Super Micro Computer, Inc.
Form 10-Q
November 06, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 2014
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)	(I.R.S. Employer Identification No.)

980 Rock Avenue
San Jose, CA 95131
(Address of principal executive offices) (Zip Code)
(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 x 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	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

As of October 30, 2014 there were 45,976,613 shares of the registrant's common stock, $0.001 par value, outstanding, which is the only class of common stock of the registrant issued.

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Table of Contents

SUPER MICRO COMPUTER, INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2014

TABLE OF CONTENTS

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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, 2014	June 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 117,512	$96,872
Accounts receivable, net of allowances of $1,461 and $1,922 at September 30, 2014 and June 30, 2014, respectively (including amounts receivable from a related party of $2,416 and $621 at September 30, 2014 and June 30, 2014, respectively)	194,370	212,738
Inventory	341,541	315,837
Deferred income taxes-current	17,392	16,842
Prepaid income taxes	9,578	5,555
Prepaid expenses and other current assets	4,709	6,237
Total current assets	685,102	654,081
Long-term investments	2,647	2,647
Property, plant and equipment, net	133,067	130,589
Deferred income taxes-noncurrent	4,631	6,154
Other assets	2,828	2,854
Total assets	$ 828,275	$796,325
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable (including amounts due to a related party of $45,145 and $48,969 at September 30, 2014 and June 30, 2014, respectively)	$ 222,556	$219,354
Accrued liabilities	35,704	37,564
Income taxes payable	21,248	11,414
Short-term debt and current portion of long-term debt	34,446	42,554
Total current liabilities	313,954	310,886
Long-term debt-net of current portion	3,033	3,733
Other long-term liabilities	12,814	12,475
Total liabilities	329,801	327,094
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Common stock and additional paid-in capital, $0.001 par value		
Authorized shares: 100,000,000		
Issued shares: 46,132,106 and 45,739,936 at September 30, 2014 and June 30, 2014, respectively	207,442	199,062
Treasury stock (at cost), 445,028 shares at September 30, 2014 and June 30, 2014	(2,030)	(2,030)
Accumulated other comprehensive loss	(66)	(63)
Retained earnings	292,950	272,087
Total Super Micro Computer, Inc. stockholders' equity	498,296	469,056
Noncontrolling interest	178	175
Total stockholders' equity	498,474	469,231
Total liabilities and stockholders' equity	$ 828,275	$796,325

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SUPER MICRO COMPUTER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended September 30,	
	2014	2013
Net sales (including related party sales of $26,578 and $3,528 in the three months ended September 30, 2014 and 2013, respectively)	$443,322	$309,016
Cost of sales (including related party purchases of $54,403 and $45,317 in the three months ended September 30, 2014 and 2013, respectively)	374,129	262,224
Gross profit	69,193	46,792
Operating expenses:		
Research and development	21,509	20,236
Sales and marketing	11,002	8,865
General and administrative	5,056	5,648
Total operating expenses	37,567	34,749
Income from operations	31,626	12,043
Interest and other income, net	35	17
Interest expense	(196)	(195)
Income before income tax provision	31,465	11,865
Income tax provision	10,602	4,166
Net income	$20,863	$7,699
Net income per common share:		
Basic	$0.46	$0.18
Diluted	$0.42	$0.17
Weighted-average shares used in calculation of net income per common share:		
Basic	45,473	42,496
Diluted	49,687	44,602

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SUPER MICRO COMPUTER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three Months Ended September 30,	
	2014	2013
Net income	$20,863	$7,699
Other comprehensive income, net of tax:		
Foreign currency translation gain (loss)	(3)	4
Unrealized gain (loss) on investments	—	—
Total other comprehensive income	(3)	4
Comprehensive income	$20,860	$7,703

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SUPER MICRO COMPUTER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended September 30,	
	2014	2013
OPERATING ACTIVITIES:		
Net income	$20,863	$7,699
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	1,847	1,393
Stock-based compensation expense	2,980	2,589
Excess tax benefits from stock-based compensation	(705)	(882)
Allowance for doubtful accounts	(54)	849
Provision for inventory	1,660	4
Exchange loss (gain)	(235)	241
Deferred income taxes	973	91
Changes in operating assets and liabilities:		
Accounts receivable, net (including changes in related party balances of $(1,795) and $(103) during the three months ended September 30, 2014 and 2013, respectively)	18,422	14,435
Inventory	(27,364)	(144)
Prepaid expenses and other assets	1,547	960
Accounts payable (including changes in related party balances of $(3,824) and $(7,948) during the three months ended September 30, 2014 and 2013, respectively)	2,131	(7,732)
Income taxes payable, net	6,726	1,841
Accrued liabilities	(1,903)	(3,207)
Other long-term liabilities	158	170
Net cash provided by operating activities	27,046	18,307
INVESTING ACTIVITIES:		
Restricted cash	10	(14)
Purchases of property, plant and equipment	(2,766)	(1,948)
Net cash used in investing activities	(2,756)	(1,962)
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	4,485	1,535
Minimum tax withholding paid on behalf of an officer for restricted stock awards	—	(651)
Excess tax benefits from stock-based compensation	705	882
Repayment of debt	(8,500)	(700)
Payment of obligations under capital leases	(28)	(5)
Advance (payments) under receivable financing arrangements	(4)	736
Net cash provided by (used in) financing activities	(3,342)	1,797
Effect of exchange rate fluctuations on cash	(308)	278
Net increase in cash and cash equivalents	20,640	18,420
Cash and cash equivalents at beginning of period	96,872	93,038
Cash and cash equivalents at end of period	$117,512	$111,458
Supplemental disclosure of cash flow information:		
Cash paid for interest	$202	$200
Cash paid for taxes, net of refunds	$3,123	$1,807
Non-cash investing and financing activities:		

Equipment purchased under capital leases	$256	$—
Accrued costs for property, plant and equipment purchases	$2,976	$1,836

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Organization

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

Basis of Presentation

The condensed consolidated financial statements reflect the condensed consolidated balance sheets, results of operations, comprehensive income and cash flows of Super Micro Computer, Inc. and its wholly-owned subsidiaries (collectively, the “Company”). All intercompany accounts and transactions have been eliminated in consolidation.

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, 2014 included in its Annual Report on Form 10-K, as filed 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, 2014 are not necessarily indicative of the results that may be expected for future quarters or for the fiscal year ending June 30, 2015.

The Company consolidates its investment in Super Micro Business Park, Inc. as it is variable interest entity and the Company is the primary beneficiary. The noncontrolling interest is presented as a separate component from the Company's equity in the equity section of the condensed consolidated balance sheets. Net income attributable to the noncontrolling interest is not presented separately in the condensed consolidated statements of operations and is included in the general and administrative expenses as the amount is not material for any of the fiscal periods presented.

Fair Value of Financial Instruments

The Company accounts for certain assets and liabilities at fair value. Accounts receivable and accounts payable are carried at cost, which approximates fair value due to the short maturity of these instruments. Cash equivalents and long-term investments are carried at fair value. Short-term and long-term debt is carried at amortized cost, which approximates its fair value based on borrowing rates currently available to the Company for loans with similar terms. 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 its 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.

Table of Contents
SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

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.

Adoption of New Accounting Pronouncements

In March 2013, the FASB issued authoritative guidance associated with a parent company’s accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. The standard applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity. The adoption of this guidance did not have a material impact on the Company's results of operations or financial position.

In July 2013, the FASB issued authoritative guidance associated with the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. It requires a liability related to an unrecognized tax benefit to offset a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if a settlement is required or expected in the event the uncertain tax position is disallowed. The adoption of this guidance did not have a material impact on the Company's results of operations or financial position.
In May 2014, the FASB issued new accounting guidance related to revenue recognition. This new standard replaces all current U.S. GAAP guidance on revenue, eliminates all industry-specific guidance and provides a unified model in determining when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance can be applied either retrospectively or as a cumulative-effect adjustment as of the date of adoption. The new standard is effective for the Company on July 1, 2017. The Company is currently evaluating the effect the guidance will have on the Company's financial statement disclosures, results of operations or financial position.

Note 2. Stock-based Compensation and Stockholders’ Equity

Equity Incentive Plan

The authorized number of shares that may be issued under 2006 Equity Incentive Plan (the "2006 Plan") automatically increases on July 1 each year through 2016, by an amount equal to (a) 3.0% 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 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. The 2006 Plan is the successor equity incentive plan to the Company's 1998 Stock Option Plan. As of September 30, 2014, the Company had 1,369,499 authorized shares available for future issuance under the 2006 plan.

Table of Contents
SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

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 for the stock options granted prior to June 30, 2011. For stock options granted after June 30, 2011, the expected term is based on a combination of the Company's peer group and the Company's historical experience.

Expected Volatility—Expected volatility is based on a combination of the Company's implied and 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, 2014 and 2013 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended September 30,			
	2014		2013	
Risk-free interest rate	1.76	%	1.54	%
Expected life	5.44 years		5.49 years	
Dividend yield	—	%	—	%
Volatility	46.93	%	50.05	%
Weighted-average fair value	$11.75		$5.48	

The following table shows total stock-based compensation expense included in the consolidated statements of operations for the three months ended September 30, 2014 and 2013 (in thousands):

	Three Months Ended September 30,	
	2014	2013
Cost of sales	$207	$235
Research and development	1,896	1,561
Sales and marketing	365	314
General and administrative	512	479

Stock-based compensation expense before taxes	2,980	2,589
Income tax impact	(607)	(288)
Stock-based compensation expense, net	$2,373	$2,301

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. The Company had $915,000 and $1,070,000 of excess tax benefits accounted in the Company's

Table of Contents
SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

additional paid-in capital in the three months ended September 30, 2014 and 2013, respectively. The Company had excess tax benefits that are classified as cash from financing activities of $705,000 and $882,000 in the three months ended September 30, 2014 and 2013, respectively, for options issued since July 1, 2006. Excess tax benefits for stock options issued prior to July 1, 2006 continue to be classified as cash from operating activities.

Stock Option Activity

The following table summarizes stock option activity during the three months ended September 30, 2014 under all stock option plans:

	Options Outstanding	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in thousands)
Balance as of June 30, 2014 (7,558,631 shares exercisable at weighted average exercise price of $11.05 per share)	10,905,602	12.24		
Granted	388,900	26.41		
Exercised	(392,170)	11.44		
Forfeited	(44,584)	17.80		
Balance as of September 30, 2014	10,857,748	$12.76	6.17	$ 180,911
Options vested and expected to vest at September 30, 2014	10,613,802	$12.63	6.10	$ 178,165
Options vested and exercisable at September 30, 2014	7,640,548	$11.24	5.12	$ 138,939

The total pretax intrinsic value of options exercised during the three months ended September 30, 2014 and 2013 was $5,349,000 and $1,981,000, respectively. As of September 30, 2014, 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 $20,300,000, which will be recognized over a weighted-average vesting period of approximately 2.37 years.

Restricted Stock Award Activity

The Company had no restricted stock award activity for the three months ended September 30, 2014. The total pretax intrinsic value of restricted stock awards vested was $2,337,000 for the three months ended September 30, 2013. In the three months ended September 30, 2013, upon vesting, 179,641 shares of restricted stock awards were partially net share-settled such that the Company withheld 50,000 shares, with value equivalent to an officer's minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld was based on the value of the restricted stock awards on their vesting date as determined by the Company’s closing stock price. Total payments for an officer's tax obligations to the taxing authorities was $651,000 in the three months ended September 30, 2013, and is reflected as a financing activity within the consolidated statements of cash flows. These net-share settlements had the effect of share repurchases by the Company as they reduced and retired the number of shares that would have otherwise been issued as a result of the vesting and did not represent an expense to the Company. There is no unvested restricted stock awards at September 30, 2014.

Table of Contents
SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Note 3. Net Income Per Common Share

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

	Three Months Ended September 30,	
	2014	2013
Basic net income per common share calculation		
Net income	$20,863	$7,699
Less: Undistributed earnings allocated to participating securities	—	(20)
Net income attributable to common shares—basic	$20,863	$7,679
Weighted-average number of common shares used to compute basic net income per common share	45,473	42,496
Basic net income per common share	$0.46	$0.18
Diluted net income per common share calculation		
Net income	$20,863	$7,699
Less: Undistributed earnings allocated to participating securities	—	(19)
Net income attributable to common shares—diluted	$20,863	$7,680
Weighted-average number of common shares used to compute basic net income per common share	45,473	42,496
Dilutive effect of options to purchase common stock	4,214	2,106
Weighted-average number of common shares used to compute diluted net income per common share	49,687	44,602
Diluted net income per common share	$0.42	$0.17

For the three months ended September 30, 2014 and 2013, the Company had stock options outstanding that could potentially dilute basic earnings per share in the future, but were excluded from the computation of diluted net income per 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 1,135,000 and 5,909,000 for the three months ended September 30, 2014 and 2013, respectively.

Note 4. Balance Sheet Components

The following tables provide details of the selected balance sheet items (in thousands):
Inventory:

	September 30, 2014	June 30, 2014
Finished goods	$252,366	$246,803
Work in process	33,064	18,794
Purchased parts and raw materials	56,111	50,240
Total inventory	$341,541	$315,837

The Company recorded a provision for lower of cost or market and excess and obsolete inventory totaling $1,660,000 and $4,000 in the three months ended September 30, 2014 and 2013, respectively.

SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Property, Plant, and Equipment:

	September 30, 2014	June 30, 2014
Land	$63,962	$63,962
Buildings	51,959	51,959
Building and leasehold improvements	7,625	7,683
Buildings construction in progress (1)	1,241	587
Machinery and equipment	36,341	34,342
Furniture and fixtures	6,293	5,892
Purchased software	3,637	3,606
Purchased software construction in progress (2)	3,741	2,548
	174,799	170,579
Accumulated depreciation and amortization	(41,732)	(39,990)
Property, plant and equipment, net	$133,067	$130,589

(1) In connection with the purchase of the property located in San Jose, California, the Company engaged several contractors for the development and construction of improvements on the property, which is still in progress.
(2) The Company continues its implementation of a new enterprise resource planning, or ERP, system and capitalized the costs of the new ERP software and certain expenses associated directly with the development of the ERP system, which is still in progress.

Other Assets:

	September 30, 2014	June 30, 2014
Prepaid royalty license	$ 1,184	$1,246
Restricted cash	440	450
Investment in a privately held company	750	750
Others	454	408
Total other assets	$ 2,828	$2,854

Restricted cash consists primarily of certificates of deposits pledged as security for one irrevocable letter of credit required in connection with a warehouse lease in Fremont, California and bank guarantees in connection with office leases in the Netherlands.

Accrued Liabilities:

	September 30, 2014	June 30, 2014
Accrued payroll and related expenses	$11,521	$11,624
Customer deposits	4,800	4,185
Accrued warranty costs	7,077	7,083
Accrued cooperative marketing expenses	4,586	4,387
Others	7,720	10,285
Total accrued liabilities	$35,704	$37,564

Table of Contents
SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Product Warranties:

	Three Months Ended September 30,	
	2014	2013
Balance, beginning of period	$7,083	$6,472
Provision for warranty	3,656	3,434
Costs charged to accrual	(3,465)	(3,351)
Change in estimated liability for pre-existing warranties	(197)	45
Balance, end of period	$7,077	$6,600

Note 5. Long-term Investments

As of September 30, 2014 and June 30, 2014, the Company held $2,647,000 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; such auction rate securities were rated AAA or AA2 at September 30, 2014 and June 30, 2014. These auction rate preferred shares have no stated maturity date.

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 salable in the auction, thereby losing the short-term liquidity previously provided by the auction process. As a result, as of September 30, 2014 and June 30, 2014, $2,647,000 of these auction rate securities have been classified as long-term available-for-sale investments.

The Company has used a discounted cash flow model to estimate the fair value of the auction rate securities as of September 30, 2014 and June 30, 2014. The material factors used in preparing the discounted cash flow model are (i) the discount rate utilized to present value the cash flows, (ii) the time period until redemption and (iii) the estimated rate of return. As of September 30, 2014, the discount rate, the time period until redemption and the estimated rate of return were 1.6%, 3 years and 0.3%, respectively. Management derives the estimates by obtaining input from market data on the applicable discount rate, estimated time to redemption 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. The fair value of the Company's 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. On a quarterly basis, the Company reviews the inputs to assess their continued appropriateness and consistency. If any significant differences were to be noted, they would be researched in order to determine the reason. However, historically, no significant differences have been noted. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the auction rate securities. Movement of these inputs would not significantly impact the fair value of the auction rate securities.

Based on this assessment of fair value, the Company determined there were no changes in fair value of its auction rate securities during the three months ended September 30, 2014 and 2013. There was a cumulative total decline of $103,000 as of September 30, 2014 and June 30, 2014. That amount has been recorded as a component of other comprehensive income. As of September 30, 2014 and June 30, 2014, the Company has recorded an accumulated unrealized loss of $62,000, net of deferred income taxes, on long-term auction rate securities. 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 analysis. In the three months ended September 30, 2014 and 2013, there was no auction rate securities redeemed or sold.

Note 6. Fair Value Disclosure

The financial assets of the Company measured at fair value on a recurring basis are included in cash equivalents 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 for the identical underlying securities in active markets. The Company's 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, 2014 and June 30, 2014. Refer to Note 1 for a discussion of the Company's policies regarding the fair value hierarchy. The Company's methodology for valuing these investments is the discounted cash flow model and is described in Note 5.

The following table sets forth the Company's cash equivalents and long-term investments as of September 30, 2014 and June 30, 2014 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, 2014	Level 1	Level 2	Level 3	Asset at Fair Value
Money market funds	$311	$—	$—	$311
Auction rate securities	—	—	2,647	2,647
Total	$311	$—	$2,647	$2,958

June 30, 2014	Level 1	Level 2	Level 3	Asset at Fair Value
Money market funds	$311	$—	$—	$311
Auction rate securities	—	—	2,647	2,647
Total	$311	$—	$2,647	$2,958

The above table excludes $116,967,000 and $96,324,000 of cash and $733,000 and $746,000 of certificates of deposit held by the Company as of September 30, 2014 and June 30, 2014, respectively. There were no transfers between Level 1, Level 2 or Level 3 securities in the three months ended September 30, 2014 and 2013.

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, 2014 and 2013 (in thousands):

	Three Months Ended September 30,	
	2014	2013
Balance as of beginning of period	$2,647	$2,637
Total realized gains or (losses) included in net income	—	—
Total unrealized gains or (losses) included in other comprehensive income	—	—
Sales and settlements at par	—	—
Transfers in and/or out of Level 3	—	—
Balance as of end of period	$2,647	$2,637

SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

The following is a summary of the Company's long-term investments as of September 30, 2014 and June 30, 2014 (in thousands):

	September 30, 2014			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Auction rate securities	$2,750	$—	$(103)	$2,647

	June 30, 2014			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Auction rate securities	$2,750	$—	$(103)	$2,647

The Company measures the fair value of outstanding debt for disclosure purposes on a recurring basis. As of September 30, 2014 and June 30, 2014, short-term and long-term debt of $37,479,000 and $46,287,000, respectively, are reported at amortized cost. This outstanding debt is classified as Level 2 as they are not actively traded and are valued using a discounted cash flow model that uses observable market inputs. Based on the discounted cash flow model, the fair value of the outstanding debt approximates amortized cost.

Note 7. Short-term and Long-term Obligations

Short-term and long-term obligations as of September 30, 2014 and June 30, 2014 consisted of the following (in thousands):

	September 30, 2014	June 30, 2014
Line of credit:		
Bank of America	$9,899	$17,699
Total line of credit	9,899	17,699
Building term loans:		
Bank of America	5,833	6,533
CTBC Bank	21,747	22,055
Total building term loans	27,580	28,588
Total debt	37,479	46,287
Current portion	(34,446)	(42,554)
Long-term portion	$3,033	$3,733

Activities under Revolving Lines of Credit and Term Loans

Bank of America

In October 2011, the Company entered into an amendment to the existing credit agreement with Bank of America N.A. ("Bank of America") which provided for (i) a $40,000,000 revolving line of credit facility that matured on June 15, 2013 and (ii) a five-year $14,000,000 term loan facility. The term loan is secured by the three buildings located in San Jose, California and the principal and interest are payable monthly through September 30, 2016 with an interest rate at the LIBOR rate plus 1.50% per annum. The credit agreement was subsequently amended to extend the maturity date of the revolving line of credit facility to November 15, 2014. The Company is currently negotiating with Bank of America to renew the revolving line of credit.

The line of credit facility provides for borrowings denominated both in U.S. dollars and in Taiwanese dollars. For borrowings denominated in U.S. dollars, the interest rate for the revolving line of credit is at the LIBOR rate plus 1.25% per annum. The LIBOR rate was 0.16% at September 30, 2014. For borrowings denominated in Taiwanese dollars, the interest rate is equal to the lender's established interest rate which is adjusted monthly.

As of September 30, 2014 and June 30, 2014, the total outstanding borrowings under the Bank of America term loan was $5,833,000 and $6,533,000, respectively. The total outstanding borrowings under the Bank of America line of credit was $9,899,000 and $17,699,000 as of September 30, 2014 and June 30, 2014, respectively. The interest rates for these loans ranged from 1.19% to 1.66% per annum at September 30, 2014 and from 1.19% to 1.65% per annum at June 30, 2014, respectively. As of September 30, 2014, the unused revolving line of credit with Bank of America was $30,101,000.

CTBC Bank

In October 2011, the Company obtained an unsecured revolving line of credit from CTBC Bank Co., Ltd ("CTBC Bank", formerly, China Trust Bank) totaling NT$300,000,000 Taiwanese dollars or $9,898,000 U.S. dollars equivalents. In July 2012, the Company increased the credit facility to NT$450,000,000 Taiwanese dollars or $14,912,000 U.S. dollars equivalents. The term loan was secured by the land and building located in Bade, Taiwan with an interest rate equal to the lender's established interest rate plus 0.30% which is adjusted monthly.

In November 2013, the Company entered into an amendment to the existing credit agreement with CTBC Bank to increase the credit facility amount and extend the maturity date to November 30, 2014. The amendment provides for (i) a 13-month NT$700,000,000 or $23,787,000 U.S. dollar equivalents term loan secured by the land and building located in Bade, Taiwan with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum which is adjusted monthly and (ii) a 13-month unsecured term loan up to NT$100,000,000 or $3,398,000 U.S. dollar equivalents, and a 13-month revolving line of credit up to 80% of eligible accounts receivable in an aggregate amount of up to NT$500,000,000 or $16,991,000 U.S. dollar equivalents with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum or lender's established USD interest rate plus 0.30% per annum which is adjusted monthly. The total borrowings allowed under the credit agreement is capped at NT$1,000,000,000 or $33,981,000 U.S. dollar equivalents.

The total outstanding borrowings under the CTBC Bank term loan was denominated in Taiwanese dollars and was translated into U.S. dollars of $21,747,000 and $22,055,000 at September 30, 2014 and June 30, 2014, respectively. There were no outstanding borrowings under the CTBC Bank revolving line of credit at September 30, 2014 and June 30, 2014. The interest rate for the loan was at 1.16% and 1.15% per annum at September 30, 2014 and June 30, 2014, respectively. At September 30, 2014, NT$340,000,000 or $11,203,000 U.S. dollar equivalents were available for future borrowing under this credit agreement. The Company is currently negotiating with CTBC Bank to renew the credit agreement.

Covenant Compliance

The credit agreement with Bank of America contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries. The credit agreement contains certain financial covenants, including the following:

- Not to incur on a consolidated basis, a net loss before taxes and extraordinary items in any two consecutive quarterly accounting periods;
- The Company's funded debt to EBITDA ratio (ratio of all outstanding liabilities for borrowed money and other interest-bearing liabilities, including current and long-term debt, less the non-current portion of

subordinated liabilities to EBITDA) shall not be greater than 2.00;

- The Company’s unencumbered liquid assets, as defined in the agreement, held in the United States shall have an aggregate market value of not less than $30,000,000, measured as of the last day of each fiscal quarter and the last day of each fiscal year.

As of September 30, 2014 and June 30, 2014, the total assets of $783,506,000 and $751,396,000, respectively collateralized the line of credit with Bank of America and were all of the assets of the Company except for the three buildings purchased in San Jose, California in June 2010 and the land and building located in Bade, Taiwan, As of September 30, 2014 and June 30, 2014, total assets collateralizing the term loan with Bank of America were $17,526,000 and $17,584,000, respectively. As of September 30, 2014, the Company was in compliance with all financial covenants associated with the credit agreement with Bank of America.

Table of Contents
SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

As of September 30, 2014 and June 30, 2014, the land and building located in Bade, Taiwan collateralizing the term loan with CTBC Bank was $27,243,000 and $27,345,000, respectively. There are no financial covenants associated with the term loan with CTBC Bank at September 30, 2014.

Note 8. 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. Ablecom owns approximately 1.0% 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 own approximately 35.9% of Ablecom at September 30, 2014.

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. The Company has agreed to pay for Ablecom's cost of chassis and related product tooling and engineering services and will pay for those items when the work has been completed.

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. The Company purchased products from Ablecom totaling $54,403,000 and $45,317,000, and sold products to Ablecom totaling $26,578,000 and $3,528,000 for the three months ended September 30, 2014 and 2013, respectively.

Amounts owed to the Company by Ablecom as of September 30, 2014 and June 30, 2014, were $2,416,000 and $621,000, respectively. Amounts owed to Ablecom by the Company as of September 30, 2014 and June 30, 2014, were $45,145,000 and $48,969,000, respectively. For the three months ended September 30, 2014 and 2013, the Company paid Ablecom the majority of invoiced dollars between 52 and 66 days of invoice date. For the three months ended September 30, 2014 and 2013, the Company paid $2,002,000 and $2,276,000, respectively, for tooling assets and miscellaneous costs to Ablecom.

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 $70,455,000 and $64,464,000 at September 30, 2014 and June 30, 2014, 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.

In May 2012, the Company and Ablecom jointly established Super Micro Business Park, Inc. ("Management Company") in Taiwan to manage the common areas shared by the Company and Ablecom for their separately constructed manufacturing facilities. Each company contributed $168,000 and own 50% of the Management Company. Although the operations of the Management Company are independent of the Company, through governance rights, the Company has the ability to direct the Management Company's business strategies. Therefore, the Company has concluded that the Management Company is a variable interest entity of the Company as the Company is the primary beneficiary of the Management Company. The accounts of the Management Company are consolidated with the accounts of the Company, and a noncontrolling interest has been recorded for the Ablecom's interests in the net assets and operations of the Management Company. In the three months ended September 30, 2014 and 2013, $3,000 and $(6,000) of net income (loss) attributable to Ablecom's interest was included in the Company's general and administrative expenses in the condensed consolidated statements of operations.

Note 9. Income Taxes

The Company recorded provisions for income taxes of $10,602,000 and $4,166,000 for the three months ended September 30, 2014 and 2013. The effective tax rate was 33.7% and 35.1% for the three months ended September 30, 2014 and 2013, respectively. The effective tax rate for the three months ended September 30, 2014 is estimated to be lower than the federal statutory rate primarily due to the benefit from disqualifying dispositions of shares issued upon exercise of incentive stock options and higher income taxed at foreign jurisdictions with lower tax rate, which are in part offset by the tax impact of federal research and development tax credits not being extended as of September 30, 2014.

As of September 30, 2014, the Company had a liability for gross unrecognized tax benefits of $11,608,000, substantially all of which, if recognized, would affect the Company's effective tax rate. During the three months ended September 30, 2014, there were no material changes 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 condensed consolidated statements of operations. As of September 30, 2014, the Company had accrued $960,000 of interest and penalties relating to unrecognized tax benefits.

The Company is subject to U.S. federal income tax as well as income taxes in many state and foreign jurisdictions. The statutes of limitation in federal jurisdiction remain open in general for tax years 2011 through 2014. The state jurisdictions remain open in general for tax years 2010 through 2014. The Company's tax returns for its most significant foreign jurisdictions remain open for examination in general for tax years 2008 through 2014. The Company does not expect its unrecognized tax benefits to change materially over the next 12 months.

Note 10. Commitments and Contingencies

Litigation and Claims— The Company is involved in various legal proceedings arising from the normal course of business activities. The Company defends itself vigorously against any such claims. In management’s opinion, the resolution of any matters will not have a material adverse effect on the Company’s consolidated financial condition, results of operations or liquidity.

Purchase Commitments— The Company has agreements to purchase certain units of inventory and non-inventory items through fiscal year 2016. As of September 30, 2014, these remaining non-cancellable commitments were $226,532,000 compared to $211,090,000 as of June 30, 2014.

Included in the above non-cancellable commitments are hard disk drive purchase commitments totaling approximately $29,224,000, which will be paid through December 2014. The Company entered into purchase agreements with selected suppliers of hard disk drives in order to ensure continuity of supply for these components. The agreements provide for some variation in the amount of units the Company is required to purchase and the suppliers may modify the purchase price for these components due to significant changes in market or component supply conditions. Product mix for these components may be negotiated quarterly and the purchase price for these components will be reviewed quarterly with the suppliers. The Company has been negotiating the purchase price with the suppliers on an ongoing basis based upon market rates.

Note 11. 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 and region to which the products were shipped. The following is a summary for the three months ended September 30, 2014 and 2013, of net sales by geographic region (in thousands):

Table of Contents
SUPER MICRO COMPUTER, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

	Three Months Ended September 30,	
	2014	2013
Net sales:		
United States	$243,378	$175,214
Europe	89,557	71,185
Asia	88,438	54,972
Other	21,949	7,645
	$443,322	$309,016

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

	September 30, 2014	June 30, 2014
Long-lived assets:		
United States	$95,792	$94,119
Asia	36,968	36,123
Europe	307	347
	$133,067	$130,589

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

	Three Months Ended September 30,					
	2014			2013		
	Amount	Percent of Net Sales		Amount	Percent of Net Sales	
Server systems	$255,609	57.7	%	$143,283	46.4	%
Subsystems and accessories	187,713	42.3	%	165,733	53.6	%
Total	$443,322	100.0	%	$309,016	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 in the three months ended September 30, 2014 and 2013. No customer accounted for 10% or more of the Company's accounts receivable as of September 30, 2014 and June 30, 2014.

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,” “ “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 high-performance, high-efficiency server technology and innovation. We develop and provide end-to-end green computing solutions to the Data Center, Cloud Computing, Enterprise IT, Big Data, HPC and Embedded markets. Our solutions range from complete server, storage, blade and workstations to full racks, networking devices, server management software and technology support and services. For the three months ended September 30, 2014 and 2013, net sales of optimized servers were $255.6 million and $143.3 million, respectively, and net sales of subsystems and accessories were $187.7 million and $165.7 million, respectively. The increase in our net sales in the three months ended September 30, 2014 compared with the three months ended September 30, 2013 was primarily due to our continued increased sales of our complete integrated-high-end server solutions such as the Twin family of servers, storage, and GPU/Xeon Phi servers which offered higher density computing and more memory and hard disk drive capacity. The percentage of our net sales represented by sales of complete server systems increased to 57.7% in the three months ended September 30, 2014 from 46.4% in the three months ended September 30, 2013.

We commenced operations in 1993 and have been profitable every year since inception. Our net sales were $443.3 million and $309.0 million for the three months ended September 30, 2014 and 2013, respectively. Our net income was $20.9 million and $7.7 million for the three months ended September 30, 2014 and 2013, respectively. Our increase in net income in the three months ended September 30, 2014 was primarily attributable to an increase in our gross profit resulting primarily from higher sales of server systems, higher utilization of our manufacturing facilities in Taiwan and a $1.9 million refund of value added taxes on research and development expenses, partially offset by higher income tax expenses.

We sell our server systems and subsystems and accessories primarily through distributors and to a lesser extent to Building Block Solution Original Equipment Manufacturers, or OEMs, as well as through our direct sales force. For the three months ended September 30, 2014 and 2013, we derived 56.0% and 60.9%, respectively, of our net sales from products sold to distributors, and derived 44.0% and 39.1% from sales to OEMs and to end customers, respectively. None of our customers accounted for 10% or more of our net sales in the three months ended September 30, 2014 and 2013. We derived 54.9% and 56.7% of our net sales from customers in the United States for the three months ended September 30, 2014 and 2013, respectively.

We perform the majority of our research and development efforts in-house. Research and development expenses represented 4.9% and 6.5% of our net sales for the three months ended September 30, 2014 and 2013, respectively.

We use several suppliers and contract manufacturers to design and manufacture components in accordance with our specifications, with most final assembly and testing performed at our manufacturing facility in San Jose, California. During fiscal year 2015, we have continued to increase manufacturing and service operations in Taiwan and the Netherlands to support our Asian and European customers and we have increased our utilization of our overseas manufacturing capacity. 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, 2014 and 2013, our purchases from Ablecom represented 14.5% and 17.3% of our cost of sales, respectively. 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 cost of sales. 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 United States 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, AMD and Nvidia carefully. This also impacts our research and development expenditures. For example, in fiscal year 2012 and in prior years, our results have been adversely impacted by customer order delays in anticipation of the introduction of the new lines 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 2015:

- Net cash provided by operating activities was $27.0 million and $18.3 million during the three months ended September 30, 2014 and 2013, respectively. Our cash and cash equivalents, together with our investments, were $120.2 million at the end of first quarter of fiscal year 2015, compared with $99.6 million at the end of fiscal year 2014. The increase in our cash and cash equivalents, together with our investments at the end of first quarter of fiscal year 2015 was primarily due to $27.0 million of cash generated from our operating activities, $4.5 million of proceeds from the exercise of stock options, offset in part by $8.5 million of repayments in loans and $2.8 million of purchases of property and equipment.

- Days sales outstanding in accounts receivable (“DSO”) at the end of the first quarter of fiscal year 2015 and at the end of the fourth quarter of fiscal year 2014 was both 42 days.

- Our inventory balance was $341.5 million at the end of the first quarter of fiscal year 2015, compared with $315.8 million at the end of the fiscal year 2014. Days sales of inventory (“DSI”) at the end of the first quarter of fiscal year 2015 was 81 days, compared with 77 days at the end of the fourth quarter of fiscal year 2014. The increase in our inventory was to support our anticipated level of growth in net sales in fiscal year 2015 and the transition to Intel's Haswell DP processor based products.

- Our purchase commitments with contract manufacturers and suppliers were $226.5 million at the end of the first quarter of fiscal year 2015 and $211.1 million at the end of the fiscal year 2014. Included in the above non-cancellable commitments are hard disk drive purchase commitments totaling approximately $29.2 million, which have terms expiring through December 2014. See Note 10 of Notes to our Condensed Consolidated Financial Statements for a discussion of purchase commitments.

Fiscal Year

Our fiscal year ends on June 30. References to fiscal year 2015, for example, refer to the fiscal year ending June 30, 2015.

Table of Contents

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, but generally higher in the case of sales of server systems to internet data system customers. Because we generally 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. 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 incentive bonuses 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.

Interest and other expense, net. Interest and other expense, net represents interest expense on our term loans and line of credit, offset by interest earned on our investment and cash 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, Taiwan, the Netherlands, and to a lesser extent, China and Japan.

Our effective tax rate differs from the statutory rate primarily due to research and development tax credits, the domestic production activities deduction and lower taxes in foreign jurisdictions which were partially offset by the impact of state taxes and stock option expenses. In recent years, our effective tax rate from period to period has been significantly impacted by delays in the approval of extensions of the U.S. research and development tax credit. If Congress extends the research and development tax credit within our fiscal year 2015, there will be a favorable impact on our effective income tax rate.

Table of Contents

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated 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, 30 to 60 days payment terms, Ex-works terms, except for a few customers who have free-on-board destination terms, for which revenue is recognized when the products arrive at the destination. 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). 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.

In addition, certain customers have acceptance provisions and revenue is deferred until the customers provide the necessary acceptance. At September 30, 2014 and June 30, 2014, we had deferred revenue of $43,000 and $7.7 million and related deferred product costs of $38,000 and $6.7 million, respectively, related to shipments to customers pending acceptances.

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 concentration, 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. Our provision (recovery) for bad debt was $(54,000) and $0.8 million in the three months ended September 30, 2014 and 2013, respectively. If a major customer's creditworthiness deteriorates, if actual defaults are higher than our historical experience, or if other circumstances arise, our estimates of the recoverability of amounts due to us could be overstated, and additional allowances could be required, which could have an adverse impact on our reported operating expenses. 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 on-site service and non-warranty repairs. Revenue for on-site service is recognized over the contracted service period, and revenue for non-warranty repair service 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.

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

Table of Contents

charged to cost of sales and included in accrued liabilities. The liability for product warranties was $7.1 million as of September 30, 2014 and June 30, 2014. The provision for warranty reserve was $3.7 million and $3.4 million in the three months ended September 30, 2014 and 2013, respectively. Our estimates and assumptions used have been historically close to actual. The change in estimated liability for pre-existing warranties was ($0.2) million and $45,000 in the three months ended September 30, 2014 and 2013, respectively. As a result of our increase in cost of servicing warranty claims from our increase in net sales in the three months ended September 30, 2014 and 2013, the provision for warranty reserve increased $0.2 million compared to the three months ended September 30, 2013. 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 based upon the number of units that are unlikely to be sold based upon estimated demand for the following twelve months as well as historical usage and sales activity. This evaluation takes into account matters including expected demand, historical usage and sales, 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 for inventory was $1.7 million and $4,000 in the three months ended September 30, 2014 and 2013, 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 9 of Notes to Condensed Consolidated Financial Statements for the impact on our condensed consolidated financial statements.

Stock-based compensation. We measure and recognize the compensation expense for all share-based awards made to employees and non-employee members of the Board of Directors including employee stock options and restricted stock awards based on estimated fair values. We are required to estimate the fair value of share-based awards on the date of grant. The value of awards that are ultimately expected to vest is recognized as an expense over the requisite service periods. Compensation expense for options and restricted stock awards granted to employees was $3.0 million and $2.6 million for the three months ended September 30, 2014 and 2013, respectively.

As of September 30, 2014, the total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options granted since July 1, 2006 to employees and non-employee members of the Board of Directors, was $20.3 million, which is expected to be recognized as an expense over a weighted-average period of approximately 2.37 years. See Note 2 of Notes to our 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.

Table of Contents

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 for the stock options granted prior to June 30, 2011. For stock options and restricted stock awards granted after June 30, 2011, expected term is based on a combination of our peer group and our historical experience. The expected volatility is based on a combination of our implied and 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. We have concluded that Ablecom and its subsidiaries ("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.

In May 2012, we and Ablecom jointly established Super Micro Business Park, Inc. ("Management Company") in Taiwan to manage the common areas shared by us and Ablecom for our separately constructed manufacturing facilities. Each company contributed $168,000 and own 50% of the Management Company. Although the operations of the Management Company are independent of us, through governance rights, we have the ability to direct the Management Company's business strategies. Therefore, we have concluded that the Management Company is a variable interest entity of us as we are the primary beneficiary of the Management Company. As of September 30, 2014, the accounts of the Management Company have been consolidated with our accounts, and a noncontrolling interest has been recorded for Ablecom's interests in the net assets and operations of the Management Company. In the three months ended September 30, 2014 and 2013, $3,000 and $(6,000) of net income (loss) attributable to Ablecom's interest was included in our general and administrative expenses in the consolidated statements of operations, respectively.

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,			
	2014		2013	
Net sales	100.0	%	100.0	%
Cost of sales	84.4		84.9	
Gross profit	15.6		15.1	
Operating expenses:				
Research and development	4.9		6.5	
Sales and marketing	2.5		2.9	
General and administrative	1.1		1.8	
Total operating expenses	8.5		11.2	
Income from operations	7.1		3.9	
Interest and other income, net	—		—	
Interest expense	—		(0.1	)
Income before income tax provision	7.1		3.8	
Income tax provision	2.4		1.3	

Net income	4.7 %	2.5 %

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Table of Contents

Comparison of Three Months Ended September 30, 2014 and 2013

Net sales. Net sales increased by $134.3 million, or 43.5%, to $443.3 million from $309.0 million, for the three months ended September 30, 2014 and 2013, respectively. This increase was due primarily to an increase in the average selling price of our server systems and to a lesser extent an increase in unit volumes of server systems as we sold more higher density server systems.

For the three months ended September 30, 2014, the number of server system units sold increased 29.1% to 71,000 compared to 55,000 for the three months ended September 30, 2013. The average selling price of server system units increased 38.5% to $3,600 in the three months ended September 30, 2014 compared to $2,600 in the three months ended September 30, 2013. The average selling prices of our server systems increased primarily due to an increase in average selling prices of our complete integrated-high-end servers solutions such as the Twin family of servers, storage and GPU/Xeon Phi servers which offered higher density computing and more memory and hard disk drive capacity. Sales of server systems increased by $112.3 million or 78.4% from the three months ended September 30, 2013 to the three months ended September 30, 2014, primarily due to the increased sales of the products described above. Sales of server systems represented 57.7% of our net sales for the three months ended September 30, 2014 compared to 46.4% of our net sales for the three months ended September 30, 2013.

For the three months ended September 30, 2014, the number of subsystems and accessories units sold increased 18.8% to 1.3 million compared to 1.1 million for the three months ended September 30, 2013. Sales of subsystems and accessories increased by $22.0 million or 13.3% from the three months ended September 30, 2013 to the three months ended September 30, 2014, primarily related to higher sales of hard disk drives and memory bundled with our server solutions sold to our distributors and system integrators who are purchasing additional accessories from us and completing the final assembly themselves. Sales of subsystems and accessories represented 42.3% of our net sales for the three months ended September 30, 2014 as compared to 53.6% of our net sales for the three months ended September 30, 2013.

For the three months ended September 30, 2014 and 2013, we derived 56.0% and 60.9%, respectively, of our net sales from products sold to distributors and we derived 44.0% and 39.1%, respectively, from sales to OEMs and to end customers. For the three months ended September 30, 2014, customers in the United States, Europe and Asia accounted for 54.9%, 20.2% and 19.9%, of our net sales, respectively, as compared to 56.7%, 23.0% and 17.8% of our net sales, respectively, for the three months ended September 30, 2013.

Cost of sales. Cost of sales increased by $111.9 million, or 42.7%, to $374.1 million from $262.2 million, for the three months ended September 30, 2014 and 2013, respectively. Cost of sales as a percentage of net sales was 84.4% and 84.9% for the three months ended September 30, 2014 and 2013, respectively. The increase in absolute dollars of cost of sales was primarily attributable to the increase in net sales and an increase of $1.7 million in provision for inventory reserve. The lower cost of sales as a percentage of net sales was primarily due to an increase in purchasing power, an increase in the mix of complete server system sales and higher utilization of our manufacturing facilities in Taiwan offset in part by higher internet data center sales which generally have a lower margin. In the three months ended September 30, 2014, we recorded a $1.7 million expense, net of recovery, or 0.4% of net sales, related to the inventory provision as compared to $4,000, or 0.0% of net sales, in the three months ended September 30, 2013. The increase in the inventory provision was primarily due to higher inventory reserves for earlier generation products partially offset by higher sales of previously reserved inventory of $2.1 million.

In the three months ended September 30, 2014, we recorded a $3.7 million expense, or 0.8% of net sales, related to the provision for warranty reserve as compared to $3.4 million, or 1.1% of net sales, in the three months ended September 30, 2013. The increase in the provision for warranty reserve was primarily due to higher cost of servicing warranty claims from higher net sales in the three months ended September 30, 2014. 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, our gross margin would be affected.

Research and development expenses. Research and development expenses increased by $1.3 million, or 6.3%, to $21.5 million from $20.2 million, for the three months ended September 30, 2014 and 2013, respectively. Research and development expenses were 4.9% and 6.5% of net sales for the three months ended September 30, 2014 and 2013, respectively. The increase in absolute dollars was primarily due to an increase of $4.2 million in compensation and benefits resulting from annual salary increases and growth in research and development personnel related to expanded product development initiatives in the United States and in Taiwan, partially offset by a $1.9 million refund of value added taxes on research and development expenses and an increase of $0.7 million in non-recurring engineering funding from certain suppliers and customers. The decrease as a percentage of net sales was primarily due to the increase in net sales in the three months ended September 30, 2014.

Table of Contents

Research and development expenses include stock-based compensation expense of $1.9 million and $1.6 million for the three months ended September 30, 2014 and 2013, respectively.

Sales and marketing expenses. Sales and marketing expenses increased by $2.1 million, or 24.1%, to $11.0 million from $8.9 million, for the three months ended September 30, 2014 and 2013, respectively. Sales and marketing expenses were 2.5% and 2.9% of net sales for the three months ended September 30, 2014 and 2013, respectively. The increase in absolute dollars was primarily due to an increase of $1.7 million in compensation and benefits resulting from growth in sales and marketing personnel. The decrease as a percentage of net sales was primarily due to the increase in net sales in the three months ended September 30, 2014.

Sales and marketing expenses include stock-based compensation expense of $0.4 million and $0.3 million for the three months ended September 30, 2014 and 2013, respectively.

General and administrative expenses. General and administrative expenses decreased by $0.6 million, or 10.5%, to $5.1 million from $5.6 million, for the three months ended September 30, 2014 and 2013, respectively. General and administrative expenses were 1.1% and 1.8% of net sales for the three months ended September 30, 2014 and 2013, respectively. The decrease in absolute dollars was primarily due to a decrease of $0.9 million in bad debt expenses, an increase of $0.7 million in foreign currency transaction gain, offset in part by a decrease of $0.7 million in miscellaneous income relating to the settlement of our outstanding accounts payable with one vendor in the prior year. The decrease as a percentage of net sales was primarily due to the increase in net sales in the three months ended September 30, 2014.

General and administrative expenses include stock-based compensation expense of $0.5 million for both three months ended September 30, 2014 and 2013.

Interest and other expense, net. Interest and other expense, net, was $0.2 million of expense for both three months ended September 30, 2014 and 2013, represented interest expense for both three months ended September 30, 2014 and 2013.

Provision for income taxes. Provision for income taxes increased by $6.4 million, or 154.5%, to $10.6 million from $4.2 million, for the three months ended September 30, 2014 and 2013, respectively. The effective tax rate was 33.7% and 35.1% for the three months ended September 30, 2014 and 2013, respectively. The higher income tax provision for the three months ended September 30, 2014 was primarily attributable to our higher operating income.

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 $117.6 million and $96.9 million as of September 30, 2014 and June 30, 2014, respectively. Our cash in foreign locations was $42.1 million and $28.3 million at September 30, 2014 and June 30, 2014, respectively. It is management's intention to reinvest the undistributed foreign earnings indefinitely in foreign operations.

Operating Activities. Net cash provided by operating activities was $27.0 million and $18.3 million for the three months ended September 30, 2014 and 2013, respectively.

Net cash provided by our operating activities for the three months ended September 30, 2014 was primarily due to our net income of $20.9 million, a decrease in accounts receivable of $18.4 million, an increase in net income taxes payable of $6.7 million, stock-based compensation expense of $3.0 million, an increase in accounts payable of $2.1 million, depreciation expense of $1.8 million, a decrease in prepaid expenses and other assets of $1.5 million, which were partially offset by an increase in inventory of $27.4 million and a decrease in accrued liabilities of $1.9 million.

Net cash provided by our operating activities for the three months ended September 30, 2013 was primarily due to our net income of $7.7 million, a decrease in accounts receivable of $14.4 million, stock-based compensation expense of $2.6 million, an increase in net income tax payable of $1.8 million, depreciation expense of $1.4 million and a decrease in prepaid expenses and other assets of $1.0 million, which were partially offset by a decrease in accounts payable of $7.7 million and a decrease in accrued liabilities of $3.2 million.

Table of Contents

The decrease for the three months ended September 30, 2014 in accounts receivable was primarily due to higher accounts receivable collection in the first quarter of fiscal year 2015 partially offset by an increase in our net sales late in the first quarter. The increase for the three months ended September 30, 2014 in inventory and accounts payable was primarily due to higher purchases to support the anticipated level of growth in our net sales in the second quarter of fiscal year 2015. We anticipate that accounts receivable, inventory and accounts payable will increase to the extent we continue to grow our product lines and our business.

The decrease for the three months ended September 30, 2013 in accounts receivable was primarily due to a lower net sales in the first quarter of fiscal year 2014. The decrease for the three months ended September 30, 2013 in accounts payable was due to lower cost of goods sold in the first quarter of fiscal year 2014.

Investing activities. Net cash used in our investing activities was $2.8 million and $2.0 million for the three months ended September 30, 2014 and 2013, respectively. In the three months ended September 30, 2014 and 2013, $2.8 million and $1.9 million, respectively, was related to the purchase of property, plant and equipment.
We plan to develop five manufacturing buildings through fiscal 2016 on the real property we purchased in San Jose, California, to serve as our Green Computing Park. We anticipate the costs of approximately $22.1 million during fiscal year 2015. We plan to finance this development through our operating cash flows and additional borrowings from banks.

Financing activities. Net cash provided by (used in) our financing activities was $(3.3) million and $1.8 million for the three months ended September 30, 2014 and 2013, respectively. In the three months ended September 30, 2014, we received $4.5 million related to the proceeds from the exercise of stock options. Further, we repaid $8.5 million in loans in the three months ended September 30, 2014.We expect the net cash provided by financing activities will increase throughout fiscal year 2015 as we intend to obtain additional financing from banks to construct our manufacturing buildings at our Green Computing Park in San Jose, California.

In the three months ended September 30, 2013, we received $1.5 million related to the proceeds from the exercise of stock options. We withheld shares and paid the minimum tax withholding on behalf of one executive officer for his restricted stock awards of $0.7 million for the three months ended September 30, 2013. Further, we received $0.7 million in advance from our receivable financing arrangements and repaid $0.7 million in loans in the three months ended September 30, 2013. In the three months ended September 30, 2013, excess tax benefits from stock-based compensation were $0.9 million.

We expect to experience continued growth in our working capital requirements and capital expenditures as we continue to expand our business. 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 intend to fund this continued expansion through cash generated by operations and by drawing on the revolving credit facility or through other debt financing. However we cannot be certain whether such financing will be available on commercially reasonable or otherwise favorable terms or that such financing will be available at all. We anticipate that working capital and capital expenditures will constitute a material use of our cash resources. We have sufficient cash on hand to continue to operate for at least the next 12 months.

Other factors affecting liquidity and capital resources

Activities under Revolving Lines of Credit and Term Loans

Bank of America

In October 2011, we entered into an amendment to the existing credit agreement with Bank of America, which provided for (i) a $40.0 million revolving line of credit facility through June 15, 2013 and (ii) a five-year $14.0 million term loan facility. The term loan is secured by three buildings located in San Jose, California and the principal and interest are payable monthly through September 30, 2016 with an interest rate at the LIBOR rate plus 1.50% per annum. The credit agreement was subsequently amended to extend the maturity date of the revolving line of credit to November 15, 2014. We are currently negotiating with Bank of America to renew the revolving line of credit.

The line of credit facility provided for borrowings denominated both in U.S. dollars and in Taiwanese dollars. For borrowings denominated in U.S. dollars, the interest rate for the revolving line of credit is at the LIBOR rate plus 1.25% per annum. The LIBOR rate was 0.16% at September 30, 2014. For borrowings denominated in Taiwanese dollars, the interest rate for the revolving line of credit is equal to the lender's established interest rate which is adjusted monthly.

Table of Contents

As of September 30, 2014 and June 30, 2014, the total outstanding borrowings under the Bank of America term loan was $5.8 million and $6.5 million, respectively. The total outstanding borrowings under the Bank of America line of credit was $9.9 million and $17.7 million as of September 30, 2014 and June 30, 2014, respectively. The interest rates for these loans ranged from 1.19% to 1.66% per annum at September 30, 2014 and 1.19% to 1.65% per annum at June 30, 2014, respectively. As of September 30, 2014, the unused revolving line of credit under Bank of America was $30.1 million.

CTBC Bank
In October 2011, we obtained an unsecured revolving line of credit from CTBC Bank totaling NT$300.0 million or $9.9 million U.S. dollars equivalents. In July 2012, we increased the credit line to NT$450.0 million or $14.9 million U.S. dollars equivalents. The term loan was secured by the land and building located in Bade, Taiwan with an interest rate at the lender's established interest rate plus 0.3% which is adjusted monthly.

In November 2013, we entered into an amendment to the existing credit agreement with CTBC Bank to increase the credit facility amount and extend the maturity date to November 30, 2014. The amendment provides for (i) a 13-month NT$700.0 million or $23.8 million U.S. dollar equivalents term loan secured by the land and building located in Bade, Taiwan with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum which is adjusted monthly and (ii) a 13-month unsecured term loan up to NT$100.0 million or $3.4 million U.S. dollar equivalents, and a 13-month revolving line of credit up to 80% of eligible accounts receivable in an aggregate amount of up to NT$500.0 million or $17.0 million U.S. dollar equivalents with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum or lender's established USD interest rate plus 0.30% per annum which is adjusted monthly. The total borrowings allowed under the credit agreement is capped at NT$1.0 billion or $34.0 million U.S. dollar equivalents.

The total outstanding borrowings under the CTBC Bank term loan was denominated in Taiwanese dollars and was translated into U.S. dollars of $21.7 million and $22.1 million as of September 30, 2014 and 2013, respectively. There were no outstanding borrowings under the CTBC Bank revolving line of credit at September 30, 2014 and 2013. The interest rate for the loan was at 1.16% and 1.15% per annum at June 30, 2014 and 2013, respectively. At September 30, 2014, NT$340.0 million or $11.2 million U.S. dollar equivalents were available for future borrowing under this credit agreement. We are currently negotiating with CTBC Bank to renew the credit agreement.

Covenant Compliance
The credit agreement with Bank of America contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries. The credit agreement contains certain financial covenants, including the following:

- Not to incur on a consolidated basis, a net loss before taxes and extraordinary items in any two consecutive quarterly accounting periods;
- The Company's funded debt to EBITDA ratio (ratio of all outstanding liabilities for borrowed money and other interest-bearing liabilities, including current and long-term debt, less the non-current portion of subordinated liabilities to EBITDA) shall not be greater than 2.00;
- The Company's unencumbered liquid assets, as defined in the agreement, held in the United States shall have an aggregate market value of not less than $30,000,000, measured as of the last day of each fiscal quarter and the last day of each fiscal year.

As of September 30, 2014, our total assets of $783.5 million collateralized the line of credit with Bank of America and were all of our assets except for the three buildings purchased in San Jose, California in June 2010 and the land and building located in Bade, Taiwan. As of September 30, 2014, total assets collateralizing the term loan with Bank of America were $17.5 million. As of September 30, 2014, the Company was in compliance with all financial covenants associated with the term loan and line of credit with Bank of America.

As of September 30, 2014, the net book value of land and building located in Bade, Taiwan collateralizing the term loan with CTBC Bank was $27.2 million. There are no financial covenants associated with the term loan with CTBC Bank at September 30, 2014.

Table of Contents

Contract Manufacturers

For the three months ended September 30, 2014, we paid our contract manufacturers within 43 to 71 days of invoice and Ablecom between 52 to 66 days of invoice. Ablecom, a Taiwan corporation, is one of our major contract manufacturers and a related party. As of September 30, 2014 and June 30, 2014, amounts owed to Ablecom by us were approximately $45.1 million and $49.0 million, respectively.

Auction Rate Securities Valuation

As of September 30, 2014, we held $2.6 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; the auction rate security was rated AAA or AA2 at September 30, 2014. These auction rate preferred shares have no stated maturity date.

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, 2014, $2.6 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, 2014, we have recorded an accumulated unrealized loss of $0.1 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. In the three months ended September 30, 2014 and 2013, there was no auction rate securities redeemed or sold.

Contractual Obligations

The following table describes our contractual obligations as of September 30, 2014:

	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	$2,968	$959	$17	$—	$3,944
Capital leases, including interest	159	299	185	—	643
Long-term debt, including interest (1)	34,528	3,065	—	—	37,593
Purchase commitments (2)	226,532	—	—	—	226,532
Total (3)	$264,187	$4,323	$202	$—	$268,712

(1) Amount reflects total anticipated cash payments, including anticipated interest payments based on the interest rate at September 30, 2014.

(2) Amount reflects total gross purchase commitments under our manufacturing arrangements with third-party contract manufacturers or vendors. Our purchase obligations included $29.2 million of hard disk drive purchase commitments at September 30, 2014, which will be paid through December 2014. See Note 10 of Notes to our Condensed Consolidated Financial Statements for a discussion of purchase commitments.

(3) The table above excludes liabilities for deferred revenue for warranty and on-site services of $6.6 million and unrecognized tax benefits and related interest and penalties accrual of $9.2 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.

Adoption of New Accounting Pronouncements

In March 2013, the FASB issued authoritative guidance associated with a parent company's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. The standard applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a business (other than a sale of in substance real estate or conveyance of oil and gas mineral

Table of Contents

rights) within a foreign entity. The adoption of this guidance did not have a material impact on our results of operations or financial position.

In July 2013, the FASB issued authoritative guidance associated with the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. It requires a liability related to an unrecognized tax benefit to offset a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if a settlement is required or expected in the event the uncertain tax position is disallowed. The adoption of this guidance did not have a material impact on our results of operations or financial position.

In May 2014, the FASB issued new accounting guidance related to revenue recognition. This new standard replaces all current U.S. GAAP guidance on revenue, eliminates all industry-specific guidance and provides a unified model in determining when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance can be applied either retrospectively or as a cumulative-effect adjustment as of the date of adoption. The new standard is effective for us on July 1, 2017. We are currently evaluating the effect the guidance will have on our financial statement disclosures, results of operations or financial position.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

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, 2014, our investments were in money market funds, certificates of deposits and auction rate securities.

We are exposed to changes in interest rates as a result of our borrowings under our term loan and revolving lines of credit. The interest rates for the term loans and the revolving lines of credit ranged from 1.16% to 1.66% at September 30, 2014 and 1.15% to 1.65% at June 30, 2014, respectively. Based on the outstanding principal indebtedness of $37.5 million under our credit facilities as of September 30, 2014, 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, 2014, we held $2.6 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; the auction rate security was rated AAA or AA2 at September 30, 2014. These auction rate preferred shares have no stated maturity date. 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, 2014, $2.6 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, 2014, we have recorded an accumulated unrealized loss of $0.1 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, 2014 and 2013, no auction rate securities were redeemed or sold.

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, 2014, as the market for these investments is presently uncertain. In any event, we do not have a

Table of Contents

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, 2014 in respect to these securities and, if a liquid market does not develop for these investments, we could be required to hold them to market recovery.

Foreign Currency Risk

To date, our international customer and supplier agreements have been denominated primarily in U.S. dollars, and accordingly, we have limited exposure 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 including financing arrangements are denominated 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. Foreign exchange gain (loss) for the three months ended September 30, 2014 and 2013 was \$0.5 million and \$(0.2) million, respectively.

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, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) and 15d-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 us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, 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, 2014.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we have been involved in various legal proceedings arising from the normal course of business activities. We defend ourselves vigorously against any such claims. In management's opinion, the resolution of any pending matters will not have a material adverse effect on our consolidated financial condition, results of operations, or liquidity.

Item 1A. Risk Factors

The Risk Factors included in our Annual Report on Form 10-K for the year ended June 30, 2014 have not materially changed. You should carefully consider the following risk factors, as well as the other information in this Form 10-Q.

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 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:

Table of Contents

- fluctuations based upon seasonality, with the quarters ending March 31 and September 30 typically being weaker;
- 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 key components and other materials needed to satisfy customer requirements;
- variability of our margins based on the mix of server systems, subsystems and accessories we sell and the percentage of our sales to internet datacenter cloud customers or geographical regions;
- 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;
- 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 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.

We may fail to meet publicly announced financial guidance or other expectations about our business, which would cause our stock to decline in value.

We typically provide forward looking financial guidance when we announce our financial results from the prior quarter. We undertake no obligation to update such guidance at any time. Frequently in the past, our financial results have failed to meet the guidance we provided. There are a number of reasons why we might fail, including, but not limited to, the factors described in the preceding Risk Factor.

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

Table of Contents

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, and our net sales were adversely impacted in fiscal year 2013 and 2012 by disk drive shortages resulting from the flooding in Thailand. 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.

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, materially change contracts or commitments to us or fail to meet the quality or delivery requirements needed to satisfy customer demand for our products, whether due to shortages or other reasons, 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.

We may incur additional expenses and suffer lower margins if our expectations regarding long term hard disk drive commitments prove incorrect.

Notwithstanding our general practice of not entering into long term supply contracts, as a result of severe flooding in Thailand during the first quarter of fiscal year 2012, we have entered into purchase agreements with selected suppliers of hard disk drives in order to ensure continuity of supply for these components. The hard disk drive purchase commitments totaled approximately $29.2 million as of September 30, 2014 and will be paid through December 2014. Higher costs compared to the lower selling prices for these components incurred under these agreements contributed to our lower gross profit in fiscal year 2013 and will likely impact our gross profit in the future. We have not yet determined whether to enter into similar commitments upon the expiration of our current commitments. Our existing and any other similar future supply commitments that we may enter into expose us to risk for lower margins or loss on disposal of such inventory if our expectations of customer demand are incorrect and the market price of the material or component inventory decline. Likewise if we fail to enter into commitments we may be exposed to limited available of supply or higher inventory costs which could result in lower net sales and adversely impact gross margin and net income.

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. In addition, from time to time we assume greater inventory risk in connection with the purchase or manufacture of more specialized components in connection with higher volume sales opportunities. We have from time to time experienced inventory write downs associated with higher volume sales that were not completed as anticipated. For example, we recorded a reserve in the quarters ended March 31, 2013 and June 30, 2013 relating to specialized inventory purchased for one customer. We expect that we will experience such write downs from time to time in the future related to existing and future commitments. If we are later able to sell inventory with respect to which we have taken a reserve 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, 2014 and 2013, we recorded inventory write-downs charged to cost of sales of $1.7 million and $4,000, for lower of cost or market and 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-Inventory Valuation.”

Table of Contents

As we increasingly target larger customers and larger sales opportunities, our customer base may become more concentrated, our cost of sales may increase, our margins may be lower and our sales may be less predictable.

As our business continues to grow, we have become increasingly dependent upon larger sales to maintain our rate of growth. In particular, in recent years, we have completed larger sales to datacenters, leading internet companies and for other cloud computing applications. As 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, timeframes or geographies that we expect, our ability to maintain or grow our net sales will be adversely affected.

Additionally, as we and our 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. 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 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 revenues and net income. Likewise, large orders are generally subject to intense pricing pressure which can have an adverse impact on our margins and results of operations. As a result, our quarter-to-quarter results of operations may be subject to greater fluctuation and our stock price may be adversely affected.

If we do not successfully manage the expansion of our international manufacturing operations, our business could be harmed.

Since inception we have conducted substantially all of our manufacturing operations near our corporate headquarters in California. We have recently begun significant manufacturing operations in Taiwan and more limited manufacturing operations in the Netherlands. The commencement of new manufacturing operations in new locations, particularly in other jurisdictions, entails additional risks and challenges. If we are unable to successfully ramp up these operations we may incur unanticipated costs, difficulties in making timely delivery of products or suffer other business disruptions which could adversely impact our results of operations.

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. We expect that our annual operating expenses will continue to increase 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 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.

Table of Contents

We may encounter difficulties with our ERP Systems.

We are currently in the process of implementing a new enterprise resource planning, or ERP, System. We have incurred and expect to continue to incur additional expenses for our implementation. Many companies have experienced delays and difficulties with the implementation of new or changed ERP systems that have had a negative effect on their business. Any disruptions, delays or deficiencies in the design and implementation of a revised or new ERP system could result in potentially much higher costs than we had anticipated and could adversely affect our ability to develop new products, provide services, fulfill contractual obligations, file reports with the SEC in a timely manner and/or otherwise operate our business, or otherwise impact our controls environment. Any of these consequences could have an adverse effect on our results of operations and financial condition.

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.

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 or geographies, particularly for internet datacenter customers and other large sale opportunities. 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, less efficient utilization of our manufacturing operations, 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, IBM, Cisco and Intel. In addition, we also compete with a number of other vendors who also sell application optimized servers, contract manufacturers 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 and larger sales volume allowing for better costs;
- 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. In addition, in recent periods each of Hewlett-Packard, Dell and IBM have experienced or initiated substantial changes. Also initiatives like the Open Compute Project, or OCP, a project to establish more industry standard datacenter configurations, could have the impact of supporting an approach which is less favorable to the flexibility and customization that we offer. These changes could have a significant impact on the market and impact our results of operations. 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.

Table of Contents

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

We expect that our direct sales force will continue to grow as larger customers increasingly require a direct sales approach. 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. We have traditionally experienced much greater turnover in our sales and marketing personnel as compared to other departments and other companies. 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, develop and retain sufficient numbers of productive sales personnel, sales of our server solutions will suffer.

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, AMD and Nvidia, to anticipate and deliver new products on a timely basis when new generation materials and core components are made available. Intel, AMD and Nvidia 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, AMD and Nvidia, 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, 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.

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 majority of our revenues have resulted from sales of our products through third party distributors and resellers, which sales accounted for 56.0% and 60.9% of our net sales in the three months ended September 30, 2014 and 2013, 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 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.

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

We expect our direct sales force to continue 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.

The average selling prices for our existing server solutions are subject to decline if customers do not continue to purchase our latest generation products or additional components, 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 prices continue to decline, our business, financial condition and results of operations will be harmed. In addition, our average selling prices have increased rapidly in recent periods as we have sold more products including additional components such as more memory and hard disk drive capacity. There is no assurance that our average selling prices will continue to increase and may decline due to decreased demand for, or lower prices of, the additional components that we sell with our server solutions.

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 cannot 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.

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 the past 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

Table of Contents

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 14.5% and 17.3% of our cost of sales for the three months ended September 30, 2014 and 2013, 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, while Mr. Steve Liang and other family members 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.

If Steve Liang ceases to have significant influence over Ablecom, or if those of our stockholders who hold shares of Ablecom cease to have a significant amount 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 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 and continue to operate a joint management company with Ablecom to manage the common areas shared by us and Ablecom for our separately constructed manufacturing facilities in Taiwan.

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

Table of Contents

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.

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 and are expanding our business operations in Europe and Asia, particularly in Taiwan, the Netherlands, China and Japan. In particular, we have and continue to make substantial investments for the purchase of land and the development of new facilities in Taiwan to accommodate our expected growth. 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;
- 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 or our results of 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 United States.

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 time frame. 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 United States 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.

Table of Contents

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. Our primary competitors have substantially greater numbers of issued patents than we have which may position us less favorably in the event of any claims or litigation with them. Other third-parties have in the past sent us correspondence regarding their intellectual property or filed claims that our products infringe or violate third parties' intellectual property rights. In addition, increasingly non-operating companies are purchasing patents and bringing claims against technology companies. We have been subject to several such claims and may be subject to such claims in the future. 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.

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

Table of Contents

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 and 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 have also established significant manufacturing and research and development operations in Taiwan which is also subject to seismic activity risks. 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.

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.

We are also subject to new regulations concerning the supply of minerals coming from the conflict zones in and around the Democratic Republic of Congo. New U.S. legislation includes disclosure requirements regarding the use of conflict minerals mined from the Democratic Republic of Congo and adjoining countries and procedures regarding a manufacturer's efforts to prevent the sourcing of such conflict minerals. The implementation of these requirements could affect the sourcing and availability of minerals used in the manufacture of semiconductor or other devices. As a result, there may only be a limited

Table of Contents

pool of suppliers who provide conflict-free metals, and we cannot assure you that we will be able to obtain products in sufficient quantities or at competitive prices.

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 historically have been highly volatile and the trading price of our common stock has been and is likely to continue to be subject to wide fluctuations. Factors, in addition to those outlined elsewhere in this filing, 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;
- 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. All of our shares are eligible for sale in the public market, including shares held by directors, executive officers and other affiliates, sales of which are subject to volume limitations under Rule 144 under the Securities Act. In addition, 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 30, 2014, our executive officers, directors, current five percent or greater stockholders and affiliated entities together beneficially owned 38.7% of our common stock, 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 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.

Table of Contents

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

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

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

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

Not applicable.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

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Table of Contents

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 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 of the Registrant pursuant to Section 906, as adopted pursuant to the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, 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 6, 2014	/s/ CHARLES LIANG Charles Liang President, Chief Executive Officer and Chairman of the Board (Principal Executive Officer)
Date: November 6, 2014	/s/ Howard Hideshima Howard Hideshima Senior Vice President, Chief Financial Officer (Principal Financial and Accounting Officer)