

Edgar Filing: Super Micro Computer, Inc. - Form 10-Q

Super Micro Computer, Inc.  
Form 10-Q  
May 07, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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FORM 10-Q

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

For the quarterly period ended March 31, 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

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Super Micro Computer, Inc.  
(Exact name of Registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)  
980 Rock Avenue  
San Jose, CA 95131  
(Address of principal executive offices)  
(408) 503-8000  
(Registrant's telephone number, including area code)

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77-0353939  
(IRS Employer  
Identification Number)

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  No

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

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

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

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

As of April 28, 2014, there were 44,931,042 shares of the registrant's common stock, \$0.001 par value, outstanding, which is the only class of common or voting stock of the registrant issued.

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SUPER MICRO COMPUTER, INC.

QUARTERLY REPORT ON FORM 10-Q  
FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2014

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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)

	March 31, 2014	June 30, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 101,714	\$ 93,038
Accounts receivable, net of allowances of \$1,808 and \$1,966 at March 31, 2014 and June 30, 2013, respectively (including amounts receivable from a related party of \$469 and \$974 at March 31, 2014 and June 30, 2013, respectively)	182,028	149,340
Inventory	295,089	254,170
Deferred income taxes-current	21,168	15,786
Prepaid income taxes	5,426	4,039
Prepaid expenses and other current assets	5,420	6,819
Total current assets	610,845	523,192
Long-term investments	2,637	2,637
Property, plant and equipment, net	128,504	95,912
Deferred income taxes-noncurrent	5,740	7,275
Other assets	2,815	3,241
Total assets	\$ 750,541	\$ 632,257
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable (including amounts due to a related party of \$42,198 and \$50,448 at March 31, 2014 and June 30, 2013, respectively)	\$ 205,246	\$ 172,855
Accrued liabilities	32,372	34,122
Income taxes payable	12,782	6,049
Short-term debt and current portion of long-term debt	42,130	28,638
Total current liabilities	292,530	241,664
Long-term debt-net of current portion	4,433	6,533
Other long-term liabilities	11,039	10,336
Total liabilities	308,002	258,533
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: 44,977,675 and 42,744,500 at March 31, 2014 and June 30, 2013, respectively	188,931	157,712
Treasury stock (at cost), 445,028 shares at March 31, 2014 and June 30, 2013	(2,030 )	(2,030 )
Accumulated other comprehensive loss	(74 )	(69 )
Retained earnings	255,538	217,930
Total Super Micro Computer, Inc. stockholders' equity	442,365	373,543
Noncontrolling interest	174	181
Total stockholders' equity	442,539	373,724

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Total liabilities and stockholders' equity	\$750,541	\$632,257
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See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Net sales (including related party sales of \$3,418 and \$3,600 in the three months ended March 31, 2014 and 2013, respectively, and \$10,805 and \$9,390 in the nine months ended March 31, 2014 and 2013, respectively)	\$373,755	\$278,034	\$1,039,133	\$840,228
Cost of sales (including related party purchases of \$45,398 and \$44,765 in the three months ended March 31, 2014 and 2013, respectively, and \$145,139 and \$132,704 in the nine months ended March 31, 2014 and 2013, respectively)	316,491	239,141	879,985	726,198
Gross profit	57,264	38,893	159,148	114,030
Operating expenses:				
Research and development	20,570	18,606	61,234	55,651
Sales and marketing	9,416	8,713	27,257	25,424
General and administrative	5,806	6,134	16,938	18,225
Total operating expenses	35,792	33,453	105,429	99,300
Income from operations	21,472	5,440	53,719	14,730
Interest and other income, net	10	2	73	24
Interest expense	(156)	(142)	(535)	(449)
Income before income tax provision	21,326	5,300	53,257	14,305
Income tax provision (benefit)	4,752	(1,740)	15,649	1,452
Net income	\$16,574	\$7,040	\$37,608	\$12,853
Net income per common share:				
Basic	\$0.38	\$0.17	\$0.87	\$0.31
Diluted	\$0.35	\$0.16	\$0.82	\$0.29
Weighted-average shares used in calculation of net income per common share:				
Basic	43,992	42,147	43,128	41,901
Diluted	47,424	44,148	45,857	43,921

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	March 31, 2014	2013	March 31, 2014	2013
Net income	\$16,574	\$7,040	\$37,608	\$12,853
Other comprehensive income, net of tax:				
Foreign currency translation loss	(4	) (9	) (5	) (1
Unrealized gains on investments	—	—	—	16
Total other comprehensive income (loss)	(4	) (9	) (5	) 15
Comprehensive income	\$16,570	\$7,031	\$37,603	\$12,868

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended March 31,	
	2014	2013
<b>OPERATING ACTIVITIES:</b>		
Net income	\$37,608	\$12,853
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	4,590	5,900
Stock-based compensation expense	8,183	8,662
Excess tax benefits from stock-based compensation	(2,719)	(844)
Allowance for doubtful accounts	1,384	696
Provision for inventory	2,427	8,744
Deferred income taxes	(3,847)	(6,205)
Exchange gain	(334)	(158)
Changes in operating assets and liabilities:		
Accounts receivable, net (including changes in related party balances of \$505 and \$(280) during the nine months ended March 31, 2014 and 2013, respectively)	(34,072)	(21,021)
Inventory	(43,346)	10,514
Prepaid expenses and other assets	1,417	169
Accounts payable (including changes in related party balances of \$(8,250) and \$(11,001) during the nine months ended March 31, 2014 and 2013, respectively)	32,492	(9,602)
Income taxes payable, net	9,879	1,943
Accrued liabilities	(1,767)	3,268
Other long-term liabilities	579	(1,350)
Net cash provided by operating activities	12,474	13,569
<b>INVESTING ACTIVITIES:</b>		
Restricted cash	401	(407)
Proceeds from investments	—	300
Purchases of property, plant and equipment	(36,779)	(4,346)
Net cash used in investing activities	(36,378)	(4,453)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock options	19,154	1,446
Minimum tax withholding paid on behalf of an officer for restricted stock awards	(651)	(1,022)
Excess tax benefits from stock-based compensation	2,719	844
Proceeds from debt	17,354	20,641
Repayment of debt	(5,620)	(17,373)
Payment of obligations under capital leases	(26)	(31)
Payment under receivable financing arrangements	(8)	(586)
Contributions from noncontrolling interests	—	168
Net cash provided by financing activities	32,922	4,087
Effect of exchange rate fluctuations on cash	(342)	(55)
Net increase in cash and cash equivalents	8,676	13,148
Cash and cash equivalents at beginning of period	93,038	80,826
Cash and cash equivalents at end of period	\$101,714	\$93,974
Supplemental disclosure of cash flow information:		

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Cash paid for interest	\$533	\$551
Cash paid for taxes, net of refunds	\$8,940	\$6,793
Non-cash investing and financing activities:		
Accrued costs for property, plant and equipment purchases	\$2,055	\$180

See accompanying notes to condensed consolidated financial statements.

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

Note 1. 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 and China.

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, 2013 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 and nine months ended March 31, 2014 are not necessarily indicative of the results that may be expected for future quarters or for the fiscal year ending June 30, 2014.

As of March 31, 2014, the Company contributed \$168,000 and owned a 50% interest in Super Micro Business Park, Inc. ("Management Company") in Taiwan. The Management Company was established to manage the common areas shared by the Company and Ablecom for their separately constructed manufacturing facilities. 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. Therefore, the accounts of the Management Company have been consolidated with the accounts of the Company, and a noncontrolling interest has been recorded for Ablecom's interests in the net assets and operations of the Management Company. In the three and nine months ended March 31, 2014, \$6,000 and \$(7,000), respectively, 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. In the three and nine months ended March 31, 2013, \$7,000 of net income attributable to Ablecom's interest was included in the Company's general and administrative expenses in the condensed consolidated statements of operations.

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

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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;

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

• 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.

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 February 2013, the Financial Accounting Standards Board ("FASB") issued authoritative guidance associated with reporting of amounts reclassified out of accumulated other comprehensive income, which requires companies to present significant reclassifications out of accumulated other comprehensive income in their entirety in the statement of operations or in a separate footnote to the financial statements. For amounts that are not required to be reclassified in their entirety to net income, the standard requires companies to cross-reference to related footnoted disclosures. The new disclosure requirements are effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those years, beginning after December 15, 2012 and early adoption is permitted. The adoption of this guidance did not have a material impact on the Company's financial statement disclosures, results of operations or financial position.

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. This new accounting pronouncement is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company is currently reviewing the provisions but does not expect it to have a material impact on the Company's financial statement disclosures, 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 Company currently plans to adopt the new disclosure requirement on July 1, 2014. The Company does not believe the adoption of this guidance will have a material impact on its financial statement disclosures,

results of operations or financial position.

Note 2. Stock-based Compensation and Stockholders' Equity

Equity Incentive Plan

In January 2011, the Board of Directors approved an amendment to the 2006 Equity Incentive Plan (the "2006 Plan") that increased by 2,000,000 the aggregate maximum number of shares that may be issued under the 2006 Plan. The amendment to the 2006 Plan was approved by the Company's stockholders in February 2011. The authorized number of shares that may be issued under 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

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

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. As of March 31, 2014, the Company had 777,248 authorized shares available for future issuance under the 2006 Plan.

#### Restricted Stock Awards

Restricted stock awards are share awards that provide the rights to a set number of shares of the Company's stock on the grant date. In August 2008, the Compensation Committee of the Board of Directors of the Company (the "Committee") approved the terms of an agreement (the "Option Exercise Agreement") with Charles Liang, a director and President and Chief Executive Officer of the Company, pursuant to which Mr. Liang exercised a fully vested option previously granted to him for the purchase of 925,000 shares. The option was exercised using a "net-exercise" procedure in which he was issued a number of shares representing the spread between the option exercise price and the then current market value of the shares subject to the option (898,205 shares based upon the market value as of the date of exercise). The shares issued upon exercise of the option are subject to vesting over five years. Vesting of the shares subject to the award may accelerate in certain circumstances pursuant to the terms of the Option Exercise Agreement. The Company determined that there was no incremental fair value of the option exchanged for the award. 898,205 and 718,564 shares were vested as of March 31, 2014 and June 30, 2013, respectively.

#### 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 and nine months ended March 31, 2014 and 2013 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

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	Three Months Ended		Nine Months Ended	
	March 31, 2014	2013	March 31, 2014	2013
Risk-free interest rate	1.69% - 1.81%	0.80% - 0.90%	1.53% - 1.81%	0.65% - 0.90%
Expected life	5.58 years	5.14 years	5.49 - 5.58 years	5.03 - 5.14 years
Dividend yield	— %	— %	— %	— %
Volatility	43.48% - 44.66%	51.27% - 51.49%	43.48% - 50.07%	51.27% - 51.57%
Weighted-average fair value	\$7.70	\$3.92	\$6.67	\$4.56

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

The following table shows total stock-based compensation expense included in the condensed consolidated statements of operations for the three and nine months ended March 31, 2014 and 2013 (in thousands):

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2014	2013	2014	2013
Cost of sales	\$246	\$232	\$726	\$696
Research and development	1,723	1,666	4,993	4,928
Sales and marketing	306	389	925	1,182
General and administrative	531	563	1,539	1,856
Stock-based compensation expense before taxes	2,806	2,850	8,183	8,662
Income tax impact	(1,477	) (40	) (2,146	) (449
Stock-based compensation expense, net	\$ 1,329	\$ 2,810	\$ 6,037	\$ 8,213

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 \$4,533,000 and \$1,687,000 of excess tax benefits accounted in the Company's additional paid-in capital in the nine months ended March 31, 2014 and 2013, respectively. The Company had excess tax benefits that are classified as cash from financing activities of \$2,719,000 and \$844,000 in the nine months ended March 31, 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 nine months ended March 31, 2014 under all stock option plans:

	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at July 1, 2013	12,206,178	\$ 10.83	6.23	\$ 22,631
Granted	1,339,160	14.80		
Exercised	(2,103,534	) 9.11		
Forfeited or cancelled	(211,489	) 14.22		
Outstanding at March 31, 2014	11,230,315	11.57	6.12	67,169
Options vested and expected to vest at March 31, 2014	10,965,812	11.50	6.05	66,292
Options vested and exercisable at March 31, 2014	7,914,484	\$ 10.44	5.05	\$ 55,876

The total pretax intrinsic value of options exercised was \$14,746,000 and \$19,961,000 for the three and nine months ended March 31, 2014, respectively, and \$1,152,000 and \$4,220,000 for the three and nine months ended March 31,

2013, respectively. As of March 31, 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 \$18,557,000, which will be recognized over a weighted-average vesting period of approximately 2.38 years.



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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Restricted Stock Award Activity

The following table summarizes the Company's restricted stock award activity for the nine months ended March 31, 2014:

	Restricted Stock Awards Number of Shares	Weighted Average Grant Date Fair Value Per Share
Nonvested stock at July 1, 2013	179,641	\$10.66
Granted	3,500	14.23
Vested	(179,641 )	10.66
Forfeited	—	—
Nonvested stock at March 31, 2014	3,500	\$14.23

The total pretax intrinsic value of restricted stock awards vested was \$0 and \$2,337,000 for the three and nine months ended March 31, 2014, respectively, and \$0 and \$2,190,000 for the three and nine months ended March 31, 2013, respectively. In the nine months ended March 31, 2014 and 2013, upon vesting, 179,641 shares of restricted stock awards were partially net share-settled such that the Company withheld 50,000 and 83,857 shares, respectively, 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 were based on the value of the restricted stock awards on the vesting date as determined by the Company's closing stock price. Total payments for an officer's tax obligations to the taxing authorities were \$651,000 and \$1,022,000 in the nine months ended March 31, 2014 and 2013, respectively, and are reflected as a financing activity within the condensed 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. The total intrinsic value of the outstanding restricted stock awards was \$61,000 as of March 31, 2014.

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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 net income per common share using the two-class method is as follows (in thousands, except per share amounts):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Basic net income per common share calculation				
Net income	\$ 16,574	\$ 7,040	\$ 37,608	\$ 12,853
Less: Undistributed earnings allocated to participating securities	(1	) (30	) (34	) (67
Net income attributable to common shares—basic	\$ 16,573	\$ 7,010	\$ 37,574	\$ 12,786
Weighted-average number of common shares used to compute basic net income per common share	43,992	42,147	43,128	41,901
Basic net income per common share	\$0.38	\$0.17	\$0.87	\$0.31
Diluted net income per common share calculation				
Net income	\$ 16,574	\$ 7,040	\$ 37,608	\$ 12,853
Less: Undistributed earnings allocated to participating securities	(1	) (29	) (32	) (64
Net income attributable to common shares—diluted	\$ 16,573	\$ 7,011	\$ 37,576	\$ 12,789
Weighted-average number of common shares used to compute basic net income per common share	43,992	42,147	43,128	41,901
Dilutive effect of options to purchase common stock	3,432	2,001	2,729	2,020
Weighted-average number of common shares used to compute diluted net income per common share	47,424	44,148	45,857	43,921
Diluted net income per common share	\$0.35	\$0.16	\$0.82	\$0.29

For the three and nine months ended March 31, 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 2,142,000 and 3,892,000 for the three and nine months ended March 31, 2014, respectively, and 6,551,000 and 6,076,000 for the three and nine months ended March 31, 2013, respectively.

## Note 4. Balance Sheet Components

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

## Inventory:

	March 31, 2014	June 30, 2013
Finished goods	\$216,775	\$185,459
Work in process	29,607	10,440

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Purchased parts and raw materials	48,707	58,271
Total inventory	\$295,089	\$254,170

The Company recorded a provision for lower of cost or market and excess and obsolete inventory totaling \$889,000 and \$2,427,000 in the three and nine months ended March 31, 2014, respectively, and \$2,431,000 and \$8,744,000 in the three and nine months ended March 31, 2013, respectively.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Property, Plant, and Equipment:

	March 31, 2014	June 30, 2013
Land	\$63,958	\$41,774
Buildings	51,959	43,979
Building and leasehold improvements	7,632	7,483
Machinery and equipment	32,978	26,941
Furniture and fixtures	5,119	4,731
Purchased software	5,547	5,380
	167,193	130,288
Accumulated depreciation and amortization	(38,689 )	(34,376 )
Property, plant and equipment, net	\$128,504	\$95,912

On October 31, 2013, the Company completed the purchase of real property for \$30,158,000. The property consists of approximately 324,000 square feet of building space on 36 acres of land. The purchase values allocated to the land and building were \$22,178,000 and \$7,980,000, respectively.

## Other Assets:

	March 31, 2014	June 30, 2013
Prepaid royalty license	\$1,308	\$1,496
Restricted cash	446	847
Investment in a privately held company	750	750
Others	311	148
Total other assets	\$2,815	\$3,241

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:

	March 31, 2014	June 30, 2013
Accrued payroll and related expenses	\$10,757	\$12,084
Customer prepayments	3,727	4,134
Accrued warranty costs	6,921	6,472
Accrued cooperative marketing expenses	4,095	4,016
Others	6,872	7,416
Total accrued liabilities	\$32,372	\$34,122

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Product Warranties:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2014	2013	2014	2013
Balance, beginning of period	\$6,822	\$6,227	\$6,472	\$5,522
Provision for warranty	3,517	3,055	10,458	9,547
Costs charged to accrual	(3,558 )	(2,963 )	(10,222 )	(9,020 )
Change in estimated liability for pre-existing warranties	140	(240 )	213	30
Balance, end of period	\$6,921	\$6,079	\$6,921	\$6,079

## Note 5. Long-term Investments

As of March 31, 2014 and June 30, 2013, the Company held \$2,637,000 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 March 31, 2014 and June 30, 2013. 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 saleable in the auction, thereby losing the short-term liquidity previously provided by the auction process. As a result, as of March 31, 2014 and June 30, 2013, \$2,637,000 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 March 31, 2014 and June 30, 2013. 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 March 31, 2014, the discount rate, the time period until redemption and the estimated rate of return were 1.70%, 3 years and 0.35%, 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 and nine months ended March 31, 2014 and the three months ended March 31, 2013. There was a recovery in fair value of \$27,000 during the nine months ended March 31, 2013. There was a cumulative total decline in fair value of \$113,000 as of March 31, 2014 and June 30, 2013. That amount has been recorded as a component of other comprehensive income. As of March 31, 2014 and June 30, 2013, the Company has recorded an accumulated unrealized loss of \$68,000, 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. During the three and nine months ended March 31, 2014, there were no auction rate securities redeemed or sold. During the three and nine months ended March 31, 2013, \$0 and \$300,000 of the auction rate securities were redeemed at par.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## 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 March 31, 2014 and June 30, 2013. 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 March 31, 2014 and June 30, 2013 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):

	Level 1	Level 2	Level 3	Asset at Fair Value
March 31, 2014				
Money market funds	\$310	\$—	\$—	\$310
Auction rate securities	—	—	2,637	2,637
Total	\$310	\$—	\$2,637	\$2,947
June 30, 2013				
Money market funds	\$310	\$—	\$—	\$310
Auction rate securities	—	—	2,637	2,637
Total	\$310	\$—	\$2,637	\$2,947

The above table excludes \$101,171,000 and \$92,495,000 of cash and \$738,000 and \$1,139,000 of certificates of deposit held by the Company as of March 31, 2014 and June 30, 2013, respectively. There were no transfers between Level 1, Level 2 or Level 3 securities in the three and nine months ended March 31, 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 and nine months ended March 31, 2014 and 2013 (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Balance as of beginning of period	\$2,637	\$2,650	\$2,637	\$2,923
Total realized gains or (losses) included in net income	—	—	—	—
Total unrealized gains or (losses) included in other comprehensive income	—	—	—	27
Sales and settlements at par	—	—	—	(300)
Transfers in and/or out of Level 3	—	—	—	—
Balance as of end of period	\$2,637	\$2,650	\$2,637	\$2,650





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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

The following is a summary of the Company's long-term investments as of March 31, 2014 and June 30, 2013 (in thousands):

	March 31, 2014			Fair Value
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	
Auction rate securities	\$2,750	\$—	\$(113 )	\$2,637
	June 30, 2013			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Auction rate securities	\$2,750	\$—	\$(113 )	\$2,637

The Company measures the fair value of outstanding debt for disclosure purposes on a recurring basis. As of March 31, 2014 and June 30, 2013, short-term and long-term debt of \$46,563,000 and \$35,171,000, respectively, are reported at amortized cost. This outstanding debt is classified at 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 March 31, 2014 and June 30, 2013 consisted of the following (in thousands):

	March 31, 2014	June 30, 2013
Lines of credit:		
Bank of America	\$17,699	\$10,899
Building term loans:		
Bank of America	7,233	9,333
CTBC Bank	21,631	14,939
Total building term loans	28,864	24,272
Total debt	46,563	35,171
Current portion	(42,130 )	(28,638 )
Long-term portion	\$4,433	\$6,533

## Activities under Revolving Lines of Credit and Term Loans

Bank of America

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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 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 August 15, 2014.

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

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

annum. The LIBOR rate was 0.15% at March 31, 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 March 31, 2014 and June 30, 2013, the total outstanding borrowings under the Bank of America term loan was \$7,233,000 and \$9,333,000, respectively. The total outstanding borrowings under the Bank of America line of credit was \$17,699,000 as of March 31, 2014 and \$10,899,000 as of June 30, 2013, respectively. The interest rates for these loans ranged from 1.19% to 1.65% per annum at March 31, 2014 and 1.23% to 1.69% per annum at June 30, 2013, respectively. As of March 31, 2014, the unused revolving line of credit with Bank of America was \$22,301,000.

#### 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, or \$9,898,000 U.S. dollar equivalents. In July 2012, the Company increased the credit facility to NT\$450,000,000 or \$14,912,000 U.S. dollar 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 was 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 New Taiwan Dollar ("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 \$21,631,000 and \$14,939,000 at March 31, 2014 and June 30, 2013, respectively. There were no outstanding borrowings under the CTBC Bank revolving line of credit at March 31, 2014 and June 30, 2013. The interest rate for the loan was at 1.13% per annum at March 31, 2014 and was at 1.20% per annum at June 30, 2013. At March 31, 2014, NT\$340,000,000 or \$11,143,000 U.S. dollar equivalents were available for future borrowing under this 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;
-

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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 March 31, 2014 and June 30, 2013, total assets of \$705,506,000 and \$586,742,000, respectively collateralized the line of credit with Bank of America and were all of the assets of the Company except for the three buildings located in San Jose, California and the land and building located in Bade, Taiwan. As of March 31, 2014 and June 30, 2013, total assets collateralizing the term loan with Bank of America were \$17,641,000 and \$17,813,000, respectively. As of March 31, 2014, the Company was in compliance with all financial covenants associated with the credit agreement with Bank of America.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

As of March 31, 2014 and June 30, 2013, the net book value of land and building located in Bade, Taiwan collateralizing the term loan with CTBC Bank was \$27,394,000 and \$27,702,000, respectively. There are no financial covenants associated with the term loan with CTBC Bank at March 31, 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 March 31, 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 \$45,398,000 and \$145,139,000 and sold products to Ablecom totaling \$3,418,000 and \$10,805,000 for the three and nine months ended March 31, 2014, respectively. The Company purchased products from Ablecom totaling \$44,765,000 and \$132,704,000 and sold products to Ablecom totaling \$3,600,000 and \$9,390,000 for the three and nine months ended March 31, 2013, respectively.

Amounts owed to the Company by Ablecom as of March 31, 2014 and June 30, 2013, were \$469,000 and \$974,000, respectively. Amounts owed to Ablecom by the Company as of March 31, 2014 and June 30, 2013, were \$42,198,000 and \$50,448,000, respectively. For the three and nine months ended March 31, 2014, the Company paid Ablecom the majority of invoiced dollars between 50 and 96 days of invoice. For the three and nine months ended March 31, 2014, the Company paid \$2,187,000 and \$5,923,000, respectively, for tooling assets and miscellaneous costs to Ablecom. For the three and nine months ended March 31, 2013, the Company paid \$531,000 and \$3,398,000, 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 \$63,997,000 and \$53,684,000 at March 31, 2014 and June 30, 2013, 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

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

has been recorded for the Ablecom's interests in the net assets and operations of the Management Company. In the three and nine months ended March 31, 2014, \$6,000 and \$(7,000), respectively, 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. In the three and nine months ended March 31, 2013, \$7,000 of net income 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 (benefits from) income taxes of \$4,752,000 and \$15,649,000 for the three and nine months ended March 31, 2014, respectively, and \$(1,740,000) and \$1,452,000 for the three and nine months ended March 31, 2013. The effective tax rate was 22.3% and 29.4% for the three and nine months ended March 31, 2014, respectively, and (32.8)% and 10.2% for the three and nine months ended March 31, 2013, respectively. The effective tax rates for three and nine months ended March 31, 2014 are 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 foreign tax credits, which are in part offset by an increase in state tax expenses.

As of March 31, 2014, the Company had a liability for gross unrecognized tax benefits of \$9,397,000, substantially all of which, if recognized, would affect the Company's effective tax rate. During the three and nine months ended March 31, 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 March 31, 2014, the Company had accrued \$780,000 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 2010 through 2013. The state jurisdictions remain open in general for tax years 2008 through 2013. The Company's tax returns for its most significant foreign jurisdictions remain open for examination in general for tax years 2006 through 2013. 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 condensed 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 March 31, 2014, these remaining non-cancellable commitments were \$271,209,000 compared to \$249,005,000 at June 30, 2013. The increase was primarily due to support the growth of the Company's revenue.

Included in the above non-cancellable commitments are hard disk drive purchase commitments totaling approximately \$72,395,000, 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.



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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## 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 and nine months ended March 31, 2014 and 2013, of net sales by geographic region (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Net sales:				
United States	\$203,638	\$157,370	\$558,423	\$448,729
Europe	81,165	61,115	237,327	191,438
Asia	78,373	52,820	215,556	177,917
Other	10,579	6,729	27,827	22,144
	\$373,755	\$278,034	\$1,039,133	\$840,228

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

	March 31, 2014	June 30, 2013
Long-lived assets:		
United States	\$91,713	\$61,976
Asia	36,442	33,500
Europe	349	436
	\$128,504	\$95,912

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

	Three Months Ended March 31,				Nine Months Ended March 31,					
	2014		2013		2014		2013			
	Amount	Percent of Net Sales	Amount	Percent of Net Sales	Amount	Percent of Net Sales	Amount	Percent of Net Sales	Amount	Percent of Net Sales
Server systems	\$187,282	50.1 %	\$116,209	41.8 %	\$504,637	48.6 %	\$349,175	41.6 %		
Subsystems and accessories	186,473	49.9 %	161,825	58.2 %	534,496	51.4 %	491,053	58.4 %		
Total	\$373,755	100.0 %	\$278,034	100.0 %	\$1,039,133	100.0 %	\$840,228	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 and nine months ended March 31, 2014 and 2013. No customer accounted for 10% or more of accounts receivable as of March 31, 2014. One customer accounted for 14.4% of the Company's accounts receivable as of June 30, 2013.

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

This section and other parts of this Form 10-Q contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended that involve risks and uncertainties. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology including “would,” “could,” “may,” “will,” “should,” “expect,” “intend,” “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 green computing innovation. We develop and provide advanced server Building Block Solutions to Data Center, Cloud Computing, Enterprise, Hadoop/Big Data, High Performance Computing, or HPC, and Embedded markets. Our solutions range from complete server, storage, blade, workstation and full rack solutions to networking devices and server management software, which can be used by distributors, original equipment manufacturers, or OEMs, and end customers. Net sales of optimized servers were \$187.3 million and \$504.6 million for the three and nine months ended March 31, 2014, respectively, and \$116.2 million and \$349.2 million for the three and nine months ended March 31, 2013, respectively. Net sales of subsystems and accessories were \$186.5 million and \$534.5 million for the three and nine months ended March 31, 2014, respectively, and \$161.8 million and \$491.1 million for the three and nine months ended March 31, 2013, respectively. The increase in our net sales in the three and nine months ended March 31, 2014 compared with the three and nine months ended March 31, 2013 was primarily due to increased sales of complete integrated-high-end server systems particularly to our internet data center customers. We are also benefited from the technology transition from Intel's Sandybridge to Ivybridge processor as well as new product offerings of FatTwin, Storage and GPU/Xeon Phi based solutions. The strength of our innovative and broad product lines and the beginning of a technology refresh cycle resulted in a sequential growth in sales notwithstanding what has traditionally been a seasonally weak quarter for the industry. On a geographical basis, we had strong growth in the United States in the three months ended March 31, 2014 as we benefited from the expansion of the cloud and internet data center customers.

We commenced operations in 1993 and have been profitable every year since inception. Our net sales were \$373.8 million and \$1,039.1 million for the three and nine months ended March 31, 2014, respectively, and \$278.0 million and \$840.2 million for the three and nine months ended March 31, 2013, respectively. Our net income was \$16.6 million and \$37.6 million for the three and nine months ended March 31, 2014, respectively, and \$7.0 million and \$12.9 million for the three and nine months ended March 31, 2013, respectively. Our increase in net income in the three and nine months ended March 31, 2014 compared to the three and nine months ended March 31, 2013 was primarily attributable to an increase in our gross profit resulting primarily from higher sales of server systems partially offset by higher research and development expenses.

We sell our server systems and subsystems and accessories primarily through distributors and to a lesser extent to OEMs as well as through our direct sales force. We derived 51.9% and 55.1% of our net sales from products sold to distributors and derived 48.1% and 44.9% from sales to OEMs and to end customers for the three and nine months ended March 31, 2014, respectively, and 58.8% and 56.2% of our net sales from products sold to distributors, and 41.2% and 43.8% from sales to OEMs and to end customers for the three and nine months ended March 31, 2013,

respectively. None of our customers accounted for 10% or more of our net sales in the three and nine months ended March 31, 2014 and 2013. We derived 54.5% and 53.7% of our net sales from customers in the United States for the three and nine months ended March 31, 2014, respectively, and 56.6% and 53.4% for the three and nine months ended March 31, 2013, respectively. We derived 45.5% and 46.3% of our net sales from customers outside the United States for the three and nine months ended March 31, 2014, respectively, and 43.4% and 46.6% for the three and nine months ended March 31, 2013, respectively.

We perform the majority of our research and development efforts in-house. Research and development expenses represented 5.5% and 5.9% of our net sales for the three and nine months ended March 31, 2014, respectively, and 6.7% and 6.6% for the three and nine months ended March 31, 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 2014, we have continued to invest in expanding our operations both in San Jose, California and our subsidiaries in Taiwan and the Netherlands in order to support our growth. We have increased manufacturing and service operations in Taiwan

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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 and nine months ended March 31, 2014, our purchases from Ablecom represented 14.4% and 16.5%, respectively, compared to 18.8% and 18.3% of our cost of sales for the three and nine months ended March 31, 2013, 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 product costs. 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 third quarter of fiscal year 2014:

Net cash provided by (used in) operating activities was \$(5.9) million and \$12.5 million during the three and nine months ended March 31, 2014, respectively, and \$8.0 million and \$13.6 million during the three and nine months ended March 31, 2013, respectively. Our cash and cash equivalents, together with our investments, were \$104.4 million at the end of the third quarter of fiscal year 2014, compared with \$95.7 million at the end of fiscal year 2013. The increase in our cash, cash equivalents and investments at the end of the third quarter of fiscal year 2014 was primarily due to \$19.2 million of proceeds from exercise of stock options, \$12.5 million of cash generated from operating activities and \$11.7 million of proceeds from debt, net of repayment, partially offset by \$36.8 million of purchases of property and equipment.

Days sales outstanding in accounts receivables ("DSO") at the end of the third quarter of fiscal year 2014 was 41 days, compared with 38 days at the end of the fourth quarter of fiscal year 2013. The increase in DSO was primarily due to an increase in sales late in the quarter.

Our inventory balance was \$295.1 million at the end of the third quarter of fiscal year 2014, compared with \$254.2 million at the end of fiscal year 2013. Days sales of inventory ("DSI") at the end of the third quarter of fiscal year 2014 was 83 days, compared with 84 days at the end of the fourth quarter of fiscal year 2013. The increase in our inventory

was to support our revenue growth in fiscal year 2014.

Our purchase commitments with contract manufacturers and suppliers were \$271.2 million at the end of the third quarter of fiscal year 2014 and \$249.0 million at the end of fiscal year 2013. Included in the above non-cancellable commitments are hard disk drive purchase commitments totaling approximately \$72.4 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 2014, for example, refer to the fiscal year ending June 30, 2014.

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Revenues and Expenses

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

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

#### Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. We evaluate our estimates on an on-going basis, including those related to allowances for doubtful accounts and sales returns, cooperative marketing accruals, investment valuations, inventory valuations, income taxes, warranty obligations and stock-based compensation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making the



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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 March 31, 2014 and June 30, 2013, we had deferred revenue of \$0.5 million and \$1.0 million and related deferred product costs of \$0.5 million and \$0.7 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 concentrations, customer-credit-worthiness, current economic trends and changes in customer payment terms to evaluate the adequacy of the allowance for doubtful accounts. On a quarterly basis, we evaluate aged items in the accounts receivable aging report and provide an allowance in an amount we deem adequate for doubtful accounts. Our provision for bad debt was \$0.3 million and \$1.4 million in the three and nine months ended March 31, 2014, respectively, and \$0.6 million and \$0.7 million in the three and nine months ended March 31, 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 charged to cost of sales and included in accrued liabilities. The liability for product warranties was \$6.9 million as of March 31, 2014, compared with \$6.5 million as of June 30, 2013. The provision for warranty reserve was \$3.5 million and \$10.5 million in the three and nine months ended March 31, 2014, respectively, and \$3.1 million and \$9.5 million in the three and nine months ended March 31, 2013, respectively. Our estimates and assumptions used have been historically close to actual. The change in estimated liability for pre-existing warranties was \$0.1 million and \$0.2 million in the three and nine months ended March 31, 2014, respectively, and (\$0.2) million and \$30,000 in the three and nine months ended March 31, 2013, respectively. As a result of our increase in cost of servicing warranty claims from our increase in net sales in the three and nine months ended March 31, 2014, the provision for warranty reserve increased \$0.5 million and \$0.9 million compared to the three and

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nine months ended March 31, 2013, respectively. If in future periods, we experience or anticipate an increase or decrease in warranty claims as a result of new product introductions or change in unit volumes compared with our historical experience, or if the cost of servicing warranty claims is greater or lesser than expected, we intend to adjust our estimates appropriately.

**Inventory valuation.** Inventory is valued at the lower of cost or market. We evaluate inventory on a quarterly basis for lower of cost or market and excess and obsolescence and, as necessary, write down the valuation of units to lower of cost or market or for excess and obsolescence based upon the number of units that are unlikely to be sold based upon estimated demand for the following twelve months. This evaluation takes into account matters including expected demand, anticipated sales price, product obsolescence and other factors. If actual future demand for our products is less than currently forecasted, additional inventory adjustments may be required. Once a reserve is established, it is maintained until the product to which it relates is sold or scrapped. If a unit that has been written down is subsequently sold, the cost associated with the revenue from this unit is reduced to the extent of the write down, resulting in an increase in gross profit. We monitor the extent to which previously written down inventory is sold at amounts greater or less than carrying value, and based on this analysis, adjust our estimate for determining future write downs. If in future periods, we experience or anticipate a change in recovery rate compared with our historical experience, our gross margin would be affected. Our provision for inventory was \$0.9 million and \$2.4 million in the three and nine months ended March 31, 2014, respectively, and \$2.4 million and \$8.7 million in the three and nine months ended March 31, 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 \$2.8 million and \$8.2 million for the three and nine months ended March 31, 2014, respectively, and \$2.9 million and \$8.7 million for the three and nine months ended March 31, 2013, respectively.

As of March 31, 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 \$18.6 million, which is expected to be recognized as an expense over a weighted-average period of approximately

2.38 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.

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

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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 March 31, 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 and nine months ended March 31, 2014, \$6,000 and \$(7,000), respectively, 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. In the three and nine months ended March 31, 2013, \$7,000 of net income attributable to Ablecom's interest was included in the Company's general and administrative expenses in the condensed consolidated statements of operations.

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## Results of Operations

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

	Three Months Ended March 31,		Nine Months Ended March 31,		
	2014	2013	2014	2013	
Net sales	100.0	% 100.0	% 100.0	% 100.0	%
Cost of sales	84.7	86.0	84.7	86.4	
Gross profit	15.3	14.0	15.3	13.6	
Operating expenses:					
Research and development	5.5	6.7	5.9	6.6	
Sales and marketing	2.5	3.1	2.6	3.0	
General and administrative	1.6	2.2	1.6	2.2	
Total operating expenses	9.6	12.0	10.1	11.8	
Income from operations	5.7	2.0	5.2	1.8	
Interest and other income, net	—	—	—	—	
Interest expense	—	(0.1	) (0.1	) (0.1	)
Income before income tax provision	5.7	1.9	5.1	1.7	
Income tax provision	1.3	(0.6	) 1.5	0.2	
Net income	4.4	% 2.5	% 3.6	% 1.5	%

## Comparison of Three Months Ended March 31, 2014 and 2013

Net sales. Net sales increased by \$95.7 million, or 34.4%, to \$373.8 million from \$278.0 million, for the three months ended March 31, 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 and subsystems and accessories as we sold more higher density server systems on a processing compute basis.

For the three months ended March 31, 2014, the number of server system units sold increased 33.3% to 72,000 compared to 54,000 for the three months ended March 31, 2013. The average selling price of server system units increased 23.8% to \$2,600 in the three months ended March 31, 2014 compared to \$2,100 in the three months ended March 31, 2013. The average selling prices of our server systems increased primarily due to higher average selling prices of complete integrated-high-end server solutions particularly to internet data center customers, the Twin family of servers, especially the FatTwin, storage and GPU/Xeon Phi servers which offered higher density computing and more CPU, memory and hard disk drive capacity. Sales of server systems increased by \$71.1 million or 61.2% from the three months ended March 31, 2013 to the three months ended March 31, 2014, primarily due to the increased sales of the products described above. In addition, our new server products based on Intel's Ivy Bridge processor, which was launched in September 2013, also contributed to our growth in server systems sales in the three months ended March 31, 2014. Sales of server systems represented 50.1% of our net sales for the three months ended March 31, 2014 compared to 41.8% of our net sales for the three months ended March 31, 2013.

For the three months ended March 31, 2014, the number of subsystems and accessories units sold increased 0.5% to 1,116,000 compared to 1,111,000 for the three months ended March 31, 2013. Sales of subsystems and accessories increased by \$24.6 million or 15.2% from the three months ended March 31, 2013 to the three months ended March 31, 2014, primarily related to higher sales of hard disk drives and memory bundled with our server solutions to our distributors and system integrators who purchased additional accessories from us prior to completing the final assembly themselves. Sales of subsystems and accessories represented 49.9% of our net sales for the three months ended March 31, 2014 as compared to 58.2% of our net sales for the three months ended March 31, 2013.

For the three months ended March 31, 2014 and 2013, we derived 51.9% and 58.8%, respectively, of our net sales from products sold to distributors and we derived 48.1% and 41.2%, respectively, from sales to OEMs and to end customers. For the three months ended March 31, 2014, customers in the United States, Europe and Asia accounted for 54.5%, 21.7% and 21.0% of our net sales, respectively, as compared to 56.6%, 22.0% and 19.0%, respectively, for the three months ended March 31, 2013.

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Cost of sales. Cost of sales increased by \$77.4 million, or 32.3%, to \$316.5 million from \$239.1 million, for the three months ended March 31, 2014 and 2013, respectively. Cost of sales as a percentage of net sales was 84.7% and 86.0% for the three months ended March 31, 2014 and 2013, respectively. The increase in absolute dollars of cost of sales was primarily attributable to the increase in net sales partially offset by a decrease of \$1.5 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, a lower provision for inventory reserve, an increase in the mix of server system sales and higher utilization of our manufacturing facilities in Taiwan, offset by higher sales to internet data center customers, which generally have a lower gross margin. In the three months ended March 31, 2014, we recorded a \$0.9 million expense or 0.2% of net sales related to the inventory provision as compared to \$2.4 million, or 0.9% of net sales, in the three months ended March 31, 2013. The decrease in the inventory provision was primarily due to lower inventory reserves for special items as we have improved our processes and reduced our excess and slow moving inventory. In the three months ended March 31, 2014, we recorded a \$3.5 million expense, or 0.9% of net sales, related to the provision for warranty reserve as compared to \$3.1 million, or 1.1% of net sales, in the three months ended March 31, 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 March 31, 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 \$2.0 million, or 10.6%, to \$20.6 million from \$18.6 million, for the three months ended March 31, 2014 and 2013, respectively. Research and development expenses were 5.5% and 6.7% of net sales for the three months ended March 31, 2014 and 2013, respectively. The increase in absolute dollars was primarily due to an increase of \$2.4 million in compensation and benefits resulting from an annual salary increase and growth in research and development personnel related to expanded product development initiatives in the United States and in Taiwan. This increase was partially offset by an increase of \$0.9 million in non-recurring engineering funding from certain suppliers and customers. The decrease as a percentage of net sales was primarily due to the significant increase in net sales during the period.

Research and development expenses include stock-based compensation expense of \$1.7 million for both three months ended March 31, 2014 and 2013.

Sales and marketing expenses. Sales and marketing expenses increased by \$0.7 million, or 8.1%, to \$9.4 million from \$8.7 million, for the three months ended March 31, 2014 and 2013, respectively. Sales and marketing expenses were 2.5% and 3.1% of net sales for the three months ended March 31, 2014 and 2013, respectively. The increase in absolute dollars was primarily due to an increase of \$0.4 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 significant increase in net sales during the period.

Sales and marketing expenses include stock-based compensation expense of \$0.3 million and \$0.4 million for the three months ended March 31, 2014 and 2013, respectively.

General and administrative expenses. General and administrative expenses decreased by \$0.3 million, or 5.3%, to \$5.8 million from \$6.1 million, for the three months ended March 31, 2014 and 2013, respectively. General and administrative expenses were 1.6% and 2.2% of net sales for the three months ended March 31, 2014 and 2013, respectively. The decrease in absolute dollars was primarily due to a decrease of \$0.3 million in bad debt expense. The decrease as a percentage of net sales was primarily due to the significant increase in net sales during the period.

General and administrative expenses include stock-based compensation expense of \$0.5 million and \$0.6 million for three months ended March 31, 2014 and 2013, respectively.



Interest and other expense, net. Interest and other expense, net was \$0.1 million for both three months ended March 31, 2014 and 2013, which included \$0.2 million and \$0.1 million of interest expense for both three months ended March 31, 2014 and 2013, respectively.

Provision for (benefit from) income taxes. Provision for income taxes increased by \$6.5 million, or 373.1%, to \$4.8 million from \$(1.7) million, for the three months ended March 31, 2014 and 2013, respectively. The effective tax rate was 22.3% and (32.8)% for the three months ended March 31, 2014 and 2013, respectively. The higher income tax provision and effective tax rate for the three months ended March 31, 2014 were primarily attributable to our higher operating income and the expiration of the U.S. federal research and development credit on December 31, 2013. The higher income tax benefit and lower effective tax rate for the three months ended March 31, 2013 were primarily attributable to our lower operating income, a tax benefit of \$2.9 million related to the reinstatement of the U.S. federal research and development tax credit, of which \$2.3

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million related to calendar year 2012, and the recognition of \$2.0 million related to our resolution of IRS audits for all outstanding items covering fiscal year 2008 through 2010.

Comparison of Nine Months Ended March 31, 2014 and 2013

Net sales. Net sales increased by \$198.9 million, or 23.7%, to \$1,039.1 million from \$840.2 million, for the nine months ended March 31, 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 subsystems and accessories and server systems as we sold more higher density server systems on a processing compute basis.

For the nine months ended March 31, 2014, the number of server system units sold increased 12.4% to 190,000 compared to 169,000 for the nine months ended March 31, 2013. The average selling price of server system units increased 28.6% to \$2,700 in the nine months ended March 31, 2014 compared to \$2,100 in the nine months ended March 31, 2013. The average selling prices of our server systems increased primarily due to higher average selling prices of our complete integrated-high-end servers solutions to OEM and end customers, 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 \$155.5 million or 44.5% from the nine months ended March 31, 2013 to the nine months ended March 31, 2014, primarily due to the increased sales of the products described above. In addition, our new server products based on Intel's Ivy Bridge processor, which was launched in September 2013, also contributed to our growth in server system sales in the nine months ended March 31, 2014. Sales of server systems represented 48.6% of our net sales for the nine months ended March 31, 2014, compared to 41.6% of our net sales for the nine months ended March 31, 2013.

For the nine months ended March 31, 2014, the number of subsystems and accessories units sold increased 3.4% to 3,345,000 compared to 3,234,000 for the nine months ended March 31, 2013. Sales of subsystems and accessories increased by \$43.4 million or 8.8% from the nine months ended March 31, 2013 to the nine months ended March 31, 2014, primarily related to higher sales of hard disk drives and memory bundled with our server solutions to our distributors and system integrators who purchased additional accessories from us prior to completing the final assembly themselves. Sales of subsystems and accessories represented 51.4% of our net sales for the nine months ended March 31, 2014 as compared to 58.4% of our net sales for the nine months ended March 31, 2013.

For the nine months ended March 31, 2014 and 2013, we derived 55.1% and 56.2% of our net sales from products sold to distributors, respectively, and we derived 44.9% and 43.8%, respectively, from sales to OEMs and to end customers. For the nine months ended March 31, 2014, customers in the United States, Europe and Asia accounted for 53.7%, 22.8% and 20.7% of our net sales, respectively, as compared to 53.4%, 22.8% and 21.2%, respectively, for the nine months ended March 31, 2013.

Cost of sales. Cost of sales increased by \$153.8 million, or 21.2%, to \$880.0 million from \$726.2 million, for the nine months ended March 31, 2014 and 2013, respectively. Cost of sales as a percentage of net sales was 84.7% and 86.4% for the nine months ended March 31, 2014 and 2013, respectively. The increase in absolute dollars of cost of sales was primarily attributable to the increase in net sales partially offset by a decrease of \$6.3 million in provision for inventory reserve. The lower cost of sales as a percentage of net sales was primarily due to a lower provision for inventory reserve, an increase in purchasing power, an increase in the mix of server system sales and higher utilization of our manufacturing facilities in Taiwan, offset by higher sales to internet data center customers, which generally have a lower gross margin. In the nine months ended March 31, 2014, we recorded a \$2.4 million expense, or 0.2% of net sales, related to the inventory provision as compared to \$8.7 million, or 1.0% of net sales, in the nine months ended March 31, 2013. The decrease in the inventory provision was primarily due to lower inventory reserves for special items and higher sales of previously reserved inventory as we have improved our processes and reduced our excess and slow moving inventory. In the nine months ended March 31, 2014, we recorded a \$10.5 million expense,

or 1.0% of net sales, related to the provision for warranty reserve as compared to \$9.5 million, or 1.1% of net sales, in the nine months ended March 31, 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 nine months ended March 31, 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 \$5.6 million, or 10.0%, to \$61.2 million from \$55.7 million, for the nine months ended March 31, 2014 and 2013, respectively. Research and development expenses were 5.9% and 6.6% of net sales for the nine months ended March 31, 2014 and 2013, respectively. The increase in absolute dollars was primarily due to an increase of \$5.3 million in compensation and benefits resulting from an annual salary increase and growth in research and development personnel related to expanded product development initiatives

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in the United States and in Taiwan and an increase of \$1.7 million in development expenses for prototype materials and testing associated with new product introductions, particularly related to the introduction of new products including servers based on Intel's Ivy Bridge processor, TwinPro, UltraTwin and MicroBlade series of servers. This increase was partially offset by an increase of \$1.0 million in non-recurring engineering funding from certain suppliers and customers. The decrease as a percentage of net sales was primarily due to the significant increase in net sales during the period.

Research and development expenses include stock-based compensation expense of \$5.0 million and \$4.9 million for the nine months ended March 31, 2014 and 2013, respectively.

Sales and marketing expenses. Sales and marketing expenses increased by \$1.8 million, or 7.2%, to \$27.3 million from \$25.4 million, for the nine months ended March 31, 2014 and 2013, respectively. Sales and marketing expenses were 2.6% and 3.0% of net sales for the nine months ended March 31, 2014 and 2013, respectively. The increase in absolute dollars was primarily due to an increase of \$1.3 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 significant increase in net sales during the period.

Sales and marketing expenses include stock-based compensation expense of \$0.9 million and \$1.2 million for the nine months ended March 31, 2014 and 2013, respectively.

General and administrative expenses. General and administrative expenses decreased by \$1.3 million, or 7.1%, to \$16.9 million from \$18.2 million, for the nine months ended March 31, 2014 and 2013, respectively. General and administrative expenses were 1.6% and 2.2% of net sales for the nine months ended March 31, 2014 and 2013, respectively. The decrease in absolute dollars was primarily due to an increase of \$0.7 million in miscellaneous income relating to the settlement of our outstanding accounts payable with one vendor, a decrease of \$0.6 million resulting from payroll tax audit assessment in fiscal year 2013 and a decrease of \$0.6 million in audit/tax and other professional service fees, offset in part by an increase of \$0.7 million in bad debt expenses. The decrease as a percentage of net sales was primarily due to the significant increase in net sales during the period.

General and administrative expenses include stock-based compensation expense of \$1.5 million and \$1.9 million for the nine months ended March 31, 2014 and 2013, respectively.

Interest and other expense, net. Interest and other expense, net was \$0.5 million and \$0.4 million for the nine months ended March 31, 2014 and 2013, respectively, which included \$0.5 million and \$0.4 million of interest expense for the nine months ended March 31, 2014 and 2013, respectively.

Provision for income taxes. Provision for income taxes increased by \$14.2 million, to \$15.6 million from \$1.5 million, for the nine months ended March 31, 2014 and 2013, respectively. The effective tax rate was 29.4% and 10.2% for the nine months ended March 31, 2014 and 2013, respectively. The higher of provision for income taxes and effective tax rate for the nine months ended March 31, 2014 were primarily attributable to our higher operating income and the expiration of the U.S. federal research and development tax credit on December 31, 2013. The lower of provision for income taxes and effective tax rate for the nine months ended March 31, 2013 were primarily attributable to our lower operating income, a tax benefit of \$2.9 million related to the reinstatement of the U.S. federal research and development tax credit, of which \$2.3 million related to calendar year 2012, and the recognition of \$2.0 million related to our resolution of IRS audits for all outstanding items covering fiscal year 2008 through 2010.

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 \$101.8 million and \$93.1 million as of March 31, 2014 and June 30, 2013, respectively. Our cash in foreign locations was \$28.9 million and \$16.6 million at March 31, 2014 and June 30, 2013, 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 \$12.5 million and \$13.6 million for the nine months ended March 31, 2014 and 2013, respectively.

Net cash provided by our operating activities for the nine months ended March 31, 2014 was primarily due to our net income of \$37.6 million, an increase in accounts payable of \$32.5 million, an increase in net income tax payable of \$9.9 million, stock-based compensation expense of \$8.2 million and depreciation expense of \$4.6 million, which were partially offset by an increase in inventory of \$43.3 million and an increase in accounts receivable of \$34.1 million.

Net cash provided by our operating activities for the nine months ended March 31, 2013 was primarily due to our net income of \$12.9 million, a decrease in inventory of \$10.5 million, provision for inventory of \$8.7 million, stock-based compensation expense of \$8.7 million, depreciation expense of \$5.9 million, an increase in accrued liabilities of \$3.3 million and an increase in net income taxes payable of \$1.9 million, which were partially offset by an increase in accounts receivable of \$21.0 million, a decrease in accounts payable of \$9.6 million, an increase in deferred income taxes of \$6.2 million and excess tax benefits from stock-based compensation of \$0.8 million.

The increase for the nine months ended March 31, 2014 in accounts receivable was primarily due to an increase in our sales late in the third quarter. The increase for the nine months ended March 31, 2014 in accounts payable was due to higher purchases and timing of payments to our vendors. The increase for the nine months ended March 31, 2014 in inventory was due to support the anticipated level of growth in net sales in fiscal year 2014. 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 increase for the nine months ended March 31, 2013 in accounts receivable was primarily due to an increase in sales late in the third quarter and an increase in sales with longer payment term. The decrease for the nine months ended March 31, 2013 in accounts payable was due to timing of payments to our vendors. The decrease for the nine months ended March 31, 2013 in inventory was in part due to increased sales in hard disk drives and memory as we have aggressively promoted hard disk drives and memory bundling with server solutions.

Investing activities. Net cash used in our investing activities was \$36.4 million and \$4.5 million for the nine months ended March 31, 2014 and 2013, respectively. In the nine months ended March 31, 2014, \$36.8 million was related to the purchase of property, plant and equipment including \$30.2 million related to the real property purchased in San Jose, California in October 2013, offset in part by the termination of the certificates of deposits for \$0.4 million, which were pledged as security for value added tax examination required by tax authority of Taiwan. In the nine months ended March 31, 2013, \$4.3 million was related to the purchase of property, plant and equipment and \$0.4 million was related to certificates of deposits pledged as security for value added tax examination required by tax authority of Taiwan, offset in part by the redemption at par of investments in auction rate securities of \$0.3 million.

Financing activities. Net cash provided by our financing activities was \$32.9 million and \$4.1 million for the nine months ended March 31, 2014 and 2013, respectively. In the nine months ended March 31, 2014, we received \$19.2 million

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related to proceeds from the exercise of stock options. We withheld shares and paid the minimum tax withholding mainly on behalf of one executive officer for his restricted stock awards of \$0.7 million for the nine months ended March 31, 2014. Further, we borrowed an additional \$6.8 million under the line of credit from Bank of America, borrowed \$7.1 million from the CTBC Bank secured term loan, and borrowed \$3.5 million of our CTBC Bank revolving line of credit and repaid \$5.6 million in loans in the nine months ended March 31, 2014. In the nine months ended March 31, 2014, excess tax benefits from stock-based compensation were \$2.7 million.

In the nine months ended March 31, 2013, we received \$1.4 million of 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 \$1.0 million for the nine months ended March 31, 2013. Further, we borrowed \$15.0 million under a new term loan from China Trust Bank, borrowed \$5.6 million of our revolving line of credit from Bank of America and repaid \$17.4 million in loans in the nine months ended March 31, 2013. In the nine months ended March 31, 2013, excess tax benefits from stock-based compensation were \$0.8 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.

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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 August 15, 2014.

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 0.15% at March 31, 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.

As of March 31, 2014 and June 30, 2013, the total outstanding borrowings under the Bank of America term loan was \$7.2 million and \$9.3 million, respectively. The total outstanding borrowings under the Bank of America line of credit was \$17.7 million as of March 31, 2014 and \$10.9 million as of June 30, 2013. The interest rates for these loans ranged from 1.19% to 1.65% per annum at March 31, 2014 and ranged from 1.23% to 1.69% per annum at June 30, 2013, respectively. As of March 31, 2014, the unused revolving line of credit under Bank of America was \$22.3 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. dollar equivalents. In July 2012, we increased the credit line to a NT\$450.0 million, or \$14.9 million U.S. dollar 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 \$21.6 million and \$14.9 million at March 31, 2014 and June 30, 2013, respectively. There were no outstanding borrowings under the CTBC Bank revolving line of credit at March 31, 2014 and June 30, 2013. The interest rate for the loan was at 1.13% per annum at March 31, 2014 and was at 1.20% per annum at June 30, 2013. At March 31, 2014, NT\$340.0 million or \$11.1 million U.S. dollar equivalents were available for future borrowing under this credit agreement.

Covenant Compliance

The credit agreement with Bank of America contains customary representations and warranties and customary affirmative and negative covenants applicable to us and our 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;
- Our 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;



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Our unencumbered liquid assets, as defined in the agreement, held in the United States shall have an

- aggregate market value of not less than \$30.0 million, measured as of the last day of each fiscal quarter and the last day of each fiscal year.

As of March 31, 2014 and June 30, 2013, our total assets of \$705.5 million and \$586.7 million, respectively, collateralized the line of credit with Bank of America and were all of our assets except for the three buildings located in San Jose, California and the land and building located in Bade, Taiwan. As of March 31, 2014 and June 30, 2013, total assets collateralizing the term loan with Bank of America were \$17.6 million and \$17.8 million, respectively. As of March 31, 2014, we were in compliance with all financial covenants associated with the term loan and line of credit with Bank of America.

As of March 31, 2014 and June 30, 2013, the net book value of land and building located in Bade, Taiwan collateralizing the term loan with CTBC Bank was \$27.4 million and \$27.7 million, respectively. There are no financial covenants associated with the term loan with CTBC Bank at March 31, 2014.

**Contract Manufacturers**

For the three and nine months ended March 31, 2014, we paid our contract manufacturers within 61 to 75 days of invoice and Ablecom between 50 to 96 days of invoice. Ablecom, a Taiwan corporation, is one of our major contract manufacturers and a related party. As of March 31, 2014 and June 30, 2013 amounts owed to Ablecom by us were approximately \$42.2 million and \$50.4 million, respectively.

**Auction Rate Securities Valuation**

As of March 31, 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 March 31, 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 March 31, 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 March 31, 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 and nine months ended March 31, 2014, there were no auction rate securities redeemed or sold. During the three and nine months ended March 31, 2013, \$0 and \$0.3 million of the auction rate securities were redeemed at par, respectively.

**Contractual Obligations**

The following table describes our contractual obligations as of March 31, 2014:

	Payments Due by Period				Total
	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years	
	(in thousands)				
Operating leases	\$3,474	\$1,947	\$—	\$—	\$5,421
Capital leases, including interest	69	129	99	—	297
Short-term and Long-term debt, including interest (1)	42,237	4,499	—	—	46,736
License arrangements	600	—	—	—	600
Purchase commitments (2)	271,106	103	—	—	271,209
Total	\$317,486	\$6,678	\$99	\$—	\$324,263

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(1) Amount reflects total anticipated cash payments, including anticipated interest payments based on the interest rate at March 31, 2014.

(2) Amount reflects total gross purchase commitments under our manufacturing arrangements with third-party contract manufacturers or vendors. Our purchase obligations included \$72.4 million of hard disk drive purchase commitments at March 31, 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.

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The table above excludes liabilities for deferred revenue for warranty and on-site services of \$4.1 million and unrecognized tax benefits and related interest and penalties accrual of \$8.7 million as of March 31, 2014. 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 February 2013, FASB issued authoritative guidance associated with reporting of amounts reclassified out of accumulated other comprehensive income, which requires companies to present significant reclassifications out of accumulated other comprehensive income in their entirety in the statement of operations or in a separate footnote to the financial statements. For amounts that are not required to be reclassified in their entirety to net income, the standard requires companies to cross-reference to related footnoted disclosures. The new disclosure requirements are effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those years, beginning after December 15, 2012 and early adoption is permitted. The adoption of this guidance did not have a material impact on our financial statement disclosure, results of operations or financial position.

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. This new accounting pronouncement is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those years, beginning after December 15, 2013. We are currently reviewing the provisions but do not expect it to have a material impact on our financial statement disclosures, 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. We currently plan to adopt the new disclosure requirement on July 1, 2014. We do not believe the adoption of this guidance will have a material impact on our financial statement disclosure, 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 Risks

### Interest Rate Risk

The primary objectives of our investment activities are to preserve principal, provide liquidity and maximize income without significantly increasing the risk. Some of the securities we invest in are subject to market risk. This means that a change in prevailing interest rates may cause the fair value of the investment to fluctuate. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in money market funds and certificates of

deposit. Our long-term investments include auction rate securities, which have been classified as long-term due to the lack of a liquid market for these securities. Since our results of operations are not dependent on investments, the risk associated with fluctuating interest rates is limited to our investment portfolio, and we believe that a 10% change in interest rates would not have a significant impact on our results of operations. As of March 31, 2014, our investments were in money market funds, certificates of deposits and auction rate securities (see Liquidity Risk below).

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 1.13% to 1.65% at March 31, 2014 and 1.20% to 1.69% at June 30, 2013, respectively. Based on the outstanding principal indebtedness of \$46.6 million under our credit facilities as of March 31, 2014, we believe that a 10% change in interest rates would not have a significant impact on our results of operations.

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Liquidity Risk

As of March 31, 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 March 31, 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 March 31, 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 March 31, 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 and nine months ended March 31, 2014 and three months ended March 31, 2013, there were no auction rate securities redeemed or sold. During the nine months ended March 31, 2013, \$0.3 million of auction rate securities were redeemed at par, respectively.

Although we have determined that we will not likely be required to sell the securities before the anticipated recovery and we have the intent and ability to hold our investments until successful auctions occur, these investments are not currently liquid and in the event we need to access these funds, we will not be able to do so without a loss of principal. There can be no assurances that these investments will be settled in the short term or that they will not become other-than-temporarily impaired subsequent to March 31, 2014, as the market for these investments is presently uncertain. In any event, we do not have a present need to access these funds for operational purposes. We will continue to monitor and evaluate these investments as there is no assurance as to when the market for these investments will allow us to liquidate them. We may be required to record impairment charges in periods subsequent to March 31, 2014 with 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 for both three and nine months ended March 31, 2014 was \$0.1 million, and \$0.2 million for both three and nine months ended March 31, 2013.

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 March 31, 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 March 31, 2014 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings

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 condensed 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, 2013 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:

- 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 customers;
- 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.

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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 and in particularly during the last two fiscal years, 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 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.

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 \$72.4 million as of March 31, 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. This 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.

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

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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 and nine months ended March 31, 2014, we recorded inventory write-downs charged to cost of sales of \$0.9 million and \$2.4 million, respectively, for lower of cost or market and excess and obsolete inventory and \$2.4 million and \$8.7 million during the three and nine months ended March 31, 2013, respectively. For additional information regarding customer return rights, see "Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies-Revenue Recognition."

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.

We may encounter difficulties with our ERP Systems.

We have been in the process of planning for the implementation of a new enterprise resource planning, or ERP, System. We have incurred and expect to continue to incur additional expenses to prepare for the implementation and when we commence the 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.

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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, particularly for datacenter customers. If we are unable to maintain the margins on our server solutions, our operating results could be negatively impacted. In addition, if we do not develop new innovative server solutions, or enhance the reliability, performance, efficiency and other features of our existing server solutions, our customers may turn to our competitors for alternatives. In addition, pricing pressures and increased competition generally may also result in reduced sales, lower margins or the failure of our products to achieve or maintain widespread market acceptance, any of which could have a material adverse effect on our business, results of operations and financial condition.

Our principal competitors include global technology companies such as Dell, Inc., Hewlett-Packard Company, 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 there has been substantial speculation regarding the future plans of Hewlett-Packard, Dell and IBM. A substantial change by either with respect to their strategy in the server market 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.

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

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

Additionally, as we and our distribution partners focus increasingly on selling to larger customers and attracting larger orders, we expect greater costs of sales. Our sales cycle may become longer and more expensive, as larger customers typically spend more time negotiating contracts than smaller customers. 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.

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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 stock price.

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

We rely on our close working relationships with our suppliers, including Intel, 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 and if the economy does not improve, we expect that we may be exposed to greater customer credit risks.

Historically, we have offered limited credit terms to our customers. As our customer base expands, as our orders increase in size, and as we obtain more direct customers, we expect to offer increased credit terms and flexible payment programs to our customers. Doing so may subject us to increased credit risk, higher accounts receivable with longer days outstanding, and increases in charges or reserves, which could have a material adverse effect on our business, results of operations and financial condition. Likewise, if there is no sustained economic recovery, we could be exposed to greater credit risk.

Economic conditions could materially adversely affect us.

Our operations and performance depend significantly on worldwide economic conditions. Uncertainty about current global economic conditions poses a risk as consumers and businesses may continue to postpone spending in response to tighter credit, unemployment, negative financial news and/or declines in income or asset values, which could have a material negative effect on demand for our products and services.

In addition, economic uncertainty concerns over the sovereign debt situation in certain countries in the European Union, as well as continued turmoil in the geopolitical environment in many parts of the world, have, and may continue to, put pressure on global economic conditions, which has led, and could continue to lead, to reduced demand for our products, to delays or reductions in IT expansions or infrastructure projects, and/or higher costs of production. Economic weakness may also lead to longer collection cycles for payments due from our customers, an increase in customer bad debt, restructuring initiatives and associated expenses, and impairment of investments. Furthermore, continued weakness and the sovereign debt situation in certain countries in the European Union, may adversely impact the ability of our customers to adequately fund their expected capital expenditures, which could lead to delays or cancellations of planned purchases of our products or services. In addition, our operating expenses are largely based on anticipated revenue trends and a high percentage of our expenses is, and will continue to be, fixed in the short and medium term.

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Uncertainty about future economic conditions also makes it difficult to forecast operating results and to make decisions about future investments. Future or continued economic weakness, failure of our customers and markets to recover from such weakness, customer financial difficulties, increases in costs of production, and reductions in spending on IT maintenance and expansion could have a material adverse effect on demand for our products and consequently on our business, financial condition, and results of operations. Uncertainty about current global economic conditions could also continue to increase the volatility of our stock price.

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

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

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

Historically, a majority of our revenues have resulted from sales of our products through third party distributors and resellers, which sales accounted for 51.9% and 55.1% of our net sales in the three and nine months ended March 31, 2014, respectively, and 58.8% and 56.2% in the three and nine months ended March 31, 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.



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

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

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distributors may exceed or fall below the levels we consider desirable on a going-forward basis. This could adversely affect our distributors or our ability to efficiently manage or invest in internal resources, such as manufacturing and shipping capacity, to meet the demand for our products.

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

We expect that our direct sales force will 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 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.

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

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

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

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

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

As with most electronics based products, average selling prices of servers typically are highest at the time of introduction of new products, which utilize the latest technology, and tend to decrease over time as such products become commoditized and are ultimately replaced by even newer generation products. As our business continues to

grow, we may increasingly be subject to this industry risk. We cannot predict the timing or amount of any decline in the average selling prices of our server solutions that we may experience in the future. In some instances, our agreements with our distributors limit our ability to reduce prices unless we make such price reductions available to them, or price protect their inventory. If we are unable to decrease per unit manufacturing costs faster than the rate at which average selling prices continue to decline, our business, financial condition and results of operations will be harmed.

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

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

Consequently, we are vulnerable to any disruptions in supply with respect to the materials and core components provided by limited-source suppliers, and we are at risk of being harmed by discontinuations of design, manufacturing, assembly or testing services from our contract manufacturers. We have occasionally experienced delivery delays from our suppliers and contract manufacturers because of high industry demand or because of inability to meet our quality or delivery requirements. For example, in the past we experienced delays in the delivery of printed circuit board material as a result of the loss of two of our five printed circuit board vendors which resulted in a reduction of net sales for the quarter in which it occurred. In addition, the 2011 floods in Thailand disrupted the global supply chain for hard disk drives manufactured in Thailand. Furthermore, if our relationships with our suppliers and contract manufactures are negatively impacted by late payments or other issues, we may not receive timely delivery of materials and core components.

If we were to lose any of our current supply or contract manufacturing relationships, the process of identifying and qualifying a new supplier or contract manufacturer who will meet our quality and delivery requirements, and who will appropriately safeguard our intellectual property, may require a significant investment of time and resources, adversely affecting our ability to satisfy customer purchase orders and delaying our ability to rapidly introduce new products to market. Similarly, if any of our suppliers were to cancel, 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.

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

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

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

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

materially and adversely affected.

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

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needed to be repaired. Though the vendor agreed to pay for a large percentage of the costs of the repairs, we incurred costs in connection with the recall and diverted resources from other projects.

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

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

We use Ablecom, a related party, for contract design and manufacturing coordination support. We work with Ablecom to optimize modular designs for our chassis and certain of other components. Our purchases from Ablecom represented 14.4% and 16.5% of our cost of sales for the three and nine months ended March 31, 2014, respectively, and 18.8% and 18.3% for the three and nine months ended March 31, 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.

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

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

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 and China. 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.

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

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

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

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

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

Our industry is marked by a large number of patents, copyrights, trade secrets and trademarks and by frequent litigation based on allegations of infringement or other violation of intellectual property rights. Third-parties have in the past sent us correspondence regarding their intellectual property 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

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administration departments, which have historically had limited budgets and staffing. If we are unable to attract and integrate additional key employees in a manner that enables us to scale our business and operations effectively, or if we do not maintain competitive compensation policies to retain our employees, our ability to operate effectively and efficiently could be limited.

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

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

Our business and operations are especially subject to the risks of earthquakes 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

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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 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.

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

As of April 28, 2014, our executive officers, directors, current five percent or greater stockholders and affiliated entities together beneficially owned 39.2% 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.

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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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

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Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 406T, these interactive data files are deemed not filed and otherwise are not subject to liability.

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Signatures

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

SUPER MICRO COMPUTER, INC.

Date: May 7, 2014

/S/ CHARLES LIANG

Charles Liang

President, Chief Executive Officer and Chairman of the Board  
(Principal Executive Officer)

Date: May 7, 2014

/S/ HOWARD HIDESHIMA

Howard Hideshima

Chief Financial Officer

(Principal Financial and Accounting Officer)