2010, the Company held $5,788,000 and $6,688,000, respectively, of auction-rate securities (auction rate securities), net of unrealized losses, representing its interest in auction rate preferred shares in a closed end mutual fund invested in municipal securities and student loans guaranteed by the Federal Family Education Loan Program; such auction rate securities were rated AAA, BAA1 or BAA3 at September 30, 2010 and AAA or BAA3 at June 30, 2010. These auction rate preferred shares have no stated maturity date and the stated maturity dates for these auction rate student loans range from 2033 to 2040.

During February 2008, the auctions for these auction rate securities began to fail to obtain sufficient bids to establish a clearing rate and the securities were not saleable in the auction, thereby losing the short-term liquidity previously provided by the auction process. As a result, as of September 30, 2010, $5,788,000 of these auction rate securities have been classified as long-term available-for-sale investments. As of June 30, 2010, $5,901,000 of these auction rate securities were classified as long-term available-for-sales investment and the remaining $787,000 were classified as short-term available-for-sale investments.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company has used a discounted cash flow model to estimate the fair value of the auction rate securities as of September 30, 2010 and June 30, 2010. The material factors used in preparing the discounted cash flow model are 1) the discount rate utilized to present value the cash flows, 2) the time period until redemption and 3) the estimated rate of return. Management derives the estimates by obtaining input from market data on the applicable discount rate, estimated time to maturity and estimated rate of return. The changes in fair value have been primarily due to changes in the estimated rate of return and a change in the estimated redemption period. Changes in these estimates or in the market conditions for these investments are likely in the future based upon the then current market conditions for these investments and may affect the fair value of these investments. Based on this assessment of fair value, the Company determined there was a recovery in fair value of its auction rate securities of $0 and $339,000 during the three months ended September 30, 2010, and 2009, respectively, and a cumulative total decline of $337,000 as of September 30, 2010 and June 30, 2010. That amount has been recorded as a component of other comprehensive income. The accumulated unrealized loss on the auction rate securities as of September 30, 2010 and June 30, 2010 was $204,000, net of deferred income taxes. The Company deems this loss to be temporary as it will not likely be required to sell the securities before their anticipated recovery and the Company has the intent and financial ability to hold these investments until recovery of cost.

Although the investment impairment is considered to be temporary, these investments are not currently liquid and in the event the Company needs to access these funds, the Company will not be able to do so without a loss of principal. The Company plans to continue to monitor the liquidity situation in the marketplace and the creditworthiness of its holdings and will perform periodic impairment analyses. During the three months ended September 30, 2010 and 2009, $900,000 and $3,440,000 of these auction rate securities were redeemed at par, respectively.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 9. Fair Value Disclosure

The financial assets of the Company measured at fair value on a recurring basis are cash equivalents, short-term and long-term investments. The Company s money market funds are classified within Level 1 of the fair value hierarchy which is based on quoted market prices of the identical underlying securities in active markets. The Company s short-term and long-term auction rate securities investments are classified within Level 3 of the fair value hierarchy which did not have observable inputs for its auction rate securities as of September 30, 2010 and June 30, 2010. The Company s methodology for valuing these investments is the discounted cash flow model and is described in Note 8 of Notes to Condensed Consolidated Financial Statements.

The following table sets forth the Company s cash equivalents, short-term and long-term investments as of September 30, 2010 and June 30 2010 which are measured at fair value on a recurring basis by level within the fair value hierarchy. These are classified based on the lowest level of input that is significant to the fair value measurement, (in thousands):

September 30, 2010	Level 1	Level 2	Level 3	Asset at Fair Value
Money market funds	$ 40,558	$	$	$ 40,558
Auction rate securities			5,788	5,788
Total	$ 40,558	$	$ 5,788	$ 46,346

June 30, 2010	Level 1	Level 2	Level 3	Asset at Fair Value
Money market funds	$ 29,646	$	$	$ 29,646
Auction rate securities			6,688	6,688
Total	$ 29,646	$	$ 6,688	$ 36,334

The above table excludes $42,961,000 and $42,997,000 of cash and $422,000 and $345,000 of certificates of deposit held by the Company as of September 30, 2010 and June 30, 2010, respectively. During the three months ended September 30, 2010 and 2009, $900,000 and $3,440,000 of the auction rate securities were redeemed at par and transferred into Level 1 from Level 3, respectively.

The following table provides a reconciliation of the Company s financial assets measured at fair value on a recurring basis, consisting of long-term auction rate securities, using significant unobservable inputs (Level 3) for the three months ended September 30, 2010 and 2009 (in thousands):

	Three Months Ended September 30,	
	2010	2009
Balance as of beginning of period	$ 6,688	$ 14,644
Total realized gains or (losses) included in net income		

Total unrealized gains or (losses) included in other comprehensive income		339
Sales		
Settlements at par	(900)	(3,440)
Transfers in and/or out of Level 3		
Balance as of end of period	$ 5,788	$ 11,543

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following is a summary of the Company s short-term investments as of September 30, 2010 and June 30, 2010 (in thousands):

	September 30, 2010			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Certificate of deposit	$ 59	$	$	$ 59

	June 30, 2010			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Certificate of deposit	$ 58	$	$	$ 58
Auction rate securities	800		(13)	787
Total	$ 858	$	$ (13)	$ 845

The following is a summary of the Company s long-term investments as of September 30, 2010 and June 30, 2010 (in thousands):

	September 30, 2010			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Auction rate securities	$ 6,125	$	$ (337)	$ 5,788

	June 30, 2010			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Auction rate securities	$ 6,225	$	$ (324)	$ 5,901

Note 10. Advances from Receivable Financing Arrangements

The Company has accounts receivable financing agreements with certain financing companies whereby the financing companies pay the Company for sales transactions that have been pre-approved by these financing companies. The financing companies then collect the receivable from the customers. Such sales transactions totaled $5,993,000 and $6,550,000 for the three months ended September 30, 2010 and 2009, respectively. At September 30, 2010 and June 30, 2010, $1,110,000 and $1,193,000, respectively, remained uncollected from customers subject to these arrangements. Such amounts have been recorded as advances from receivable financing arrangements as the Company has obligations to repurchase inventories seized by the financing companies from defaulting customers. Historically, the Company has not been required to

repurchase inventories from the financing companies. These financing arrangements bear interest at rates ranging from 11.40% to 13.80% and 11.70% to 13.80% per annum, depending on the customers credit ratings, at September 30, 2010 and June 30, 2010, respectively.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 11. Short-term and Long-term Obligations

Long-term obligations consisted of the following (in thousands):

	September 30, 2010	June 30, 2010
Short-term debt	$ 18,553	$ 18,553
Capital leases	90	108
Total	18,643	18,661
Current portion	(18,602)	(18,615)
Long-term portion	$ 41	$ 46

In June 2010, the Company obtained a revolving line of credit totaling $25,000,000 that matures on June 15, 2013 with an interest rate at the LIBOR rate plus 1.50% per annum. The Company used $18,553,000 of the line of credit to purchase three buildings in San Jose, California and is required to obtain a mortgage loan to pay-off this line of credit by December 2010. The loan is secured by all the Company s assets except for the three buildings purchased in San Jose, California. As of both September 30, 2010 and June 30, 2010, the total outstanding borrowing was $18,553,000. As of September 30, 2010, the Company was in compliance with the financial covenants associated with the line of credit.

As of September 30, 2010 and June 30, 2010, the total assets except for the three buildings purchased in San Jose, California in June 2010 collateralizing the borrowing were $385,142,000 and $352,259,000, respectively.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 12. Related-party and Other Transactions

Ablecom Technology Inc. Ablecom, a Taiwan corporation, together with one of its subsidiaries, Compuware (collectively Ablecom), is one of the Company s major contract manufacturers. Ablecom s ownership of Compuware is below 50% but Compuware remains a related party as Ablecom still has significant influence over the operations. Ablecom s chief executive officer, Steve Liang, is the brother of Charles Liang, the Company s President, Chief Executive Officer and Chairman of the Board of Directors, and owns approximately 2.0% of the Company s common stock. Charles Liang and his wife, also an officer of the Company, collectively own approximately 10.5% of Ablecom, while Steve Liang and other family members owned approximately 35.9% of Ablecom at September 30, 2010 and June 30, 2010.

The Company has product design and manufacturing services agreements (product design and manufacturing agreements) and a distribution agreement (distribution agreement) with Ablecom.

Under the product design and manufacturing agreements, the Company outsources a portion of its design activities and a significant part of its manufacturing of components such as server chassis to Ablecom. Ablecom agrees to design products according to the Company s specifications. Additionally, Ablecom agrees to build the tools needed to manufacture the products. Under the product design and manufacturing agreements, the Company commits to purchase a minimum quantity over a set period. The purchase price of the products manufactured by Ablecom is negotiated on a purchase order by purchase order basis at each purchase date. However, a fixed charge is added to the price of each unit purchased until the agreed minimum number of units is purchased. In August 2007, the Company entered into a new product development, manufacturing and service agreement with Ablecom. Under the new agreement, the Company has agreed to pay for the cost of blade server tooling and engineering services and will pay for those items when the work has been completed. In this case no fixed charge is added to future purchases for reimbursement of tooling costs. In September 2009, the Company entered into a similar product development agreement with Ablecom. Under this agreement, the Company has agreed to pay for the cost of chassis and related product tooling and engineering services and will pay for those items when the work has been completed. In this case no fixed charge is added to future purchases for reimbursement of tooling costs.

Under the distribution agreement, Ablecom purchases server products from the Company for distribution in Taiwan. The Company believes that the pricing and terms under the distribution agreement are similar to the pricing and terms of distribution arrangements the Company has with similar, third party distributors.

Ablecom s net sales to the Company and its net sales of the Company s products to others comprise a substantial majority of Ablecom s net sales. For the three months ended September 30, 2010 and 2009, the Company purchased products from Ablecom totaling $36,418,000 and $27,262,000, respectively. For the three months ended September 30, 2010 and 2009, the Company sold products to Ablecom totaling $2,133,000 and $1,701,000, respectively.

Amounts owed to the Company by Ablecom as of September 30, 2010 and June 30, 2010, were $355,000 and $1,201,000, respectively. Amounts owed to Ablecom by the Company as of September 30, 2010 and June 30, 2010, were $30,496,000 and $19,464,000, respectively. Historically, the Company has paid Ablecom the majority of invoiced dollars between 50 and 100 days of invoice. For the three months ended September 30, 2010 and 2009, the Company received $1,000 and $0, respectively, from Ablecom for penalty charges and paid $791,000 and $484,000, respectively, in tooling assets and miscellaneous costs to Ablecom. Penalty charges are assessments relating to delayed deliveries or quality issues.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company s exposure to loss as a result of its involvement with Ablecom is limited to (a) potential losses on its purchase orders in the event of an unforeseen decline in the market price and/or demand of the Company s products such that the Company incurs a loss on the sale or cannot sell the products and (b) potential losses on outstanding accounts receivable from Ablecom in the event of an unforeseen deterioration in the financial condition of Ablecom such that Ablecom defaults on its payable to the Company. Outstanding purchase orders with Ablecom were $44,189,000 and $35,266,000 at September 30 , 2010 and June 30, 2010, respectively, representing the maximum exposure to loss relating to (a) above. The Company does not have any direct or indirect guarantees of losses of Ablecom.

Non-Management Director For the three months ended September 30, 2010 and 2009, the Company had sales to Mentor Graphics of $115,000 and $0, respectively. Gregory Hinckley, a member of the Company s board of directors, is president of Mentor Graphics. As of September 30, 2010 and June 30, 2010, the amount owed to the Company by Mentor Graphics was $0 and $87,000, respectively.

Note 13. Income Taxes

The Company recorded provisions for income taxes of $4,653,000 and $2,496,000 for the three months ended September 30, 2010 and 2009, respectively. The effective tax rate was 39.2% and 39.3% in the three months ended September 30, 2010 and 2009, respectively. The effective tax rate of 39.2% is estimated to be higher than the Federal statutory rate primarily due to the impact of state taxes and stock option expenses, which were partially offset by the tax benefits of California research and development credits and domestic production activities deduction.

As of September 30, 2010, the Company had a liability for gross unrecognized tax benefits of $6,616,000, substantially all of which, if recognized, would affect the Company s effective tax rate. During the three months ended September 30, 2010, there was no material change in the total amount of the liability for gross unrecognized tax benefits.

The Company s policy is to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the consolidated statements of operations. As of September 30, 2010, the Company had a liability for accrued interest and penalties related to the unrecognized tax benefits of $530,000. During the three months ended September 30, 2010, there was no material change in the total amount of the liability for accrued interest and penalties related to the unrecognized tax benefits.

The Company files U.S. federal, U.S. state, and foreign income tax returns. The Company is generally no longer subject to tax examinations for years prior to the fiscal year beginning July 1, 2003.

In connection with the regular examination of the Company s California tax returns for the fiscal years ended June 30, 2002 and 2003 the Franchise Tax Board has presented certain adjustments to the amounts reflected by the Company on those returns. The timing of the resolution and/or closure on audits is expected to be in the fourth quarter of fiscal year 2011. The Company does not believe that its unrecognized tax benefits will materially change in the next 12 months.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 14. Commitments and Contingencies

Litigation and Claims The Company was a defendant in a lawsuit with Digitechnic, S.A. (Digitechnic), a former customer, before the Bobigny Commercial Court in Paris, France, in which Digitechnic alleged that certain products purchased from the Company were defective. In September 2003, the Bobigny Commercial Court found in favor of Digitechnic and awarded damages totaling $1,178,000 and the matter was subsequently appealed. In October 2009, the Paris Court of Appeals awarded damages of $1,089,000 against the Company. The Company entered into a settlement agreement with Digitechnic, pursuant to which the Company made a payment of $1,055,000 with $34,000 of foreign exchange gain in December 2009 and a provision of $1,089,000 for litigation loss was recorded.

In addition to the above, the Company is involved in various legal proceedings arising from the normal course of business activities. In management s opinion, resolution of these matters is not expected to have a material adverse impact on the Company s consolidated results of operations, cash flows or the Company s financial position. However, depending on the amount and timing, an unfavorable resolution of a matter could materially affect the Company s future results of operations, cash flows or financial position in a particular period.

Lease Commitments The Company leases offices and equipment under non-cancelable operating leases which expire at various dates through 2016. In addition, the Company leases certain of its equipment under capital leases.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 15. Segment Reporting

The Company operates in one operating segment that develops and provides high performance server solutions based upon an innovative, modular and open-standard architecture. The Company s chief operating decision maker is the Chief Executive Officer.

International net sales are based on the country to which the products were shipped. The following is a summary for the three months ended September 30, 2010 and 2009, of net sales by geographic region (in thousands):

	Three Months Ended September 30,	
	2010	2009
Net sales:		
United States	$ 121,678	$ 93,605
Europe	46,455	30,258
Asia	32,468	19,984
Other	6,577	4,674
	$ 207,178	$ 148,521

Net sales amounts previously disclosed by geography have been combined to conform to the current presentation.

The following is a summary of long-lived assets, excluding financial instruments, deferred tax assets, goodwill and intangible assets (in thousands):

	September 30, 2010	June 30, 2010
Long-lived assets:		
United States	$ 58,849	$ 59,129
Taiwan	7,002	804
Other	2,885	2,758
	$ 68,736	$ 62,691

The following is a summary of net sales by product type (dollars in thousands):

	Three Months Ended September 30,	
	2010	2009
	Amount	Amount

		Percent of Revenues		Percent of Net Sales
Server systems	$ 74,007	35.7%	$ 51,172	34.5%
Subsystems and accessories	133,171	64.3%	97,349	65.5%
Total	$ 207,178	100.0%	$ 148,521	100.0%

Subsystems and accessories are comprised of serverboards, chassis and accessories. Server systems constitute an assembly of subsystems and accessories done by the Company. No customer represented greater than 10% of the Company s total net sales nor did net sales in any country other than the United States represent greater than 10% of the Company s total net sales. One customer accounted for 10.9% and 10.2% of the Company s accounts receivable as of September 30, 2010 and June 30, 2010, respectively.

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

This section and other parts of this Form 10-Q contain 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, as amended that involve risks and uncertainties. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology including would, could, may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, potential, or continue, the negative of these terms or other comparable terminology. In evaluating these statements, you should specifically consider various factors, including the risks described under Risk Factors below and in other parts of this Form 10-Q as well as in our other filings with the SEC. These factors may cause our actual results to differ materially from those anticipated or implied in the forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. We cannot guarantee future results, levels of activity, performance or achievements.

Overview

We are a global leader in server technology and green computing innovation. We develop and provide high performance server solutions based on an innovative, modular and open-standard architecture. Our solutions include a range of complete rackmount, workstation, storage, graphic processing unit and blade server systems, as well as subsystems and accessories which can be used by distributors, OEMs and end customers to assemble server systems. To date, we have generated the majority of our net sales from subsystems. Since 2000, we have gradually shifted our focus and resources to designing, developing, manufacturing and selling application optimized server systems. In recent years our growth in net sales has been driven by the growth in the market for application optimized server systems. Net sales of optimized servers were $74.0 million and $51.2 million for the three months ended September 30, 2010 and 2009, respectively. Net sales of subsystems and accessories were $133.2 million and $97.3 million for the three months ended September 30, 2010 and 2009, respectively. In the three months ended September 30, 2010, we experienced an increase in net sales compared with the three months ended September 30, 2009 which we believe was primarily attributable to the economic recovery and increased sales of our 2U Twin, 2U Twin², GPU and storage solutions.

We commenced operations in 1993 and have been profitable every year since inception. Our net sales were $207.2 million and $148.5 million for the three months ended September 30, 2010 and 2009, respectively. Our net income was $7.2 million and $3.9 million for the three months ended September 30, 2010 and 2009, respectively. Our increase in profitability in the three months ended September 30, 2010 was primarily attributable to the increase in our net sales and to a lesser degree from a decrease in provision for litigation loss which was offset in part by a decline in gross margins.

We sell our server systems and subsystems and accessories primarily through distributors and to a lesser extent to OEMs as well as through our direct sales force. We derived approximately 60.2% and 68.1% of our net sales from products sold to distributors, and 39.8% and 31.9% from sales to OEMs and to end customers for the three months ended September 30, 2010 and 2009, respectively. None of our customers accounted for 10% or more of our net sales in the three months ended September 30, 2010 and 2009. We derived approximately 58.7% and 63.0% of our net sales from customers in the United States for the three months ended September 30, 2010 and 2009, respectively. We derived approximately 41.3% and 37.0% of our net sales from customers outside the United States for the three months ended September 30, 2010 and 2009, respectively.

We perform the majority of our research and development efforts in-house. Research and development expenses represented approximately 5.0% and 5.8% of our net sales for three months ended September 30, 2010 and 2009, respectively.

We use several suppliers and contract manufacturers to design and manufacture subsystems and accessories in accordance with our specifications, with most final assembly and testing performed at our manufacturing facility in San Jose, California. During fiscal year 2010, we continued to invest in expanding our operations both in San Jose, California and at our subsidiaries in the Netherlands and Taiwan in order to support our growth. We have increased manufacturing and service operations in the Netherlands and Taiwan to support our European and Asian customers and we plan to continue expanding our overseas manufacturing capacity in fiscal year

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2011. One of our key suppliers is Ablecom, a related party, which supplies us with contract design and manufacturing support. For the three months ended September 30, 2010 and 2009, our purchases from Ablecom represented approximately 20.9% and 22.0% of our cost of sales, respectively. The decrease in percentage of cost of sales in the three months ended September 30, 2010 was primarily related to a higher product mix of subsystems and accessories which were purchased from other suppliers in the three months ended September 30, 2010. Ablecom s sales to us constitute a substantial majority of Ablecom s net sales. We continue to maintain our manufacturing relationship with Ablecom in Asia in an effort to reduce our product costs and do not have any current plans to reduce our reliance on Ablecom product purchases. In addition to providing a larger volume of contract manufacturing services for us, Ablecom continues to warehouse for us a number of components and subassemblies manufactured by multiple suppliers prior to shipment to our facilities in the U.S. and Europe. We typically negotiate the price of products that we purchase from Ablecom on a quarterly basis; however, either party may re-negotiate the price of products with each order. As a result of our relationship with Ablecom, it is possible that Ablecom may in the future sell products to us at a price higher or lower than we could obtain from an unrelated third party supplier. This may result in our future reporting of gross profit as a percentage of net sales that is less than or in excess of what we might have obtained absent our relationship with Ablecom.

In order to continue to increase our net sales and profits, we believe that we must continue to develop flexible and customizable server solutions and be among the first to market with new features and products. We measure our financial success based on various indicators, including growth in net sales, gross profit as a percentage of net sales, operating income as a percentage of net sales, levels of inventory, and days sales outstanding, or DSOs. In connection with these efforts, we monitor daily and weekly sales and shipment reports. Among the key non-financial indicators of our success is our ability to rapidly introduce new products and deliver the latest application optimized server solutions. In this regard, we work closely with microprocessor and other component vendors to take advantage of new technologies as they are introduced. Historically, our ability to introduce new products rapidly has allowed us to benefit from the introduction of new microprocessors and as a result we monitor the introduction cycles of Intel and AMD carefully. This also impacts our research and development expenditures. For example, our results for the quarter ended March 31, 2009 were in part adversely impacted by customer order delays in anticipation of the introduction of the Nehalem line of microprocessors and research and development expenditures necessary for us to prepare for the introduction.

Other Financial Highlights

The following is a summary of other financial highlights of the first quarter of fiscal year 2011:

- We generated cash flows from operations of $16.9 million and $9.7 million during the three months ended September 30, 2010 and 2009, respectively. Our cash and cash equivalents, together with our investments, were $89.4 million at the end of the first quarter of fiscal year 2011, compared with $79.4 million at the end of fiscal year 2010.

- Days sales outstanding in accounts receivable (DSO) at the end of the first quarter of fiscal year 2011 was 32 days, compared with 30 days at the end of fiscal year 2010.

- Our inventory balance was $151.5 million at the end of the first quarter of fiscal year 2011, compared with $135.6 million at the end of fiscal year 2010. Days sales of inventory (DSI) at the end of the first quarter of fiscal year 2011 was 76 days, compared with 67 days at the end of fiscal year 2010. The increase in our inventory balance at the end of the first quarter of fiscal year 2011 was due in part to some delays in receiving parts at the end of fiscal year 2010 as well as preparing for our anticipated growth of the Company in the quarter ending December 31, 2010. Our purchase commitments with contract manufacturers and suppliers were $107.6 million at the end of the first quarter of fiscal year 2011 and $92.1 million at the end of fiscal year 2010.

- In August 2010, we purchased land in Taiwan, consisting of approximately 4.7 acres. The purchase price is $6.1 million and we plan to develop the land for manufacturing and service operations through fiscal year 2012.

We believe that our cash position, our balance sheet, our visibility into our supply chain and our financing capabilities position us well to manage through the current economic recovery.

Fiscal Year

Our fiscal year ends on June 30. References to fiscal year 2011, for example, refer to the fiscal year ending June 30, 2011.

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Revenues and Expenses

Net sales. Net sales consist of sales of our server solutions, including server systems, subsystems and accessories. The main factors which impact our net sales are unit volumes shipped and average selling prices. The prices for server systems range widely depending upon the configuration, and the prices for our subsystems and accessories vary based on the type. As with most electronics-based products, average selling prices typically are highest at the time of introduction of new products which utilize the latest technology and tend to decrease over time as such products mature in the market and are replaced by next generation products.

Cost of sales. Cost of sales primarily consists of the costs to manufacture our products, including the costs of materials, contract manufacturing, shipping, personnel and related expenses, equipment and facility expenses, warranty costs and inventory excess and obsolete provisions. The primary factors that impact our cost of sales are the mix of products sold and cost of materials, which include raw material costs, shipping costs and salary and benefits related to production. Cost of sales as a percentage of net sales may increase over time if decreases in average selling prices are not offset by corresponding decreases in our costs. Our cost of sales, as a percentage of net sales, is generally lower on server systems than on subsystems and accessories. Because we do not have long-term fixed supply agreements, our cost of sales is subject to change based on market conditions.

Research and development expenses. Research and development expenses consist of the personnel and related expenses of our research and development teams, and materials and supplies, consulting services, third party testing services and equipment and facility expenses related to our research and development activities. All research and development costs are expensed as incurred. We occasionally receive non-recurring engineering, or NRE funding from certain suppliers and customers towards our development efforts. Under these programs, we are reimbursed for certain research and development costs that we incur as part of the joint development of our products and those of our suppliers and customers. These amounts offset a portion of the related research and development expenses and have the effect of reducing our reported research and development expenses.

Sales and marketing expenses. Sales and marketing expenses consist primarily of salaries and commissions for our sales and marketing personnel, costs for tradeshows, independent sales representative fees and marketing programs. From time to time, we receive cooperative marketing funding from certain suppliers. Under these programs, we are reimbursed for certain marketing costs that we incur as part of the joint promotion of our products and those of our suppliers. These amounts offset a portion of the related expenses and have the effect of reducing our reported sales and marketing expenses. Similarly, we from time to time offer our distributors cooperative marketing funding which has the effect of increasing our expenses. The timing, magnitude and estimated usage of our programs and those of our suppliers can result in significant variations in reported sales and marketing expenses from period to period. Spending on cooperative marketing, either by us or our suppliers, typically increases in connection with significant product releases by us or our suppliers.

General and administrative expenses. General and administrative expenses consist primarily of general corporate costs, including personnel expenses, financial reporting, corporate governance and compliance and outside legal, audit and tax fees.

Provision for litigation loss. Loss from litigation relates to an action filed in France by Digitechnic, S.A., a former customer. The Company entered into a settlement agreement with Digitechnic, pursuant to which the Company made a payment of $1.1 million in December 2009.

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Interest and other income, net. Interest and other income, net represents the net of our interest income on investments or interest expense on the building loans for our owned facilities offset by interest earned on our cash and investments balances.

Income tax provision. Our income tax provision is based on our taxable income generated in the jurisdictions in which we operate, currently primarily the United States and the Netherlands and to a lesser extent, Taiwan. Our effective tax rate differs from the statutory rate primarily due to tax benefit of tax exempt interest income, stock option expenses/deductions, research and development tax credits and the domestic production activities deduction.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. We evaluate our estimates on an on-going basis, including those related to allowances for doubtful accounts and sales returns, cooperative marketing accruals, investment valuations, inventory valuations, income taxes, warranty obligations and stock-based compensation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making the judgments we make about the carrying values of assets and liabilities that are not readily apparent from other sources. Because these estimates can vary depending on the situation, actual results may differ from the estimates.

We believe the following are our most critical accounting policies as they require our more significant judgments in the preparation of our financial statements.

Revenue recognition. We recognize revenue from sales of products, when persuasive evidence of an arrangement exists, shipment has occurred and title has transferred, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured, and all significant obligations have been met. Generally this occurs at the time of shipment when risk of loss and title has passed to the customer. Our standard arrangement with our customers includes a signed purchase order or contract, free-on-board shipping point terms, except for a few customers who have free-on-board destination terms, and revenue is recognized when the products arrive at the destination, 30 to 60 days payment terms, and no customer acceptance provisions. We generally do not provide for non-warranty rights of return except for products which have Out-of-box failure, where customers could return these products for credit within 30 days of receiving the items. Certain distributors and OEMs are also permitted to return products in unopened boxes, limited to purchases over a specified period of time, generally within 60 to 90 days of the purchase, or to products in the distributor s or OEM s inventory at certain times (such as the termination of the agreement or product obsolescence). In addition, we have a sale arrangement with an OEM that has limited product return rights. To estimate reserves for future sales returns, we regularly review our history of actual returns for each major product line. We also communicate regularly with our distributors to gather information about end customer satisfaction, and to determine the volume of inventory in the channel. Reserves for future returns are adjusted as necessary, based on returns experience, returns expectations and communication with our distributors.

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Probability of collection is assessed on a customer-by-customer basis. Customers are subjected to a credit review process that evaluates the customers financial position and ability to pay. If it is determined from the outset of an arrangement that collection is not probable based upon the review process, the customers are required to pay cash in advance of shipment. We also make estimates of the uncollectibility of accounts receivables, analyzing accounts receivable and historical bad debts, customer concentrations, customer-credit-worthiness, current economic trends and changes in customer payment terms to evaluate the adequacy of the allowance for doubtful accounts. On a quarterly basis, we evaluate aged items in the accounts receivable aging report and provide an allowance in an amount we deem adequate for doubtful accounts. If management were to make different judgments or utilize different estimates, material differences in the amount of our reported operating expenses could result. We provide for price protection to certain distributors. We assess the market competition and product technology obsolescence, and make price adjustments based on our judgment. Upon each announcement of price reductions, the accrual for price protection is calculated based on our distributors inventory on hand. Such reserves are recorded as a reduction to revenue at the time we reduce the product prices.

We have an immaterial amount of service revenue relating to non-warranty repairs, which is recognized upon shipment of the repaired units to customers. Service revenue has been less than 10% of net sales for all periods presented and is not separately disclosed.

Cooperative marketing accruals. We have arrangements with resellers of our products to reimburse the resellers for cooperative marketing costs meeting specified criteria. We accrue the cooperative marketing costs based on these arrangements and our estimate for resellers claims for marketing activities. We record marketing costs meeting such specified criteria within sales and marketing expenses in the accompanying condensed consolidated statements of operations. For those marketing costs that do not meet the specified criteria, the amounts are recorded as a reduction to sales in the accompanying condensed consolidated statements of operations.

Impairment of short-term and long-term investments. Impairment of short-term and long-term investments relates to the unrealized loss on the carrying value of our investments in auction rate securities; such securities were rated AAA at the date of purchase. The liquidity and fair value of these securities has been negatively impacted by the uncertainty in the credit markets and exposure of these securities to the financial condition of bond insurance companies. We have received all interest payments due on these instruments on a timely basis. Each of these securities has been subject to auction processes for which there had been insufficient bidders on the scheduled rollover dates and the auctions have subsequently failed. When these securities lost the short-term liquidity previously provided by the auction processes, we reclassified these securities as long-term investments. For the securities with the stated maturity less than a year, the securities were classified as short-term available-for-sale investments. We have used a discounted cash flow model to estimate the fair value of these investments as of September 30, 2010 and June 30, 2010. The material factors used in preparing the discounted cash flow model are 1) the discount rate utilized to present value the cash flows, 2) the time period until redemption and 3) the estimated rate of return. Management derives the estimates by obtaining input from market data on the applicable discount rate, estimated time to maturity and estimated rate of return. The changes in fair value have been primarily due to changes in the estimated rate of return and a change in the estimated period to liquidity. The fair value of our investment portfolio may change between 1% to 3% by increasing or decreasing the rate of return used by 1% or by increasing or decreasing the term used by 1 year. Changes in these estimates or in the market conditions for these investments are likely in the future based upon the then current market conditions for these investments and may affect the fair value of these investments. The accumulated unrealized loss as of September 30, 2010 and June 30, 2010 was $204,000, net of deferred income taxes, on the securities. We deem this loss to be temporary as we determined that we will not likely be required to sell the securities before their anticipated recovery and we have the intent and ability to hold our investments until recovery of cost.

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Product warranties. We offer product warranties ranging from 15 to 39 months against any defective product. We accrue for estimated returns of defective products at the time revenue is recognized, based on historical warranty experience and recent trends. We monitor warranty obligations and may make revisions to our warranty reserve if actual costs of product repair and replacement are significantly higher or lower than estimated. Accruals for anticipated future warranty costs are charged to cost of sales and included in accrued liabilities. The liability for product warranties was $4.6 million as of September 30, 2010 and June 30, 2010. The provision for warranty reserve was $2.6 million and $1.6 million in the three months ended September 30, 2010 and 2009, respectively. Our estimates and assumptions used have been historically close to actual. The change in estimated liability for pre-existing warranties was ($0.5) million and ($0.3) million in the three ended September 30, 2010 and 2009, respectively. As we experienced an increase in net sales in the three months ended September 30, 2010, the provision for warranty reserve increased $1.0 million compared to the three months ended September 30, 2009. If in future periods, we experience or anticipate an increase or decrease in warranty claims as a result of new product introductions or change in unit volumes compared with our historical experience, or if the cost of servicing warranty claims is greater or lesser than expected, we intend to adjust our estimates appropriately.

Inventory valuation. Inventory is valued at the lower of cost or market. We evaluate inventory on a quarterly basis for lower of cost or market and excess and obsolescence and, as necessary, write down the valuation of units to lower of cost or market or for excess and obsolescence based upon the number of units that are unlikely to be sold given the estimated demand for the following twelve months. This evaluation takes into account matters including expected demand, anticipated sales price, product obsolescence and other factors. If actual future demand for our products is less than currently forecasted, additional inventory adjustments may be required. Once a reserve is established, it is maintained until the product to which it relates is sold or scrapped. If a unit that has been written down is subsequently sold, the cost associated with the revenue from this unit is reduced to the extent of the write down, resulting in an increase in gross profit. We monitor the extent to which previously written down inventory is sold at amounts greater or less than carrying value, and based on this analysis, adjust our estimate for determining future write downs. If in future periods, we experience or anticipate a change in recovery rate compared with our historical experience, our gross margin would be affected. Our provision (benefit) for inventory was ($0.1) million and $0.3 million in the three months ended September 30, 2010 and 2009, respectively.

Accounting for income taxes. We account for income taxes under an asset and liability approach. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for income tax reporting purposes, net operating loss carry-forwards and other tax credits measured by applying currently enacted tax laws. Valuation allowances are provided when necessary to reduce deferred tax assets to an amount that is more likely than not to be realized.

We recognize the tax liability for uncertain income tax positions on the income tax return based on the two-step process. The first step is to determine whether it is more likely than not that each income tax position would be sustained upon audit. The second step is to estimate and measure the tax benefit as the amount that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority. Estimating these amounts requires us to determine the probability of various possible outcomes. We evaluate these uncertain tax positions on a quarterly basis. This evaluation is based on the consideration of several factors, including changes in facts or circumstances, changes in applicable tax law, settlement of issues under audit and new exposures. If we later determine that our exposure is lower or that the liability is not sufficient to cover our revised expectations, we adjust the liability and effect a related change in our tax provision during the period in which we make such determination. See Note 13 of Notes to Condensed Consolidated Financial Statements for the impact on our condensed consolidated financial statements.

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Stock-based compensation. Since July 1, 2006, the Company measures the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). Compensation expense for options granted to employees after July 1, 2006, was $1.8 million and $1.5 million for the three months ended September 30, 2010 and 2009, respectively.

As of September 30, 2010, the total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options granted since July 1, 2006 to employees and non-employee directors, was $14.6 million, which is expected to be recognized as an expense over a weighted-average period of approximately 2.09 years. See Note 4 of Notes to Condensed Consolidated Financial Statements for additional information.

We estimated the fair value of stock options granted using a Black-Scholes option-pricing model and a single option award approach. This model requires us to make estimates and assumptions with respect to the expected term of the option, the expected volatility of the price of our common stock and the expected forfeiture rate. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

The expected term represents the period that our stock-based awards are expected to be outstanding and was determined based on an analysis of the relevant peer companies post-vest termination rates and exercise behavior. The expected volatility is based on a combination of the implied and historical volatility of our relevant peer group for the stock options granted prior to September 30, 2009. For stock options granted after September 30, 2009, expected volatility is based solely on our historical volatility. In addition, forfeitures of share-based awards are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

Variable interest entities. In June 2009, the FASB issued authoritative guidance on the consolidation of variable interest entities, which is effective for fiscal years beginning after November 15, 2009 and interim periods therein and thereafter. The new guidance requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. We adopted this standard and have analyzed our relationship with Ablecom and its subsidiaries (collectively Ablecom). We have concluded that Ablecom is a variable interest entity in accordance with applicable accounting standards and guidance; however, we are not the primary beneficiary of Ablecom and therefore, we do not consolidate Ablecom. In performing our analysis, we considered our explicit arrangements with Ablecom including the supplier and distributor arrangements. Also, as a result of the substantial related party relationship between the two companies, we considered whether any implicit arrangements exist that would cause us to protect those related parties interests in Ablecom from suffering losses. We determined that no implicit arrangements exist with Ablecom or its shareholders. Such an arrangement would be inconsistent with the fiduciary duty that we have towards our stockholders who do not own shares in Ablecom.

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Results of Operations

The following table sets forth our financial results, as a percentage of net sales for the periods indicated:

	Three Months Ended September 30,	
	2010	2009
Net sales	100.0%	100.0%
Cost of sales	84.1	83.5
Gross profit	15.9	16.5
Operating expenses:		
Research and development	5.0	5.8
Sales and marketing	3.0	3.1
General and administrative	2.1	2.6
Provision of litigation loss		0.7
Total operating expenses	10.1	12.2
Income from operations	5.8	4.3
Interest and other income, net		
Interest expense	(0.1)	
Income before income tax provision	5.7	4.3
Income tax provision	2.2	1.7
Net income	3.5%	2.6%

Comparison of Three Months Ended September 30, 2010 and 2009

Net sales. Net sales increased by $58.7 million, or 39.5%, to $207.2 million from $148.5 million, for the three months ended September 30, 2010 and 2009, respectively. This increase was due primarily to an increase in average selling prices of server systems and an increase in unit volumes of server systems and subsystems and accessories. For the three months ended September 30, 2010, the approximate number of server system units sold increased 35.1% to 50,000 compared to 37,000 for the three months ended September 30, 2009. The average selling price of server system units increased 7.1% to approximately $1,500 in the three months ended September 30, 2010 compared to approximately $1,400 in the three months ended September 30, 2009. The average selling prices of our server systems increased principally due to higher average selling prices of 6000 and 7000 Series configuration of servers which incorporated additional features such as higher density, memory and hard disk drive capacity. Sales of server systems increased by $22.8 million or 44.6% from the three months ended September 30, 2009 to the three months ended September 30, 2010, primarily due to higher sales of 6000 and 7000 Series configuration of servers including 2U Twin, 2U Twin², GPU and storage solutions and higher sales to OEM and end customers. Sales of server systems represented 35.7% of our net sales for the three months ended September 30, 2010 as compared to 34.5% of our net sales for the three months ended September 30, 2009. For the three months ended September 30, 2010, the approximate number of subsystems and accessories units sold increased 44.8% to 950,000 compared to 656,000 for the three months ended September 30, 2009. Sales of subsystems and accessories units increased by $35.8 million or 36.8% from the three months ended September 30, 2009 to the three months ended September 30, 2010, primarily due to higher sales to distributors, resellers and system integrators who increasingly are purchasing additional accessories from us and completing the final assembly themselves. Sales of subsystems and accessories represented 64.3% of our net sales for the three months ended September 30, 2010 as compared to 65.5% of our net sales for the three months ended September 30, 2009. We believe that the increase in our net sales in the three months ended September 30, 2010 was primarily attributable to the continuing improvement in the global economy. As a result, the amount of the percentage increases do not reflect a trend expected to continue in future periods. For the three months ended September 30, 2010 and 2009, we derived approximately 60.2% and 68.1%, respectively, of our net sales from products sold to distributors and we derived approximately 39.8% and 31.9%, respectively, from sales to OEMs and to end customers. For the three months ended September 30, 2010, customers in the United States, Europe, and Asia

accounted for approximately 58.7%, 22.4% and 15.7%, of our net sales, respectively, as compared to 63.0%, 20.4% and 13.5%, respectively, for the three months ended September 30, 2009.

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Cost of sales. Cost of sales increased by $50.1 million, or 40.4%, to $174.1 million from $124.0 million, for the three months ended September 30, 2010 and 2009, respectively. Cost of sales as a percentage of net sales was 84.1% and 83.5% for the three months ended September 30, 2010 and 2009, respectively. The increase in absolute dollars of cost of sales was primarily attributable to the increase in net sales, an increase of $2.6 million in freight-in charges associated with our growth in volume of products shipped at higher peak season rates, an increase of $1.1 million in our overseas production overhead and an increase of $1.0 million in provision for warranty reserve offset in part by a decrease of $0.4 million in provision for inventory reserve. The higher cost of sales as a percentage of net sales was primarily due to a higher percentage of sales from server systems to OEM and system integrators as we bundled additional features such as memories and hard disk drives into our server systems as well as a higher percentage of sales to internet data centers. In the three months ended September 30, 2010, we recorded a $2.6 million expense, or 1.3% of net sales, related to the provision for warranty reserve as compared to $1.6 million, or 1.1% of net sales, in the three months ended September 30, 2009. The increase in the provision for warranty reserve was primarily due to higher net sales in the three months ended September 30, 2010. If in future periods we experience or anticipate an increase or decrease in warranty claims as a result of new product introductions or a change in unit volumes compared with our historical experience, or if the cost of servicing warranty claims is greater or less than expected, our gross margin would be affected. In the three months ended September 30, 2010, we recorded a $0.1 million benefit, or 0.0% of net sales, related to the inventory provision as compared to $0.3 million expense, or 0.2% of net sales, in the three months ended September 30, 2009. The decrease in the inventory provision was primarily due to an increase sales of our previously reserved inventory in the three months ended September 30, 2010.

Research and development expenses. Research and development expenses increased by $1.8 million, or 21.1%, to $10.4 million from $8.6 million for the three months ended September 30, 2010 and 2009, respectively. Research and development expenses were 5.0% and 5.8% of net sales for the three months ended September 30, 2010 and 2009, respectively. The increase in absolute dollars was primarily due to an increase of $1.9 million in compensation and benefits, including higher stock-based compensation expense, resulting from growth in research and development personnel to support the expansion of our operations of our headquarter and operations in the Netherlands and Taiwan and an increase of $0.5 million in development costs associated with new products. These increases were partially offset by an increase of $0.7 million in non-recurring engineering funding from certain suppliers and customers.

Research and development expenses include stock-based compensation expense of $0.9 million and $0.7 million for the three months ended September 30, 2010 and 2009, respectively. The increase in absolute dollars was primarily due to the growth in research and development personnel related to expanded product development initiatives.

Sales and marketing expenses. Sales and marketing expenses increased by $1.7 million, or 36.9%, to $6.2 million from $4.5 million, for the three months ended September 30, 2010 and 2009, respectively. Sales and marketing expenses were 3.0% and 3.1% of net sales for the three months ended September 30, 2010 and 2009, respectively. The increase in absolute dollars was primarily due to an increase of $0.7 million in compensation and benefits resulting from growth in sales and marketing personnel, an increase of $0.5 million in cooperative marketing funding to customers, an increase of $0.2 million in advertising and promotion expenses and an increase of $0.2 million in trade show and travel expenses.

Sales and marketing expenses include stock-based compensation expense of $0.3 million and $0.2 million for three months ended September 30, 2010 and 2009.

General and administrative expenses. General and administrative expenses increased by $0.6 million, or 15.1%, to $4.4 million from $3.8 million, for the three months ended September 30, 2010 and 2009, respectively. General and administrative expenses were 2.1% and 2.6% of net sales for three months ended September 30, 2010 and 2009, respectively. The increase in absolute dollars was primarily due to an increase of $0.4 million in compensation and benefits, an increase of $0.4 million in accrued claim associated with a technology license and an increase of $0.3 million in legal expenses offset in part by an increase of $0.4 million in rental income and a decrease of $0.3 million in building loan fees.

General and administrative expenses include stock-based compensation expense of $0.5 million for both three months ended September 30, 2010 and 2009, respectively.

Provision for litigation loss. There was no loss from litigation for the three months ended September 30, 2010 as compared to $1.1 million for the three months ended September 30, 2009. The decrease was due to a settlement payment related to the Digitechnic lawsuit. (See Note 14 of Notes to Condensed Consolidated Financial Statements.)

Interest and other expense, net. Interest and other expense increased by $38,000, to $139,000 of expense from $101,000 of expense, for the three months ended September 30, 2010 compared to the three months ended September 30, 2009, of which $159,000 and $133,000 was interest

expense for the three months ended September 30, 2010 and 2009, respectively. The net change was primarily due to higher interest expense as we borrowed $18.6 million to purchase three buildings with approximately 167,000 square feet of space in San Jose, California adjacent to our headquarters in June 2010.

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Provision for income taxes. Provision for income taxes increased $2.2 million, or 86.4% to $4.7 million from $2.5 million for the three months ended September 30, 2010 and 2009, respectively. The effective tax rate was 39.2% and 39.3% for the three months ended September 30, 2010 and 2009, respectively. The effective tax rate of 39.2% is estimated to be higher than the Federal statutory rate primarily due to the impact of state taxes and stock option expenses, which were partially offset by the tax benefits of California research and development credits and domestic production activities deduction.

Liquidity and Capital Resources

Since our inception, we have financed our growth primarily with funds generated from operations and from the proceeds of our initial public offering. In addition, we have from time to time utilized borrowing facilities, particularly in relation to the financing of real property acquisitions. Our cash and cash equivalents and short-term investments were $83.6 million and $73.5 million as of September 30, 2010 and June 30, 2010, respectively.

Operating Activities. Net cash provided by operating activities was $16.9 million and $9.7 million for the three months ended September 30, 2010 and 2009, respectively. Net cash provided by our operating activities for the three months ended September 30, 2010 consisted of our net income of $7.2 million, an increase in accounts payable of $17.6 million, an increase in accrued liabilities of $4.3 million, an increase in deferred income taxes of $2.7 million, stock-based compensation expense of $1.8 million, an allowance for sales returns of $1.3 million and a depreciation expense of $1.3 million, which was substantially offset by an increase in inventory of $15.8 million and an increase in prepaid expense and other assets of $3.8 million. Net cash provided by operating activities for the three months ended September 30, 2009 was primarily due to our net income of $3.9 million, an increase in accounts payable of $12.9 million, an increase in prepaid income taxes of $2.2 million and stock-based compensation expense of $1.5 million, which was substantially offset by an increase in inventory of $10.3 million and an increase in accounts receivable of $5.4 million.

The increase for the three months ended September 30, 2010 in inventory, accounts payable and accrued liabilities was due to an increase in demand for our products resulting from a recovering economy and to support the growth of the Company. We anticipate that accounts receivable, sales returns, inventory and accounts payable will continue to increase to the extent we continue to grow our product lines and our business.

The increase for the three months ended September 30, 2009 in accounts receivable was primarily due to higher net sales during the three months ended September 30, 2009. The increase for the three months ended September 30, 2009 in inventory, accounts payable and accrued liabilities was due to an increase from a recovering economy and support of new products.

Investing activities. Net cash provided by (used in) our investing activities was ($6.4) million and $2.8 million for the three months ended September 30, 2010 and 2009, respectively. In the three months ended September 30, 2010, $7.3 million was related to the purchase of property, plant and equipment offset in part by the redemption at par of investments in auction rate securities of $0.9 million. In the three months ended September 30, 2009, the redemption at par of investments in auction rate securities of $3.4 million was offset in part by the purchase of property, plant and equipment of $0.7 million. We have historically owned our manufacturing facilities and have leased off-shore offices. In August 2010, we purchased land in Taiwan, consisting of approximately 4.7 acres. The purchase price is $6.1 million and we plan to develop the land for manufacturing and service operations through fiscal year 2012. We plan to finance the purchase and the development of the land in Taiwan through operating cash flows and additional financing from banks in fiscal year 2011.

Financing activities. Net cash provided by (used in) our financing activities was $0.4 million and ($9.1) million for the three months ended September 30, 2010 and 2009, respectively. In the three months ended September 30, 2010 and 2009, $0.6 million and $0.7 million, respectively was related to the proceeds from the exercise of stock options. We paid the minimum tax withholding on behalf of an executive officer for his restricted stock awards of $0.8 million for the three months ended September 30, 2010. We repaid $10.0 million in loans for the three months ended September 30, 2009. We expect the net cash used in financing activities will increase in the quarter ending December 31, 2010 as we intend to pay-off our existing line of credit by December 2010 with our operating cash and a mortgage loan. However, we cannot provide any assurance that such financing will be available at terms acceptable to the Company.

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We have historically generated cash from our operating activities as we have grown. We expect to experience continued growth in our working capital requirements as we continue to expand our business. We intend to fund this continued expansion through cash generated by operations. We anticipate that working capital will constitute a material use of our cash resources. We have sufficient cash on hand to continue to operate in the next 12 months.

Other factors affecting liquidity and capital resources

As of September 30, 2010, we had a revolving line of credit totaling $25.0 million that matures on June 15, 2013 with an interest rate at the LIBOR rate plus 1.50% per annum. In June 2010, we used $18.6 million of the line of credit to purchase three buildings with approximately 167,000 square feet of space in San Jose, California adjacent to our headquarters. The loan is secured by all our assets except for the three buildings purchased in San Jose, California, and we are required to obtain a mortgage loan to pay-off this line of credit by December 2010. As of September 30, 2010, we were in compliance with the financial covenants associated with the line of credit.

In addition, we have historically paid our contract manufacturers within 40 to 75 days of invoice and Ablecom between 50 and 100 days of invoice. Ablecom, a Taiwan corporation, is one of our major contract manufacturers and a related party. As of September 30, 2010 and June 30, 2010 amounts owed to Ablecom by us were approximately $30.5 million and $19.5 million, respectively.

In February 2008, we leased an office building of approximately 246,000 square feet in Fremont, California with total payment obligations of approximately $8.0 million over the next 4.8 years as of September 30, 2010. We also obtained an irrevocable standby letter of credit required by the landlord of the office lease totaling $121,000. This amount has been classified as a restricted asset as of September 30, 2010.

As of September 30, 2010, we held $5.8 million of auction rate securities, net of unrealized losses, representing our interest in auction rate preferred shares in a closed end mutual fund invested in municipal securities and auction rate student loans guaranteed by the Federal Family Education Loan Program; such auction rate securities were rated AAA, BAA1 or BAA3 at September 30, 2010. These auction rate preferred shares have no stated maturity date and stated maturity dates for these auction rate student loans range from 2033 to 2040. During February 2008, the auctions for these auction rate securities began to fail to obtain sufficient bids to establish a clearing rate and were not saleable in the auction, thereby losing the short-term liquidity previously provided by the auction process. As a result, as of September 30, 2010, $5.8 million of these auction rate securities have been classified as long-term available-for-sale investments. Based on our assessment of fair value at September 30, 2010, we have recorded an accumulated unrealized loss of $0.2 million, net of deferred income taxes, on long-term auction rate securities. The unrealized loss was deemed to be temporary and has been recorded as a component of accumulated other comprehensive loss. Although we have determined that we will not likely be required to sell the securities before the anticipated recovery and we have the intent and ability to hold these investments until successful auctions occur, these investments are not currently liquid and in the event we need to access these funds, we will not be able to do so without a loss of principal. There can be no assurances that these investments will be settled in the short term or that they will not become other-than-temporarily impaired subsequent to September 30, 2010, as the market for these investments is presently uncertain. In any event, we do not have a present need to access these funds for operational purposes. We will continue to monitor and evaluate these investments as there is no assurance as to when the market for these investments will allow us to liquidate them. We may be required to record impairment charges in periods subsequent to September 30, 2010 with respect to these securities and, if a liquid market does not develop for these investments, we could be required to hold them to maturity. During the three months ended September 30, 2010 and 2009, $0.9 million and $3.4 million of these auction rate securities were redeemed at par, respectively.

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Our long-term future capital requirements will depend on many factors, including our level of revenues, the timing and extent of spending to support our product development efforts, the expansion of sales and marketing activities, the timing of our introductions of new products, the costs to ensure access to adequate manufacturing capacity and the continuing market acceptance of our products. We could be required, or could elect, to seek additional funding through public or private equity or debt financing and additional funds may not be available on terms acceptable to us or at all.

Contractual Obligations

The following table describes our contractual obligations as of September 30, 2010:

	Payments Due by Period				
	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years	Total
	(in thousands)				
Operating leases	$ 2,787	$ 4,296	$ 3,776	$ 240	$ 11,099
Capital leases, including interest	53	40	5		98
Building loan, including interest	18,553				18,553
License arrangements	3,419	911	570		4,900
Purchase commitments	44,189				44,189
Total	$ 69,001	$ 5,247	$ 4,351	$ 240	$ 78,839

The table above excludes liabilities for deferred rent of $0.8 million, deferred revenue for warranty services of $1.7 million and unrecognized tax benefits and related interest and penalties accrual of $6.6 million. We have not provided a detailed estimate of the payment timing of unrecognized tax benefits due to the uncertainty of when the related tax settlements will become due.

We expect to fund our remaining contractual obligations from our ongoing operations and existing cash and cash equivalents on hand.

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Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosure About Market Risks

Interest Rate Risk

The primary objectives of our investment activities are to preserve principal, provide liquidity and maximize income without significantly increasing the risk. Some of the securities we invest in are subject to market risk. This means that a change in prevailing interest rates may cause the fair value of the investment to fluctuate. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in money market funds and certificates of deposit. Our long-term investments include auction rate securities, which have been classified as long-term due to the lack of a liquid market for these securities. Since our results of operations are not dependent on investments, the risk associated with fluctuating interest rates is limited to our investment portfolio, and we believe that a 10% change in interest rates would not have a significant impact on our results of operations. As of September 30, 2010, our short-term investments were in certificates of deposits. (see Liquidity Risk below).

We had $18.6 million of indebtedness under our credit facilities as of September 30, 2010 and June 30, 2010. In July and August 2009, we paid off the building loans of $10.2 million including a prepayment penalty of $0.2 million. The annual interest rate on our credit facilities for our outstanding loan is based on the LIBOR rate plus 1.5% per annum. At September 30, 2010 and June 30, 2010, the interest rate was 1.76% and 1.84%, respectively. We believe that a 10% change in interest rates would not have a significant impact on our results of operations.

Liquidity Risk

As of September 30, 2010, we held approximately $5.8 million of auction rate securities, net of unrealized losses, representing our interest in auction rate preferred shares in a closed end mutual fund invested in municipal securities and auction rate student loans guaranteed by the Federal Family Education Loan Program; such auction rate securities were rated AAA, BAA1 or BAA3 at September 30, 2010. These auction rate preferred shares have no stated maturity date and the stated maturity dates for these auction rate student loans range from 2033 to 2040. During February 2008, the auctions for these auction rate securities began to fail to obtain sufficient bids to establish a clearing rate and were not saleable in the auction, thereby losing the short-term liquidity previously provided by the auction process. As a result, as of September 30, 2010, $5.8 million of these auction rate securities have been classified as long-term available-for-sale investments. Based on our assessment of fair value at September 30, 2010, we have recorded an accumulated unrealized loss of $0.2 million, net of deferred income taxes, on long-term auction rate securities. The unrealized loss was deemed to be temporary and has been recorded as a component of accumulated other comprehensive loss. During the three months ended September 30, 2010 and 2009, approximately $0.9 million and $3.4 million of auction rate securities were redeemed at par, respectively.

Although we have determined that we will not likely be required to sell the securities before the anticipated recovery and we have the intent and ability to hold our investments until successful auctions occur, these investments are not currently liquid and in the event we need to access these funds, we will not be able to do so without a loss of principal. There can be no assurances that these investments will be settled in the short term or that they will not become other-than-temporarily impaired subsequent to September 30, 2010, as the market for these investments is presently uncertain. In any event, we do not have a present need to access these funds for operational purposes. We will continue to monitor and evaluate these investments as there is no assurance as to when the market for these investments will allow us to liquidate them. We may be required to record impairment charges in periods subsequent to September 30, 2010 with respect to these securities and, if a liquid market does not develop for these investments, we could be required to hold them to maturity.

Foreign Currency Risk

To date, our international customer and supplier agreements have been denominated solely in U.S. dollars, and accordingly, we have not been exposed to foreign currency exchange rate fluctuations from customer agreements, and do not currently engage in foreign currency hedging transactions. However, the functional currency of our operations in the Netherlands and Taiwan is the U.S. dollar and our local accounts are maintained in the local currency in the Netherlands and Taiwan, respectively, and thus we are subject to foreign currency exchange rate fluctuations associated with re-measurement to U.S. dollars. Such fluctuations have not been significant historically. For example, foreign exchange gain or (loss) was $183,000 and ($16,000) for the three months ended September 30, 2010 and 2009, respectively.

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Item 4. Controls and Procedures

Evaluation of Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, the Company evaluated the effectiveness of its disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). The evaluation considered the procedures designed to ensure that information required to be disclosed by us in the reports filed or submitted by the Company under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and communicated to our management as appropriate to allow timely decisions regarding required disclosure. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of September 30, 2010.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting as defined in Exchange Act Rule 13a-15(f) during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings.

We were subject to a suit brought by Digitechnic, S.A. which was filed in the Bobigny Commercial Court in Paris, in 1999. The claims involve allegations of damages stemming from allegedly defective products. In September 2003, the Bobigny Commercial Court awarded damages of approximately $1.2 million against us. In February 2005, the Paris Court of Appeals reversed the trial court s ruling, dismissed all of Digitechnic s claims and awarded costs to us. Digitechnic appealed the decision to the French Supreme Court and asked for $2.4 million for damages. On February 13, 2007, the French Supreme Court reversed the decision of the Paris Court of Appeals, ordering a new hearing before a different panel of the Paris Court of Appeals. In March 2008, we posted a bond in the amount of $3.1 million required by the court. The bond was collateralized by an irrevocable standby letter of credit totaling $1.5 million. In October 2009, the Paris Court of Appeals awarded damages of approximately $1.1 million against the Company. A provision of $1.1 million for litigation loss was recorded in the nine months ended March 31, 2010. The Company entered into a settlement agreement with Digitechnic, pursuant to which the Company made a payment of $1.1 million in December 2009.

In addition to the above, from time to time, we may be involved in various legal proceedings arising from the normal course of business activities. In our opinion, resolution of these and the above matters is not expected to have a material adverse impact on our consolidated results of operations, cash flows or our financial position. However, depending on the amount and timing, an unfavorable resolution of a matter could materially affect our future results of operations, cash flows or financial position in a particular period.

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Item 1a. Risk Factors.

The Risk Factors included in our Annual Report on Form 10-K for the year ended June 30, 2010 have not materially changed. You should carefully consider the following risk factors, as well as the other information in this Form 10-Q, before deciding whether to invest in shares of our common stock. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our common stock would likely decline and you might lose all or part of your investment in our common stock. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

Risks Related to Our Business and Industry

Our operating results may be adversely affected if the economic recovery is not sustained.

Our results of operations have improved as the economy has begun to recover. Although we cannot predict the level of such reductions or the impact on our business in future periods, if the economic recovery is not sustained, we could experience:

- reduced demand for our products as a result of continued constraints on IT-related capital spending and limitations on available financing;
- increased price competition for our products;
- risk of excess and obsolete inventories;
- excess facilities and manufacturing capacity;
- higher overhead costs as a percentage of revenue and higher interest expense; and
- risk of uncollectible accounts receivable.

Our operating results may also be affected by uncertain or changing economic conditions relating to specific geographical or product market segments. If global economic and market conditions, or economic conditions in the United States or other key markets, remain uncertain or persist, spread, or deteriorate further, we may experience material negative impacts on our business, operating results, and financial condition.

Our quarterly operating results will likely fluctuate in the future, which could cause rapid declines in our stock price.

As our business continues to grow, we believe that our quarterly operating results will be subject to greater fluctuation due to various factors, many of which are beyond our control. Factors that may affect quarterly operating results in the future include:

- our ability to attract new customers, retain existing customers and increase sales to such customers;
- unpredictability of the timing and size of customer orders, since most of our customers purchase our products on a purchase order basis rather than pursuant to a long term contract;

fluctuations in availability and costs associated with materials needed to satisfy customer requirements;

variability of our margins based on the mix of server systems, subsystems and accessories we sell;

variability of operating expenses as a percentage of net sales;

the timing of the introduction of new products by leading microprocessor vendors and other suppliers;

our ability to introduce new and innovative server solutions that appeal to our customers;

our ability to address technology issues as they arise, improve our products functionality and expand our product offerings;

changes in our product pricing policies, including those made in response to new product announcements and pricing changes of our competitors;

mix of whether customer purchases are of full systems or subsystems and accessories and whether made directly or through indirect sales channels;

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fluctuations based upon seasonality, with the quarters ending March 31 and September 30 typically being weaker;

the rate of expansion, domestically and internationally;

the effectiveness of our sales force and the efforts of our distributors;

the effect of mergers and acquisitions among our competitors, suppliers or partners;

general economic conditions in our geographic markets; and

impact of regulatory changes on our cost of doing business.

Accordingly, it is difficult for us to accurately forecast our growth and results of operations on a quarterly basis. If we fail to meet expectations of investors or analysts, our stock price may fall rapidly and without notice. Furthermore, the fluctuation of quarterly operating results may render less meaningful period-to-period comparisons of our operating results, and you should not rely upon them as an indication of future performance.

Our future financial performance will depend on the timely introduction and widespread acceptance of new server solutions and increased functionality of our existing server solutions.

Our future financial performance will depend on our ability to meet customer specifications and requirements by enhancing our current server solutions and developing server solutions with new and better functionality. The success of new features and new server solutions depends on several factors, including their timely introduction and market acceptance. We may not be successful in developing enhancements or new server solutions, or in timely bringing them to market. Customers may also defer purchases of our existing products pending the introduction of anticipated new products. For example, we experienced customer order delays in advance of Intel s Nehalem microprocessor release at the end of the quarter ended March 31, 2009. If our new server solutions are not competitive with solutions offered by other vendors, we may not be perceived as a technology leader and could miss market opportunities. If we are unable to enhance the functionality of our server solutions or introduce new server solutions which achieve widespread market acceptance, our reputation will be damaged, the value of our brand will diminish, and our business will suffer. In addition, uncertainties about the timing and nature of new features and products could result in increases in our research and development expenses with no assurance of future sales.

We may not be able to successfully manage our planned growth and expansion.

Over time we expect to continue to make investments to pursue new customers and expand our product offerings to grow our business rapidly. In connection with this growth, we expect that our annual operating expenses will increase significantly if the economy continues to improve and as we invest in sales and marketing, research and development, manufacturing and production infrastructure, and strengthen customer service and support resources for our customers. Our failure to expand operational and financial systems timely or efficiently could result in additional operating inefficiencies, which could increase our costs and expenses more than we had planned and prevent us from successfully executing our business plan. We may not be able to offset the costs of operation expansion by leveraging the economies of scale from our growth in negotiations with our suppliers and contract manufacturers. Additionally, if we do increase our operating expenses in anticipation of the growth of our business and this growth does not meet our expectations, our financial results will be negatively impacted.

If our business grows, we will have to manage additional product design projects, materials procurement processes, and sales efforts and marketing for an increasing number of SKUs, as well as expand the number and scope of our relationships with suppliers, distributors and end customers. If we fail to manage these additional responsibilities and relationships successfully, we may incur significant costs, which may negatively impact our operating results.

Additionally, in our efforts to be first to market with new products with innovative functionality and features, we may devote significant research and development resources to products and product features for which a market does not develop quickly, or at all. If we are not able to predict market trends accurately, we may not benefit from such research and development activities, and our results of operations may suffer.

During fiscal 2010 and the three months ended September 30, 2010, we began to significantly increase our operations in Taiwan and the Netherlands, in part to enable us to manufacture products and provide service closer to the location of customers in Europe and Asia. If we fail to effectively manage the transition of manufacturing and service operations to these locations or if we misjudge our ability to utilize this additional capacity, our gross margin and results of operations may suffer.

The market in which we participate is highly competitive, and if we do not compete effectively, we may not be able to increase our market penetration, grow our net sales or improve our gross margins.

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The market for server solutions is intensely competitive and rapidly changing. Barriers to entry in our market are relatively low and we expect increased challenges from existing as well as new competitors. Some of our principal competitors offer server solutions at a lower price, which has resulted in pricing pressures on sales of our server solutions. We expect further downward pricing pressure from our competitors and expect that we will have to price some of our server solutions aggressively to increase our market share with respect to those products. If we are unable to maintain the margins on our server solutions, our operating results could be negatively impacted. In addition, if we do not develop new innovative server solutions, or enhance the reliability, performance, efficiency and other features of our existing server solutions, our customers may turn to our competitors for alternatives. In addition, pricing pressures and increased competition generally may also result in reduced sales, lower margins or the failure of our products to achieve or maintain widespread market acceptance, any of which could have a material adverse effect on our business, results of operations and financial condition.

Our principal competitors include global technology companies such as Dell, Inc., Hewlett-Packard Company, International Business Machines Corporation and Intel. In addition, we also compete with a number of smaller vendors who also sell application optimized servers and original design manufacturers, or ODMs, such as Quanta Computer Incorporated. ODMs sell server solutions marketed or sold under a third party brand.

Many of our competitors enjoy substantial competitive advantages, such as:

- greater name recognition and deeper market penetration;
- longer operating histories;
- larger sales and marketing organizations and research and development teams and budgets;
- more established relationships with customers, contract manufacturers and suppliers and better channels to reach larger customer bases;
- larger customer service and support organizations with greater geographic scope;
- a broader and more diversified array of products and services; and
- substantially greater financial, technical and other resources.

As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. Competitors may seek to copy our innovations and use cost advantages from greater size to compete aggressively with us on price. Certain customers are also current or prospective competitors and as a result, assistance that we provide to them as customers may ultimately result in increased competitive pressure against us. Furthermore, because of these advantages, even if our application optimized server solutions are more effective than the products that our competitors offer, potential customers might accept competitive products in lieu of purchasing our products. The challenges we face from larger competitors will become even greater if consolidation or collaboration between or among our competitors occurs in our industry. For all of these reasons, we may not be able to compete successfully against our current or future competitors, and if we do not compete effectively, our ability to increase our net sales may be impaired.

As we increasingly target larger customers, our customer base may become less diversified, our cost of sales may increase, and our sales may be less predictable.

We expect that as our business continues to grow, we will be increasingly dependent upon larger sales to new customer to maintain our rate of growth and that selling our server solutions to larger customers will create new challenges. However, if certain customers buy our products in greater volumes, and their business becomes a larger percentage of our net sales, we may grow increasingly dependent on those customers to maintain our growth. If our largest customers do not purchase our products at the levels or in the timeframes that we expect, our ability to

maintain or grow our net sales will be adversely affected.

Additionally, as we and our distribution partners focus increasingly on selling to larger customers and attracting larger orders, we expect greater costs of sales. Our sales cycle may become longer and more expensive, as larger customers typically spend more time negotiating contracts than smaller customers. In addition, larger customers often seek to gain greater pricing concessions, as well as greater levels of support in the implementation and use of our server solutions. These factors can result in lower margins for our products.

Increased sales to larger companies may also cause fluctuations in results of operations. A larger customer may seek to fulfill all or substantially all of its requirements in a single order, and not make another purchase for a significant period of time. Accordingly, a significant

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increase in revenue during the period in which we recognize the revenue from the sale may be followed by a period of time during which the customer purchases none or few of our products. A significant decline in net sales in periods following a significant order could adversely affect our stock price.

We must work closely with our suppliers to make timely new product introductions.

We rely on our close working relationships with our suppliers, including Intel and AMD, to anticipate and deliver new products on a timely basis when new generation materials and core components are made available. Intel and AMD are the only suppliers of the microprocessors we use in our server systems. If we are not able to maintain 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 quickly offer advanced technology and product innovations to our customers would be impaired. We have no long term agreements that obligate our suppliers to continue to work with us or to supply us with products.

Our suppliers failure to improve the functionality and performance of materials and core components for our products may impair or delay our ability to deliver innovative products to our customers.

We need our material and core component suppliers, such as Intel and AMD, to provide us with core components that are innovative, reliable and attractive to our customers. Due to the pace of innovation in our industry, many of our customers may delay or reduce purchase decisions until they believe that they are receiving best of breed products that will not be rendered obsolete by an impending technological development. Accordingly, demand for new server systems that incorporate new products and features is significantly impacted by our suppliers new product introduction schedules and the functionality, performance and reliability of those new products. If our materials and core component suppliers fail to deliver new and improved materials and core components for our products, we may not be able to satisfy customer demand for our products in a timely manner, or at all. If our suppliers components do not function properly, we may incur additional costs and our relationships with our customers may be adversely affected.

As our business grows and if the economy does not improve, we expect that we may be exposed to greater customer credit risks.

Historically, we have offered limited credit terms to our customers. As our customer base expands, as our orders increase in size, and as we obtain more direct customers, we expect to offer increased credit terms and flexible payment programs to our customers. Doing so may subject us to increased credit risk, higher accounts receivable with longer days outstanding, and increases in charges or reserves, which could have a material adverse effect on our business, results of operations and financial condition. Likewise, if the economic recovery does not continue, we could be exposed to greater credit risk.

Our ability to develop our brand is critical to our ability to grow.

We believe that acceptance of our server solutions by an expanding customer base depends in large part on increasing awareness of the Supermicro brand and that brand recognition will be even more important as competition in our market develops. In particular, we expect an increasing proportion of our sales to come from sales of server systems, the sales of which we believe may be particularly impacted by brand strength. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and on our ability to develop reliable and useful products at competitive prices. To date, we have not devoted significant resources to building our brand, and have limited experience in increasing customer awareness of our brand. Our future brand promotion activities, including any expansion of our cooperative marketing programs with strategic partners, may involve significant expense and may not generate desired levels of increased revenue, and even if such activities generate some increased revenue, such increased revenue may not offset the expenses we incurred in endeavoring to build our brand. If we fail to successfully promote and maintain our brand, or incur substantial expenses in our attempts to promote and maintain our brand, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, and as a result our operating results and financial condition could suffer.

We principally rely on indirect sales channels for the sale and distribution of our products and any disruption in these channels could adversely affect our sales.

Historically, a substantial majority of our revenues have resulted from sales of our products through third party distributors and resellers, which sales accounted for 60.2% and 68.1% of our net sales in the three months ended September 30 2010 and 2009, respectively. We depend on our distributors to assist us in promoting market acceptance of our products and anticipate that a majority of our revenues will continue to result from sales through indirect channels. To maintain and potentially increase our revenue and profitability, we will have to successfully preserve and expand our existing distribution relationships as well as develop new distribution relationships. Our distributors also sell products offered by our competitors and may elect to focus their efforts on these sales. If our competitors offer our distributors more favorable terms or have more

products available to meet the needs of their customers, or utilize the leverage of broader product lines sold through the distributors, those distributors may de-emphasize or decline to carry our products. In addition, our distributors order decision-making process is complex and involves several factors, including end customer demand, warehouse allocation and marketing resources, which can make it difficult to accurately predict total sales for the quarter until late in the quarter. We also do not control the pricing or discounts offered by distributors to end customers. To maintain our participation in distributors marketing programs, in the past we have provided cooperative marketing

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arrangements or made short-term pricing concessions. The discontinuation of cooperative marketing arrangements or pricing concessions could have a negative effect on our business. Our distributors could also modify their business practices, such as payment terms, inventory levels or order patterns. If we are unable to maintain successful relationships with distributors or expand our distribution channels or we experience unexpected changes in payment terms, inventory levels or other practices by our distributors, our business will suffer.

We may be unable to accurately predict future sales through our distributors, which could harm our ability to efficiently manage our resources to match market demand.

Since a significant portion of our sales are made through domestic and international distributors, our financial results, quarterly product sales, trends and comparisons are affected by fluctuations in the buying patterns of end customers and our distributors, and by the changes in inventory levels of our products held by these distributors. We generally record revenue based upon a sell-in model which means that we generally record revenue upon shipment to our distributors. For more information regarding our revenue recognition policies, see Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies. While we attempt to assist our distributors in maintaining targeted stocking level of our products, we may not consistently be accurate or successful. This process involves the exercise of judgment and use of assumptions as to future uncertainties including end customer demand. Our distributors also have various rights to return products which could, among other things, result in our having to repurchase inventory which has declined in value or is obsolete. Consequently, actual results could differ from our estimates. Inventory levels of our products held by our distributors may exceed or fall below the levels we consider desirable on a going-forward basis. This could adversely affect our distributors or our ability to efficiently manage or invest in internal resources, such as manufacturing and shipping capacity, to meet the demand for our products.

Any failure to adequately expand our sales force will impede our growth.

Though we expect to continue to rely primarily on third party distributors to sell our server solutions, we expect that, over time, our direct sales force will grow. Competition for direct sales personnel with the advanced sales skills and technical knowledge we need is intense. Our ability to grow our revenue in the future will depend, in large part, on our success in recruiting, training, retaining and successfully managing sufficient qualified direct sales personnel. New hires require significant training and may take six months or longer before they reach full productivity. Our recent hires and planned hires may not become as productive as we would like, and we may be unable to hire sufficient numbers of qualified individuals in the future in the markets where we do business. If we are unable to hire and develop sufficient numbers of productive sales personnel, sales of our server solutions will suffer.

Our direct sales efforts may create confusion for our end customers and harm our relationships with our distributors and OEMs.

Though our direct sales efforts have historically been limited and focused on customers who typically do not buy from distributors or OEMs, we expect our direct sales force to grow as our business grows. As our direct sales force becomes larger, our direct sales efforts may lead to conflicts with our distributors and OEMs, who may view our direct sales efforts as undermining their efforts to sell our products. If a distributor or OEM deems our direct sales efforts to be inappropriate, the distributor or OEM may not effectively market our products, may emphasize alternative products from competitors, or may seek to terminate our business relationship. Disruptions in our distribution channels could cause our revenues to decrease or fail to grow as expected. Our failure to implement an effective direct sales strategy that maintains and expands our relationships with our distributors and OEMs could lead to a decline in sales and adversely affect our results of operations.

If we are required to change the timing of our revenue recognition, our net sales and net income could decrease.

We currently record revenue based upon a sell-in model with revenues generally recorded upon shipment of products to our distributors. This is in contrast to a sell-through model pursuant to which revenues are generally recognized upon sale of products by distributors to their customers. This requires that we maintain a reserve to cover the estimated costs of any returns or exercises of stock rotation rights, which we estimate primarily based on our historical experience. If facts and circumstances change such that the rate of returns of our products exceeds our historical experience, we may have to increase our reserve, which, in turn, would cause our revenue to decline. Similarly, if facts and circumstances change such that we are no longer able to determine reasonable estimates of our sales returns, we would be required to defer our revenue recognition until the point of sale from the distributors to their customers. Any such change may negatively impact our net sales or net income for particular periods and cause a decline in our stock price. For additional information regarding our revenue recognition policies, see Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies.

The average selling prices for our existing server solutions are subject to decline if customers do not continue to purchase our latest generation products, which could harm our results of operations.

As with most electronics based products, average selling prices of servers typically are highest at the time of introduction of new products, which utilize the latest technology, and tend to decrease over time as such products become commoditized and are ultimately replaced by even newer generation products. As our business continues to grow, we may increasingly be subject to this industry risk. We cannot predict the timing or amount of any decline in the average selling prices of our server solutions that we may experience in the future. In some instances, our agreements with our distributors limit our ability to reduce prices unless we make such price reductions available to them, or price protect their inventory. If we are unable to decrease per unit manufacturing costs faster than the rate at which average selling continue to decline, our business, financial condition and results of operations will be harmed.

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Our cost structure and ability to deliver server solutions to customers in a timely manner may be adversely affected by volatility of the market for core components and materials for our products.

Prices of materials and core components utilized in the manufacture of our server solutions, such as serverboards, chassis, central processing units, or CPUs, memory and hard drives represent a significant portion of our cost of sales. We generally do not enter into long-term supply contracts for these materials and core components, but instead purchase these materials and components on a purchase order basis. Prices of these core components and materials are volatile, and, as a result, it is difficult to predict expense levels and operating results. In addition, if our business growth renders it necessary or appropriate to transition to longer term contracts with materials and core component suppliers, our costs may increase and our gross margins could correspondingly decrease.

Because we often acquire materials and core components on an as needed basis, we may be limited in our ability to effectively and efficiently respond to customer orders because of the then-current availability or the terms and pricing of materials and core components. Our industry has experienced materials shortages and delivery delays in the past, and we may experience shortages or delays of critical materials in the future. From time to time, we have been forced to delay the introduction of certain of our products or the fulfillment of customer orders as a result of shortages of materials and core components. For example, we were unable to fulfill certain orders at the end of the quarter ended June 30, 2010 due to component shortages. If shortages or delays arise, the prices of these materials and core components may increase or the materials and core components may not be available at all. In addition, in the event of shortages, some of our larger competitors may have greater abilities to obtain materials and core components due to their larger purchasing power. We may not be able to secure enough core components or materials at reasonable prices or of acceptable quality to build new products to meet customer demand, which could adversely affect our business and financial results.

We may lose sales or incur unexpected expenses relating to insufficient, excess or obsolete inventory.

As a result of our strategy to provide greater choice and customization of our products to our customers, we are required to maintain a high level of inventory. If we fail to maintain sufficient inventory, we may not be able to meet demand for our products on a timely basis, and our sales may suffer. If we overestimate customer demand for our products, we could experience excess inventory of our products and be unable to sell those products at a reasonable price, or at all. As a result, we may need to record higher inventory reserves. If we are later able to sell such products at a profit, it may increase the quarterly variances in our operating results. Additionally, the rapid pace of innovation in our industry could render significant portions of our existing inventory obsolete. Certain of our distributors and OEMs have rights to return products, limited to purchases over a specified period of time, generally within 60 to 90 days of the purchase, or to products in the distributor s or OEM s inventory at certain times, such as termination of the agreement or product obsolescence. Any returns under these arrangements could result in additional obsolete inventory. In addition, server systems, subsystems and accessories that have been customized and later returned by those of our customers and partners who have return rights or stock rotation rights may be unusable for other purposes or may require reformation at additional cost to be made ready for sale to other customers. Excess or obsolete inventory levels for these or other reasons could result in unexpected expenses or increases in our reserves against potential future charges which would adversely affect our business and financial results. For example, during the three months ended September 30, 2010 and 2009, we recorded inventory write-downs charged (benefit) to cost of sales of ($0.1) million and $0.3 million, respectively, for excess and obsolete inventory. For additional information regarding customer return rights, see Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Revenue Recognition.

Our focus on internal development and customizable server solutions could delay our introduction of new products and result in increased costs.

Our strategy is to rely to a significant degree on internally developed components, even when third party components may be available. We believe this allows us to develop products with a greater range of features and functionality and allows us to develop solutions that are more customized to customer needs. However, if not properly managed, this reliance on internally developed components may be more costly than use of third party components, thereby making our products less price competitive or reducing our margins. In addition, our reliance on internal development may lead to delays in the introduction of new products and impair our ability to introduce products rapidly to market. We may also experience increases in our inventory costs and obsolete inventory, thereby reducing our margins.

Our research and development expenditures, as a percentage of our net sales, are considerably higher than many of our competitors and our earnings will depend upon maintaining revenues and margins that offset these expenditures.

Our strategy is to focus on being consistently rapid-to-market with flexible and customizable server systems that take advantage of our own internal development and the latest technologies offered by microprocessor manufacturers and other component vendors. Consistent with this strategy, we spend higher amounts, as a percentage of revenues, on research and development costs than many of our competitors. If we can not sell our products in sufficient volume and with adequate gross margins to compensate for such investment in research and development, our earnings may be materially and adversely affected.

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If our limited number of contract manufacturers or suppliers of materials and core components fail to meet our requirements, we may be unable to meet customer demand for our products, which could decrease our revenues and earnings.

We purchase many sophisticated materials and core components from one or a limited number of qualified suppliers and rely on a limited number of contract manufacturers to provide value added design, manufacturing, assembly and test services. We generally do not have long-term agreements with these vendors, and instead obtain key materials and services through purchase order arrangements. We have no contractual assurances from any contract manufacturer that adequate capacity will be available to us to meet future demand for our products.

Consequently, we are vulnerable to any disruptions in supply with respect to the materials and core components provided by limited-source suppliers, and we are at risk of being harmed by discontinuations of design, manufacturing, assembly or testing services from our contract manufacturers. We have occasionally experienced delivery delays from our suppliers and contract manufacturers because of high industry demand or because of inability to meet our quality or delivery requirements. For example, in the quarter ended September 30, 2006, we experienced delays in the delivery of printed circuit board material as a result of the loss of two of our five printer circuit board vendors. One of the vendors filed for bankruptcy and the other changed its business model and ceased supplying us. The delays in delivery of the materials resulted in a reduction of net sales for the quarter of approximately two to three million dollars. If our relationships with our suppliers and contract manufactures are negatively impacted by late payments or other issues, we may not receive timely delivery of materials and core components. If we were to lose any of our current supply or contract manufacturing relationships, the process of identifying and qualifying a new supplier or contract manufacturer who will meet our quality and delivery requirements, and who will appropriately safeguard our intellectual property, may require a significant investment of time and resources, adversely affecting our ability to satisfy customer purchase orders and delaying our ability to rapidly introduce new products to market. Similarly, if any of our suppliers were to cancel or materially change contracts or commitments to us or fail to meet the quality or delivery requirements needed to satisfy customer demand for our products, our reputation and relationships with customers could be damaged. We could lose orders, be unable to develop or sell some products cost-effectively or on a timely basis, if at all, and have significantly decreased revenues, margins and earnings, which would have a material adverse effect on our business.

Our failure to deliver high quality server solutions could damage our reputation and diminish demand for our products.

Our server solutions are critical to our customers business operations. Our customers require our server solutions to perform at a high level, contain valuable features and be extremely reliable. The design of our server solutions is sophisticated and complex, and the process for manufacturing, assembling and testing our server solutions is challenging. Occasionally, our design or manufacturing processes may fail to deliver products of the quality that our customers require. For example, in 2000, a vendor provided us with a defective capacitor that failed under certain heavy use applications. As a result, our product needed to be repaired. Though the vendor agreed to pay for a large percentage of the costs of the repairs, we incurred costs in connection with the recall and diverted resources from other projects.

New flaws or limitations in our server solutions may be detected in the future. Part of our strategy is to bring new products to market quickly, and first-generation products may have a higher likelihood of containing undetected flaws. If our customers discover defects or other performance problems with our products, our customers businesses, and our reputation, may be damaged. Customers may elect to delay or withhold payment for defective or underperforming server solutions, request remedial action, terminate contracts for untimely delivery, or elect not to order additional server solutions, which could result in an increase in our provision for doubtful accounts, an increase in collection cycles for accounts receivable or subject us to the expense and risk of litigation. We may incur expense in recalling, refurbishing or repairing defective server solutions. If we do not properly address customer concerns about our products, our reputation and relationships with our customers may be harmed. For all of these reasons, customer dissatisfaction with the quality of our products could substantially impair our ability to grow our business.

Conflicts of interest may arise between us and Ablecom Technology Inc., one of our major contract manufacturers, and those conflicts may adversely affect our operations.

We use Ablecom, a related party, for contract design and manufacturing coordination support. We work with Ablecom to optimize modular designs for our chassis and certain of other components. Our purchases from Ablecom represented 20.9% and 22.0% of our cost of sales for three month months ended September 30 2010 and 2009, respectively. Ablecom s sales to us constitute a substantial majority of Ablecom s net sales. Ablecom is a privately-held Taiwan-based company.

Steve Liang, Ablecom s Chief Executive Officer and largest shareholder, is the brother of Charles Liang, our President, Chief Executive Officer and Chairman of the Board. Charles Liang, and his spouse, Chiu-Chu (Sara) Liu Liang, our Vice President of Operations, Treasurer and director,

jointly own 10.5% of Ablecom s outstanding common stock. Charles Liang served as a director of Ablecom during our fiscal 2006, but is not currently serving in such capacity. Mr. Charles Liang, Ms. Liang, Mr. Steve Liang and relatives of these individuals own 35.9% of Ablecom s outstanding common stock. Mr. and Mrs. Charles Liang, as directors, officers and significant stockholders of the Company, have considerable influence over the management of our business relationships. Accordingly, we may be disadvantaged by their economic interests as stockholders of Ablecom and their personal relationship with Ablecom s Chief Executive Officer. We may not negotiate or enforce contractual terms as aggressively with Ablecom as we might with an unrelated party, and the commercial terms of our agreements may be less favorable than we might obtain in negotiations with third parties. If our business dealings with Ablecom are not as favorable to us as arms-length transactions, our results of operations may be harmed.

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In addition, our relationships with Ablecom could be adversely affected by declines in our stock price or divestments by Ablecom of its shares of our common stock. Steve Liang, Ablecom s Chief Executive Officer, held 2.0% of our outstanding common stock as of September 30, 2010. If the value of the shares that Steve Liang holds should decline, by decrease in our stock price or by disposition of the shares, if Steve Liang ceases to have significant influence over Ablecom, or if those of our stockholders who hold shares of Ablecom cease to hold a majority of the outstanding shares of Ablecom, the terms and conditions of our agreements with Ablecom may not be as favorable as those in our existing contracts. As a result, our costs could increase and adversely affect our margins and results of operations.

Our relationship with Ablecom may allow us to benefit from favorable pricing which may result in reported results more favorable than we might report in the absence of our relationship.

Although we generally re-negotiate the price of products that we purchase from Ablecom on a quarterly basis, pursuant to our agreements with Ablecom either party may re-negotiate the price of products for each order. As a result of our relationship with Ablecom, it is possible that Ablecom may in the future sell products to us at a price lower than we could obtain from an unrelated third party supplier. This may result in future reporting of gross profit as a percentage of net sales that is less than or in excess of what we might have obtained absent our relationship with Ablecom.

Our reliance on Ablecom could be subject to risks associated with our reliance on a limited source of contract manufacturing services and inventory warehousing.

We continue to maintain our manufacturing relationship with Ablecom in Asia. In order to provide a larger volume of contract manufacturing services for us, Ablecom will continue to warehouse for us an increasing number of components and subassemblies manufactured by multiple suppliers prior to shipment to our facilities in the U.S. and Europe. We also anticipate that we will continue to lease office space from Ablecom in Taiwan to support the research and development efforts we are undertaking.

If we or Ablecom fail to manage the contract manufacturing services and warehouse operations in Asia, we may experience delays in our ability to fulfill customer orders. Similarly, if Ablecom s facility in Asia is subject to damage, destruction or other disruptions, our inventory may be damaged or destroyed, and we may be unable to find adequate alternative providers of contract manufacturing services in the time that we or our customers require. We could lose orders and be unable to develop or sell some products cost-effectively or on a timely basis, if at all.

Currently, we purchase contract manufacturing services primarily for our chassis and power supply products from Ablecom. If our commercial relationship with Ablecom were to deteriorate or terminate, establishing direct relationships with those entities supplying Ablecom with key materials for our products or identifying and negotiating agreements with alternative providers of warehouse and contract manufacturing services might take a considerable amount of time and require a significant investment of resources. Pursuant to our agreements with Ablecom and subject to certain exceptions, Ablecom has the exclusive right to be our supplier of the specific products developed under such agreements. As a result, if we are unable to obtain such products from Ablecom on terms acceptable to us, we may need to identify a new supplier, change our design and acquire new tooling, all of which could result in delays in our product availability and increased costs. If we need to use other suppliers, we may not be able to establish business arrangements that are, individually or in the aggregate, as favorable as the terms and conditions we have established with Ablecom. If any of these things should occur, our net sales, margins and earnings could significantly decrease, which would have a material adverse effect on our business.

We are increasing our operations in Taiwan, China and the Netherlands and could be subject to risks of doing business in the region.

We intend to increase our business operations in Europe and Asia, and particularly in the Netherlands, Taiwan and China. As a result, our exposure to the business risks presented by the economies and regulatory environments of Asia will increase. For example, the validity, enforceability and scope of protection of intellectual property is uncertain and evolving in the Netherlands, Taiwan and China, and our intellectual property rights may not be protected under the laws of the Netherlands, Taiwan and China to the same extent as under laws of the United States. If our intellectual property is misappropriated, we may experience unfair competition and declining sales or be forced to incur increased costs of enforcing our intellectual property rights, both of which would adversely affect our net sales, gross margins and results of operations.

Our growth into markets outside the United States exposes us to risks inherent in international business operations.

We market and sell our systems and components both domestically and outside the United States. We intend to expand our international sales efforts, especially into Asia, but our international expansion efforts may not be successful. Our international operations expose us to risks and

challenges that we would otherwise not face if we conducted our business only in the United States, such as:

- heightened price sensitivity from customers in emerging markets;
- our ability to establish local manufacturing, support and service functions, and to form channel relationships with resellers in non-U.S. markets;
- localization of our systems and components, including translation into foreign languages and the associated expenses;
- compliance with multiple, conflicting and changing governmental laws and regulations;

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- foreign currency fluctuations;
- limited visibility into sales of our products by our distributors;
- laws favoring local competitors;
- weaker legal protections of intellectual property rights and mechanisms for enforcing those rights;
- market disruptions created by public health crises in regions outside the U.S., such as Avian flu, SARS and other diseases;
- difficulties in staffing and managing foreign operations, including challenges presented by relationships with workers councils and labor unions; and
- changing regional economic and political conditions.

These factors could limit our future international sales or otherwise adversely impact our operations.

We have in the past entered into plea and settlement agreements with the government relating to violations of export control and related laws; if we fail to comply with laws and regulations restricting dealings with sanctioned countries, we may be subject to future civil or criminal penalties, which may have a material adverse effect on our business or ability to do business outside the U.S.

In 2006, we entered into certain plea and settlement agreement with government agencies relating to export control and related law violations for activities that occurred in the 2001 to 2003 timeframe. We believe we are currently in compliance in all material respects with applicable export related laws and regulations. However, if our export compliance program is not effective, or if we are subject to any future claims regarding violation of export control and economic sanctions laws, we could be subject to civil or criminal penalties, which could lead to a material fine or other sanctions, including loss of export privileges, that may have a material adverse effect on our business, financial condition, results of operation and future prospects. In addition, these plea and settlement agreements and any future violations could have an adverse impact on our ability to sell our products to U.S. federal, state and local government and related entities.

Any failure to protect our intellectual property rights, trade secrets and technical know-how could impair our brand and our competitiveness.

Our ability to prevent competitors from gaining access to our technology is essential to our success. If we fail to protect our intellectual property rights adequately, we may lose an important advantage in the markets in which we compete. Trademark, patent, copyright and trade secret laws in the United States and other jurisdictions as well as our internal confidentiality procedures and contractual provisions are the core of our efforts to protect our proprietary technology and our brand. Our patents and other intellectual property rights may be challenged by others or invalidated through administrative process or litigation, and we may initiate claims or litigation against third parties for infringement of our proprietary rights. Such administrative proceedings and litigation are inherently uncertain and divert resources that could be put towards other business priorities. We may not be able to obtain a favorable outcome and may spend considerable resources in our efforts to defend and protect our intellectual property.

Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our products are available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States, and mechanisms for enforcement of intellectual property rights may be inadequate.

Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property and using our technology for their competitive advantage. Any such infringement or misappropriation could have a material adverse effect on our business, results of operations and financial condition.

Resolution of claims that we have violated or may violate the intellectual property rights of others could require us to indemnify our customers, resellers or vendors, redesign our products, or pay significant royalties to third parties, and materially harm our business.

Our industry is marked 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. Third-parties have in the past sent us correspondence regarding their intellectual property and in the future we may receive claims that our products infringe or violate third parties intellectual property rights. For example, we were subject to a lawsuit filed in 2005 by Rackable Systems, Inc. In May 2007, we settled the claims on terms which had no adverse effect on our business, financial condition and result of operations. In addition, increasingly non-operating companies are purchasing patents and bringing claims against technology companies. We are currently subject to one such claim and recently settled another. Successful intellectual property claims against us from others could result in significant financial liability or prevent us from operating our business or portions of our business as we currently conduct it or as we may later conduct it. In addition, resolution of claims may require us to redesign our technology, to obtain licenses to use intellectual property belonging to third parties, which we may not be able to obtain on reasonable terms, to cease using the technology covered by those rights, and to indemnify our customers, resellers or vendors. Any claim, regardless of its merits, could be expensive and time consuming to defend against, and divert the attention of our technical and management resources.

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If we lose Charles Liang, our President, Chief Executive Officer and Chairman, or any other key employee or are unable to attract additional key employees, we may not be able to implement our business strategy in a timely manner.

Our future success depends in large part upon the continued service of our executive management team and other key employees. In particular, Charles Liang, our President, Chief Executive Officer and Chairman of the Board, is critical to the overall management of our company as well as to the development of our culture and our strategic direction. Mr. Liang co-founded our company and has been our Chief Executive Officer since our inception. His experience in running our business and his personal involvement in key relationships with suppliers, customers and strategic partners are extremely valuable to our company. We currently do not have a succession plan for the replacement of Mr. Liang if it were to become necessary. Additionally, we are particularly dependent on the continued service of our existing research and development personnel because of the complexity of our products and technologies. Our employment arrangements with our executives and employees do not require them to provide services to us for any specific length of time, and they can terminate their employment with us at any time, with or without notice, without penalty. The loss of services of any of these executives or of one or more other key members of our team could seriously harm our business.

To execute our growth plan, we must attract additional highly qualified personnel, including additional engineers and executive staff. Competition for qualified personnel is intense, especially in San Jose, where we are headquartered. We have experienced in the past and may continue to experience difficulty in hiring and retaining highly skilled employees with appropriate qualifications. In particular, we are currently working to add personnel in our finance, accounting and general administration departments, which have historically had limited budgets and staffing. If we are unable to attract and integrate additional key employees in a manner that enables us to scale our business and operations effectively, or if we do not maintain competitive compensation policies to retain our employees, our ability to operate effectively and efficiently could be limited.

Backlog does not provide a substantial portion of our net sales in any quarter.

Our net sales are difficult to forecast because we do not have sufficient backlog of unfilled orders to meet our quarterly net sales targets at the beginning of a quarter. Rather, a majority of our net sales in any quarter depend upon customer orders that we receive and fulfill in that quarter. Because our expense levels are based in part on our expectations as to future net sales and to a large extent are fixed in the short term, we might be unable to adjust spending in time to compensate for any shortfall in net sales. Accordingly, any significant shortfall of revenues in relation to our expectations would harm our operating results.

Our business and operations are especially subject to the risks of earthquakes other natural catastrophic events.

Our corporate headquarters, including our most significant research and development and manufacturing operations, are located in the Silicon Valley area of Northern California, a region known for seismic activity. We do not currently have a comprehensive disaster recovery program and as a result, a significant natural disaster, such as an earthquake, could have a material adverse impact on our business, operating results, and financial condition. Although we are in the process of preparing such a program, there is no assurance that it will be effective in the event of such a disaster.

We invest in auction rate securities that are subject to market risk and the recent problems in the financial markets could adversely affect the value and liquidity of our assets.

As of September 30, 2010, we held $5.8 million of auction rate securities, net of unrealized losses, representing our interest in auction rate preferred shares in a closed end mutual fund invested in municipal securities and auction rate student loans guaranteed by the Federal Family Education Loan Program; such auction rate securities were rated AAA, BAA1 or BAA3 at September 30, 2010. These auction rate preferred shares have no stated maturity date and the stated maturity dates for these auction rate student loans range from 2033 to 2040.

Based on our assessment of fair value at September 30, 2010, we have recorded an accumulated unrealized loss of $0.2 million, net of deferred income taxes, on long-term auction rate securities. The unrealized loss was deemed to be temporary and has been recorded as a component of accumulated other comprehensive loss.

Although we have determined that we will not likely be required to sell the securities before their anticipated recovery and we have the intent and ability to hold our investments until successful auctions occur, these investments are not currently liquid and in the event we need to access these funds, we will not be able to do so without a loss of principal. There can be no assurances that these investments will be settled in the short term or that they will not become other-than-temporarily impaired subsequent to September 30, 2010, as the market for these investments is

presently uncertain. In any event, we do not have a present need to access these funds for operational purposes. We will continue to monitor and evaluate these investments as there is no assurance as to when the market for these investments will allow us to liquidate them. We may be required to record impairment charges in periods subsequent to September 30, 2010 with respect to these securities and, if a liquid market does not develop for these investments, we could be required to hold them to maturity. During three months ended September 30, 2010 and 2009, $0.9 million and $3.4 million of auction rate securities were redeemed at par, respectively.

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If we are unable to favorably assess the effectiveness of our internal control over financial reporting, or if our independent auditors are unable to provide an unqualified attestation report on our internal control over financial reporting, our stock price could be adversely affected.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, or Section 404, our management is required to report on the effectiveness of our internal control over financial reporting in our annual reports. In addition, our independent auditors must attest to and report on the effectiveness of our internal control over financial reporting. The rules governing the standards that must be met for management to assess our internal control over financial reporting are complex, and require significant documentation, testing and possible remediation. As a result, our efforts to comply with Section 404 have required the commitment of significant managerial and financial resources. As we are committed to maintaining high standards of public disclosure, our efforts to comply with Section 404 are ongoing, and we are continuously in the process of reviewing, documenting and testing our internal control over financial reporting, which will result in continued commitment of significant financial and managerial resources. Although we strive to maintain effective internal controls over financial reporting in order to prevent and detect material misstatements in our annual and quarterly financial statements and prevent fraud, we cannot assure that such efforts will be effective. If we fail to maintain effective internal controls in future periods, our operating results, financial position and stock price could be adversely affected.

Our operations involve the use of hazardous and toxic materials, and we must comply with environmental laws and regulations, which can be expensive, and may affect our business and operating results.

We are subject to federal, state and local regulations relating to the use, handling, storage, disposal and human exposure to hazardous and toxic materials. If we were to violate or become liable under environmental laws in the future as a result of our inability to obtain permits, human error, accident, equipment failure or other causes, we could be subject to fines, costs, or civil or criminal sanctions, face third party property damage or personal injury claims or be required to incur substantial investigation or remediation costs, which could be material, or experience disruptions in our operations, any of which could have a material adverse effect on our business. In addition, environmental laws could become more stringent over time imposing greater compliance costs and increasing risks and penalties associated with violations, which could harm our business.

We also face increasing complexity in our product design as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead and other hazardous substances applicable to specified electronic products placed on the market in the European Union (Restriction on the Use of Hazardous Substances Directive 2002/95/EC, also known as the RoHS Directive). We are also subject to laws and regulations such as California s Proposition 65 which requires that clear and reasonable warnings be given to consumers who are exposed to certain chemicals deemed by the State of California to be dangerous, such as lead. We expect that our operations will be affected by other new environmental laws and regulations on an ongoing basis. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, and could require that we change the design and/or manufacturing of our products, any of which could have a material adverse effect on our business.

Risks Related to Owning Our Stock

The trading price of our common stock is likely to be volatile, and you might not be able to sell your shares at or above the price at which you purchased the shares.

The trading prices of technology company securities in general have been highly volatile. Accordingly, the trading price of our common stock is likely to be subject to wide fluctuations. Factors, in addition to those outlined elsewhere in this prospectus, that may affect the trading price of our common stock include:

- actual or anticipated variations in our operating results;
- announcements of technological innovations, new products or product enhancements, strategic alliances or significant agreements by us or by our competitors;

Changes in recommendations by any securities analysts that elect to follow our common stock;

the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;

the loss of a key customer;

the loss of key personnel;

technological advancements rendering our products less valuable;

Lawsuits filed against us;

Changes in operating performance and stock market valuations of other companies that sell similar products;

price and volume fluctuations in the overall stock market;

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market conditions in our industry, the industries of our customers and the economy as a whole; and

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

Future sales of shares by existing stockholders could cause our stock price to decline.

Attempts by existing stockholders to sell substantial amounts of our common stock in the public market could cause the trading price of our common stock to decline significantly. As of September 30, 2010, we had 37.4 million shares of common stock outstanding, net of treasury stock. All of these shares are eligible for sale in the public market, including 11.4 million shares held by directors, executive officers and other affiliates, which are subject to volume limitations under Rule 144 under the Securities Act. In addition, 12.3 million shares subject to outstanding options and reserved for future issuance under our stock option plans are eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements. If these additional shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline.

If securities analysts do not publish research or reports about our business or if they downgrade our stock, the price of our stock could decline.

The research and reports that industry or financial analysts publish about us or our business likely have an effect on the trading price of our common stock. If an industry analyst decides not to cover our company, or if an industry analyst decides to cease covering our company at some point in the future, we could lose visibility in the market, which in turn could cause our stock price to decline. If an industry analyst downgrades our stock, our stock price would likely decline rapidly in response.

The concentration of our capital stock ownership with insiders will likely limit your ability to influence corporate matters.

As of October 31, 2010, our executive officers, directors, current five percent or greater stockholders and affiliated entities together beneficially owned 36.2 percent of our common stock outstanding, net of treasury stock. As a result, these stockholders, acting together, will have significant influence over all matters that require approval by our stockholders, including the election of directors and approval of significant corporate transactions. Corporate action might be taken even if other stockholders, including those who purchase shares in this offering, oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial.

Provisions of our certificate of incorporation and bylaws and Delaware law might discourage, delay or prevent a change of control of our company or changes in our management and, as a result, depress the trading price of our common stock.

Our certificate of incorporation and bylaws contain provisions that could discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions:

establish a classified board of directors so that not all members of our board are elected at one time;

require super-majority voting to amend some provisions in our certificate of incorporation and bylaws;

authorize the issuance of blank check preferred stock that our board could issue to increase the number of outstanding shares and to discourage a takeover attempt;

limit the ability of our stockholders to call special meetings of stockholders;

prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;

provide that the board of directors is expressly authorized to adopt, or to alter or repeal our bylaws; and

establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings.

In addition, we are subject to Section 203 of the Delaware General Corporation Law, which, subject to some exceptions, prohibits business combinations between a Delaware corporation and an interested stockholder, which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation s voting stock for a three-year period following the date that the stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control that our stockholders might consider to be in their best interests.

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 you and other stockholders to elect directors of your choosing and cause us to take corporate actions other than those you desire.

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

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
Not applicable.

Item 3. Defaults Upon Senior Securities.
Not applicable.

Item 4. Reserved
Not applicable.

Item 5. Other Information.
Not applicable.

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Item 6. Exhibits
(a) Exhibits.

31.1	Certification of Charles Liang, President and Chief Executive Officer of the Registrant pursuant to Section 302, as adopted pursuant to the Sarbanes-Oxley Act of 2002
31.2	Certification of Howard Hideshima, Chief Financial Officer and Secretary of the Registrant pursuant to Section 302, as adopted pursuant to the Sarbanes-Oxley Act of 2002
32.1	Certification of Charles Liang, President and Chief Executive Officer of the Registrant pursuant to Section 906, as adopted pursuant to the Sarbanes-Oxley Act of 2002
32.2	Certification of Howard Hideshima, Chief Financial Officer and Secretary of the Registrant pursuant to Section 906, as adopted pursuant to the Sarbanes-Oxley Act of 2002

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Signatures

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

SUPER MICRO COMPUTER, INC.

Date: November 8, 2010

/s/ CHARLES LIANG
Charles Liang
President, Chief Executive Officer and Chairman of the Board
(Principal Executive Officer)

Date: November 8, 2010

/s/ HOWARD HIDESHIMA
Howard Hideshima
Chief Financial Officer
(Principal Financial and Accounting Officer)