Super Micro Computer, Inc.
Form 10-Q
May 15, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2008

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from_____ to _____

Commission file number 001-33383

Super Micro Computer, Inc.

(Exact name of Registrant as specified in its charter)

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

980 Rock Avenue

San Jose, CA 95131

(Address of principal executive offices)

(408) 503-8000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant 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 x (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of May 9, 2008 there were 32,522,019 shares of the registrant s common stock, $0.001 par value, outstanding, which is the only class of common or voting stock of the registrant issued.

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FORM 10-Q

SUPER MICRO COMPUTER, INC.

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PART I: FINANCIAL INFORMATION

ITEM 1.

SUPER MICRO COMPUTER, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

	March 31, 2008	June 30, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 41,354	$ 50,864
Short-term investments	456	15,055
Accounts receivable, net of allowances of $1,003 and $770 at March 31, 2008 and June 30, 2007, respectively (including amounts receivable from a related party of $656 and $853 at March 31, 2008 and June 30, 2007, respectively)	42,141	33,426
Inventories, net	93,378	66,772
Deferred income taxes - current	7,954	5,630
Prepaid expenses and other current assets	2,014	1,759
Total current assets	187,297	173,506
Long-term investments	17,564	
Property, plant and equipment, net	45,564	31,089
Deferred income taxes-noncurrent	1,374	624
Restricted assets	1,727	57
Other assets	128	307
Total assets	$ 253,654	$ 205,583
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable (including amounts due to a related party of $35,197 and $26,094 at March 31, 2008 and June 30, 2007, respectively)	$ 79,756	$ 61,453
Accrued liabilities	14,295	14,074
Income tax payable		1,489
Advances from receivable financing arrangements	1,379	982
Current portion of capital lease obligations	48	118
Current portion of long-term debt	294	304
Total current liabilities	95,772	78,420
Long-term capital lease obligations-net of current portion	30	40
Long-term debt-net of current portion	10,080	11,251
Other long-term liabilities	4,384	
Total liabilities	110,266	89,711
Commitments and contingencies (Note 12)		

Stockholders equity:		
Common stock and additional paid-in capital, $0.001 par value Authorized shares: 100,000,000; Issued and outstanding shares: 32,294,651 and 30,205,264 at March 31, 2008 and June 30, 2007, respectively	67,918	58,239
Deferred stock-based compensation	(859)	(1,500)
Accumulated other comprehensive loss	(386)	
Retained earnings	76,715	59,133
Total stockholders equity	143,388	115,872
Total liabilities and stockholders equity	$ 253,654	$ 205,583

See accompanying notes to condensed consolidated financial statements.

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SUPER MICRO COMPUTER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share amounts)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Net sales (including related party sales of $1,235 and $1,432 in the three months ended March 31, 2008 and 2007, respectively, and $4,834 and $5,703 in the nine months ended March 31, 2008 and 2007, respectively)	$ 136,755	$ 105,659	$ 391,637	$ 309,448
Cost of sales (including related party purchases of $30,687 and $29,446 in the three months ended March 31, 2008 and 2007, respectively, and $83,551 and $69,438 in the nine months ended March 31, 2008 and 2007, respectively)	111,929	87,592	316,511	254,381
Gross profit	24,826	18,067	75,126	55,067
Operating expenses:				
Research and development	8,050	5,143	21,743	15,637
Sales and marketing	4,602	3,485	12,891	8,968
General and administrative	3,903	3,278	10,799	8,789
Reversal of litigation loss				(120)
Total operating expenses	16,555	11,906	45,433	33,274
Income from operations	8,271	6,161	29,693	21,793
Interest income	327	69	1,319	190
Interest expense	(248)	(369)	(748)	(1,040)
Income before income tax provision	8,350	5,861	30,264	20,943
Income tax provision	3,326	1,790	11,693	7,105
Net income	$ 5,024	$ 4,071	$ 18,571	$ 13,838
Net income per share:				
Basic	$ 0.16	$ 0.18	$ 0.60	$ 0.62
Diluted	$ 0.13	$ 0.13	$ 0.48	$ 0.43
Shares used in per share calculation:				
Basic	31,759,958	22,277,339	30,958,660	22,226,460
Diluted	38,961,284	32,434,182	38,780,837	32,373,284

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,	
	2008	**2007**
OPERATING ACTIVITIES:		
Net income	$ 18,571	$ 13,838
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	1,921	1,179
Stock-based compensation expense	2,849	1,673
Allowance for doubtful accounts	174	172
Allowance for sales returns	4,150	2,950
Provision for inventory	6,667	2,850
Loss on disposal of property, plant and equipment		2
Deferred income taxes	(2,824)	(98)
Changes in operating assets and liabilities:		
Accounts receivable, net (including changes in related party balances of $197 and $(459) during the nine months ended March 31, 2008 and 2007, respectively)	(13,039)	(13,647)
Inventories, net	(33,273)	(18,234)
Prepaid expenses and other current assets	(255)	(715)
Other assets	89	
Accounts payable (including increases in related party balances of $9,103 and $5,333 during the nine months ended March 31, 2008 and 2007, respectively)	17,080	14,177
Income tax payable	3,565	538
Accrued litigation loss		(575)
Accrued liabilities	241	5,457
Other long-term liabilities	3,395	
Net cash provided by operating activities	9,311	9,567
INVESTING ACTIVITIES:		
Proceeds from investments	18,824	53
Purchases of investments	(22,425)	
Purchases of property, plant and equipment	(15,056)	(2,642)
Restricted assets	(1,670)	(43)
Net cash used in investing activities	(20,327)	(2,632)
FINANCING ACTIVITIES:		
Repayment of long-term debt	(1,181)	(458)
Proceeds from exercise of stock options	2,417	1,157
Payment of obligations under capital leases	(107)	(137)
Advances under receivable financing arrangements	397	144
Payment of offering costs	(20)	(3,322)
Net cash provided by (used in) financing activities	1,506	(2,616)
Net increase (decrease) in cash and cash equivalents	(9,510)	4,319

Cash and cash equivalents at beginning of period	50,864	16,509
Cash and cash equivalents at end of period	$ 41,354	$ 20,828
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 748	$ 852
Cash paid for taxes	$ 7,685	$ 6,665
Non-cash investing and financing activities:		
Equipment purchased under capital leases	$ 27	$ 109
Reversal of deferred stock-based compensation for cancellation of stock options	$ 22	$ 133
Accrued costs for property, plant and equipment purchases	$ 1,223	$ 112
Accrued offering costs	$	$ 706
Changes in fair values of investments	$ (636)	$

See accompanying notes to condensed consolidated financial statements.

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SUPER MICRO COMPUTER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Organization

Super Micro Computer, Inc. was incorporated in California on September 28, 1993 and reincorporated in Delaware on March 19, 2007. Super Micro Computer develops and provides high performance server solutions based upon an innovative, modular and open-standard architecture. Super Micro Computer has wholly owned subsidiaries in the Netherlands and Taiwan.

Basis of Presentation

The unaudited condensed consolidated financial statements included herein have been prepared by Super Micro Computer, Inc. pursuant to the rules and regulations of the United States Securities and Exchange Commission (SEC) and include the accounts of Super Micro Computer, Inc. and its wholly-owned subsidiaries (collectively Super Micro or the Company). 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. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk, and the Consolidated Financial Statements and Notes thereto included in the Super Micro Annual Report on Form 10-K for the year ended June 30, 2007 (2007 Form 10-K) filed with the SEC.

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, 2008 and 2007 are not necessarily indicative of the results that may be expected for future quarters or for the year ending June 30, 2008.

Principles of Consolidation

The condensed consolidated financial statements reflect the operations of Super Micro and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

Reclassifications

Certain prior period amounts on the Condensed Consolidated Balance Sheet and Condensed Consolidated Statements of Cash Flows have been reclassified to conform to the current period presentation.

Note 2. Recently Issued Accounting Standards

EITF 07-3

In June 2007, the Financial Accounting Standards Board (FASB) issued Emerging Issues Task Force Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* (EITF No. 07-3). The EITF requires nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed. EITF No. 07-3 is effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the effects that EITF No. 07-3 will have on the Company s consolidated financial position, results of operations or cash flows.

FAS157

In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2), to partially defer FASB Statement No. 157, Fair Value Measurements (FAS 157). FSP 157-2 defers the effective date of FAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least

annually), to fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. The Company is currently evaluating the effects that FAS 157 will have on the Company s consolidated financial position, results of operations or cash flows.

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Note 3. Stock-based Compensation and Stockholders Equity

Stock Option Plan

In August 2006, the Board of Directors approved the 2006 Equity Incentive Plan (the 2006 Plan) and reserved for issuance 4,000,000 shares of common stock for the granting of stock options, stock appreciation rights, restricted stock awards, restricted stock units and other equity-based awards. The number of shares reserved automatically increased on July 1, 2007 and will increase on each subsequent anniversary through 2016, by an amount equal to the smaller of (a) three percent of the number of shares of stock issued and outstanding on the immediately preceding June 30, or (b) a lesser amount determined by the Board of Directors. The 2006 Plan was approved by the stockholders of the Company on January 8, 2007. The exercise price per share for options granted to employees and consultants owning shares representing more than 10% of the Company at the time of grant cannot be less than 110% of the fair value. Incentive and nonqualified stock options granted to all other persons shall be granted at an exercise price not less than 100% of the fair value. Options generally expire ten years after the date of grant and vest over four years; 25% at the end of one year and one sixteenth per quarter thereafter. In the nine months ended March 31, 2008, the Company granted 1,170,606 options under the 2006 Plan. At March 31, 2008, 3,593,572 shares of common stock are available for future grant.

Stock-Based Compensation

The Company adopted SFAS 123(R) effective July 1, 2006 using the prospective transition method. Prior to the adoption of SFAS 123(R), the Company accounted for its stock options issued to employees in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations in accounting for its employee stock options rather than the alternative fair value accounting provided for under Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), as amended by SFAS No. 148. Under APB 25, when the exercise price of the Company s employee and director stock options is equal to or greater than the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Determining Fair Value

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

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

Expected Volatility Expected volatility is based on a combination of the implied and historical volatility for both the Company and its peer group.

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.

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The fair value of stock option grants for the three and nine months ended March 31, 2008 and 2007 under SFAS 123(R) was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Risk-free interest rate	2.64%	4.50%	2.64% - 4.58%	4.50% - 4.60%
Expected life	4.39 years	4.04 years	4.32 - 4.39 years	4.04 - 4.38 years
Dividend yield	0%	0%	0%	0%
Volatility	48.43%	42.65%	43.03% -48.43%	42.65% -50.51%
Estimated forfeitures	3.30% - 15.16%	3.30% - 15.16%	3.30% - 15.16%	3.30% - 15.16%
Weighted-average fair value	$3.59	$3.14	$3.82	$4.98

The total intrinsic value of options exercised was $8,401,000 and $16,314,000 for the three and nine months ended March 31, 2008, respectively, and $5,272,000 and $5,808,000 for the three and nine months ended March 31, 2007, respectively. The fair value of options accounted for in accordance with SFAS No. 123(R) and vested was $837,000 and $2,227,000 for the three and nine months ended March 31, 2008, respectively, and $486,000 and $977,000 for the three and nine months ended March 31, 2007, respectively. As of March 31, 2008, 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 $8,404,000, which will be recognized over a weighted-average remaining vesting period of approximately 4.0 years.

The following table shows total stock-based compensation expense included in the condensed consolidated statements of operations for the three and nine month periods ended March 31, 2008 and 2007 (in thousands).

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Cost of sales	$ 124	$ 84	$ 354	$ 168
Research and development	465	304	1,220	785
Sales and marketing	161	81	453	270
General and administrative	291	215	822	450
Stock-based compensation expense before taxes	1,041	684	2,849	1,673
Income tax benefit	(94)	(219)	(334)	(175)
Stock-based compensation expense, net	$ 947	$ 465	$ 2,515	$ 1,498

SFAS No. 123(R) requires 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) to be classified as cash from financing activities for options accounted for under SFAS No. 123(R). The Company had no excess tax benefits in the nine months ended March 31, 2008 and 2007, respectively, for options accouted for under SFAS No. 123(R). Excess tax benefits for stock options accounted for under APB 25 continue to be classified as cash from operating activities.

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Stock Option Activity

The following table summaries stock option activity during the nine months ended March 31, 2008 under all stock option plans (aggregate, intrinsic value in thousands):

	Number of Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at June 30, 2007	14,350,061	$ 2.61		
Granted	1,170,606	$ 9.15		
Exercised	(2,089,387)	$ 1.16		
Forfeited or cancelled	(188,843)	$ 9.75		
Outstanding at March 31, 2008	13,242,437	$ 3.32	4.72	$ 72,596
Exercisable at March 31, 2008	10,647,828	$ 2.02	3.72	$ 69,742

Note 4. Comprehensive Income

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Net income	$ 5,024	$ 4,071	$ 18,571	$ 13,838
Unrealized loss on investment, net of taxes	(386)		(386)	
Total comprehensive income	$ 4,638	$ 4,071	$ 18,185	$ 13,838

Note 5. Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period.

Diluted net income per share is computed by dividing the net income for the period by the weighted average number of common and common equivalent shares outstanding during the period. Potentially dilutive securities, comprised of incremental common shares, issuable upon the exercise of stock options are included in diluted net income per share, using the treasury stock method, to the extent such shares are dilutive.

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A reconciliation of shares used in the calculation of basic and diluted net income per share is as follows (in thousands, except for per share amounts):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Numerator:				
Net income	$ 5,024	$ 4,071	$ 18,571	$ 13,838
Denominator:				
Basic weighted-average number of common shares outstanding	31,760	22,277	30,959	22,226
Dilutive common stock options	7,201	10,157	7,822	10,147
Diluted weighted-average number of common equivalent shares outstanding	38,961	32,434	38,781	32,373
Basic net income per share	$ 0.16	$ 0.18	$ 0.60	$ 0.62
Diluted net income per share	$ 0.13	$ 0.13	$ 0.48	$ 0.43

For the three and nine months ended March 31, 2008 and 2007, 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 outstanding stock options were 2,767,000 and 2,418,000 for the three and nine months ended March 31, 2008, respectively, and 939,000 and 499,000 for the three and nine months ended March 31, 2007, respectively.

Note 6. Balance Sheet Components (in thousands)

Short-term Investments:

Short-term investments consist of certificate of deposits with maturities of more than three months but less than a year and an auction rate security which was sold in April 2008. The certificates of deposits are carried at amortized cost which approximates fair value. The Company classifies the auction rate security with contractual maturities in excess of ten years as available-for-sale in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. The auction rate security is reported at fair value. There are no unrealized gains or losses in relation to this auction rate security as of March 31, 2008 and June 30, 2007. (See Note 7).

Inventories:

	March 31, 2008	June 30, 2007
Finished goods	$ 59,524	$ 44,804
Work in process	1,346	441
Purchased parts and raw materials	32,508	21,527
Total inventories, net	$ 93,378	$ 66,772

The Company recorded write-downs of excess and obsolete inventory totaling $2,157 and $6,667 in the three and nine months ended March 31, 2008, respectively, and $1,683 and $2,850 in the three and nine months ended March 31, 2007, respectively.

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Property, Plant and Equipment:

	March 31, 2008	June 30, 2007
Land	$ 19,219	$ 13,859
Buildings	19,108	13,162
Building and leasehold improvements	3,040	2,947
Machinery and equipment	8,012	4,062
Furniture and fixtures	2,046	1,390
Purchased software	1,228	941
	52,653	36,361
Accumulated depreciation and amortization	(7,089)	(5,272)
Property, plant and equipment, net	$ 45,564	$ 31,089

On October 16, 2007, the Company purchased land and a building at 880 Fox Lane in San Jose, California to support the Company s growth.

The costs of assets under capital leases were $305,000 and $294,000 as of March 31, 2008 and June 30, 2007, respectively, and accumulated amortization was $96,000 and $57,000, respectively.

Restricted Assets:

The restricted assets consist of certificates of deposits secured for two irrevocable letters of credit of $121,000 and $1,540,000 as of March 31, 2008. In February 2008, the Company obtained an irrevocable standby letter of credit required by the landlord of its office lease totaling $121,000. In March 2008, the Company posted a bond in the amount of $3,080,000 required by the Paris Court of Appeals related to the Digitechnic lawsuit (see Note 12). The bond was collateralized by an irrevocable standby letter of credit totaling $1,540,000.

Product Warranties:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Balance, beginning of period	$ 2,271	$ 1,726	$ 2,243	$ 1,462
Provision for warranty	2,027	1,308	4,470	3,109
Costs charged to accrual	(1,724)	(982)	(4,139)	(2,519)
Balance, end of period	$ 2,574	$ 2,052	$ 2,574	$ 2,052

Note 7. Investments

As of March 31, 2008, the Company held approximately $17.6 million of long-term auction-rate securities (auction rate securities), net of unrealized losses, representing its interest in student loans guaranteed by the Federal Family Education Loan Program (FFELP) and auction rate preferred shares in a closed end mutual fund invested in municipal securities; such auction rate securities were rated AAA at March 31, 2008. The stated maturity dates of these auction-rates securities may be one year or more beyond the balance sheet date.

The auction rate securities contain variable interest rates that periodically reset to prevailing market rates every 7 to 35 days through the auction process. Due to the liquidity provided by the interest rate reset mechanism and the short-term nature of the Company s investment, the auction rate securities had previously been classified as short-term investments available-for-sale. The Company held approximately $15.1 million in auction rate securities as of June 30, 2007.

Typically, the fair value of auction-rate securities approximates par value due to the frequent of resetting interest rate. 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, the auction rate securities have been classified as non-current investments available-for-sale as of March 31, 2008.

The Company has used a discounted cash flow model to estimate the fair value of the auction rate securities. The assumptions used in preparing the discounted cash flow model include estimates for interest rates which among other things incorporate, as applicable, creditworthiness of the associated insurers, timing of cash flows and expected holding periods of the auction-rates securities. Based on this assessment of fair value, for the three months ended March 31, 2008 the Company determined there was a decline in fair value of its auction rate securities of $636,000 which was deemed temporary. That amount has been recorded net of tax, as a component of other comprehensive income.

Additionally, the Company has the financial ability and intent to hold its investments in auction rate securities until successful auctions occur, a buyer is found outside of the auction process or the preferred shares are redeemed. 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.

Note 8. Advances from Receivable Financing Arrangements

The Company has accounts receivable financing agreements with certain financing companies whereby the financing companies pay the Company for sales transactions that have been pre-approved by these financing companies. The financing company then collects the receivable from the customer. Such sales transactions totaled approximately $6,694,000 and $17,517,000 for the three and nine months ended March 31, 2008, respectively, and $4,853,000 and $11,220,000 for the three and nine months ended March 31, 2007, respectively. At March 31, 2008 and June 30, 2007, approximately $1,379,000 and $982,000, respectively, remained uncollected from customers subject to these arrangements. Such amounts have been recorded as advances from receivable financing arrangements as the Company has obligations to repurchase inventories seized by the financing companies from defaulting customers. Historically, the Company has not been required to repurchase inventories from the financing companies. As of March 31, 2008 and June 30, 2007, these financing arrangements bore interest at rates ranging from 12.00% to 21.48% and 13.65% to 21.48% per annum, respectively, depending on the customers credit ratings.

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Note 9. Long-term Obligations

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

	March 31, 2008	June 30, 2007
Building loans	$ 10,374	$ 10,585
Small Business Administration loan		970
Capital leases (Note 11)	78	158
Total	10,452	11,713
Current portion, debt and capital leases	(342)	(422)
Long-term portion, debt and capital leases	$ 10,110	$ 11,291

In April 2004, the Company borrowed $4,275,000 from a bank to purchase a building in San Jose, California. The loan is secured by the property purchased and principal and interest are payable monthly through May 1, 2029. As of March 31, 2008 and June 30, 2007, the total outstanding borrowings were $3,932,000 and $3,990,000, respectively, with interest at 7.23% per annum through July 2012 and then it is adjusted every five years to equal the index of 5-Year United States Treasury Notes as publish in the Wall Street Journal plus 2.75% per annum.

In September 2005, the Company obtained two loans totaling $7,920,000 from a bank to purchase a building in San Jose, California. Both loans are secured by the property purchased and the assignment of all rent on the property purchased. The first loan of $6,930,000 is repayable in equal monthly installments through September 2010. As of March 31, 2008 and June 30, 2007, the total outstanding borrowings were $6,442,000 and $6,595,000, respectively, with interest at 5.77% per annum through September 2010, and then it is adjusted every five years to equal the index of 5-Year United States Treasury Notes plus 1.65% per annum. The second loan of $990,000 was paid off using a Small Business Administration loan of $1,019,000 on November 16, 2005. The second loan is secured by the property purchased and guaranteed by two officers/shareholders of the Company. In October 2007, the Company paid off the loan for $1,011,000 including a pre-payment penalty of $46,000.

As of March 31, 2008, the gross cost and net book value of the land, building and related improvements collateralizing the borrowings were approximately $17,127,000 and $16,449,000, respectively. As of June 30, 2007, the gross cost and net book value of the land, building and related improvements collateralizing the borrowings were approximately $29,797,000 and $27,756,000, respectively.

In February 2008, the Company obtained an irrevocable standby letter of credit required by the landlord of its office lease totaling $121,000 that expires on September 1, 2009. As of March 31, 2008, the Company had an unused revolving line of credit totaling $5,000,000 that matures on November 1, 2008 and the interest rate on this credit line is 7.50% per annum at March 31, 2008. As of March 31, 2008, the Company was in compliance with the financial covenants associated with the line of credit

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Note 10. Related-party and Other Transactions

Ablecom Technology Inc. Ablecom Technology, Inc., a Taiwan corporation, together with its subsidiaries (Ablecom), is one of the Company s major contract manufacturers. Ablecom s chief executive officer, Steve Liang, is the brother of Charles Liang, the Company s President, Chief Executive Officer and Chairman of the Board of Directors, and owns approximately 2.5% of the Company s common stock. In addition, Charles Liang and his wife, also a director and officer of the Company, collectively own approximately 30.7% of Ablecom and Yih-Shyan (Wally) Liaw, an officer and director of the Company, and his spouse collectively own approximately 5.2% of Ablecom, while Steve Liang and other family members own approximately 49.3% of Ablecom at March 31, 2008.

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

Under the product design and manufacturing agreements, the Company outsources a portion of its design activities and a significant part of its manufacturing of components such as server chassis to Ablecom. Ablecom agrees to design products according to the Company s specifications. Additionally, Ablecom agrees to build the tools needed to manufacture the products. Under the product design and manufacturing agreements, the Company commits to purchase a minimum quantity over a set period. The purchase price of the products manufactured by Ablecom is negotiated on a purchase order by purchase order basis at each purchase date. However, a fixed charge is added to the price of each unit purchased until the agreed minimum number of units is purchased. In August 2007, the Company entered into a new product development, manufacturing and service agreement with Ablecom. Under the new agreement, the Company has agreed to pay for the cost of tooling and engineering services and will pay for those items when the work has been completed. In this case no fixed charge is added to future purchases for reimbursement of tooling costs. The Company purchased tooling assets for $2,135,000 and engineering services for $708,000 from Ablecom during the nine months ended March 31, 2008.

Under the distribution agreement, Ablecom purchases from the Company server products for distribution in Taiwan. 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 approximately $30,687,000 and $83,551,000 and sold products to Ablecom totaling approximately $1,235,000 and $4,834,000 for the three and nine months ended March 31, 2008, respectively. The Company purchased products from Ablecom totaling approximately $29,446,000 and $69,438,000 and sold products to Ablecom totaling approximately $1,432,000 and $5,703,000 for the three and nine months ended March 31, 2007, respectively.

Amounts owed to the Company by Ablecom as of March 31, 2008 and June 30, 2007, were approximately $656,000 and $853,000, respectively. Amounts owed to Ablecom by the Company as of March 31, 2008 and June 30, 2007, were approximately $35,197,000 and $26,094,000, respectively. Historically, the Company has paid Ablecom the majority of invoiced dollars between 45 and 160 days of invoice. For the three and nine months ended March 31, 2008, the Company received $30,000 and $100,000, respectively, from Ablecom for penalty charges, and paid approximately $976,000 and $3,491,000, respectively, in tooling and other miscellaneous costs to Ablecom. For the three and nine months ended March 31, 2007, the Company received $40,000 and $89,000, respectively, from Ablecom for penalty charges, and paid approximately $65,000 and $346,000, respectively, in tooling and other miscellaneous costs to Ablecom. Penalty charges are assessments relating to delayed deliveries or quality issues.

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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 (b) impairment of the tooling cost and (c) 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 $4.4 million and $2.2 million at March 31, 2008 and June 30, 2007, respectively, representing the maximum exposure to loss relating to (a) above. The Company does not have any direct or indirect guarantees of losses, if any, of Ablecom.

Tatung Tatung was a significant contract manufacturer for the Company and owns approximately 1.9% of the Company s common stock at March 31, 2008.

The Company had a product manufacturing agreement (product manufacturing agreement) with Tatung. The product manufacturing agreement was terminated by Tatung in the quarter ended December 31, 2007.

The Company purchased contract manufacturing services and products from Tatung totaling approximately $0 and $6,085,000 and sold products to Tatung totaling approximately $0 and $2,887,000 for the three and nine months ended March 31, 2008, respectively. The Company purchased contract manufacturing services and products from Tatung totaling approximately $3,096,000 and $15,787,000 and sold products to Tatung totaling approximately $2,145,000 and $4,518,000 for the three and nine months ended March 31, 2007, respectively. The amounts owed to the Company by Tatung as of March 31, 2008 and June 30, 2007, were approximately $2,000 and $886,000, respectively. The amounts owed to Tatung by the Company as of March 31, 2008 and June 30, 2007, were approximately $0 and $5,616,000, respectively. For the three and nine months ended March 31, 2008 and 2007, the Company received no penalty charges from Tatung but received approximately $248,000 from Tatung for its termination.

Note 11. Income Taxes

The Company recorded provisions for income taxes of $3,326,000 and $11,693,000 for the three and nine months ended March 31, 2008, respectively, and $1,790,000 and $7,105,000 for the three and nine months ended March 31, 2007, respectively. The effective tax rate for the three and nine months ended March 31, 2008 differs from the federal and state statutory rate primarily due to tax exempt interest income, research and development credits, domestic production activities deduction and certain stock compensation expenses for which deferred tax assets cannot be recorded in accordance with SFAS 123(R). The effective tax rate for the three and nine months ended March 31, 2007 differs from the federal and state net statutory income tax rates primarily due to research and development credits, foreign sales corporation tax benefits, domestic production activities deduction and certain stock compensation expenses for which deferred tax assets cannot be recorded in accordance with SFAS 123R.

Effective July 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. As a result of the implementation of FIN 48, the Company increased the liability for net unrecognized tax benefits by $989,000, and accounted for the reduction as a cumulative effect of a change in accounting principle that resulted in a decrease to retained earnings of $989,000. The total amount of gross unrecognized tax benefits as of the date of adoption was $3,861,000. The Company historically classified unrecognized tax benefits in current taxes payable. As a result of adoption of FIN 48, $3,604,000 of the unrecognized tax benefits were reclassified to long-term FIN 48 liabilities (included in other long-term liabilities in the consolidated balance sheet) and $257,000 of the unrecognized tax benefits were reclassified to current FIN 48 liabilities. Of the $3,861,000 total unrecognized tax benefits, $3,465,000 would affect the effective tax rate if realized, and $396,000 would affect the Company s deferred tax assets if realized.

The Company s policy to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the condensed consolidated statements of operations did not change as a result of implementing the provisions of FIN 48. As of the date of adoption of FIN 48, the Company had accrued $377,000 for the payment of interest and penalties relating to unrecognized tax benefits.

The Company files U.S. federal, U.S. state, and foreign income tax returns. The Company is generally no longer subject to tax examinations for years prior to the fiscal year beginning July 1, 2002.

In connection with the regular examination of the Company s California tax returns for the fiscal years ended June 30, 2002 and 2003 the Franchise tax board has presented certain adjustments to the amounts reflected by the Company on those returns. Although the timing of the resolution and/or closure on audits is highly uncertain, the Company does not believe that its unrecognized tax benefits would materially change in the next 12 months.

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Note 12. Commitments and Contingencies

Litigation and Claims The Company has been a defendant in a lawsuit with Digitechnic, S.A., a former customer, before the Bobigny Commercial Court in Paris, France, in which Digitechnic alleged that certain products purchased from the Company were defective. In September 2003, the Bobigny Commercial Court found in favor of Digitechnic and awarded damages totaling $1,178,000. The Company accrued for these damages in its consolidated financial statements as of June 30, 2004, as the best estimate of its loss in this situation. In February 2005, the Paris Court of Appeals reversed the trial court s ruling, dismissed all of Digitechnic s claims and awarded $11,000 to the Company for legal expenses. Accordingly, the Company reversed the $1,178,000 accrued in fiscal 2005. Digitechnic has appealed the Paris Court of Appeals decision to the French Supreme Court and asked for $2,416,000 for damages. On February 13, 2007, the French Supreme Court reversed the decision of the Paris Court of Appeals, ordering a new hearing before a different panel of the Paris Court of Appeals. Pending a new hearing, the trial court ruling is reinstated. In March 2008, the Company posted a bond in the amount of $3,040,000 required by the court. The bond was collateralized by an irrevocable standby letter of credit totaling $1,540,000. Although the Company cannot predict with certainty the final outcome of this litigation, it believes the claim to be without merit and intends to continue to defend it vigorously. Management believes that the ultimate resolution of this matter will not result in a material adverse impact on the Company s results of operations, cash flows or financial position.

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

Lease Commitments The Company leases a warehouse facility and various equipment under operating leases which expire at various dates through 2016. In February 2008, the Company leased an office building of approximately 246,000 square feet in Fremont, California with total payment obligation of approximately $11.2 million over the next 7.3 years. In addition, the Company leases certain of its equipments under capital leases.

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Note 13. Segment Reporting

The Company operates in one operating segment: developing and providing 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.

Net sales by geographic region are based on the country to which the products were shipped. The following is a summary for the three and nine months ended March 31, 2008 and 2007, of net sales by geographic region (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Net sales:				
United States	$ 79,367	$ 60,531	$ 237,127	$ 179,798
United Kingdom	5,009	6,041	17,263	16,216
Germany	7,776	6,779	21,295	21,540
China	7,619	1,951	9,034	3,454
Rest of Europe	18,619	12,551	51,390	35,854
Rest of Asia	16,293	15,894	47,815	45,165
Other	2,072	1,912	7,713	7,421
	$ 136,755	$ 105,659	$ 391,637	$ 309,448

The Company s long-lived assets located outside the United States are not significant.

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

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2008		2007		2008		2007	
	Amount	Percent of Revenues	Amount	Percent of Net Sales	Amount	Percent of Net Sales	Amount	Percent of Net Sales
Server systems	$ 47,882	35.0%	$ 38,779	36.7%	$ 151,463	38.7%	$ 110,707	35.8%
Serverboards and other components	88,873	65.0%	66,880	63.3%	240,174	61.3%	198,741	64.2%
Total	$ 136,755	100.0%	$ 105,659	100.0%	$ 391,637	100.0%	$ 309,448	100.0%

Serverboards and other components are comprised of serverboards, chassis and accessories. Server systems constitute an assembly of components done by the Company.

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

This section and other parts of this Form 10-Q contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended that involve risks and uncertainties. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology including would, could, may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, potential, or continue, the negative of these terms or other comparable terminology. In evaluating these statements, you should specifically consider various factors, including the risks described under Risk Factors below and in other parts of this Form 10-Q as well as in our other filings with the SEC. These factors may cause our actual results to differ materially from those anticipated or implied in the forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. We cannot guarantee future results, levels of activity, performance or achievements.

Overview

We design, develop, manufacture and sell application optimized, high performance server solutions based on an innovative, modular and open-standard x86 architecture. Our solutions include a range of complete server systems, as well as components which can be used by distributors, OEMs and end customers to assemble server systems. To date, we have generated the majority of our net sales from components. Since 2000, we have gradually shifted our focus and resources to designing, developing, manufacturing and selling application optimized server systems. In recent years our growth in net sales has been driven by the growth in the market for application optimized server systems. Net sales of optimized servers were $47.9 million and $151.5 million for the three and nine months ended March 31, 2008, respectively, and $38.8 million and $110.7 million for the three and nine months ended March 31, 2007, respectively.

We commenced operations in 1993 and have been profitable every year since inception. Our net sales were $136.8 million and $391.6 million for the three and nine months ended March 31, 2008, respectively, and $105.7 million and $309.4 million for the three and nine months ended March 31, 2007, respectively. Our net income was $5.0 million and $18.6 million for the three and nine months ended March 31, 2008, respectively, and $4.1 million and $13.8 million for the three and nine months ended March 31, 2007, respectively.

We sell our server systems and components primarily through distributors and to a lesser extent to OEMs as well as through our direct sales force. We derived approximately 62.8% and 61.6% of our net sales from products sold to distributors, and 37.2% and 38.4% from sales to OEMs and to end customers for both the three and nine months ended March 31, 2008, respectively. For the three and nine months ended March 31, 2007, we derived approximately 72.8% and 69.1%, respectively, of our net sales from products sold to distributors, and we derived approximately 27.2% and 30.9%, respectively, from sales to OEMs and to end customers. None of our customers accounted for 10% or more of our net sales in the three and nine months ended March 31, 2008 and 2007. We derived approximately 58.0% and 60.5% of our net sales from customers in the United States for the three and nine months ended March 31, 2008, respectively, and approximately 57.3% and 58.1% of our net sales from customers in the United States for the three and nine months ended March 31, 2007, respectively. We derived approximately 42.0% and 39.5% of our net sales from customers outside the United States for the three and nine months ended March 31, 2008, respectively, and approximately 42.7% and 41.9% of our net sales from customers outside the United States for the three and nine months ended March 31, 2007, respectively.

We perform the majority of our research and development efforts in-house. Research and development expenses represented approximately 5.8% and 5.5% of our net sales for the three and nine months ended March 31, 2008, respectively, compare to approximately 4.9% and 5.1% of our net sales for the three and nine months ended March 31, 2007, 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. This arrangement enables us to maintain our cost structure and to benefit from our suppliers and contract manufacturers research and development and economies of scale.

One of our key suppliers is Ablecom, which supplies us with contract design and manufacturing support. For the three and nine months ended March 31, 2008, our purchases from Ablecom represented approximately 27.4% and 26.4% of our cost of sales, respectively, compared to approximately 33.6% and 27.3% of our cost of sales for the three and nine months ended March 31, 2007, respectively. The decrease in percentage of cost of sales was primarily due to our higher costs for serverboards and other components. Ablecom s sales to us constitute a substantial majority of Ablecom s net sales. We plan to expand our warehousing capacity and our manufacturing relationship with Ablecom in China in an effort to reduce our product costs. Ablecom is expanding operations from Taiwan to a larger facility in China. In addition to providing a larger volume of contract manufacturing services for us, Ablecom will 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 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 reporting for one or more periods gross profit as a percentage of net sales

less than or in excess of what we might have obtained absent our relationship with Ablecom.

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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. We also solicit input from our customers to understand their future needs as we design and develop our products.

Fiscal Year

Our fiscal year ends on June 30. References to fiscal year 2008, for example, refer to the fiscal year ending June 30, 2008.

Revenues and Expenses

Net sales. Net sales consist of sales of our server solutions, including server systems and components. 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 components vary based on the type of component. 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 write-offs. 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. We expect cost of sales to increase in absolute dollars in the future from an expected increase in net sales. Costs 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 components. Because we do not have long-term fixed supply agreements, our cost of sales is subject to change based on market conditions.

Research and development expenses. Research and development expenses consist of the personnel and related expenses of our research and development teams, and materials and supplies, consulting services, third party testing services and equipment and facility expenses related to our research and development activities. All research and development costs are expensed as incurred. We occasionally receive non-recurring engineering (NRE) funding from certain suppliers and customers towards our development efforts. Under these programs, we are reimbursed for certain research and development costs that we incur as part of the joint development of our products and those of our suppliers and customers. These amounts offset a portion of the related research and development expenses and have the effect of reducing our reported research and development expenses. We expect that research and development expenses will continue to increase in absolute dollars in the future as we increase our investment in developing new products and adding new features in current products, but such expenditures may fluctuate as a percentage of net sales.

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

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. We expect general and administrative expenses to continue to increase significantly on an absolute dollar basis to support our anticipated growth and cover additional costs associated with being a public company, such as regulatory reporting requirements, Sarbanes-Oxley compliance, higher insurance premiums and investor relations, but such expenses may fluctuate as a percentage of net sales.

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Interest expense and other, net. Interest expense and other, net represents the net of our interest expense on the building loans for our owned facilities and a Small Business Administration loan offset by interest earned on our 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 and the Netherlands and to a lesser extent, Taiwan. Our effective tax rate differs from the statutory rate primarily due to the tax benefit of tax exempt interest income, research and development tax credits and the extraterritorial income exclusion. In future years, we anticipate our effective tax rate will increase due to the phase out of the extraterritorial income exclusion.

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 cooperative marketing accruals, investment valuations, inventory valuations, income taxes, warranty obligations and stock-based compensation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making the judgments we make about the carrying values of assets and liabilities that are not readily apparent from other sources. Because these estimates can vary depending on the situation, actual results may differ from the estimates.

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

Revenue recognition. We account for revenue under the provisions of Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition in Financial Statements* . Under the provisions of SAB No. 104, we recognize revenue from sales of products, when persuasive evidence of an arrangement exists, shipment has occurred and title has transferred, the sales price is fixed or determinable, collection of the resulting receivable is reasonably assured, and all significant obligations have been met. Generally this occurs at the time of shipment when risk of loss and title has passed to the customer. Our standard arrangement with our customers includes a signed purchase order or contract, free-on-board shipping point terms, except for a few customers who have free-on-board destination terms and revenue is recognized when the products arrive at the destination, 30 to 60 days payment terms, and no customer acceptance provisions. We generally do not provide for non-warranty rights of return except for products which have Out-of-box failure, where customers could return these products for credit within 30 days of receiving the items. Certain distributors and OEMs are also permitted to return products in unopened boxes, limited to purchases over a specified period of time, generally within 60 to 90 days of the purchase, or to products in the distributor s or OEM s inventory at certain times (such as the termination of the agreement or product obsolescence). In addition, we have a sale arrangement with an OEM that has limited product return rights. To estimate reserves for future sales returns, we regularly review our history of actual returns for each major product line. We also communicate regularly with our distributors to gather information about end customer satisfaction, and to determine the volume of inventory in the channel. Reserves for future returns are adjusted as necessary, based on returns experience, returns expectations and communication with our distributors.

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 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 in accordance with Emerging Issues Task Force Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (including a Reseller of the Vendor s Products*). Credits that we issued pursuant to these provisions were $70,000 and $198,000 for the three and nine months ended March 31, 2008, respectively and $44,000 and $129,000 for the three and nine months ended March 31, 2007, respectively. We do not commit to future price reductions with any of our customers.

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

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Cooperative marketing accruals. We follow EITF Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (including a Reseller of the Vendor s Products).* We have arrangements with resellers of our products to reimburse the resellers for cooperative marketing costs meeting specified criteria. In accordance with EITF Issue No. 01-9, we record advertising costs meeting such specified criteria within sales and marketing expenses in the accompanying consolidated statements of operations. For those advertising costs that do not meet the criteria set forth in EITF Issue No. 01-9, the amounts are recorded as a reduction to sales in the accompanying condensed consolidated statements of operations.

Impairment of long-term investments. We follow the guidance provided by FSP 115-1/124-1 and Emerging Issues Task Force (EITF) No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* to assess whether our investments with unrealized loss positions are other than temporarily impaired. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in the condensed consolidated statement of operations. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

Product warranties. We offer product warranties ranging from 12 to 36 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.

Inventory valuation. Inventory is valued at the lower of cost or market. We evaluate inventory on a quarterly basis for excess and obsolescence and write-down the valuation of units that are unlikely to be sold based upon estimated demand for the following twelve months. This evaluation may take 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.

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.

Effective July 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. See Note 11 for the impact of FIN 48 on our condensed consolidated financial statements.

Stock-based compensation. Effective July 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment* , using the prospective transition method, which establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on accounting for transactions where an entity obtains employee services in share-based payment transactions. Prior to July 1, 2006, we accounted for stock-based compensation awards issued to our employees using the intrinsic value measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* , or Opinion 25. Accordingly, we have recorded compensation expense for stock options granted with exercise prices less than the fair value of the underlying common stock at the option grant date. SFAS No. 123(R) requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). SFAS No. 123(R) supersedes our previous accounting under APB No. 25 for periods beginning in fiscal 2007. We recorded stock-based compensation expense of $1.0 million and $2.8 million for the three and nine months ended March 31, 2008, respectively, and $0.7 million and $1.7 million for the three and nine months ended March 31, 2007, respectively.

As of March 31, 2008, the total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options granted since July 1, 2006 to employees and non-employee directors, was $8.4 million, which is expected to be recognized as an expense over a weighted-average remaining period of approximately 4.0 years. Amount related to stock options granted prior to July 1, 2006 was $0.8 million.

We estimated the fair value of stock options granted using a Black-Scholes option-pricing formula 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.

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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 the exercise factors. The expected volatility is based on a combination of the implied and historical volatility of our company and the relevant peer group. In addition, we estimated the forfeiture rate based on our historical experience.

Variable interest entities. We have analyzed our relationship with Ablecom and its subsidiaries and we have concluded that Ablecom is a variable interest entity as defined by FIN No. 46R; however, the Company is 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.

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,	
	2008	2007	2008	2007
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	81.8	82.9	80.8	82.2
Gross profit	18.2	17.1	19.2	17.8
Operating expenses:				
Research and development	5.8	4.9	5.5	5.1
Sales and marketing	3.4	3.3	3.3	2.9
General and administrative	2.9	3.1	2.8	2.8
Total operating expenses	12.1	11.3	11.6	10.8
Income from operations	6.1	5.8	7.6	7.0
Interest income	0.2	0.1	0.3	0.1
Interest expense	(0.2)	(0.4)	(0.2)	(0.3)
Income before income tax provision	6.1	5.5	7.7	6.8
Income tax provision	2.4	1.7	3.0	2.3
Net income	3.7%	3.8%	4.7%	4.5%

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Comparison of Three Months Ended March 31, 2008 and 2007

Net sales. Net sales increased by $31.1 million, or 29.4%, to $136.8 million from $105.7 million, for the three months ended March 31, 2008 and 2007, respectively. This was due primarily to an increase in unit volumes and average selling prices. For the three months ended March 31, 2008, the approximate number of units sold increased 22.3% to 659,000 compared to 539,000 for the three months ended March 31, 2007. Growth in unit volumes was primarily due to the growth of X7 series motherboards and an increase in sales of chassis and accessories such as memory and disk drives offset in part by lower sales of X6 and P4 motherboards. For the three months ended March 31, 2008, the approximate number of server system units sold increased 20.6% to 41,000 compared to 34,000 for the three months ended March 31, 2007. The average selling price of server system units increased 9.1% to approximately $1,200 in the three months ended March 31, 2008 compared to approximately $1,100 in the three months ended March 31, 2007. Growth in the average selling prices of our server systems was principally driven by an increase in sales of servers to OEMs and end customers, offset in part by declines in average selling prices of more mature products. Sales of server systems increased by $9.1 million or 23.5% from the three months ended March 31, 2007 to the three months ended March 31, 2008, primarily due to higher sales of our OEM and bundled server solutions utilizing our high efficiency power supplies and higher sales of 6000 Series configurations of servers. Sales of server systems represented 35.0% of our net sales for the three months ended March 31, 2008 as compared to 36.7% of our net sales for the three months ended March 31, 2007. For the three months ended March 31, 2008 and 2007, we derived approximately 62.8% and 72.8%, respectively, of our net sales from products sold to distributors and we derived approximately 37.2% and 27.2%, respectively, from sales to OEMs and to end customers. For the three months ended March 31, 2008, customers in the United States, Asia, Germany and rest of Europe accounted for approximately 58.0%, 17.5%, 5.7% and 17.3%, of our net sales, respectively, as compared to 57.3%, 16.9%, 6.4% and 17.6%, respectively, for the three months ended March 31, 2007.

Cost of sales. Cost of sales increased by $24.3 million, or 27.8%, to $111.9 million from $87.6 million, for the three months ended March 31, 2008 and 2007, respectively. Cost of sales as a percentage of net sales was 81.8% and 82.9% for the three months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars of cost of sales was primarily attributable to the increase in net sales and higher inventory write down of $0.5 million. The lower cost of sales as a percentage of net sales was primarily due to higher revenue mix of server systems and newer products. In the three months ended March 31, 2008, we recorded a $2.2 million expense, or 1.6% of net sales, related to the write down of excess and obsolete inventory as compared to $1.7 million, or 1.6% of net sales, in the three months ended March 31, 2007. The increase in the inventory write down was primarily for the Company s older products.

Research and development expenses. Research and development expenses increased by $2.9 million, or 56.5%, to $8.1 million from $5.1 million, for the three months ended March 31, 2008 and 2007, respectively. Research and development expenses were 5.8% and 4.9% of net sales for the three months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars was primarily due to an increase of $2.2 million in compensation and benefits resulting from growth in research and development personnel, including higher stock-based compensation expense and an increase of $0.5 million in development costs associated with new products offset in part by an increase of $0.4 million in non-recurring engineering funding from certain suppliers and customers.

Research and development expenses include stock-based compensation expense of $465,000 and $304,000 for the three months ended March 31, 2008 and 2007, respectively.

Sales and marketing expenses. Sales and marketing expenses increased by $1.1 million, or 32.1%, to $4.6 million from $3.5 million, for the three months ended March 31, 2008 and 2007, respectively. Sales and marketing expenses were 3.4% and 3.3% of net sales for the three months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars and percentage of net sales was primarily due to an increase of $0.8 million in compensation and benefits resulting from growth in sales and marketing personnel, including higher stock-based compensation expense and an increase of $0.2 million in sales consulting fees.

Sales and marketing expenses include stock-based compensation expense of $161,000 and $81,000 for the three months ended March 31, 2008 and 2007, respectively.

General and administrative expenses. General and administrative expenses increased by $0.6 million, or 19.1%, to $3.9 million from $3.3 million, for the three months ended March 31, 2008 and 2007, respectively. General and administrative expenses were 2.9% and 3.1% of net sales for the three months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars was primarily due to an increase of $0.5 million in consulting fees related to Sarbanes-Oxley 404 (SOX) compliance and an increase of $0.5 million in compensation and benefits, including higher stock-based compensation expense offset in part by a decrease of $0.7 million in legal expenses primarily associated with our defense of certain litigation matters.

General and administrative expenses include stock-based compensation expense of $291,000 and $215,000 for the three months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars was primarily due to the growth in general and administrative personnel.

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Interest and other expense, net. Interest and other expense, decreased by $0.4 million, or 126.3%, to $(0.1) million from $0.3 million, for the three months ended March 31, 2008 compare to same period in 2007, respectively, of which $0.2 million and $0.4 million was interest expenses for the three months ended March 31, 2008 and 2007, respectively. The net decrease was due to higher interest income of $0.3 million from higher cash and cash equivalent and investment balances primarily as a result of our initial public offering.

Provision for income taxes. Provision for income taxes increased by $1.5 million, or 85.8%, to $3.3 million from $1.8 million, for the three months ended March 31, 2008 and 2007, respectively. The effective tax rate was 39.8% and 30.5% for the three months ended March 31, 2008 and 2007, respectively. The increase of the effective tax rate was the result of the additional benefit of the retroactive reinstatement of federal research and development tax credits during the three months ended March 31, 2007 which was not available for the three months ended March 31, 2008.

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Comparison of Nine Months Ended March 31, 2008 and 2007

Net sales. Net sales increased by $82.2 million, or 26.6%, to $391.6 million from $309.4 million, for the nine months ended March 31, 2008 and 2007, respectively. This was due primarily to an increase in unit volumes and average selling prices. For the nine months ended March 31, 2008, the approximate number of units sold increased 25.0% to 2.0 million compared to 1.6 million for the nine months ended March 31, 2007. Growth in unit volumes was primarily due to the growth of X7 and PD series motherboards and an increase in sales of chassis and accessories such as memory and disk drives offset in part by lower sales of X6 motherboards. For the nine months ended March 31, 2008, the approximate number of server system units sold increased 24.2% to 123,000 compared to 99,000 for the nine months ended March 31, 2007. The average selling price of server system units sold increased 9.1% to approximately $1,200 in the nine months ended March 31, 2008 compared to approximately $1,100 in the nine months ended March 31, 2007. Growth in the average selling prices of our server systems was principally driven by an increase in sales of our 5000 Series of server systems and sales of servers to OEMS and end customers, offset in part by declines in average selling prices of more mature products. Sales of server systems increased by $40.8 million or 36.8% from the nine months ended March 31, 2007 to the nine months ended March 31, 2008, primarily due to increases in shipments of servers to OEMs and end customers and 6000 Series configurations of servers, offset in part by lower shipments of AMD servers. Sales of server systems represented 38.7% of our net sales for the nine months ended March 31, 2008 as compared to 35.8% of our net sales for the nine months ended March 31, 2007. For the nine months ended March 31, 2008 and 2007, we derived approximately 61.6% and 69.1%, respectively, of our net sales from products sold to distributors and we derived approximately 38.4% and 30.9%, respectively, from sales to OEMs and to end customers. For the nine months ended March 31, 2008, customers in the United States, Asia, Germany and rest of Europe accounted for approximately 60.5%, 14.5%, 5.4% and 17.5%, of our net sales, respectively, as compared to 58.1%, 15.7%, 7.0% and 16.8%, respectively, for the nine months ended March 31, 2007.

Cost of sales. Cost of sales increased by $62.1 million, or 24.4%, to $316.5 million from $254.4 million, for the nine months ended March 31, 2008 and 2007, respectively. Cost of sales as a percentage of net sales was 80.8% and 82.2% for the nine months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars of cost of sales was primarily attributable to the increase in net sales and higher inventory write down of $3.8 million. The lower cost of sales as a percentage of net sales was primarily due to higher revenue mix of server systems and newer products. In the nine months ended March 31, 2008, we recorded a $6.7 million expense, or 1.7% of net sales, related to the write down of excess and obsolete inventory as compared to $2.9 million, or 0.9% of net sales, in the nine months ended March 31, 2007. The increase in the inventory write down was primarily for the Company s AMD DDRI products.

Research and development expenses. Research and development expenses increased by $6.1 million, or 39.0%, to $21.7 million from $15.6 million for the nine months ended March 31, 2008 and 2007, respectively. Research and development expenses were 5.5% and 5.1% of net sales for the nine months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars was primarily due to an increase of $4.9 million in compensation and benefits resulting from growth in research and development personnel, including higher stock-based compensation expense and an increase of $1.0 million in development costs associated with new product, SuperBlades offset in part by an increase of $1.1 million in non-recurring engineering funding from certain suppliers and customers. The increase in personnel was primarily related to expanded product development initiatives.

Research and development expenses include stock-based compensation expense of $1,220,000 and $785,000 for the nine months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars was primarily due to the growth in research and development personnel.

Sales and marketing expenses. Sales and marketing expenses increased by $3.9 million, or 43.7%, to $12.9 million from $9.0 million, for the nine months ended March 31, 2008 and 2007, respectively. Sales and marketing expenses were 3.3% and 2.9% of net sales for the nine months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars and percentage of net sales was primarily due to an increase of $2.4 million in compensation and benefits resulting from growth in sales and marketing personnel, including higher stock-based compensation expense, an increase of $0.3 million in marketing co-op funding to customers, an increase of $0.2 million in advertising and promotion expenses, an increase of $0.2 million in freight out costs and a decrease of $0.2 million in marketing co-op funding from vendors.

Sales and marketing expenses include stock-based compensation expense of $453,000 and $270,000 for the nine months ended March 31, 2008 and 2007, respectively.

General and administrative expenses. General and administrative expenses increased by $2.0 million, or 22.9%, to $10.8 million from $8.8 million, for the nine months ended March 31, 2008 and 2007, respectively. General and administrative expenses were 2.8% of net sales for both the nine months ended March 31, 2008 and 2007. The increase in absolute dollars was primarily due to an increase of $1.5 million in compensation and benefits, including higher stock-based compensation expense, an increase of $0.9 million in consulting fees related to SOX compliance, $0.6 million for accrued claims and $0.3 million in professional fees to support being a public company offset in part by a decrease of $1.8 million in legal expenses primarily associated with our defense of certain litigation matters.

General and administrative expenses include stock-based compensation expense of $822,000 and $450,000 for the nine months ended March 31, 2008 and 2007, respectively. The increase in absolute dollars was primarily due to the growth in general and administrative personnel.

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Reversal of litigation loss. Loss from litigation decreased by $0.1 million to zero for the nine months ended March 31, 2008 compare to same period in 2007, respectively. The decrease was due to the final settlement of export control matter at less than the estimated loss amount.

Interest and other expense, net. Interest and other expense, net, decreased by $1.4 million, or 167.2%, to $(0.6) million from $0.9 million, for the nine months ended March 31, 2008 compare to same period in 2007, respectively, of which $0.7 million and $1.0 million was interest expenses for the nine months ended March 31, 2008 and 2007, respectively. The decrease was due to higher interest income of $1.1 million from higher cash and cash equivalent and investment balances primarily as a result of our initial public offering.

Provision for income taxes. Provision for income taxes increased by $4.6 million, or 64.6%, to $11.7 million from $7.1 million, for the nine months ended March 31, 2008 and 2007, respectively. The effective tax rate was 38.6% and 33.9% for the nine months ended March 31, 2008 and 2007, respectively. The increase of the effective tax rate was the result of the decreased benefit of federal research and development tax credits and foreign income deductions relative to our higher taxable income.

Liquidity and Capital Resources

Since our inception, we have financed our growth primarily with funds generated from operations and from the proceeds of our initial public offering. Our cash and cash equivalents and short-term investments were $41.8 million and $65.9 million as of March 31, 2008 and June 30, 2007, respectively.

Operating Activities. Net cash provided by operating activities was $9.3 million and $9.6 million for the nine months ended March 31, 2008 and 2007, respectively. Net cash provided by our operating activities in the nine months ended March 31, 2008 was primarily due to our net income of $18.6 million, an increase in accounts payable of $17.1 million, an increase in the provision for inventory of $6.7 million, an increase in the allowance for sales returns of $4.2 million, an increase in income tax payable of $3.6 million and an increase in other long-term liabilities of $3.4 million relating to our FIN48 liability, which was substantially offset by an increase in inventory of $33.3 million and an increase in accounts receivable of $13.0 million. Net cash provided by our operating activities in the nine months ended March 31, 2007 was primarily due to our net income of $13.8 million, an increase in accounts payable of $14.2 million, an increase in accrued liabilities of $5.5 million and an increase in the allowance for sales returns of $3.0 million, an increase in the provision for inventory of $2.9 million, which was substantially offset by an increase in inventory of $18.2 million and an increase in accounts receivable of $13.6 million. The increases for the nine months ended March 31, 2008 and 2007 in accounts receivable, sales returns, inventory and accounts payable were primarily due to growth in net sales during the periods as a result of new product introductions, increased sales of existing server systems and components and increased purchases from our suppliers. We anticipate that accounts receivable, sales returns, inventory and accounts payable will continue to increase to the extent we continue to grow our product lines and our business.

Investing activities. Net cash used in our investing activities was $20.3 million and $2.6 million for the nine months ended March 31, 2008 and 2007, respectively. Of these amounts, $22.4 million in the nine months ended March 31, 2008 was related to the purchase of investments in auction rate securities and variable rate demand notes and $18.8 million in the nine months ended March 31, 2008 was related to the proceeds from maturity of the investments in auction rate securities and variable rate demand notes, and $15.1 million was related to the purchases of property and equipment to support the Company s growth. Net cash used in investing activities in the nine months ended March 31, 2007 was due to an increase in purchases of property, plant and equipment of $2.6 million. We have historically owned our manufacturing facilities and have leased off-shore offices. The expansion of our manufacturing capability has to date not been capital intensive as our internal manufacturing is limited to assembly and test. We do expect to make significant capital investments in the future as we expand our assembly and test capabilities and invest in our infrastructure in order to improve our controls and procedures in anticipation of growing our business and meeting regulatory requirements associated with being a public company.

Financing activities. Net cash provided by (used in) our financing activities was $1.5 million and $(2.6) million for the nine months ended March 31, 2008 and 2007, respectively. In the nine months ended March 31, 2008, $2.4 million was related to the proceeds from the exercise of stock options. In the nine months ended March 31, 2007, $3.3 million was related to the payment of our initial public offering costs. We repaid $1.2 million and $0.5 million in loans for the nine months ended March 31, 2008 and 2007, respectively.

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

Other factors affecting liquidity and capital resources

We have entered into four building loans to purchase three facilities located in San Jose, California. Total balance outstanding on these loans was $10.4 million as of March 31, 2008. The first loan was entered into in March 2001 under which we borrowed $8.7 million. The second loan was entered into in April 2004 under which we borrowed $4.3 million. The third and fourth loans were entered into in September 2005 under which we borrowed a total of $7.9 million. The first loan was paid off on May 15, 2007 for $7.2 million including a pre-payment penalty of $69,000, and the fourth loan was paid off on October 17, 2007 for $1.0 million

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including a pre-payment penalty of $46,000. The two remaining loans require us to comply with customary covenants related to business and financial condition. They also have customary restrictions on business and financial activity in which we cannot engage without the prior written consent of the bank. For example, under the terms of the building loans, we generally may not, without the lenders prior written consent, incur certain indebtedness and liens, engage in business activities substantially different from our present business, liquidate or dissolve our business, lease or dispose of all or a substantial part of our business or assets, sell assets for less than fair market price, enter into any consolidation, merger or other business combination, or make certain loans, acquisitions and guaranties.

On October 15, 2007, we closed the escrow and used approximately $11.3 million of the net proceeds from our initial public offering to purchase land and a building at 880 Fox Lane in San Jose, California to support our growth.

In addition, we have historically paid a majority of our vendors within 25 to 100 days of invoice and Ablecom between 45 and 160 days of invoice. Ablecom, a Taiwan corporation, is one of our major contract manufacturers and a related party. As of March 31, 2008 and June 30, 2007 amounts owed to Ablecom by us were approximately $35.2 million and $26.1 million, respectively.

We have entered into arrangements with certain financing companies that have committed to pay us in a specified period after shipment to customers for sales transactions that have been approved by these financing companies prior to shipment. At March 31, 2008 and June 30, 2007, approximately $1,379,000 and $982,000, respectively, remained uncollected from customers subject to these arrangements. Such amounts have been recorded as advances from receivable financing arrangements as the Company has obligations to repurchase inventories seized by the financing companies from defaulting customers. See Note 8 of Notes to Condensed Consolidated Financial Statements.

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

In February 2008, we leased an office building of approximately 246,000 square feet in Fremont, California with total payment obligation of approximately $11.2 million over the next 7.3 years.

As of March 31, 2008, the Company held approximately $17.6 million of long-term auction-rate securities (auction rate securities), net of unrealized losses, representing our interest in auction rate student loans guaranteed by the Federal Family Education Loan Program (FFELP) and auction rate preferred shares in a closed end mutual fund invested in municipal securities; such auction rate securities were rated AAA at March 31, 2008. The stated maturity dates of these auction-rates securities may be one year or more beyond the balance sheet 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, the auction rate securities have been classified as non-current investments available-for-sale as of March 31, 2008 and recorded an unrealized loss of $636,000.

Although the Company has the financial ability and intent to hold its investments in auction rate securities until successful auctions occur, a buyer is found outside of the auction process or the preferred shares are redeemed, 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 have not become other-than-temporarily impaired subsequent to March 31, 2008, 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, 2008 with respect to these securities and, if a liquid market does not develop for these investments, we could be required to hold them to maturity.

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Contractual Obligations

The following table describes our contractual obligations as of March 31, 2008 (in thousands):

	Payments Due by Period				
	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years	Total
	(in thousands)				
Operating leases	$ 1,514	$ 3,716	$ 3,506	$ 4,435	$ 13,171
Capital leases, including interest	50	32			82
Building loans, including interest	953	1,906	1,906	13,412	18,177
License arrangement	450	900	900	1,200	3,450
Purchase commitments	15,585				15,585
Total	$ 18,552	$ 6,554	$ 6,312	$ 19,047	$ 50,465

As discussed in Note 11 to the Condensed Consolidated Financial Statements, we adopted the provisions of FIN 48 as of July 1, 2007. At July 1, 2007, we had a liability for unrecognized tax benefits and an accrual for the related interest totaling $3.9 million. The Company has not provided a detailed estimate of the payment timing due to the uncertainty of when the related tax settlements are due.

In February 2008, we leased a warehouse facility under an operating lease that expires in August 2015. This warehouse facility currently occupies approximately 246,000 square feet of office space in Fremont, California with total payment obligation of approximately $11.2 million over the next 7.3 years.

We expect to fund these obligations from our ongoing operations and the proceeds of our cash on hand.

Recently Issued Accounting Standards

EITF 07-3

In June 2007, the FASB issued EITF No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities* . The EITF requires nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed. EITF No. 07-3 is effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. We are currently evaluating the effects that EITF No. 07-3 will have on our consolidated financial position, results of operations or cash flows.

FAS 157

In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2), to partially defer FASB Statement No. 157, Fair Value Measurements (FAS 157). FSP 157-2 defers the effective date of FAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. We are currently evaluating the effects that FASB 157 will have on our consolidated financial position, results of operations or cash flows.

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Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosure About Market Risks

Interest Rate Risk

The primary objectives of our investment activity 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 principal amount of the investment to fluctuate. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments and certificates of deposit which they are reasonably expected to be realized in cash or sold during the normal operating cycle of the business. Our long-term investments 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 from operations. As of March 31, 2008, our investments were in money market funds, certificates of deposit and auction rate securities.

We had $10.4 million of indebtedness under our credit facilities as of March 31, 2008 and $11.6 million of indebtedness under our credit facilities as of June 30, 2007. The annual interest rate on our credit facilities is based on various indexes as defined in the loan agreements. At March 31, 2008 and June 30, 2007, the interest rates ranged from 5.77% to 7.23%. An immediate 10% increase or decrease in the index rates would not have a material effect on our interest expense.

Liquidity Risk

As of March 31, 2008, the Company held approximately $17.6 million of long-term auction-rate securities (auction rate securities), net of unrealized losses, representing our interest in auction rate student loans guaranteed by the Federal Family Education Loan Program (FFELP) and auction rate preferred shares in a closed end mutual fund invested in municipal securities; such auction rate securities were rated AAA at March 31, 2008. The stated maturity dates of these auction-rates securities may be one year or more beyond the balance sheet 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, the auction rate securities have been classified as non-current investments available-for-sale as of March 31, 2008 and recorded an unrealized loss of $636,000.

Although, the Company has the financial ability and intent to hold its investments in auction rate securities until successful auctions occur, a buyer is found outside of the auction process or the preferred shares are redeemed, 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 have not become other-than-temporarily impaired subsequent to March 31, 2008, 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, 2008 with respect to these securities and, if a liquid market does not develop for these investments, we could be required to hold them to maturity.

Foreign Currency Risk

To date, our international customer agreements have been denominated solely in U.S. dollars, and accordingly, we have not been exposed to foreign currency exchange rate fluctuations from customer agreements, and do not currently engage in foreign currency hedging transactions. However, the functional currency of our operations in Netherlands and Taiwan is the U.S. dollar and our local accounts are maintained in the local currency in the Netherlands and Taiwan, respectively, and thus we are subject to foreign currency exchange rate fluctuations associated with re-measurement to U.S. dollars. Such fluctuations have not been significant historically. For example, foreign exchange loss (gain) was $44,000 and $71,000 for the three and nine months ended March 31, 2008, respectively, and $(19,000) and $(7,000) for the three and nine months ended March 31, 2007, respectively.

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Item 4. Controls and Procedures

Management s Evaluation of Disclosure Controls and Procedures.

As of March 31, 2008, an evaluation was performed under the supervision and with the participation of our management, including our chief executive officer and chief financial officer (together, our certifying officers), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Disclosure controls and procedures are controls and other procedures designed to ensure that information required to be disclosed by us in our periodic reports filed with the Securities and Exchange Commission (SEC) is recorded, processed, summarized and reported within the time periods specified by the SEC s rules and instructions for this Quarterly Report on Form 10-Q, and that the information is accumulated and communicated to our management, including the chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation, our certifying officers concluded that, due to the material weakness described below, the Company did not have effective disclosure controls and procedures as of the end of the period covered by this report.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company s annual or interim financial statements will not be prevented or detected on a timely basis. We had a material weakness in the operation of controls designed to ensure the proper classification of amounts in the statement of cash flows. Specifically, management had determined its level of review of the classification of amounts in the statement of cash flows was not sufficiently detailed to detect material errors and this represented a material weakness in the operating effectiveness of internal controls over financial reporting.

Changes in Internal Control over Financial Reporting

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that a controls system, no matter how well designed and operated, is based in part upon certain assumptions about the likelihood of future events, and therefore can only provide reasonable, not absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

During the quarter ended March 31, 2008, management began to implement procedures to review the preparation of the statement of cash flows and classifications within such statement at a greater level of detail to address the weakness. Except for the commencement of such remediation plan, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) during the quarter ended March 31, 2008, that our certifying officers concluded materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

At the end of the fiscal year 2008, Section 404 of the Sarbanes-Oxley Act will require our management to provide an assessment of the effectiveness of our internal control over financial reporting, and our independent registered public accounting firm will be required to report on the effectiveness of internal control over financial reporting. We are in the process of performing the information system and process documentation, and evaluation and testing required for management to make this assessment and for the Company s independent auditors to provide their attestation report. We have not completed this process or the assessment, and this process will require significant amounts of management time and resources. In the course of evaluation and testing, management may identify deficiencies that will need to be addressed and remediated.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings.

We are subject to a suit brought by Digitechnic, S.A. which was filed in the Bobigny Commercial Court in Paris, France in 1999. The claims involve allegations of damages stemming from allegedly defective products. In September 2003, the Bobigny Commercial Court awarded damages of approximately $1.2 million against us. In February 2005, the Paris Court of Appeals reversed the trial court s ruling, dismissed all of Digitechnic s claims and awarded costs to us. Digitechnic appealed the decision to the French Supreme Court and asked for $2,416,000 for damages. On February 13, 2007, the French Supreme Court reversed the decision of the Paris Court of Appeals, ordering a new hearing before a different panel of the Paris Court of Appeals. Pending a new hearing, the trial court ruling is reinstated. In March 2008, the Company posted a bond in the amount of $3,040,000 required by the court. The bond was collateralized by an irrevocable standby letter of credit totaling $1,540,000. Although we cannot predict with certainty the final outcome of this litigation, we believe the claim to be without merit and intend to continue to defend it vigorously.

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

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Item 1a. Risk Factors.

The Risk Factors included in our Annual Report on Form 10-K for the year ended June 30, 2007 have not materially changed except for the addition of a new risk factors entitled: Our business and operations are especially subject to the risks of earthquakes other natural catastrophic events; We invest in auction rate securities that are subject to market risk and the recent problems in the financial markets could adversely affect the value and liquidity of our assets; and We are currently not in compliance with certain Nasdaq independent director requirements and failure to gain compliance could jeopardize our continued Nasdaq listing. Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors, as well as the other information in this Form 10-Q, before deciding whether to invest in shares of our common stock. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our common stock would likely decline and you might lose all or part of your investment in our common stock. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

Risks Related to Our Business and Industry

Our recent significant growth makes it difficult to evaluate our current business and future prospects and may increase the risk of your investment.

Although we have been operating since 1993, our revenues have grown substantially in recent periods, which makes it difficult to evaluate our current business and future prospects. You must consider our business and prospects in light of the risks and difficulties we encounter as a rapidly growing technology company in a very competitive market. These risks and difficulties include, but are not limited to, the risks identified in this section and in particular the following factors:

- our focus on a single market, the market for application optimized server systems and components;
- our increasing focus on the sales of server systems as compared to components;
- the difficulties we face in managing rapid growth in personnel and operations;
- the timing and success of new products and new technologies introduced by us and our competitors;
- our ability to build brand awareness in a highly competitive market; and
- our ability to market new and existing products on our own and with our partners.

We may not be able to successfully address any of these risks or others. Failure to do so adequately could seriously harm our business and cause our operating results to suffer.

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

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

- our ability to attract new customers, retain existing customers and increase sales to such customers;

unpredictability of the timing and size of customer orders, since most of our customers purchase our products on a purchase order basis rather than pursuant to a long term contract;

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

variability of our margins based on the mix of server systems and components we sell;

variability of operating expenses as a percentage of net sales;

fluctuations in receipt of NRE funding, or receipt or payment of MDF payments;

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 components and whether made directly or through indirect sales channels;

fluctuations based upon seasonality;

the rate of expansion, domestically and internationally;

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

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

general economic conditions in our geographic markets; and

impact of regulatory changes on our cost of doing business.

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

If the demand for application optimized server solutions does not continue to develop as we anticipate, demand for our server solutions may not grow as we expect.

The success of our business depends on the continued adoption of application optimized server solutions by businesses for running their critical business applications. The market for application optimized server solutions has begun to develop in recent years. As the market for general purpose servers has grown and matured, leading general purpose server vendors have focused on providing a limited range of models that could be mass produced, thereby creating an opportunity for the development of a market focused on more application optimized servers. This new market has been marked by frequent introductions of new technologies and products. Many of these technologies and products have not yet gained, and may not gain, significant customer acceptance. We expect to devote significant resources to identifying new market trends and developing products to meet anticipated customer demand for application optimized server solutions. Ultimately, however, customers may not purchase application optimized server solutions and instead select general purpose lower-cost servers and components. We are also part of a broader market for server solutions and demand for these server solutions may decline or fail to grow as we expect. Accordingly, we can not assure you that demand for the type of server solutions we offer and plan to offer will continue to develop as we anticipate, or at all.

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

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

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

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

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

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

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. 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.

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

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

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

As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. Furthermore, because of these advantages, even if our application optimized server solutions are more effective than the products that our competitors offer, potential customers might accept competitive products in lieu of purchasing our products. The challenges we face from larger competitors will become even greater if consolidation or collaboration between or among our competitors occurs in our industry. For all of these reasons, we may not be able to compete successfully against our current or future competitors, and if we do not compete effectively, our ability to increase our net sales may be impaired.

Our sales cycle is lengthy and expensive, and could adversely affect the amount, timing and predictability of future net sales.

Our end customers generally need three to six months after an initial contact to make a final purchase decision with respect to our products. As customers weigh their purchase options, we may expend significant resources in pursuit of a sale that may ultimately fail to close. We have little control over our customers budget cycles and approval processes, or the strength of competitors relationships with our potential customers, all of which could adversely affect our sales efforts. The introduction of new products and product enhancements may lengthen our sales cycle as customers defer a decision on purchasing existing products and evaluate our new products. If we are unsuccessful in closing sales after expending significant resources, our net sales and operating expenses will be adversely affected.

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 selling our server solutions to larger customers will create new challenges. No one customer represented 10% or more of our revenues for fiscal years 2007 and 2006 or the three and nine months ended March 31, 2008 and 2007. However, if certain customers buy our products in greater volumes, and their business becomes a larger percentage of our net sales, we may grow increasingly dependent on those customers to maintain our growth. If our largest customers do not purchase our products at the levels or in the timeframes that we expect, our ability to maintain or grow our net sales will be adversely affected.

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

Increased sales to larger companies may also cause fluctuations in results of operations. A larger customer may seek to fulfill all or substantially all of its requirements in a single order, and not make another purchase for a significant period of time. Accordingly, a significant increase in revenue during the period in which we recognize the revenue from the sale may be followed by a period of time during which the customer purchases none or few of our products. A significant decline in net sales in periods following a significant order could adversely affect our stock price.

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

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

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

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

Our time to market advantage is dependent upon our suppliers ability to continue to introduce improved components for our products.

We are dependent upon our material and core component suppliers, such as Intel and AMD, to continue to introduce improved products with additional features that our customers will find attractive. If the pace of innovation from our suppliers slows, our products may face increased competition if our competitors are able to introduce products that use the latest technology offered by other suppliers in the industry. This price competition could lead to reduced margins and could adversely affect our results of operations.

As our business grows, we expect that we may be exposed to greater customer credit risks.

Historically, we have offered limited credit terms to our customers. As our customer base expands, as our orders increase in size, and as we obtain more direct customers, we expect to offer increased credit terms and flexible payment programs to our customers. Doing so may subject us to increased credit risk, higher accounts receivable with longer days outstanding, and increases in charges or reserves, which could have a material adverse effect on our business, results of operations and financial condition.

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

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

Historically, a substantial majority of our revenues have resulted from sales of our server solutions through third party distributors and resellers, which sales accounted for approximately 62.8% and 61.6% of our net sales in the three and nine months ended March 31, 2008, respectively, compared to approximately 72.8% and 69.1% of our net sales in the three and nine months ended March 31, 2007, 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 promotional goods or made short-term pricing concessions. The discontinuation of promotional goods 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.

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

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

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. We have not been impacted by this phenomenon to any material extent to date because most of our sales are generated from our most recently introduced products which have not yet become commoditized and therefore are not yet subject to the pressure of rapidly declining average selling prices. However, 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.

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. 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.

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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. Additionally, the rapid pace of innovation in our industry could render significant portions of our existing inventory obsolete. Certain of our distributors and OEMs have rights to return products, limited to purchases over a specified period of time, generally within 60 to 90 days of the purchase, or to products in the distributor s or OEM s inventory at certain times, such as termination of the agreement or product obsolescence. Any returns under these arrangements could result in additional obsolete inventory. In addition, server systems and components 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. We recorded inventory write-downs charged to cost of sales of $2.2 million and $6.7 million for the three and nine months ended March 31, 2008, respectively, for excess and obsolete inventory. We recorded inventory write-downs charged to cost of sales of $1.7 million and $2.9 million for the three and nine months ended March 31, 2007, respectively, for excess and obsolete inventory.

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.

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

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

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

our reputation and relationships with customers could be damaged. We could lose orders, be unable to develop or sell some products cost-effectively or on a timely basis, if at all, and have significantly decreased revenues, margins and earnings, which would have a material adverse effect on our business.

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

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

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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. Additionally, customers may make warranty claims against us, 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. or Adaptec, Inc. two of our major contract manufacturers, and those conflicts may adversely affect our operations.

We use Ablecom Technology, a related party, for contract design and manufacturing coordination support. We work with Ablecom to optimize modular designs for our chassis and certain other components. Our purchases from Ablecom represented approximately 27.4% and 26.4% of our cost of sales for the three and nine months ended March 31, 2008, respectively, and approximately 33.6% and 27.3% of our cost of sales for the three and nine months ended March 31, 2007, 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 approximately 30.7% of Ablecom s outstanding common stock. Charles Liang served as a director of Ablecom during our fiscal 2006, but is not currently serving in such capacity. In addition, Yih-Shyan (Wally) Liaw, our Vice President of International Sales and Secretary, and a director, and his wife jointly own approximately 5.2% of Ablecom s outstanding common stock, and collectively, Mr. Charles Liang, Ms. Liang, Mr. Liaw, Mr. Steve Liang and relatives of these individuals own over 80% of Ablecom s outstanding common stock. Mr. and Mrs. Charles Liang, as directors, officers and significant stockholders, and Mr. Liaw, as an officer, director and significant stockholder, 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. Historically, transactions with Ablecom were not approved by an independent committee of our board of directors as we had no independent directors.

We use Adaptec for contract manufacturing services. We purchase Adaptec drivers that are developed and configured for us, and concurrently sell our server systems and components to Adaptec. In the three and nine months ended March 31, 2008, we purchased contract manufacturing services and products, respectively, from Adaptec totaling approximately $1.3 million and $4.2 million, respectively, and sold products to Adaptec totaling approximately $0.5 million and $2.1 million, respectively. In the three and nine months ended March 31, 2007, we purchased contract manufacturing services and products from Adaptec totaling approximately $0.8 million and $5.1 million, respectively, and sold products to Adaptec totaling approximately $0.9 million and $4.5 million, respectively. Since Adaptec is both a customer and vendor, the terms and conditions of our business agreements with them may not be as favorable, individually or in aggregate, as we may be able to receive from unrelated third parties, and we may not be as strongly enforce our rights under these agreements. In addition, if a dispute were to arise under our agreement to sell our products to Adaptec, the dispute could lead to disruption or termination of the provision of services or products by them to us. This could compromise our ability to satisfy customer orders on a timely basis, if at all, or we may incur significant costs in establishing an agreement with a new vendor, the terms of which may not be as favorable as those in our agreements with Adaptec. In that event, our net sales, margins and earnings could suffer. At the same time, if a dispute were to arise under our agreement to purchase contract manufacturing services or products from Adaptec, the dispute may cause them to reduce or terminate their purchases of our products, thereby reducing our revenues.

In addition, our relationships with Ablecom could be adversely affected by declines in our stock price or divestments by Ablecom of its shares of our common stock. Steve Liang, Ablecom s Chief Executive Officer, held approximately 2.5% of our outstanding common stock as of March 31, 2008. If the value of the shares that Steve Liang holds should decline, by decrease in our stock price or by disposition of the shares, if Steve Liang ceases to have significant influence over Ablecom, or if those of our stockholders who hold shares of Ablecom cease to hold a majority of the outstanding shares of Ablecom, the terms and conditions of our agreements with Ablecom may not be as favorable as those in our existing contracts. As a result, our costs could increase and adversely affect our margins and results of operations.

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

Although we generally re-negotiate the price of products that we purchase from Ablecom on a quarterly basis, pursuant to our agreements with Ablecom either party may re-negotiate the price of products for each order. As a result of our relationship with Ablecom, it is possible that

Ablecom may in the future sell products to us at a price lower than we could obtain from an unrelated third party supplier. This may result in our reporting for one or more periods gross profit as a percentage of net sales in excess of what we might have obtained absent our relationship with Ablecom.

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

We plan to expand our warehousing capacity and our manufacturing relationship with Ablecom in China. Ablecom is transferring operations from Taiwan to a larger facility in China. In addition to providing a larger volume of contract manufacturing services for us, Ablecom will warehouse for us an increasing number of components and subassemblies manufactured by multiple suppliers prior to shipment to our facilities in the U.S. and Europe. We also anticipate that we will continue to lease office space from Ablecom in Taiwan to support the research and development efforts we are undertaking.

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

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

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

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

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

We market and sell our systems and components both domestically and outside the United States. We intend to expand our international sales efforts, especially into Asia, but our international expansion efforts may not be successful. Our international operations expose us to risks and challenges that we would otherwise not face if we conducted our business only in the United States, such as:

heightened price sensitivity from customers in emerging markets;

our ability to establish local manufacturing, support and service functions, and to form channel relationships with resellers in non-U.S. markets;

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- 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.

We have in the past entered into plea and settlement agreements with the government relating to violations of export control and economic sanctions laws that occurred during the 2001 to 2003 timeframe; if we fail to comply with laws and regulations restricting dealings with sanctioned countries, we may be subject to future civil or criminal penalties, which may have a material adverse effect on our business or ability to do business outside the U.S.

In 2004, we received subpoenas from the Bureau of Industry and Security of the Department of Commerce, or BIS, with respect to our relationship with a distributor and transactions involving the sale and resale of products to Iran that occurred prior to 2004. After receiving the first subpoena, we retained special export control counsel, conducted an internal investigation into these matters and terminated our relationship with the distributor in question. We also instituted a new export compliance program, which program we continue to develop and implement. The U.S. Department of Justice and Office of Foreign Assets Control of the Department of Treasury, or OFAC, also initiated investigations regarding these matters.

In September 2006, we entered into an agreement with the U.S. Department of Justice pursuant to which we agreed to plead guilty to one count of violating federal export regulations by shipping 300 motherboards to Dubai, UAE, with knowledge that they would be transshipped to Iran. We agreed to pay a $150,000 fine. We have also entered into a settlement agreement with BIS with respect to alleged violations of the Export Administration Regulations pursuant to which we agreed to pay a fine of approximately $125,000. We were charged by BIS with twelve violations of the Export Administration Regulations. Six of these violations involved the shipment of server systems and components without required government authorization through a distributor to end customers in Iran. Three of these violations involved allegations that shipments took place when we knew or had reason to know that the transactions would constitute a violation of the applicable regulations. Three involved claims that we made false declarations on shipping documents, stating that no license was required for the export of the products when in fact a government license was required. Finally, we have entered into a settlement agreement with OFAC relating to 21 alleged violations of U.S. sanctions laws. Pursuant to this agreement, we have paid a fine of $179,000. We believe that all issues with respect to the matters under investigation have been resolved.

We believe we are currently in compliance in all material respects with applicable export related laws and regulations. However, if our export compliance program is not effective, or if we are subject to any future claims regarding violation of export control and economic sanctions laws,

we could be subject to civil or criminal penalties, which could lead to a material fine or other sanctions, including loss of export privileges, that may have a material adverse effect on our business, financial condition, results of operation and future prospects. In addition, these plea and settlement agreements and any future violations could have an adverse impact on our ability to sell our products to U.S. federal, state and local government and related entities.

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

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

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

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

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

Our industry is marked by a large number of patents, copyrights, trade secrets and trademarks and by frequent litigation based on allegations of infringement or other violation of intellectual property rights. Third-parties have in the past sent us correspondence regarding their intellectual property and in the future we may receive claims that our products infringe or violate third parties intellectual property rights. For example, we were subject to a lawsuit filed in 2005 by Rackable Systems, Inc. The case was settled in May 2007, on terms which had no adverse effect on our business, financial condition and result of operations. 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. Additionally, we are particularly dependent on the continued service of our existing research and development personnel because of the complexity of our products and technologies. Our employment arrangements with our executives and employees do not require them to provide services to us for any specific length of time, and they can terminate their employment with us at any time, with or without notice, without penalty. The loss of services of any of these executives or of one or more other key members of our team could seriously harm our business.

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

Our board and management team have a limited history of working together and may not be able to execute our business plan.

Two members of our Board joined our Board in February 2007. We have also recently filled a number of positions in our finance and accounting staff. Accordingly, key personnel in our finance and accounting team have only recently assumed the duties and responsibilities they are now performing. Our Board members and key employees have worked together for only a limited period of time and have a limited track record of executing our business plan as a team. In addition, our executives have limited experience conducting business as a public company and fulfilling the increased legal, administrative and accounting obligations associated with being a public company. Accordingly, it is difficult to predict whether our directors and senior executives, individually and collectively, will be effective in managing our operations.

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

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

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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.

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.

If the market for modular, open standard-based products does not continue to grow, opportunities to sell our products will be scarcer and our ability to grow would suffer.

The success of our business requires companies to commit to a modular, open standard-based server architecture instead of traditional proprietary and RISC/UNIX based servers. If enterprises do not adopt this open standard-based approach, the market for our products may not grow as we anticipate and our revenues would be adversely affected. Many prospective customers have invested significant financial and human resources in their existing systems, many of which are critical to their operations, and they may be reticent to overhaul their systems. Moreover, many of the server systems that we sell currently run on the Linux operating system, and are subject to the GNU General Public License. Pending litigation involving Linux and the GNU General Public License could be resolved in a manner that adversely affects Linux adoption in our industry and could materially harm our ability to sell our products based on the Linux operating system and the GNU General Public License. If the market for open standard-based modular technologies does not continue to develop for any reason, our ability to grow our business will be adversely affected.

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

Our corporate headquarters, including our most significant research and development and manufacturing operations, are located in the Silicon Valley area of Northern California, a region known for seismic activity. We do not currently have a comprehensive disaster recovery program and as a result, a significant natural disaster, such as an earthquake, could have a material adverse impact on our business, operating results, and financial condition.

Market demand for our products may decrease as a result of changes in general economic conditions, as well as incidents of terrorism, war and other social and political instability.

Our net sales and gross profit depend largely on general economic conditions and, in particular, the strength of demand for our server solutions in the markets in which we are doing business. From time to time, customers and potential customers have elected not to make purchases of our products due to reduced budgets and uncertainty about the future, and, in the case of distributors, declining demand from their customers for their solutions in which they integrate our products. Similarly, from time to time, acts of terrorism, in particular in the United States, have had a negative impact on information technology spending. High fuel prices and turmoil in the Middle East and elsewhere have increased uncertainty in the United States and our other markets. Should the current conflicts in the Middle East and in other parts of the world suppress economic activity in the United States or globally, our customers may delay or reduce their purchases on information technology, which would result in lower demand for our products and adversely affect our results of operations.

If we acquire any companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.

In the future, we may acquire or make investments in companies, assets or technologies that we believe are complementary or strategic. We have not made any acquisitions or investments to date, and therefore our ability as an organization to make acquisitions or investments is unproven. If we decide to make an acquisition or investment, we face numerous risks, including:

difficulties in integrating operations, technologies, products and personnel;

diversion of financial and managerial resources from existing operations;

risk of overpaying for or misjudging the strategic fit of an acquired company, asset or technology;

problems or liabilities stemming from defects of an acquired product or intellectual property litigation that may result from offering the acquired product in our markets;

challenges in retaining employees key to maximize the value of the acquisition or investment;

inability to generate sufficient return on investment;

incurrence of significant one-time write-offs; and

delays in customer purchases due to uncertainty.

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If we proceed with an acquisition or investment, we may be required to use a considerable amount of our cash, including proceeds from this offering, or to finance the transaction through debt or equity securities offerings, which may decrease our financial liquidity or dilute our stockholders and affect the market price of our stock. As a result, if we fail to properly evaluate and execute acquisitions or investments, our business and prospects may be harmed.

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

As of March 31, 2008, the Company held approximately $17.6 million of long-term auction-rate securities (auction rate securities), net of unrealized losses, representing our interest in auction rate student loans guaranteed by the Federal Family Education Loan Program (FFELP) and auction rate preferred shares in a closed end mutual fund invested in municipal securities; such auction rate securities were rated AAA at March 31, 2008. The stated maturity dates of these auction-rates securities may be one year or more beyond the balance sheet 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, the auction rate securities have been classified as non-current investments available-for-sale as of March 31, 2008 and recorded an unrealized loss of $636,000.

Although, the Company has the financial ability and intent to hold its investments in auction rate securities until successful auctions occur, a buyer is found outside of the auction process or the preferred shares are redeemed, 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 have not become other-than-temporarily impaired subsequent to March 31, 2008, 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, 2008 with respect to these securities and, if a liquid market does not develop for these investments, we could be required to hold them to maturity.

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, commencing with the fiscal year ending June 30, 2008, our management will be required to report on the effectiveness of our internal control over financial reporting in each of 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.

We recently identified a material weakness in the operation of controls designed to ensure that changes in classification of amounts, or classifications of amounts associated with new transactions, between cash flows from operating activities, investing activities and financing activities in the condensed consolidated statement of cash flows are appropriate. Although we intend to diligently and regularly review and update our internal control over financial reporting in order to ensure compliance with the Section 404 requirements, in future periods we may discover areas of our internal controls that need improvement, and our management may encounter problems or delays in completing the implementation and maintenance of any such improvements necessary to make a favorable assessment of our internal controls over financial reporting. We may not be able to favorably assess the effectiveness of our internal controls over financial reporting as of June 30, 2008, or our independent auditors may be unable to provide an unqualified attestation report on our internal control over financial reporting. If this occurs, investor confidence and our 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. In June 2007, we entered into a settlement agreement regarding a claim under Proposition 65. We expect that our operations will be affected by other new environmental laws and regulations on an ongoing basis. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, and could require that we change the design and/or manufacturing of our products, any of which could have a material adverse effect on our business.

Risks Related to Owning Our Stock

We are currently not in compliance with certain Nasdaq independent director requirements and failure to gain compliance could jeopardize our continued Nasdaq listing.

As a result of the unexpected death of one of our independent directors, the Company no longer fully complies with NASDAQ s independent director and audit committee requirements. We have received notice that we must regain full compliance by adding a new outside director before the earlier of our next annual stockholders meeting or March 25, 2009 or, if the next annual stockholders meeting is held before September 22, 2008, no later than September 22, 2008. If we fail to regain compliance within such time period, our Common Stock may be subject to de-listing from Nasdaq.

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.

Our stock has been publicly traded for a relatively short period of time, having first begun trading in March 2007. The trading prices of technology company securities in general have been highly volatile. Accordingly, the trading price of our common stock is likely to be subject to wide fluctuations. Factors, in addition to those outlined elsewhere in this prospectus, that may affect the trading price of our common stock include:

- actual or anticipated variations in our operating results;
- announcements of technological innovations, new products or product enhancements, strategic alliances or significant agreements by us or by our competitors;
- changes in recommendations by any securities analysts that elect to follow our common stock;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;

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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. As of March 31, 2008, we had approximately 32.3 million shares of common stock outstanding. Substantially all of these shares are eligible for sale in the public market, including approximately 9.9 million shares held by directors, executive officers and other affiliates, which are subject to volume limitations under Rule 144 under the Securities Act. In addition, approximately 13.2 million shares subject to outstanding options and reserved for future issuance under our stock option plans are eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements, the lock-up agreements and Rules 144 and 701 under the Securities Act. If these additional shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline.

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

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

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

As of May 9, 2008, our executive officers, directors, current five percent or greater stockholders and affiliated entities together beneficially owned approximately 40.0 percent of our common stock outstanding. As a result, these stockholders, acting together, have significant influence over all matters that require approval by our stockholders, including the election of directors and approval of significant corporate transactions. Corporate action might be taken even if other stockholders, including those who purchase shares in this offering, oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial.

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

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

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

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

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

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

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

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

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

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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. See Description of Capital Stock.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take corporate actions other than those you desire.

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. Default Upon Senior Securities.
Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders.
No matters were submitted to a vote of our security holders during the quarter ended March 31, 2008.

Item 5. Other Information.
Not applicable.

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Item 6. Exhibits

(a) Exhibits.

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

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Signatures

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

SUPER MICRO COMPUTER, INC.

Dated: May 15, 2008

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

Dated: May 15, 2008

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