Super Micro Computer, Inc.
Form 10-Q
November 07, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from to

Commission File Number 001-33383

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

Delaware	77-0353939
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

980 Rock Avenue
San Jose, CA 95131
(Address of principal executive offices, including zip code)
(408) 503-8000
(Registrant's telephone number, including area code)

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

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

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

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

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

As of October 27, 2016 there were 47,980,148 shares of the registrant's common stock, $0.001 par value, outstanding, which is the only class of common stock of the registrant issued.

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SUPER MICRO COMPUTER, INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2016

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Unless the context requires otherwise, the words “Super Micro,” “Supermicro,” “we,” “Company,” “us” and “our” in this docu refer to Super Micro Computer, Inc. and where appropriate, our wholly owned subsidiaries. Supermicro, the Company logo and our other registered or common law trademarks, service marks, or trade names appearing in this Quarterly Report on Form 10-Q are the property of Super Micro Computer, Inc. or its affiliates. Other trademarks, service marks, or trade names appearing in this Quarterly Report on Form 10-Q are the property of their respective owners.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements
SUPER MICRO COMPUTER, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)
(unaudited)

	September 30, 2016	June 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$146,696	$180,964
Accounts receivable, net of allowances of $2,839 and $2,721 at September 30, 2016 and June 30, 2016, respectively (including amounts receivable from a related party of $7,251 and $4,678 at September 30, 2016 and June 30, 2016, respectively)	328,267	288,941
Inventory	499,987	448,980
Prepaid income taxes	1,019	5,682
Prepaid expenses and other current assets	13,402	13,435
Total current assets	989,371	938,002
Long-term investments	2,643	2,643
Property, plant and equipment, net	190,848	187,949
Deferred income taxes-noncurrent	29,666	28,460
Other assets	8,053	8,546
Total assets	$1,220,581	$1,165,600
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable (including amounts due to a related party of $38,290 and $39,152 at September 30, 2016 and June 30, 2016, respectively)	$287,638	$249,239
Accrued liabilities	60,843	55,618
Income taxes payable	6,029	5,172
Short-term debt and current portion of long-term debt, net of debt issuance costs	60,983	53,589
Total current liabilities	415,493	363,618
Long-term debt, net of current portion and debt issuance costs	37,212	40,000
Other long-term liabilities	44,661	40,603
Total liabilities	497,366	444,221
Commitments and contingencies (Note 9)		
Stockholders’ equity:		
Common stock and additional paid-in capital, $0.001 par value		
Authorized shares: 100,000,000		
Issued shares: 49,312,816 and 48,999,717 at September 30, 2016 and June 30, 2016, respectively	284,090	277,339
Treasury stock (at cost), 1,333,125 and 445,028 shares at September 30, 2016 and June 30, 2016, respectively	(20,491)	(2,030)
Accumulated other comprehensive loss	(76)	(85)
Retained earnings	459,503	445,971
Total Super Micro Computer, Inc. stockholders’ equity	723,026	721,195
Noncontrolling interest	189	184
Total stockholders’ equity	723,215	721,379

Total liabilities and stockholders’ equity	$1,220,581	$1,165,600

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,	
	2016	2015
Net sales (including related party sales of $3,342 and $5,220 in the three months ended September 30, 2016 and 2015, respectively)	$528,968	$519,618
Cost of sales (including related party purchases of $50,205 and $59,261 in the three months ended September 30, 2016 and 2015, respectively)	448,904	447,403
Gross profit	80,064	72,215
Operating expenses:		
Research and development	33,191	28,326
Sales and marketing	15,916	14,249
General and administrative	10,755	8,200
Total operating expenses	59,862	50,775
Income from operations	20,202	21,440
Interest and other income, net	29	87
Interest expense	(330)	(324)
Income before income tax provision	19,901	21,203
Income tax provision	6,369	7,504
Net income	$13,532	$13,699
Net income per common share:		
Basic	$0.28	$0.29
Diluted	$0.26	$0.27
Weighted-average shares used in calculation of net income per common share:		
Basic	48,165	47,517
Diluted	51,120	51,352

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,	
	2016	2015
Net income	$13,532	$13,699
Other comprehensive income, net of tax:		
Foreign currency translation gains (losses)	9	(18)
Unrealized gains (losses) on investments	—	—
Total other comprehensive gains (losses)	9	(18)
Comprehensive income	$13,541	$13,681

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30, 2016	2015
OPERATING ACTIVITIES:		
Net income	$13,532	$13,699
Reconciliation of net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,802	2,753
Stock-based compensation expense	4,504	3,876
Excess tax benefits from stock-based compensation	(302)	(134)
Allowance for doubtful accounts	73	98
Provision for inventory	3,893	1,718
Exchange loss (gain)	698	(2,007)
Deferred income taxes	(1,182)	(2,221)
Changes in operating assets and liabilities:		
Accounts receivable, net (including changes in related party balances of $(2,573) and $1,212 during the three months ended September 30, 2016 and 2015, respectively)	(39,399)	25,418
Inventory	(54,900)	404
Prepaid expenses and other assets	465	(1,247)
Accounts payable (including changes in related party balances of $(862) and $(3,129) during the three months ended September 30, 2016 and 2015, respectively)	43,362	(37,652)
Income taxes payable, net	5,314	2,966
Accrued liabilities	4,992	3,686
Other long-term liabilities	4,105	8,949
Net cash provided by (used in) operating activities	(11,043)	20,306
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(11,646)	(7,662)
Change in restricted cash	116	(3)
Net cash used in investing activities	(11,530)	(7,665)
FINANCING ACTIVITIES:		
Proceeds from debt, net of debt issuance costs	73,916	4,700
Repayment of debt	(70,033)	(2,900)
Payment to acquire treasury stock	(18,461)	—
Proceeds from exercise of stock options	2,939	951
Excess tax benefits from stock-based compensation	302	134
Minimum tax withholding paid on behalf of employees for restricted stock units	(660)	(196)
Payment of obligations under capital leases	(56)	(39)
Advances (payments) under receivable financing arrangements	19	(37)
Net cash provided by (used in) financing activities	(12,034)	2,613
Effect of exchange rate fluctuations on cash	339	198
Net increase (decrease) in cash and cash equivalents	(34,268)	15,452
Cash and cash equivalents at beginning of period	180,964	95,442
Cash and cash equivalents at end of period	$146,696	$110,894
Supplemental disclosure of cash flow information:		
Cash paid for interest	$316	$298

Cash paid for taxes, net of refunds	$1,212	$5,736
Non-cash investing and financing activities:		
Equipment purchased under capital leases	$—	$42
Accrued costs for property, plant and equipment purchases	$4,070	$5,735

See accompanying notes to condensed consolidated financial statements.

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

Note 1. Summary of Significant Accounting Policies

Organization

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

Basis of Presentation

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

The unaudited condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”) and include the accounts of the Company and its wholly-owned subsidiaries. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements for the fiscal year ended June 30, 2016 included in its Annual Report on Form 10-K, as filed with the SEC (the “Annual Report”).

The unaudited condensed consolidated financial statements included herein reflect all adjustments, including normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for the periods presented. The condensed consolidated results of operations for the three months ended September 30, 2016 are not necessarily indicative of the results that may be expected for future quarters or for the fiscal year ending June 30, 2017.

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

Fair Value of Financial Instruments

The Company accounts for certain assets and liabilities at fair value. Accounts receivable and accounts payable are carried at cost, which approximates fair value due to the short maturity of these instruments. Cash equivalents and long-term investments are carried at fair value. Short-term and long-term debt is carried at amortized cost, which approximates its fair value based on borrowing rates currently available to the Company for loans with similar terms. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 - Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly; and
- Level 3 - Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

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

Net Income Per Common Share

The Company's basic net income per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding stock options and unvested restricted stock units (“RSUs”). Under the treasury stock method, an increase in the fair market value of the Company’s common stock results in a greater dilutive effect from outstanding stock options and RSUs. Additionally, the exercise of employee stock options and the vesting of restricted stock units results in a further dilutive effect on net income per share.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued new accounting guidance, Revenue from Contracts with Customers, that replaces all current U.S. GAAP guidance on revenue, eliminates all industry-specific guidance and provides a unified model in determining when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Further, in March 2016, the FASB issued an amendment to the accounting guidance, Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies the implementation guidance for principal versus agent considerations. In April 2016, the FASB issued an amendment to the accounting guidance, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, which clarifies the guidance related to identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued an amendment to the accounting guidance, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients, which clarifies the guidance related to collectibility and non-cash consideration, as well as provides practical expedients for the transition to the new accounting guidance. This guidance can be applied either retrospectively or as a cumulative-effect adjustment as of the date of adoption. Early adoption is permitted for annual periods beginning after December 15, 2016. The new standard is effective for the Company on July 1, 2018. The Company is currently evaluating the effect the guidance will have on its financial statement disclosures, results of operations and financial position.

In April 2015, the FASB issued an amendment to the accounting guidance, Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. This amendment requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. In August 2015, the FASB issued an amendment to the accounting guidance, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. This amendment clarifies that an entity may defer and present debt issuance costs associated with line-of-credit arrangements as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. These amendments should be applied retrospectively to all prior periods presented in the financial statements. The Company adopted these amendments in the first quarter of fiscal year 2017. There was no material impact on its financial statement disclosures, results of operations and financial position.

In July 2015, the FASB issued an amendment to the accounting guidance, Inventory: Simplifying the Measurement of Inventory. The amendment requires entities to measure inventory at the lower of cost and net realizable value thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. The amendment is effective for the Company on July 1, 2018. The Company is currently evaluating the effect the amendment to the guidance will have on its financial statement disclosures, results of operations and financial position.

In February 2016, the FASB issued an amendment to the accounting guidance, Leases. The amendment will supersede the existing lease guidance, including on-balance sheet recognition of operating leases for lessees. This amendment should be applied using a modified retrospective approach and is effective for the Company on July 1, 2018. Early adoption is permitted. The Company is currently evaluating the effect the guidance will have on its financial statement disclosures, results of operations and financial position.

In March 2016, the FASB issued new accounting guidance, Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting on the accounting for certain aspects of share-based payment to employees,

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including the accounting for income taxes, forfeitures, and statutory tax withholding requirements as well as classification in the statement of cash flows. This guidance is effective for the Company on July 1, 2018. The Company is currently evaluating the effect the guidance will have on its financial statement disclosures, results of operations and financial position.

In August 2016, the FASB issued an amendment to the accounting guidance, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments. This amendment consists of eight provisions that provide guidance on the classification of certain cash receipts and cash payments. If practicable, this amendment should be applied using a retrospective transition method to each period presented. For the provisions that are impracticable to apply retrospectively, those provisions may be applied prospectively as of the earliest date practicable. This amendment is effective for the Company on July 1, 2019. Early adoption is permitted. The Company is currently evaluating the effect the guidance will have on its financial statement disclosures, results of operations and financial position.

Note 2. Stock-based Compensation and Stockholders’ Equity

Share Repurchase Program

In July 2016, the Company’s Board of Directors adopted a program to repurchase from time to time at management’s discretion up to $100,000,000 of the Company’s common stock in the open market or in private transactions during the next twelve months at prevailing market prices. Repurchases will be made under the program using the Company’s own cash resources. This share repurchase program does not obligate the Company to acquire any particular amount of common stock, and it may be suspended at any time at the Company’s discretion. During the three months ended September 30, 2016, the Company purchased 888,097 shares of the Company's common stock in the open market at a weighted average price of $20.79 for $18,461,000.

Equity Incentive Plan

In January 2016, the Board of Directors approved the 2016 Equity Incentive Plan (the "2016 Plan") and reserved for issuance 4,700,000 shares of common stock for awards of stock options, stock appreciation rights, restricted stock, RSUs and other share-based awards. The 2016 Plan was approved by the stockholders of the Company and became effective on March 8, 2016. As of such date, 8,696,444 shares of common stock were reserved for outstanding awards under the Company's 2006 Equity Incentive Plan (the "2006" Plan). Such awards remained outstanding under the 2006 Plan following the adoption of the 2016 Plan, although no further awards will be granted under the 2006 Plan. Up to 2,800,000 shares subject to awards that remained outstanding under the 2006 Plan but that are forfeited in the future will become available for use under the 2016 Plan. In addition, 1,153,412 shares of common stock originally reserved for issuance under the 2006 Plan were cancelled upon the adoption of the 2016 Plan. Under the 2016 Plan, the exercise price per share for incentive stock options granted to employees owning shares representing more than 10% of the Company at the time of grant cannot be less than 110% of the fair value of the underlying share on grant date. Nonqualified stock options and incentive stock options granted to all other persons shall be granted at a price not less than 100% of the fair value. Options generally expire ten years after the date of grant. Stock options and RSUs generally vest over four years; 25% at the end of one year and one sixteenth per quarter thereafter. As of September 30, 2016, the Company had 3,884,570 shares available for future issuance under the 2016 Plan.

Determining Fair Value

The Company's fair value of RSUs is based on the closing market price of the Company's common stock on the date of grant. 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 share-based awards are expected to be outstanding and was determined based on a combination of the Company's peer group and the Company's historical experience.

Expected Volatility—Expected volatility is based on a combination of the Company's implied and historical volatility.

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

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

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

The fair value of stock option grants for the three months ended September 30, 2016 and 2015 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended September 30,	
	2016	2015
Risk-free interest rate	1.12 %	1.57 %
Expected term	5.38 years	5.33 years
Dividend yield	— %	— %
Volatility	49.64 %	47.06 %
Weighted-average fair value	$9.29	$11.64

The following table shows total stock-based compensation expense included in the condensed consolidated statements of operations for the three months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,	
	2016	2015
Cost of sales	$309	$240
Research and development	2,908	2,402
Sales and marketing	478	404
General and administrative	809	830
Stock-based compensation expense before taxes	4,504	3,876
Income tax impact	(1,286)	(285)
Stock-based compensation expense, net	$3,218	$3,591

The cash flows resulting from the tax benefits for tax deductions resulting from the exercise of stock options and vesting of RSUs in excess of the compensation expense recorded for those share-based awards (excess tax benefits) issued or modified since July 1, 2006 are classified as cash from financing activities. Excess tax benefits for stock options issued prior to July 1, 2006 are classified as cash from operating activities. The Company had $32,000 of shortfalls recorded in additional paid-in capital in the three months ended September 30, 2016, and the Company had $714,000 of excess tax benefits recorded in additional paid-in capital in the three months ended September 30, 2015. The Company had excess tax benefits classified as cash provided by financing activities of $302,000 and $134,000 in the three months ended September 30, 2016 and 2015, respectively, for share-based awards issued since July 1, 2006.

As of September 30, 2016, the Company’s total unrecognized compensation cost related to non-vested share-based awards granted to employees and non-employee directors was $37,947,000, which will be recognized over a weighted-average vesting period of approximately 2.34 years.

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

Stock Option Activity

The following table summarizes stock option activity during the three months ended September 30, 2016 under all plans:

	Options Outstanding	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in thousands)
Balance as of June 30, 2016 (7,495,131 shares exercisable at weighted average exercise price of $13.35 per share)	8,960,867	$ 14.88		
Granted (weighted average fair value of $9.29)	127,620	$ 20.54		
Exercised	(257,453)	$ 11.41		
Forfeited	(12,854)	$ 19.78		
Balance as of September 30, 2016	8,818,180	$ 15.06	5.09	$ 79,505
Options vested and expected to vest at September 30, 2016	8,744,510	$ 14.97	5.06	$ 79,405
Options vested and exercisable at September 30, 2016	7,494,049	$ 13.62	4.55	$ 75,717

The total pretax intrinsic value of options exercised was $2,652,000 and $2,741,000 during the three months ended September 30, 2016 and 2015, respectively.

RSU Activity

The Company grants RSUs to certain employees as part of its regular employee equity compensation review program as well as to selected new hires. RSUs are share awards that entitle the holder to receive freely tradable shares of the Company's common stock upon vesting and settlement.

The following table summarizes RSUs activity during the three months ended September 30, 2016 under all plans:

	RSUs Outstanding	Weighted Average Grant-Date Fair Value per Share	Aggregate Intrinsic Value (in thousands)
Balance as of June 30, 2016	926,983	$ 30.23	
Granted	214,370	$ 20.54	
Released	(86,445)	$ 28.36	
Forfeited	(29,831)	$ 28.43	
Balance as of September 30, 2016	1,025,077	$ 28.41	$ 23,956

The total pretax intrinsic value of RSUs vested was $1,852,000 and $547,000 for the three months ended September 30, 2016 and 2015, respectively. In the three months ended September 30, 2016 and 2015, upon vesting, 86,445 and 20,199 shares of RSUs were partially net share-settled such that the Company withheld 30,799 and 7,232 shares with value equivalent to the employees' minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities, respectively. The total shares withheld were based on the value of the RSUs on their respective vesting dates as determined by the Company's closing stock price. Total payments for the employees' tax obligations to taxing authorities were $660,000 and 196,000 during the three months ended September 30, 2016 and 2015, respectively, and are reflected as a financing activity within the condensed consolidated statements of cash flows. These net-share settlements had the effect of share repurchases by the Company as they reduced and retired the number of shares that would have otherwise been issued as a result of the vesting and did not represent an expense to the Company. Pursuant to the terms of the 2016 Plan,

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

shares withheld in connection with net-share settlements are returned to the 2016 Plan and are available for future grants under the 2016 Plan.

Note 3. Net Income Per Share

The following table shows the computation of basic and diluted net income per share for the three months ended September 30, 2016 and 2015 (in thousands, except per share amounts):

	Three Months Ended September 30,	
	2016	2015
Numerator:		
Net income	$13,532	$13,699
Denominator:		
Weighted-average shares outstanding	48,165	47,517
Effect of dilutive securities	2,955	3,835
Weighted-average diluted shares	51,120	51,352
Basic net income per share	$0.28	$0.29
Diluted net income per share	$0.26	$0.27

For the three months ended September 30, 2016 and 2015, the Company had stock options and RSUs 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 anti-dilutive common share equivalents resulting from outstanding share-based awards were 1,976,000 and 1,248,000 for the three months ended September 30, 2016 and 2015, respectively.

Note 4. Balance Sheet Components

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

Inventory:

	September 30, 2016	June 30, 2016
Finished goods	$ 366,251	$351,209
Work in process	51,333	19,105
Purchased parts and raw materials	82,403	78,666
Total inventory	$ 499,987	$448,980

The Company recorded a provision for lower of cost or market and excess and obsolete inventory totaling $3,893,000 and $1,718,000 in the three months ended September 30, 2016 and 2015, respectively.

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

Property, Plant, and Equipment:

	September 30, 2016	June 30, 2016
Land	$ 70,457	$70,454
Buildings	71,665	71,665
Building and leasehold improvements	10,874	10,941
Buildings construction in progress (1)	19,834	15,803
Machinery and equipment	54,699	53,282
Furniture and fixtures	11,355	10,364
Purchased software	14,001	13,920
Purchased software construction in progress	450	532
	253,335	246,961
Accumulated depreciation and amortization	(62,487)	(59,012)
Property, plant and equipment, net	$ 190,848	$187,949

(1) In connection with the purchase of property located in San Jose, California for the Company's Green Computing Park, the Company continues to engage several contractors for the development and construction of improvements on the property.

Other Assets:

	September 30, 2016	June 30, 2016
Long-term deferred service costs	$ 3,604	$ 3,498
Restricted cash	1,764	1,851
Investment in a privately held company	1,411	1,411
Deposits	472	910
Prepaid royalty license	685	748
Others	$ 117	$ 128
Total other assets	$ 8,053	$ 8,546

Accrued Liabilities:

	September 30, 2016	June 30, 2016
Accrued payroll and related expenses	$ 16,252	$16,015
Customer deposits	7,385	6,265
Accrued warranty costs	5,600	5,816
Accrued cooperative marketing expenses	7,399	7,300
Deferred revenue (1)	16,462	13,418
Others	7,745	6,804
Total accrued liabilities	$ 60,843	$55,618

(1) As of September 30, 2016 and June 30, 2016, deferred revenue consist primarily of a deferred extended warranty and on-site service revenue of $15,160,000 and $12,746,000, respectively.

Other Long-term Liabilities:

	September 30, 2016	June 30, 2016
Deferred revenue-net of current portion (1)	$ 25,028	$21,940
Accrued unrecognized tax benefits including related interests and penalties-net of current portion	17,080	16,056
Accrued warranty costs-net of current portion	1,326	1,313
Others	1,227	1,294
Total other long-term liabilities	$ 44,661	$40,603

(1) As of September 30, 2016 and June 30, 2016, deferred revenue-net of current portion consist primarily of a deferred extended warranty and on-site service revenue of $23,717,000 and $21,265,000, respectively.

Product Warranties:

	Three Months Ended September 30,	
	2016	2015
Balance, beginning of period	$7,129	$7,700
Provision for warranty	4,926	3,866
Costs charged to accrual	(4,808)	(3,819)
Change in estimated liability for pre-existing warranties	(321)	(202)
Balance, end of period	6,926	7,545
Current portion	(5,600)	(7,545)
Long-term portion	$1,326	$—

Note 5. Fair Value Disclosure

The financial assets of the Company measured at fair value on a recurring basis are included in cash equivalents and long-term investments. The Company’s money market funds are classified within Level 1 of the fair value hierarchy which is based on quoted market prices for the identical underlying securities in active markets. The Company’s long-term auction rate securities investments are classified within Level 3 of the fair value hierarchy which did not have observable inputs as of September 30, 2016 and June 30, 2016. Refer to Note 1 for a discussion of the Company’s policies regarding the fair value hierarchy. The Company has used a discounted cash flow model to estimate the fair value of the auction rate securities as of September 30, 2016 and June 30, 2016. The material factors used in preparing the discounted cash flow model are (i) the discount rate utilized to present value the cash flows, (ii) the time period until redemption and (iii) the estimated rate of return.

The following table sets forth the Company’s cash equivalents and long-term investments as of September 30, 2016 and June 30, 2016 which are measured at fair value on a recurring basis by level within the fair value hierarchy. These are classified based on the lowest level of input that is significant to the fair value measurement (in thousands):

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September 30, 2016	Level 1	Level 2	Level 3	Asset at Fair Value
Money market funds	$ 312	$ —	$ —	$ 312
Auction rate securities	—	—	2,643	2,643
Total	$ 312	$ —	$ 2,643	$ 2,955

June 30, 2016	Level 1	Level 2	Level 3	Asset at Fair Value
Money market funds	$ 315	$ —	$ —	$ 315
Auction rate securities	—	—	2,643	2,643
Total	$ 315	$ —	$ 2,643	$ 2,958

The above table excludes $146,153,000 and $180,426,000 of cash and $2,054,000 and $2,133,000 of certificates of deposit held by the Company as of September 30, 2016 and June 30, 2016, respectively. There were no transfers between Level 1, Level 2 or Level 3 securities in the three months ended September 30, 2016 and 2015.

The following table provides a reconciliation of the Company's financial assets measured at fair value on a recurring basis, consisting of long-term auction rate securities, using significant unobservable inputs (Level 3) for the three months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,	
	2016	2015
Balance as of beginning of period	$2,643	$2,633
Total realized gains or (losses) included in net income	—	—
Total unrealized gains or (losses) included in other comprehensive income	—	—
Sales and settlements at par	—	—
Transfers in and/or out of Level 3	—	—
Balance as of end of period	$2,643	$2,633

The following is a summary of the Company's long-term investments as of September 30, 2016 and June 30, 2016 (in thousands):

	September 30, 2016			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Auction rate securities	$2,750	$ —	$ (107)	$ 2,643

	June 30, 2016			
	Amortized Cost	Gross Unrealized Holding	Gross Unrealized Holding	Fair Value

		Gains	Losses	
Auction rate securities	$2,750	$ —	$ (107)	$ 2,643

The Company measures the fair value of outstanding debt for disclosure purposes on a recurring basis. As of September 30, 2016 and June 30, 2016, short-term and long-term debt of $98,195,000 and $93,589,000, respectively, are reported at amortized cost. This outstanding debt is classified as Level 2 as it is not actively traded and is valued using a discounted cash flow model that uses observable market inputs. Based on the discounted cash flow model, the fair value of the outstanding debt approximates amortized cost.

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Note 6. Short-term and Long-term Debt Obligations

Short-term and long-term obligations as of September 30, 2016 and June 30, 2016 consisted of the following (in thousands):

	September 30, 2016	June 30, 2016
Line of credit:		
Bank of America (1)	$ 11,199	$ 62,199
CTBC Bank	18,800	10,100
Total line of credit	29,999	72,299
Term loans:		
Bank of America (1)	47,500	933
CTBC Bank	21,061	20,357
Total term loans	68,561	21,290
Total debt	98,560	93,589
Less: debt issuance costs	(365)	—
Total debt, net of debt issuance costs	98,195	93,589
Current portion, net of debt issuance costs	(60,983)	(53,589)
Long-term portion, net of debt issuance costs	$ 37,212	$ 40,000

(1) In July 2016, $50,000,000 of the revolving line of credit was refinanced to a five-year term loan under the new credit agreement with Bank of America and was reclassified to long-term loan at September 30, 2016 and June 30, 2016.

Activities under Revolving Lines of Credit and Term Loans

Bank of America

In June 2015, the Company entered into an amendment to the existing credit agreement with Bank of America N.A. ("Bank of America") which provided for (i) a $65,000,000 revolving line of credit facility that would have matured on November 15, 2015 and (ii) a five-year $14,000,000 term loan facility. The term loan is secured by three buildings located in San Jose, California and the principal and interest were payable monthly through September 30, 2016 with an interest rate at the LIBOR rate plus 1.50% per annum. The Company extended the revolving line of credit to mature on June 30, 2016.

In June 2016, the Company entered into a new credit agreement with Bank of America, which provided for (i) a $55,000,000 revolving line of credit facility including a $5,000,000 letter of credit sublimit that matures on June 30, 2017 and (ii) a five-year $50,000,000 term loan facility. This revolving line of credit facility replaced the existing revolving line of credit facility with Bank of America. This additional term loan is secured by seven buildings located in San Jose, California and the property, plant and equipment and the inventory in those buildings. The principal and interest of the term loan are payable monthly through June 30, 2021 with an interest rate at the LIBOR rate plus 1.25% per annum.

The interest rate for the revolving line of credit under the above credit agreements with Bank of America is at the LIBOR rate plus 1.25% per annum. The LIBOR rate was 0.52% at September 30, 2016. The letter of credit is charged at 1.25% per annum. In July 2016, the Company received $50,000,000 term loan proceeds from Bank of America under the new credit agreement with an interest rate at 1.71% per annum and paid down the outstanding amounts under the revolving line of credit with Bank of America.

In June 2016, the Company also entered into a separate credit agreement with Bank of America, which provided for a revolving line of credit of $10,000,000 for the Taiwan subsidiary that matures on June 30, 2017. The interest rate of the revolving line of credit is equal to a minimum of 0.9% per annum plus the lender's cost of funds.

As of September 30, 2016 and June 30, 2016, the total outstanding borrowings under the Bank of America term loan was $47,500,000 and $933,000, respectively. The total outstanding borrowings under the Bank of America lines of credit was

$11,199,000 and $62,199,000 as of September 30, 2016 and June 30, 2016, respectively. The interest rates for these loans ranged from 1.08% to 1.77% per annum at September 30, 2016 and from 1.02% to 1.96% per annum at June 30, 2016, respectively. As of September 30, 2016, the amount of the unused revolving lines of credit with Bank of America under the new credit agreements was $53,801,000.

In October 2016, the Company drew an additional $30,000,000 from Bank of America revolving line of credit with interest rates ranging from 2.14% to 3.75% per annum to support the Company's growth and expansion of its business in the Netherlands.

CTBC Bank

In November 2015, the Company entered into an amendment to the existing credit agreement with CTBC Bank Co., Ltd ("CTBC Bank") that provides for (i) a 12-month NTD$700,000,000 or $22,017,000 U.S. dollar equivalent term loan secured by the land and building located in Bade, Taiwan with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum which is adjusted monthly and (ii) a 12-month revolving line of credit up to 80.00% of eligible accounts receivable in an aggregate amount of up to $17,000,000 with an interest rate equal to the lender's established USD interest rate plus 0.30% per annum which is adjusted monthly. The total borrowings allowed under the credit agreement are capped at NTD$1,000,000,000 or $30,340,000 U.S. dollar equivalent. In January 2016, the Company extended the revolving line of credit to mature on March 31, 2016.

In April 2016, the Company entered into a credit agreement with CTBC Bank Co., Ltd that provides for (i) a 12-month NTD$700,000,000 or $21,620,000 U.S. dollar equivalent term loan facility secured by the land and building located in Bade, Taiwan with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum which is adjusted monthly. This term loan facility also includes a 12-month customs bond up to NTD$100,000,000 or $3,089,000 U.S. dollar equivalent with an annual fee equal to 0.5% per annum, and (ii) a 12-month revolving line of credit up to 80.00% of eligible accounts receivable in an aggregate amount of up to $40,000,000 with an interest rate equal to the lender's established USD interest rate plus 0.30% per annum which is adjusted monthly. The total borrowings allowed under the credit agreement are capped at $40,000,000. The credit agreement matures on March 31, 2017.

The total outstanding borrowings under the CTBC Bank term loan was denominated in Taiwanese dollars and was translated into U.S. dollars of $21,061,000 and $20,357,000 at September 30, 2016 and June 30, 2016, respectively. At September 30, 2016 and June 30, 2016, the total outstanding borrowings under the CTBC Bank revolving line of credit was $18,800,000 and $10,100,000, respectively, in U.S. dollars. The interest rate for these loans ranged from 0.89% and 1.40% at September 30, 2016 and 0.90% and 1.25% per annum at June 30, 2016. At September 30, 2016, available for future borrowing under this credit agreement was $139,000.

Covenant Compliance

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

- Not to incur on a consolidated basis, a net loss before taxes and extraordinary items for any two consecutive fiscal quarters;
-

- The Consolidated Leverage Ratio, as defined in the agreement, as of the end of any fiscal quarter, measured for the most recently completed twelve (12) months of the Company, shall not be greater than 2.00;
- The domestic unencumbered liquid assets, as defined in the agreement, maintained in accounts within the United States shall have an aggregate market value of not less than $30,000,000, measured quarterly as of the last day of each fiscal quarter.

As of September 30, 2016 and June 30, 2016, total assets of $959,924,000 and $934,625,000, respectively, collateralized the line of credit with Bank of America under the new credit agreement, which represent the total assets of the United States headquarter company, except for seven buildings located in San Jose, California and property, plant and equipment and inventory in those buildings. As of September 30, 2016 and June 30, 2016, total assets collateralizing the term loan with Bank of America under the new credit agreement were $82,006,000 and $59,258,000, respectively. As of

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September 30, 2016, the Company was in compliance with all financial covenants associated with the credit agreements with Bank of America.

As of September 30, 2016 and June 30, 2016, the land and building located in Bade, Taiwan with a value of $26,691,000 and $26,804,000, respectively, collateralized the term loan with CTBC Bank. There are no financial covenants associated with the term loan with CTBC Bank at September 30, 2016.

Note 7. Related-party and Other Transactions

Ablecom Technology Inc.—Ablecom, a Taiwan corporation, together with one of its subsidiaries, Compuware (collectively "Ablecom"), is one of the Company's major contract manufacturers. Ablecom's ownership of Compuware is below 50% but Compuware remains a related party as Ablecom still has significant influence over its operations. Ablecom's chief executive officer, Steve Liang, is the brother of Charles Liang, the Company's President, Chief Executive Officer and Chairman of the Board of Directors. Ablecom owns approximately 0.6% of the Company's common stock. Charles Liang and his wife, also an officer of the Company, collectively own approximately 10.5% of Ablecom, while Steve Liang and other family members own approximately 36.0% of Ablecom at September 30, 2016.

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

Under the product design and manufacturing agreements, the Company outsources a portion of its design activities and a significant part of its manufacturing of components such as server chassis to Ablecom. Ablecom agrees to design products according to the Company's specifications. Additionally, Ablecom agrees to build the tools needed to manufacture the products. The Company has agreed to pay for Ablecom's cost of chassis and related product tooling and engineering services and will pay for those items when the work has been completed.

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

Ablecom's net sales to the Company and its net sales of the Company's products to others comprise a substantial majority of Ablecom's net sales. The Company purchased products from Ablecom totaling $50,205,000 and $59,261,000, and sold products to Ablecom totaling $3,342,000 and $5,220,000 for the three months ended September 30, 2016 and 2015, respectively.

Amounts owed to the Company by Ablecom as of September 30, 2016 and June 30, 2016 were $7,251,000 and $4,678,000, respectively. Amounts owed to Ablecom by the Company as of September 30, 2016 and June 30, 2016 were $38,290,000 and $39,152,000, respectively. For the three months ended September 30, 2016, the Company paid Ablecom the majority of invoiced dollars between 47 and 77 days of invoice date. For the three months ended September 30, 2016 and 2015, the Company paid $1,745,000 and $1,162,000, respectively, for tooling assets and miscellaneous costs to Ablecom.

The Company's exposure to loss as a result of its involvement with Ablecom is limited to (a) potential losses on its purchase orders in the event of an unforeseen decline in the market price and/or demand of the Company's products such that the Company incurs a loss on the sale or cannot sell the products and (b) potential losses on outstanding accounts receivable from Ablecom in the event of an unforeseen deterioration in the financial condition of Ablecom such that Ablecom defaults on its payable to the Company. Outstanding purchase orders with Ablecom were $77,369,000 and $62,782,000 at September 30, 2016 and June 30, 2016, respectively, representing the maximum exposure to loss relating to (a) above. The Company does not have any direct or indirect guarantees of losses of Ablecom.

In May 2012, the Company and Ablecom jointly established Super Micro Asia Science and Technology Park, Inc. ("Management Company") in Taiwan to manage the common areas shared by the Company and Ablecom for their separately constructed manufacturing facilities. Each company contributed $168,000 and owns 50% of the Management Company. Although the operations of the Management Company are independent of the Company, through governance rights, the Company has the ability to direct the Management Company's business strategies. Therefore, the Company has concluded that the Management Company is a variable interest entity of the Company as the Company is the primary beneficiary of the Management Company. The accounts of the Management Company are consolidated with the accounts of the Company, and a noncontrolling interest has been recorded for the Ablecom's interests in the net assets and operations of the Management Company. In the three months ended September 30, 2016 and 2015, $5,000 and $2,000 of net income attributable to Ablecom's interest was included in the Company's general and administrative expenses in the condensed consolidated statements of operations.

Note 8. Income Taxes

The Company recorded provisions for income taxes of $6,369,000 and $7,504,000 for the three months ended September 30, 2016 and 2015, respectively. The effective tax rate was 32.0% and 35.4% for the three months ended September 30, 2016 and 2015, respectively. The effective tax rate for the three months ended September 30, 2016 is estimated to be lower than the federal statutory rate primarily due to the benefit from U.S. federal research and development ("R&D") tax credit and
domestic production activities deduction.

As of September 30, 2016, the Company had a liability for gross unrecognized tax benefits of $17,080,000, substantially all of which, if recognized, would affect the Company's effective tax rate. During the three months ended September 30, 2016, there were no material changes in the total amount of the liability for gross unrecognized tax benefits. The Company’s policy is to include interest and penalties related to unrecognized tax benefits within the provision for taxes on the condensed consolidated statements of operations. As of September 30, 2016, the Company had accrued $1,524,000 of interest and penalties relating to unrecognized tax benefits.

The Company is subject to United States federal income tax as well as income taxes in many state and foreign jurisdictions. The Company's 2012 and 2013 federal tax returns are currently under the IRS examination. The Company has responded to Information Document Requests ("IDRs"), issued by the Internal Revenue Service ("IRS"). No adjustment has been proposed by the IRS as of September 30, 2016. The Company is also currently under audit in Taiwan. The Taiwan Tax Authority issued income tax assessments for tax years 2013 and 2014 related to the local income tax exemption regime which the Company has participated in. The Company is currently in the process of appealing the assessments. While management believes that the Company has adequately provided reserves for all uncertain tax positions, amounts asserted by tax authorities could be greater or less than the Company’s current position. Accordingly, the Company’s provision on federal, state and foreign tax related matters to be recorded in the future may change as revised estimates are made or the underlying matters are settled or otherwise resolved.

The federal statute of limitations remain open in general for tax years 2012 through 2015. The state statute of limitations remain open in general for tax years 2011 through 2015. The statute of limitations in major foreign jurisdictions remain open for examination in general for tax years 2009 through 2015. The Company does not expect its unrecognized tax benefits to change materially over the next 12 months.

Note 9. Commitments and Contingencies

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

Purchase Commitments— The Company has agreements to purchase certain units of inventory and non-inventory items through fiscal year 2017. As of September 30, 2016, these remaining non-cancellable commitments were $354,796,000 compared to $334,010,000 as of June 30, 2016.

Included in the above non-cancellable commitments are hard disk drive purchase commitments totaling approximately $42,200,000, which will be paid through December 2016. The Company has entered into purchase agreements with selected suppliers of hard disk drives in order to ensure continuity of supply for these components. The agreements provide for some variation in the amount of units the Company is required to purchase and the suppliers may modify the purchase price for these components due to significant changes in market or component supply conditions. Product mix for these components may be negotiated quarterly and the purchase price for these components will be reviewed quarterly with the suppliers. The Company has been negotiating the purchase price with the suppliers on an ongoing basis based upon market rates.

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Note 10. Segment Reporting

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

International net sales are based on the country and region to which the products were shipped. The following is a summary for the three months ended September 30, 2016 and 2015, of net sales by geographic region (in thousands):

	Three Months Ended September 30,	
	2016	2015
Net sales:		
United States	$295,531	$338,696
Europe	113,711	86,826
Asia	96,280	74,657
Other	23,446	19,439
	$528,968	$519,618

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

	September 30, 2016	June 30, 2016
Long-lived assets:		
United States	$146,379	$142,764
Asia	41,533	42,052
Europe	2,936	3,133
	$190,848	$187,949

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

	Three Months Ended September 30,					
	2016			2015		
	Amount	Percent of Net Sales		Amount	Percent of Net Sales	
Server systems	$357,493	67.6	%	$356,211	68.6	%
Subsystems and accessories	171,475	32.4	%	163,407	31.4	%
Total	$528,968	100.0	%	$519,618	100.0	%

Subsystems and accessories are comprised of serverboards, chassis and accessories. Server systems constitute an assembly of subsystems and accessories. No customer represented greater than 10% of the Company's total net sales in the three months ended September 30, 2016 and one customer represented 12.2% of the Company's total net sales in the three months ended September 30, 2015. No country other than the United States represented greater than 10% of the Company’s total net sales in the three months ended September 30, 2016 and 2015. No customer accounted for 10% or more of the Company's accounts receivable as of September 30, 2016 and June 30, 2016.

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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 (the “Exchange Act”) 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 comparable terminology. In evaluating these statements, you should specifically consider various factors, including the risks described under “Risk Factors” below and in other parts of this Form 10-Q as well as in our other filings with the SEC. These factors may cause our actual results to differ materially from those anticipated or implied in the forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. We cannot guarantee future results, levels of activity, performance or achievements.

Overview

We are a global leader in high performance, high efficiency server technology and innovation. We develop and provide end-to-end green computing solutions to the cloud computing, data center, enterprise IT, big data, high performance computing (“HPC”), and Internet of Things (“IoT”)/embedded markets. Our solutions range from complete server, storage, blade and workstations to full racks, networking devices, server management software and technology support and services. Our net sales were $529.0 million and $519.6 million for the three months ended September 30, 2016 and 2015, respectively. The increase in our net sales in the three months ended September 30, 2016 compared with the three months ended September 30, 2015 was primarily due to increased sales of our subsystems and accessories to our distributors and to a lesser extent our server systems. Net sales of optimized servers were $357.5 million and $356.2 million for the three months ended September 30, 2016 and 2015, respectively, and net sales of subsystems and accessories were $171.5 million and $163.4 million for the three months ended September 30, 2016 and 2015, respectively. In the three months ended September 30, 2016, we experienced growth in sales of our complete systems including microblade, high density Twin family of servers, storage, IoT/embedded servers, accelerated GPU computing servers and rack scale cloud server solutions offset in part by a decrease in sales of our ultra and data center optimized servers. The percentage of our net sales represented by sales of complete server systems decreased to 67.6% in the three months ended September 30, 2016 from 68.6% in the three months ended September 30, 2015.

We commenced operations in 1993 and have been profitable every year since inception. Our net income was $13.5 million and $13.7 million for the three months ended September 30, 2016 and 2015, respectively. Our decrease in net income in the three months ended September 30, 2016 was primarily attributable to higher operating expenses from headcount and annual salary increases to support our business growth which offset increased gross profit in the quarter ended September 30, 2016.

We sell our server systems and subsystems and accessories through our direct sales force as well as through distributors and OEMs. We derived 50.0% and 54.4% of our net sales from products sold to direct customers and OEMs for the three months ended September 30, 2016 and 2015, respectively. None of our customers accounted for 10% or more of our net sales in the three months ended September 30, 2016. Sales to SoftLayer, a division of IBM Corporation, represented 12.2% of our net sales in the three months ended September 30, 2015. We derived 55.9% and 65.2% of our net sales from customers in the United States for the three months ended September 30, 2016 and 2015, respectively.

We perform the majority of our research and development efforts in-house. Research and development expenses represented 6.3% and 5.5% of our net sales for the three months ended September 30, 2016 and 2015, respectively.

We use several suppliers and contract manufacturers to design and manufacture components in accordance with our specifications, with most final assembly and testing performed at our manufacturing facility in San Jose, California. During fiscal year 2017, we have continued to increase manufacturing and service operations in Taiwan and the Netherlands primarily to support our Asian and European customers, and we have continued to improve our utilization of our overseas manufacturing capacity. One of our key suppliers is Ablecom, a related party, which supplies us with contract design and manufacturing support. For the three months ended September 30, 2016 and 2015, our purchases from Ablecom represented 11.2% and 13.2% of our cost of sales, respectively. Ablecom's sales to us constitute a substantial majority of Ablecom's net sales. We continue to maintain our manufacturing relationship with Ablecom in an effort to reduce our cost of sales. In addition to providing contract manufacturing services for us, Ablecom continues to warehouse for us a number of components and subassemblies manufactured by multiple suppliers prior to shipment to our facilities in the United States and Europe. We typically negotiate the price of products that we purchase from Ablecom on a quarterly basis; however, either party may re-negotiate the price of products with each order. As a result of our relationship with Ablecom, it is possible that Ablecom may in the future sell products to us at a price higher or lower than we could obtain from an unrelated third party supplier. This may result in our

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future reporting of gross profit as a percentage of net sales that is less than or in excess of what we might have obtained absent our relationship with Ablecom.

In order to continue to increase our net sales and profits, we believe that we must continue to develop flexible and customizable server solutions and be among the first to market with new features and products. We must also continue to expand our software and customer service and support offerings, particularly as we increasingly focus on larger enterprise sales. 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 (“DSOs”). In connection with these efforts, we monitor daily and weekly sales and shipment reports. Among the key non-financial indicators of our success is our ability to rapidly introduce new products and deliver the latest application optimized server solutions. In this regard, we work closely with microprocessor and other component vendors to take advantage of new technologies as they are introduced. Historically, our ability to introduce new products rapidly has allowed us to benefit from the introduction of new microprocessors and as a result we monitor the introduction cycles of Intel, AMD and Nvidia carefully. This also impacts our research and development expenditures.

Other Financial Highlights

The following is a summary of other financial highlights of the first quarter of fiscal 2017:

- Net cash provided by (used in) operating activities was $(11.0) million and $20.3 million during the three months ended September 30, 2016 and 2015, respectively. Our cash and cash equivalents, together with our investments, were $149.4 million at the end of the first quarter of fiscal year 2017, compared with $183.7 million at the end of fiscal year 2016. The decrease in our cash and cash equivalents, together with our investments at the end of the first quarter of fiscal year 2017 was primarily due to $11.0 million of cash used in our operating activities, $18.5 million used to purchase outstanding common stock and $11.6 million used to purchase property and equipment, of which $5.3 million was related to property and equipment for use at our Green Computing Park in San Jose, California.

- Days sales outstanding in accounts receivable (“DSO”) at the end of the first quarter of fiscal year 2017 was 54 days, compared with 50 days at the end of fiscal year 2016.

- Our inventory balance was $500.0 million at the end of the first quarter of fiscal year 2017, compared with $449.0 million at the end of fiscal year 2016. Days sales of inventory at the end of the first quarter of fiscal year 2017 was 97 days, compared with 87 days at the end of fiscal year 2016.

- Our purchase commitments with contract manufacturers and suppliers were $354.8 million at the end of the first quarter of fiscal year 2017 and $334.0 million at the end of fiscal year 2016. Included in these non-cancellable commitments are hard disk drive purchase commitments totaling approximately $42.2 million which have terms expiring through December 2016. See Note 9 of Notes to our Condensed Consolidated Financial Statements for a discussion of purchase commitments.

Fiscal Year

Our fiscal year ends on June 30. References to fiscal year 2017, for example, refer to the fiscal year ending June 30, 2017.

Revenues and Expenses

Net sales. Net sales consist of sales of our server solutions, including server systems, subsystems and accessories. The main factors which impact our net sales are the number of compute nodes shipped and average selling prices per node for our server system sales and units shipped and average selling price per unit for our subsystem and accessories sales. The prices for server systems range widely depending upon the configuration including the number of compute nodes on a server system, and the prices for our subsystems and accessories vary based on the type. A compute node is a hardware configuration having its own CPU, RAM and storage and that is capable of running its own instance of a non-virtualized operating system. Measuring volume using compute nodes enables more consistent measurement across different server form factors and across different vendors. 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.

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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 including stock based compensation, equipment and facility expenses, warranty costs and inventory excess and obsolete provisions. The primary factors that impact our cost of sales are the mix of products sold and cost of materials, which include raw material costs, shipping costs and salary and benefits related to production. Cost of sales as a percentage of net sales may increase over time if decreases in average selling prices are not offset by corresponding decreases in our costs. Our cost of sales, as a percentage of net sales, is generally higher on server systems than on subsystems and accessories in the case of sales of server systems to cloud/internet data center computing customers. Our cost of sales as a percentage of net sales is also impacted by the extent to which we are able to efficiently utilize our expanding manufacturing capacity. Because we generally do not have long-term fixed supply agreements, our cost of sales is subject to change based on market conditions.

Research and development expenses. Research and development expenses consist of the personnel and related expenses including stock based compensation 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. Under these programs, we are reimbursed for certain research and development costs that we incur as part of the joint development of our products and those of our suppliers and customers. These amounts offset a portion of the related research and development expenses and have the effect of reducing our reported research and development expenses.

Sales and marketing expenses. Sales and marketing expenses consist primarily of salaries, stock based compensation and incentive bonuses for our sales and marketing personnel, costs for tradeshows, independent sales representative fees and marketing programs. From time to time, we receive cooperative marketing funding from certain suppliers. Under these programs, we are reimbursed for certain marketing costs that we incur as part of the joint promotion of our products and those of our suppliers. These amounts offset a portion of the related expenses and have the effect of reducing our reported sales and marketing expenses. Similarly, we from time to time offer our distributors cooperative marketing funding. To the extent the funding is not recorded as contra-revenue, it has the effect of increasing our expenses. The timing, magnitude and estimated usage of our programs and those of our suppliers can result in significant variations in reported sales and marketing expenses from period to period. Spending on cooperative marketing, either by us or our suppliers, typically increases in connection with significant product releases by us or our suppliers.

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

Interest and other income, net. Interest and other income, net consist primarily of interest earned on our investment and cash balances.

Interest expense. Interest expense represents interest expense on our term loans and lines of credit.

Income tax provision. Our income tax provision is based on our taxable income generated in the jurisdictions in which we operate, primarily the United States, Taiwan and the Netherlands. Our effective tax rate differs from the statutory rate primarily due to research and development tax credits and the domestic production activities deduction which were partially offset by state taxes and unrecognized tax benefits related to permanent establishment exposures.

Critical Accounting Policies and Estimates

There have been no material changes in the matters for which we make critical accounting policies and estimates in the preparation of our Condensed Consolidated Financial Statements during the three months ended September 30, 2016, as compared to those disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2016.

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Results of Operations

Net Sales

The following table presents net sales by product type for the three months ended September 30, 2016 and 2015 (dollars in millions):

	Three Months Ended September 30,		Change	
	2016	2015	$	%
Server systems	$357.5	$356.2	$1.3	0.4%
Percentage of total net sales	67.6 %	68.6 %		
Subsystems and accessories	171.5	163.4	8.1	4.9%
Percentage of total net sales	32.4 %	31.4 %		
Total net sales	$529.0	$519.6	$9.4	1.8%

The following table presents the number of compute node sales and average selling price per node of our server systems for the three months ended September 30, 2016 and 2015 (nodes in thousands):

	Three Months Ended September 30,		Change
	2016	2015	%
Server systems:			
Number of compute node sales (1)	122	116	5.2 %
Average selling price per node	$2,927	$3,074	(4.8)%

(1) A compute node is a hardware configuration having its own CPU, RAM and storage and that is capable of running its own instance of a non-virtualized operating system.

The following table presents unit sales and average selling price of our subsystems and accessories for the three months ended September 30, 2016 and 2015 (units in thousands):

	Three Months Ended September 30,		Change
	2016	2015	%
Subsystems and accessories:			
Unit sales	1,144	916	24.9 %
Average selling price per unit	$150	$178	(15.7)%

Comparison of Three Months Ended September 30, 2016 and 2015

The increase in our net sales in the three months ended September 30, 2016 compared with the three months ended September 30, 2015 was primarily due to an increase in sales of our subsystems and accessories to our distributors. The year-over-year growth in net sales of our server systems in the three months ended September 30, 2016 was due primarily to an increase in the number of compute node sales which offset a lower average selling price per node of our server systems as we sold higher nodes per systems. The increase in the sales of these complete systems include our microblade, high density Twin family of servers, storage, IoT/embedded servers, accelerated GPU computing servers and rack scale cloud server solutions offset in part by a decrease in sales of our ultra and data center optimized servers.

The year-over-year increase in net sales and unit sales of our subsystems and accessories in the three months ended September 30, 2016 was primarily due to higher sales of serverboards and server accessories to our distributors.

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The following table presents the percentages of net sales from products sold to distributors and direct/OEM customers for the three months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Change
	2016	2015	%
Distributors	50.0 %	45.6 %	4.4 %
Direct/OEM customers	50.0 %	54.4 %	(4.4)%
Total net sales	100.0%	100.0%	

The year-over-year increase in net sales to distributors in the three months ended September 30, 2016 was primarily due to the higher demand for our subsystem and accessories which are typically sold through distributors. The year-over-year decrease in net sales to direct/OEM customers in the three months ended September 30, 2016 was primarily due to the lower demand for our server systems from cloud/internet data center computing partially offset by an increase demand for our server systems from enterprise and IoT/embedded customers.

The following table presents percentages of net sales by geographic region for the three months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Change
	2016	2015	%
United States	55.9 %	65.2 %	(9.3)%
Europe	21.5 %	16.8 %	4.7 %
Asia	18.2 %	14.3 %	3.9 %
Others	4.4 %	3.7 %	0.7 %
Total net sales	100.0%	100.0%	

The year-over-year decrease in net sales in the United States in the three months ended September 30, 2016 as a percentage of total net sales was primarily due to the lower demand for our server systems from cloud/internet data center computing which represents a higher portion of sales in the United States than in other regions. The year-over-year increase in net sales in Europe and Asia in the three months ended September 30, 2016 as a percentage of total net sales was primarily due to the higher demand for our server systems in the Netherlands, Japan and China.

Cost of Sales and Gross Margin

Cost of sales and gross margin for the three months ended September 30, 2016 and 2015 are as follows (dollars in millions):

	Three Months Ended September 30,		Change	
	2016	2015	$	%
Total cost of sales	$448.9	$447.4	$1.5	0.3 %
Total gross profit	80.1	72.2	$7.8	10.9%
Total gross margin	15.1 %	13.9 %		1.2 %

Comparison of Three Months Ended September 30, 2016 and 2015

The quarter-over-quarter increase in absolute dollars of cost of sales in the three months ended September 30, 2016 compared to the three months ended September 30, 2015 was primarily attributable to the increase in net sales. In the three months ended September 30, 2016, we recorded a $3.9 million expense, net of recovery, or 0.7% of net sales, related to the inventory provision as compared to $1.7 million, or 0.3% of net sales, in the three months ended September 30, 2015.

In the three months ended September 30, 2016, we recorded a $4.9 million expense, or 0.9% of net sales, related to the provision for warranty reserve as compared to a $3.9 million expense, or 0.7% of net sales, in the three months ended

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September 30, 2015. The increase in the provision for warranty reserve was primarily due to an increase in warranty claims and cost of servicing warranty claims in the three months ended September 30, 2016. If in future periods we experience or anticipate an increase or decrease in warranty claims as a result of new product introductions or change in unit volumes compared with our historical experience, or if the cost of servicing warranty claims is greater or lesser than expected, our gross margin would be affected.

Gross margin percentage was 15.1% and 13.9% for the three months ended September 30, 2016 and 2015, respectively. The increase was primarily due to a $9.3 million out-of-period adjustment relating to extended warranty revenue which was recognized in the three fiscal year period ended June 30, 2015 and deferred in the three months ended September 30, 2015, lower sales of cloud/internet data center server systems which typically have lower margins offset in part by lower global utilization and higher provision for inventory and warranty reserves.

Operating Expenses

Operating expenses for the three months ended September 30, 2016 and 2015 are as follows (dollars in millions):

	Three Months Ended September 30,		Change	
	2016	2015	$	%
Research and development	$33.2	$28.3	$4.9	17.2%
Percentage of total net sales	6.3 %	5.5 %		
Sales and marketing	15.9	14.2	1.7	11.7%
Percentage of total net sales	3.0 %	2.7 %		
General and administrative	10.8	8.2	2.6	31.2%
Percentage of total net sales	2.0 %	1.6 %		
Total operating expenses	$59.9	$50.8	$9.1	17.9%
Percentage of total net sales	11.3 %	9.8 %		

Comparison of Three Months Ended September 30, 2016 and 2015

Research and development expenses. Research and development expenses increased by $4.9 million, or 17.2% in the three months ended September 30, 2016 compared to the three months ended September 30, 2015. Research and development expenses were 6.3% and 5.5% of net sales for the three months ended September 30, 2016 and 2015, respectively. The increase in absolute dollars was driven primarily by an increase of $4.6 million in compensation and benefits including stock-based compensation expense.

Research and development expenses include stock-based compensation expense of $2.9 million and $2.4 million for the three months ended September 30, 2016 and 2015, respectively.

Our compensation and benefit expense in research and development increased from annual salary increases and growth in research and development personnel related to expanded product development initiatives in the United States and in Taiwan. We continue to believe that investments in research and development are critical to our future growth and competitive position in the marketplace. As such, we expect to continue to spend on current and future product development efforts.

Sales and marketing expenses. Sales and marketing expenses increased by $1.7 million, or 11.7% in the three months ended September 30, 2016 compared to the three months ended September 30, 2015. Sales and marketing expenses were 3.0% and 2.7% of net sales for the three months ended September 30, 2016 and 2015, respectively. The increase in absolute dollars was primarily due to an increase of $1.4 million in compensation and benefits including stock-based compensation expense, resulting primarily from growth in sales and marketing personnel, a decrease of $0.5 million in marketing cooperative funding from certain suppliers, an increase of $0.3 million in freight out expenses to customers, an increase of $0.3 million in cooperative marketing funding to our customers, partially offset by a decrease of $1.2 million in advertising, marketing promotional and trade show expenses.

Sales and marketing expenses include stock-based compensation expense of $0.5 million and $0.4 million for the three months ended September 30, 2016 and 2015, respectively.

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General and administrative expenses. General and administrative expenses increased by $2.6 million, or 31.2% in the three months ended September 30, 2016 compared to the three months ended September 30, 2015. General and administrative expenses were 2.0% and 1.6% of net sales for the three months ended September 30, 2016 and 2015, respectively. The increase in absolute dollars was primarily due to a $1.9 million foreign currency transaction gain in the three months ended September 30, 2015 as compared to a $0.5 million foreign currency transaction loss in the three months ended September 30, 2016, an increase of $1.0 million in compensation and benefits including stock-based compensation expense, partially offset by a decrease of $1.1 million in legal expenses.

General and administrative expenses include stock-based compensation expense of $0.8 million for both three months ended September 30, 2016 and 2015.

Interest and Other Expense, Net

Interest and other expense, net for the three months ended September 30, 2016 and 2015 are as follows (dollars in millions):

	Three Months Ended September 30,		Change	
	2016	2015	$	%
Interest and other income, net	$—	$0.1	$(0.1)	(66.7)%
Interest expense	(0.3)	(0.3)	—	1.9 %
Interest and other expense, net	$(0.3)	$(0.2)	$(0.1)	27.0 %

Comparison of Three Months Ended September 30, 2016 and 2015

Interest and other expense, net. Interest and other expense, net increased by $0.1 million in the three months ended September 30, 2016 compared to the three months ended September 30, 2015. The increases were primarily due to a decrease in other income.

Provision for Income Taxes

Provision for income taxes and effective tax rates for the three months ended September 30, 2016 and 2015 are as follows (dollars in millions):

	Three Months Ended September 30,		Change	
	2016	2015	$	%
Provision for income taxes	$6.4	$7.5	$(1.1)	(15.1)%
Percentage of total net sales	1.2 %	1.5 %		
Effective tax rate	32.0 %	35.4 %		

Comparison of Three Months Ended September 30, 2016 and 2015

Provision for income taxes. Provision for income taxes decreased by $1.1 million, or 15.1% in the three months ended September 30, 2016 compared to the three months ended September 30, 2015. The effective tax rate was 32.0% and 35.4% for the three months ended September 30, 2016 and 2015, respectively. The lower income tax provision for the three months ended September 30, 2016 was primarily attributable to our lower operating income. The effective tax rate for the three months ended September 30, 2016 was lower primarily due to the benefits from U.S. federal research and development ("R&D") tax credit and domestic production activities deduction.

Liquidity and Capital Resources

Since our inception, we have financed our growth primarily with funds generated from operations and from the proceeds of our initial public offering. In addition, we have utilized borrowing facilities, particularly in relation to the financing of real property acquisitions. Our cash and cash equivalents and short-term investments were $146.8 million and $181.0 million as of September 30, 2016 and June 30, 2016, respectively. Our cash in foreign locations was $41.3 million and $46.5 million at

September 30, 2016 and June 30, 2016, respectively. It is management's intention to reinvest the undistributed foreign earnings indefinitely in foreign operations.

Operating Activities. Net cash provided by (used in) operating activities was $(11.0) million and $20.3 million for the three months ended September 30, 2016 and 2015, respectively.

Net cash used in our operating activities for the three months ended September 30, 2016 was primarily due to an increase in inventory of $54.9 million and an increase in accounts receivable of $39.4 million, which were partially offset by an increase in accounts payable of $43.4 million, our net income of $13.5 million, an increase in income tax payable of $5.3 million, an increase in accrued liabilities of $5.0 million, stock-based compensation expense of $4.5 million, an increase in other long-term liabilities of $4.1 million, provision for inventory of $3.9 million, and depreciation expense of $3.8 million.

Net cash provided by our operating activities for the three months ended September 30, 2015 was primarily due to a decrease in accounts receivable of $25.4 million, our net income of $13.7 million, an increase in other long-term liabilities of $8.9 million, stock-based compensation expense of $3.9 million, net income taxes payable of $3.0 million, depreciation expense of $2.8 million and an increase in provision for inventory of $1.7 million, which were partially offset by a decrease in accounts payable of $37.7 million and foreign exchange gain of $2.0 million.

The increase for the three months ended September 30, 2016 in accounts receivable was primarily due to higher sales in the last month of the first quarter of fiscal year 2017 as compared to the last month of the fourth quarter of fiscal year 2016. The increase for the three months ended September 30, 2016 in inventory and accounts payable was due to higher purchases to support the anticipated level of growth in our net sales in the second quarter of fiscal year 2017. We anticipate that accounts receivable, inventory and accounts payable will increase to the extent we continue to grow our product lines and our business.

The decrease for the three months ended September 30, 2015 in accounts receivable was primarily due to lower sales in the first quarter of fiscal year 2016 as compared to the fourth quarter of fiscal year 2015. The decrease for the three months ended September 30, 2015 in accounts payable was primarily due to lower purchases and lower sales in the three months ended September 30, 2015.

Investing activities. Net cash used in our investing activities was $11.5 million and $7.7 million for the three months ended September 30, 2016 and 2015, respectively. In the three months ended September 30, 2016, of the net cash used in our investing activities, $11.6 million was related to the purchase of property, plant and equipment, of which $5.3 million was related to the property and equipment for the manufacturing buildings at our Green Computing Park in San Jose, California. We anticipate investing approximately $9.5 million through April 2017 to complete the construction of a second manufacturing facility and the remodeling of our office building. We plan to finance this development through our operating cash flows and additional borrowings from banks. In the three months ended September 30, 2015, $7.7 million was related to the purchase of property, plant and equipment.

Financing activities. Net cash provided by (used in) our financing activities was $(12.0) million and $2.6 million for the three months ended September 30, 2016 and 2015, respectively. In the three months ended September 30, 2016, we used $18.5 million to repurchase outstanding common stock. We borrowed an additional $73.9 million under term loan and revolving lines of credit from Bank of America and CTBC Bank and repaid $70.0 million in loans. Further, we received $2.9 million related to the proceeds from the exercise of stock options in the three months ended September 30, 2016.

In the three months ended September 30, 2015, we borrowed an additional $4.7 million under our revolving line of credit from Bank of America and CTBC Bank and repaid $2.9 million in loans. Further, we received $1.0

million related to the proceeds from the exercise of stock options in the three months ended September 30, 2015.

We expect our net cash provided by financing activities will increase throughout fiscal year 2017 as we intend to obtain additional financing from banks for our working capital requirements.

We expect to experience continued growth in our working capital requirements and capital expenditures as we continue to expand our business. Our long-term future capital requirements will depend on many factors, including our level of revenues, the timing and extent of spending to support our product development efforts, the expansion of sales and marketing activities, the timing of our introductions of new products, the costs to ensure access to adequate manufacturing capacity and the continuing market acceptance of our products. We intend to fund this continued expansion through cash generated by operations and by drawing on the revolving credit facility or through other debt financing. However we cannot be certain whether such financing will be available on commercially reasonable or otherwise favorable terms or that such financing will

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be available at all. We anticipate that working capital and capital expenditures will constitute a material use of our cash resources. We have sufficient cash on hand to continue to operate for at least the next 12 months.

Other factors affecting liquidity and capital resources

Activities under Revolving Lines of Credit and Term Loans

Bank of America

In June 2015, we entered into an amendment to the existing credit agreement with Bank of America, which provided for (i) a $65.0 million revolving line of credit facility and (ii) a five-year $14.0 million term loan facility. The term loan is secured by three buildings located in San Jose, California and the principal and interest were payable monthly through September 30, 2016 with an interest rate at the LIBOR rate plus 1.50% per annum. In May 2016, we extended the revolving line of credit to mature on June 30, 2016.

In June 2016, we entered into a new credit agreement with Bank of America, which provided for (i) a $55.0 million revolving line of credit facility including a $5.0 million letter of credit sublimit that matures on June 30, 2017 and (ii) a five-year $50.0 million term loan facility. This revolving line of credit facility replaced the existing revolving line of credit facility with Bank of America. This additional term loan is secured by seven buildings located in San Jose, California and the property, plant and equipment and inventory in those buildings. The principal and interest of the term loan are payable monthly through June 30, 2021 with an interest rate at the LIBOR rate plus 1.25% per annum.

The interest rate for the revolving line of credit under the above credit agreements with Bank of America is at the LIBOR rate plus 1.25% per annum. The LIBOR rate was 0.52% at September 30, 2016. The letter of credit is charged at 1.25% per annum. In July 2016, we received $50.0 million term loan proceeds from Bank of America under the new credit agreement with an interest rate at 1.71% per annum and paid down the outstanding amounts under the revolving line of credit with Bank of America.

In June 2016, we also entered into a separate credit agreement with Bank of America, which provided for a revolving line of credit of $10.0 million for our Taiwan subsidiary that matures on June 30, 2017. The interest rate of the revolving line of credit is equal to a minimum of 0.9% per annum plus the lender's cost of fund.

As of September 30, 2016 and June 30, 2016, the total outstanding borrowings under the Bank of America term loan was $47.5 million and $0.9 million, respectively. The total outstanding borrowings under the Bank of America lines of credit was $11.2 million and $62.2 million as of September 30, 2016 and June 30, 2016, respectively. The interest rates for these loans ranged from 1.08% to 1.77% per annum at September 30, 2016 and from 1.02% to 1.96% per annum at June 30, 2016, respectively. As of September 30, 2016, the unused revolving lines of credit amount with Bank of America under the new credit agreements were $53.8 million.

In October 2016, we drew an additional $30.0 million from Bank of America revolving line of credit with interest rates ranging from 2.14% to 3.75% per annum to support our growth and expansion of our business in the Netherlands.

CTBC Bank

In November 2015, we entered into an amendment to the existing credit agreement with CTBC Bank Co., Ltd ("CTBC Bank") that provides for (i) a 12-month NTD$700.0 million or $22.0 million U.S. dollar equivalent term loan secured by the land and building located in Bade, Taiwan with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum which is adjusted monthly and (ii) a 12-month revolving line of credit up to 80.0%

of eligible accounts receivable in an aggregate amount of up to $17.0 million with an interest rate equal to the lender's established USD interest rate plus 0.30% per annum which is adjusted monthly. The total borrowings allowed under the credit agreement are capped at NTD$1.0 billion or $30.3 million U.S. dollar equivalent. In January 2016, we extended the revolving line of credit to mature on March 31, 2016.

In April 2016, we entered into a new credit agreement with CTBC Bank that provides for (i) a 12-month NTD$700.0 million or $21.6 million U.S. dollar equivalent term loan facility secured by the land and building located in Bade, Taiwan with an interest rate equal to the lender's established NTD interest rate plus 0.25% per annum which is adjusted monthly. This term loan facility also includes a 12-month customs bond up to NTD$100.0 million or $3.1 million U.S. dollar equivalent with an annual fee equal to 0.5% per annum, and (ii) a 12-month revolving line of credit up to 80.0% of eligible accounts receivable in an aggregate amount of up to $40.0 million with an interest rate equal to the lender's established USD interest rate plus 0.30%

per annum which is adjusted monthly. The total borrowings allowed under the credit agreement are capped at $40.0 million. The credit agreement matures on March 31, 2017.

The total outstanding borrowings under the CTBC Bank term loan was denominated in Taiwanese dollars and was translated into U.S. dollars of $21.1 million and $20.4 million at September 30, 2016 and June 30, 2016, respectively. At September 30, 2016 and June 30, 2016, the total outstanding borrowings under the CTBC Bank revolving line of credit was $18.8 million and $10.1 million, respectively, in U.S. dollars. The interest rate for these loans ranged from 0.89% and 1.40% at September 30, 2016 and 0.90% and 1.25% per annum at June 30, 2016. At September 30, 2016, available for future borrowing under this credit agreement was $0.1 million.

Covenant Compliance

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

- Not to incur on a consolidated basis, a net loss before taxes and extraordinary items for any two consecutive fiscal quarters;
- The Consolidated Leverage Ratio, as defined in the agreement, as of the end of any fiscal quarter, measured for the most recently completed twelve (12) months, shall not be greater than 2.00;
- The domestic unencumbered liquid assets, as defined in the agreement, maintained in accounts within the United States shall have an aggregate market value of not less than $30,000,000, measured quarterly as of the last day of each fiscal quarter.

As of September 30, 2016, our total assets of $959.9 million collateralized the line of credit with Bank of America under the new credit agreement, which represent the total assets of the United States headquarters company except for seven buildings located in San Jose, California and property, plant and equipment and inventory in those buildings. As of September 30, 2016, total assets collateralizing the term loan with Bank of America were $82.0 million. As of September 30, 2016, we were in compliance with all financial covenants associated with the term loan and lines of credit with Bank of America under the new credit agreement.

As of September 30, 2016, the net book value of land and building located in Bade, Taiwan collateralizing the term loan with CTBC Bank was $26.7 million. There are no financial covenants associated with the term loan with CTBC Bank.

Contract Manufacturers

In the three months ended September 30, 2016, we paid our contract manufacturers within 35 to 76 days of invoice and Ablecom between 47 to 77 days of invoice. Ablecom is one of our major contract manufacturers and a related party. As of September 30, 2016 and June 30, 2016 amounts owed to Ablecom by us were approximately $38.3 million and $39.2 million, respectively.

Share Repurchase Program

In July 2016, our Board of Directors adopted a program to repurchase from time to time at management’s discretion up to $100,000,000 of our common stock in the open market or in private transactions during the next twelve months at prevailing market prices. Repurchases will be made under the program using our own cash resources. This share repurchase program does not obligate us to acquire any particular amount of common stock, and it may be suspended at any time at our discretion. During the three months ended September 30, 2016, we purchased 888,097 shares of our common stock in the open market at a weighted average price of $20.79 per share for approximately $18.5 million.

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Contractual Obligations

The following table describes our contractual obligations as of September 30, 2016:

	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	$4,262	$7,627	$4,807	$ 2,387	$19,083
Capital leases, including interest	254	404	98	—	756
Debt, including interest (1)	61,794	20,955	17,775	—	100,524
Purchase commitments (2)	354,796	—	—	—	354,796
Total (3)	$421,106	$28,986	$22,680	$ 2,387	$475,159

(1) Amount reflects total anticipated cash payments, including anticipated interest payments based on the interest rate at September 30, 2016.

(2) Amount reflects total gross purchase commitments under our manufacturing arrangements with third-party contract manufacturers or vendors. Our purchase obligations included $42.2 million of hard disk drive purchase commitments at September 30, 2016, which will be paid through December 2016. See Note 9 of Notes to our Condensed Consolidated Financial Statements for a discussion of purchase commitments.

(3) The table above excludes liabilities for deferred revenue of $41.5 million and unrecognized tax benefits and related interest and penalties accrual of $17.1 million. We have not provided a detailed estimate of the payment timing of unrecognized tax benefits due to the uncertainty of when the related tax settlements will become due. See Note 8 of Notes to our Condensed Consolidated Financial Statements for a discussion of income taxes.

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

Recent Accounting Pronouncements

For a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our Condensed Consolidated Financial Statements, see Note 1, “Summary of Significant Accounting Policies,” of the Notes to Condensed Consolidated Financial Statements.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

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Item 3. Quantitative and Qualitative Disclosure About Market Risk

Interest Rate Risk

The primary objectives of our investment activities are to preserve principal, provide liquidity and maximize income without significantly increasing the risk. Some of the securities we invest in are subject to market risk. This means that a change in prevailing interest rates may cause the fair value of the investment to fluctuate. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in money market funds and certificates of deposit. Our long-term investments include auction rate securities, which have been classified as long-term due to the lack of a liquid market for these securities. Since our results of operations are not dependent on investments, the risk associated with fluctuating interest rates is limited to our investment portfolio, and we believe that a 10% change in interest rates would not have a significant impact on our results of operations. As of September 30, 2016, our investments were in money market funds, certificates of deposits and auction rate securities.

We are exposed to changes in interest rates as a result of our borrowings under our term loan and revolving lines of credit. The interest rates for the term loans and the revolving lines of credit ranged from 0.89% to 1.77% at September 30, 2016 and 0.90% to 1.96% at June 30, 2016, respectively. Based on the outstanding principal indebtedness of $98.2 million under our credit facilities as of September 30, 2016, we believe that a 10% change in interest rates would not have a significant impact on our results of operations.

Foreign Currency Risk

To date, our international customer and supplier agreements have been denominated primarily in U.S. dollars, and accordingly, we have limited exposure to foreign currency exchange rate fluctuations from customer agreements, and do not currently engage in foreign currency hedging transactions. However, the functional currency of our operations in the Netherlands and Taiwan is the U.S. dollar and our local accounts including financing arrangements are denominated in the local currency in the Netherlands and Taiwan, respectively, and thus we are subject to foreign currency exchange rate fluctuations associated with re-measurement to U.S. dollars. Such fluctuations have not been significant historically. Foreign exchange gain (loss) for the three months ended September 30, 2016 and 2015 was $(0.5) million and $1.9 million, respectively.

Item 4. Controls and Procedures

Evaluation of Effectiveness of Disclosure Controls and Procedures

We are committed to maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our periodic reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Exchange Act. The evaluation considered the procedures designed to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of September 30, 2016.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the evaluation described in this Item 9A that occurred during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

The Risk Factors included in our Annual Report on Form 10-K for the year ended June 30, 2016 have not materially changed. You should carefully consider the following risk factors, as well as the other information in this Form 10-Q. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our common stock would likely decline and you might lose all or part of your investment in our common stock. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

Risks Related to Our Business and Industry

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

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

- Fluctuations based upon seasonality, with the quarters ending March 31 and September 30 typically being weaker;
- Fluctuations in the timing and size of large customer orders as larger customers and larger orders become an increasing percentage of our net sales;
- Variability of our margins based on our manufacturing capacity utilization, the mix of server systems, subsystems and accessories we sell and the percentage of our sales to internet data center cloud customers or certain geographical regions;
- Fluctuations in availability and costs associated with key components and other materials needed to satisfy customer requirements;
- The timing of the introduction of new products by leading microprocessor vendors and other suppliers;
- Fluctuations based upon changes in demand for and cost of storage solutions as such solutions become an increasing percentage of our net sales;
- Changes in our product pricing policies, including those made in response to new product announcements and pricing changes of our competitors;
- Mix of whether customer purchases are of full systems or subsystems and accessories and whether made directly or through indirect sales channels;
- The effect of mergers and acquisitions among our competitors, suppliers or partners;
- General economic conditions in our geographic markets; and
- Impact of regulatory changes on our cost of doing business.

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

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

As our business continues to grow, we have become increasingly dependent upon larger sales to maintain our rate of growth. In particular, in recent years, we have completed larger sales to leading cloud computing and data center companies. One of our customers accounted for 12.2% of our net sales in the three months ended September 30, 2015. As customers buy our products in greater volumes and their business becomes a larger percentage of our net sales, we may grow increasingly dependent on those customers to maintain our growth. If our largest customers do not purchase our products at the levels, timeframes or geographies that we expect, our ability to maintain or grow our net sales will be adversely affected.

Increased sales to larger customers may also cause fluctuations in results of operations. Large orders are generally subject to intense competition and pricing pressure which can have an adverse impact on our margins and results of operations. Likewise, larger customers may seek to fulfill all or substantially all of their requirements in a single or a few orders, and not make another significant purchase for a substantial period of time. Accordingly, a significant increase in revenue during the period in which we recognize the revenue from a large customer may be followed by a period of time during which the customer purchases none or few of our products.

Additionally, as we and our partners focus increasingly on selling to larger customers and attracting larger orders, we expect greater costs of sales. Our sales cycle may become longer and more expensive, as larger customers typically spend more time negotiating contracts than smaller customers. Larger customers often seek greater levels of support in the implementation and use of our server solutions.

As a result of the above factors, our quarter-to-quarter results of operations may be subject to greater fluctuation and our stock price may be adversely affected.

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

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

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.

In November 2015, our management determined, and the Audit Committee of our Board of Directors concurred, that a material weakness existed in our internal control over financial reporting related to the revenue recognition of contracts with extended product warranties. We identified errors related to revenue recognized prior to meeting the U.S. GAAP revenue recognition criteria that impacted prior periods, including fiscal years 2013, 2014 and 2015 which were corrected in the three months ended September 30, 2015. We have improved our controls on revenue recognition of contracts with extended product warranties and remediated this material weakness as of June 30, 2016. While we have put controls in place to remediate the material weakness, we cannot assure that there will not be additional material weaknesses or significant deficiencies that we or our independent registered public accounting firm may identify. If we identify such issues or if we are unable to produce accurate and timely financial statements, our stock price may be adversely affected and we may be unable to maintain compliance with Nasdaq listing requirements.

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

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assure that such efforts will be effective. If we fail to maintain effective internal controls in future periods, our operating results, financial position and stock price could be adversely affected.

Increases in average selling prices for our server solutions have significantly contributed to our increases in net sales. Such prices are subject to decline if customers do not continue to purchase our latest generation products or additional components, which could harm our results of operations.

Increases in average selling prices for our server solutions have significantly contributed to our increases in net sales. As with most electronics based products, average selling prices of servers typically are highest at the time of introduction of new products, which utilize the latest technology, and tend to decrease over time as such products become commoditized and are ultimately replaced by even newer generation products. As our business continues to grow, we may increasingly be subject to this industry risk. We cannot predict the timing or amount of any decline in the average selling prices of our server solutions that we may experience in the future. In some instances, our agreements with our distributors limit our ability to reduce prices unless we make such price reductions available to them, or price protect their inventory. If we are unable to decrease per unit manufacturing costs faster than the rate at which average selling prices continue to decline, our business, financial condition and results of operations will be harmed. In addition, our average selling prices for our server solutions have increased rapidly in recent periods as we have sold more products including additional components such as more memory and hard disk drive capacity. There is no assurance that our average selling prices will continue to increase and may decline due to decreased demand for, or lower prices of, the additional components that we sell with our server solutions.

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

Because we often acquire materials and core components on an as needed basis, we may be limited in our ability to effectively and efficiently respond to customer orders because of the then-current availability or the terms and pricing of materials and core components. Our industry has experienced materials shortages and delivery delays in the past, and we may experience shortages or delays of critical materials in the future. From time to time, we have been forced to delay the introduction of certain of our products or the fulfillment of customer orders as a result of shortages of materials and core components. For example, our net sales were adversely impacted in fiscal year 2013 and 2012 by disk drive shortages resulting from flooding in Thailand. If shortages or delays arise, the prices of these materials and core components may increase or the materials and core components may not be available at all. In addition, in the event of shortages, some of our larger competitors may have greater abilities to obtain materials and core components due to their larger purchasing power. We may not be able to secure enough core components or materials at reasonable prices or of acceptable quality to build new products to meet customer demand, which could adversely affect our business and financial results.

If we were to lose any of our current supply or contract manufacturing relationships, the process of identifying and qualifying a new supplier or contract manufacturer who will meet our quality and delivery requirements, and who will appropriately safeguard our intellectual property, may require a significant investment of time and resources, adversely affecting our ability to satisfy customer purchase orders and delaying our ability to rapidly introduce new products to market. Similarly, if any of our suppliers were to cancel, materially change contracts or commitments to us or fail to meet the quality or delivery requirements needed to satisfy customer demand for our products, whether due to shortages or other reasons, our reputation and relationships with customers could be damaged. We could lose orders, be unable to develop or sell some products cost-effectively or on a timely basis, if at all, and have significantly decreased revenues, margins and earnings, which would have a material adverse effect on our business.

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

Notwithstanding our general practice of not entering into long term supply contracts, as a result of severe flooding in Thailand during the first quarter of fiscal year 2012, we have entered into purchase agreements with selected suppliers of hard disk drives in order to ensure continuity of supply for these components. The hard disk drive purchase commitments totaled

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approximately $42.2 million as of September 30, 2016, a decrease from $110.5 million as of June 30, 2016 and will be paid through December 2016. Higher costs compared to the lower selling prices for these components incurred under these agreements contributed to our lower gross profit in fiscal year 2013 and if a similar event occurs in the future, our gross profit will likely be impacted. Our existing and any other similar future supply commitments that we may enter into expose us to risk for lower margins or loss on disposal of such inventory if our expectations of customer demand are incorrect and the market price of the material or component inventory decline. Likewise if we fail to enter into commitments we may be exposed to limited availability of supply or higher inventory costs which could result in lower net sales and adversely impact gross margin and net income.

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

As a result of our strategy to provide greater choice and customization of our products to our customers, we are required to maintain a high level of inventory. If we fail to maintain sufficient inventory, we may not be able to meet demand for our products on a timely basis, and our sales may suffer. If we overestimate customer demand for our products, we could experience excess inventory of our products and be unable to sell those products at a reasonable price, or at all. As a result, we may need to record higher inventory reserves. In addition, from time to time we assume greater inventory risk in connection with the purchase or manufacture of more specialized components in connection with higher volume sales opportunities. We have from time to time experienced inventory write downs associated with higher volume sales that were not completed as anticipated. We expect that we will experience such write downs from time to time in the future related to existing and future commitments. If we are later able to sell inventory with respect to which we have taken a reserve at a profit, it may increase the quarterly variances in our operating results. Additionally, the rapid pace of innovation in our industry could render significant portions of our existing inventory obsolete. Certain of our distributors and OEMs have rights to return products, limited to purchases over a specified period of time, generally within 60 to 90 days of the purchase, or to products in the distributor's or OEM's inventory at certain times, such as termination of the agreement or product obsolescence. Any returns under these arrangements could result in additional obsolete inventory. In addition, server systems, subsystems and accessories that have been customized and later returned by those of our customers and partners who have return rights or stock rotation rights may be unusable for other purposes or may require reformation at additional cost to be made ready for sale to other customers. Excess or obsolete inventory levels for these or other reasons could result in unexpected expenses or increases in our reserves against potential future charges which would adversely affect our business and financial results. For additional information regarding customer return rights, see “Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies-Inventory Valuation.”

We may encounter difficulties with our ERP systems.

We have implemented a new enterprise resource planning, or ERP, system and have commenced using the new system in the United States in July 2015 and in Taiwan and the Netherlands in January 2016. We have incurred and expect to continue to incur additional expenses related to our implementation as we continue to enhance and develop our ERP system. Many companies have experienced delays and difficulties with the implementation of new or changed ERP systems that have had a negative effect on their business. Any future disruptions, delays or deficiencies in the design and implementation of our ERP system could result in potentially much higher costs than we currently anticipate and could adversely affect our ability to provide services, fulfill contractual obligations, file reports with the SEC in a timely manner and/or otherwise operate our business, or otherwise impact our controls environment. Any of these consequences could have an adverse effect on our results of operations and financial condition.

System security risks, data protection breaches, cyber-attacks and other related cyber-security issues could disrupt our internal operations or interfere with our products, and any such disruption could reduce our expected revenues, increase our expenses, damage our reputation and adversely affect our stock price.

Experienced computer programmers and hackers may be able to penetrate our network and misappropriate or compromise our confidential information or that of third parties, create system disruptions or cause shutdowns. Computer programmers and hackers also may be able to develop and deploy viruses, worms, and other malicious software programs that attack our products or otherwise exploit any security vulnerabilities of our products. In addition, our hardware and software or third party components and software that we utilize in our products may contain defects in design or manufacture, including "bugs" and other problems that could unexpectedly interfere with the operation of the products. The costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant and, if our efforts to address these problems are not successful, this could result in interruptions, delays, cessation of service and loss of existing or potential customers that may impede our sales, manufacturing, distribution or other critical functions. Any claim that our products or systems are subject to a cyber-security risk, whether valid or not, could damage our reputation and adversely impact our revenues and results of operations.

We manage and store various proprietary information and sensitive or confidential data relating to our business as well as information from our suppliers and customers. Breaches of our or any of our third party suppliers’ security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us or our customers or suppliers, including the potential loss or disclosure of such information or data as a result of fraud, trickery or other forms of deception, could expose us or our customers or suppliers to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our brand and reputation or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

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

Since inception we have conducted a substantial majority of our manufacturing operations in San Jose. We are continuing to work on increasing our utilization of manufacturing operations in Taiwan and in the Netherlands. The commencement or scaling of new manufacturing operations in new locations, particularly in other jurisdictions, entails additional risks and challenges. Difficulties associated with our implementation of a new global operating structure adversely impacted our results of operations and tax expenses in the quarter ended June 30, 2016. If we are unable to successfully ramp up these operations we may incur unanticipated costs, difficulties in making timely delivery of products or suffer other business disruptions which could adversely impact our results of operations.

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

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

If our business grows, we will have to manage additional product design projects, materials procurement processes, and sales efforts and marketing for an increasing number of SKUs, as well as expand the number and scope of our relationships with suppliers, distributors and end customers. If we fail to manage these additional responsibilities and relationships successfully, we may incur significant costs, which may negatively impact our operating results. Additionally, in our efforts to be first to market with new products with innovative functionality and features, we may devote significant research and development resources to products and product features for which a market does not develop quickly, or at all. If we are not able to predict market trends accurately, we may not benefit from such research and development activities, and our results of operations may suffer.

Our future effective income tax rates could be affected by changes in the relative mix of our operations and income among different geographic regions and by proposed and enacted United States federal income tax legislation, which could affect our future operating results, financial condition and cash flows.

We seek to structure our worldwide operations to take advantage of certain international tax planning opportunities and incentives. Our future effective income tax rates could be adversely affected if tax authorities challenge our international tax structure or if the relative mix of our United States and international income changes for any reason, or if United States or international tax laws were to change in the future. In particular, a substantial portion of our revenue is generated from customers located outside the United States Foreign withholding taxes and United States income taxes have not been provided on undistributed earnings for certain non-United States subsidiaries, because such earnings are intended to be indefinitely reinvested in the operations of those subsidiaries. In the past, the administration has considered initiatives which could substantially reduce our ability to defer United States taxes including limitations on deferral of United States taxation of foreign earnings which could eliminate utilization or substantially reduce our ability to claim foreign tax credits, and eliminate various tax deductions until foreign earnings are repatriated to the United States. If any of these proposals are adopted, they could have a negative impact on our financial position and results of operations. We cannot assure you that we will be able to lower our effective tax rate as a result of these activities nor that such rate will not increase in the future.

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

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

Our principal competitors include global technology companies such as Dell, Inc., Hewlett-Packard Enterprise, Lenovo and Cisco. In addition, we also compete with a number of other vendors who also sell application optimized servers, contract manufacturers and original design manufacturers (“ODMs”), such as Quanta Computer Incorporated. ODMs sell server solutions marketed or sold under a third party brand.

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

- Greater name recognition and deeper market penetration;
- Longer operating histories;
- Larger sales and marketing organizations and research and development teams and budgets;
- More established relationships with customers, contract manufacturers and suppliers and better channels to reach larger customer bases and larger sales volume allowing for better costs;
- Larger customer service and support organizations with greater geographic scope;
- A broader and more diversified array of products and services; and
- Substantially greater financial, technical and other resources.

Some of our current or potential ODM competitors are also currently or have in the past been suppliers to us. As a result, they may possess sensitive knowledge or experience which may be used against us competitively and/or which may require us to alter our supply arrangements or sources in a way which could adversely impact our cost of sales or results of operations.

Our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. Competitors may seek to copy our innovations and use cost advantages from greater size to compete aggressively with us on price. Certain customers are also current or prospective competitors and as a result, assistance that we provide to them as customers may ultimately result in increased competitive pressure against us. Furthermore, because of these advantages, even if our application optimized server solutions are more effective than the products that our competitors offer, potential customers might accept competitive products in lieu of purchasing our products. The challenges we face from larger competitors will become even greater if consolidation or collaboration between or among our competitors occurs in our industry. Also initiatives like the Open Compute Project (“OCP”), a project to establish more industry standard data center configurations, could have the impact of supporting an approach which is less favorable to the flexibility and customization that we offer. These changes could have a significant impact on the market and impact our results of operations. For all of these reasons, we may not be able to compete successfully against our current or future competitors, and if we do not compete effectively, our ability to increase our net sales may be impaired.

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

We expect that our direct sales force will continue to grow as larger customers increasingly require a direct sales approach. Competition for direct sales personnel with the advanced sales skills and technical knowledge we need is intense. Our ability to grow our revenue in the future will depend, in large part, on our success in recruiting, training, retaining and successfully managing sufficient qualified direct sales personnel. We have traditionally experienced much greater turnover in our sales and marketing personnel as compared to other departments and other companies. New hires require significant training and may take six months or longer before they reach full productivity. Our recent hires and planned hires may not become as productive as we would like, and we may be unable to hire sufficient numbers of qualified individuals in the future in the markets where we do business. If we are unable to hire, develop and retain sufficient numbers of productive sales personnel, sales of our server solutions will suffer.

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

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

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

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

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

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

We rely on indirect sales channels for a significant percentage of our revenue and any disruption in these channels could adversely affect our sales.

Sales of our products through third party distributors and resellers accounted for 50.0% and 45.6% of our net sales in the three months ended September 30, 2016 and 2015, respectively. We depend on our distributors to assist us in promoting market acceptance of our products and anticipate that a significant portion of our revenues will continue to result from sales through indirect channels. To maintain and potentially increase our revenue and profitability, we will have to successfully preserve and expand our existing distribution relationships as well as develop new distribution relationships. Our distributors also sell products offered by our competitors and may elect to focus their efforts on these sales. If our competitors offer our distributors more favorable terms or have more products available to meet the needs of their customers, or utilize the leverage of broader product lines sold through the distributors, those distributors may de-emphasize or decline to carry our products. In addition, our distributors' order decision-making process is complex and involves several factors, including end customer demand, warehouse allocation and marketing resources, which can make it difficult to accurately predict total sales for the quarter until late in the quarter. We also do not control the pricing or discounts offered by distributors to end customers. To maintain our participation in distributors' marketing programs, in the past we have provided cooperative marketing arrangements or made short-term pricing concessions.

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

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

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

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

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

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

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

New flaws or limitations in our server solutions may be detected in the future. Part of our strategy is to bring new products to market quickly, and first-generation products may have a higher likelihood of containing undetected flaws. If our customers discover defects or other performance problems with our products, our customers' businesses, and our reputation, may be damaged. Customers may elect to delay or withhold payment for defective or underperforming server solutions, request remedial action, terminate contracts for untimely delivery, or elect not to order additional server solutions, which could result in 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, and those conflicts may adversely affect our operations.

We use Ablecom, a related party, for contract design and manufacturing coordination support. We work with Ablecom to optimize modular designs for our chassis and certain of other components. Our purchases from Ablecom represented 11.2% and 13.2% of our cost of sales for the three months ended September 30, 2016 and 2015, respectively. Ablecom's sales to us constitute a substantial majority of Ablecom's net sales. Ablecom is a privately-held Taiwan-based company.

Steve Liang, Ablecom's Chief Executive Officer and largest shareholder, is the brother of Charles Liang, our President, Chief Executive Officer and Chairman of the Board. Charles Liang, and his spouse, Chiu-Chu (Sara) Liu Liang, our Vice President of Operations, Treasurer and director, jointly own 10.5% of Ablecom's outstanding common stock, while Mr. Steve Liang and other family members own 36.0% of Ablecom's outstanding common stock. Mr. and Mrs. Charles Liang, as directors, officers and significant stockholders of the Company, have considerable influence over the management of our business relationships. Accordingly, we may be disadvantaged by their economic interests as stockholders of Ablecom and their personal relationship with Ablecom's Chief Executive Officer. We may not negotiate or enforce contractual terms as aggressively with Ablecom as we might with an unrelated party, and the commercial terms of our agreements may be less favorable than we might obtain in negotiations with third parties. If our business dealings with Ablecom are not as favorable to us as arms-length transactions, our results of operations may be harmed.

If Steve Liang ceases to have significant influence over Ablecom, or if those of our stockholders who hold shares of Ablecom cease to have a significant amount of the outstanding shares of Ablecom, the terms and conditions of our agreements with Ablecom may not be as favorable as those in our existing contracts. As a result, our costs could increase and adversely affect our margins and results of operations.

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

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

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

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

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

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

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

We market and sell our systems and components both domestically and outside the United States. We intend to expand our international sales efforts, especially into Asia and are expanding our business operations in Europe and Asia, particularly in Taiwan, the Netherlands, China and Japan. In particular, we have and continue to make substantial investments for the purchase of land and the development of new facilities in Taiwan to accommodate our expected growth. Our international expansion efforts may not be successful. Our international operations expose us to risks and challenges that we would otherwise not face if we conducted our business only in the United States, such as:

- Heightened price sensitivity from customers in emerging markets;
- Our ability to establish local manufacturing, support and service functions, and to form channel relationships with resellers in non-United States markets;
- Localization of our systems and components, including translation into foreign languages and the associated expenses;

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- 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 United States, such as Avian flu, SARS and other diseases;
- Difficulties in staffing and managing foreign operations, including challenges presented by relationships with workers' councils and labor unions; and
- Changing regional economic and political conditions.

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

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

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

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

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

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

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

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

Our industry is marked by a large number of patents, copyrights, trade secrets and trademarks and by frequent litigation based on allegations of infringement or other violation of intellectual property rights. Our primary competitors have substantially greater numbers of issued patents than we have which may position us less favorably in the event of any claims or litigation with them. Other third-parties have in the past sent us correspondence regarding their intellectual property or filed

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claims that our products infringe or violate third parties' intellectual property rights. In addition, increasingly non-operating companies are purchasing patents and bringing claims against technology companies. We have been subject to several such claims and may be subject to such claims in the future.

Successful intellectual property claims against us from others could result in significant financial liability or prevent us from operating our business or portions of our business as we currently conduct it or as we may later conduct it. In addition, resolution of claims may require us to redesign our technology, to obtain licenses to use intellectual property belonging to third parties, which we may not be able to obtain on reasonable terms, to cease using the technology covered by those rights, and to indemnify our customers, resellers or vendors. Any claim, regardless of its merits, could be expensive and time consuming to defend against, and divert the attention of our technical and management resources.

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

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

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

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

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

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

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

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

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substantial investigation or remediation costs, which could be material, or experience disruptions in our operations, any of which could have a material adverse effect on our business. In addition, environmental laws could become more stringent over time imposing greater compliance costs and increasing risks and penalties associated with violations, which could harm our business.

We also face increasing complexity in our product design as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead and other hazardous substances applicable to specified electronic products placed on the market in the European Union (Restriction on the Use of Hazardous Substances Directive 2002/95/EC, also known as the RoHS Directive). We are also subject to laws and regulations such as California's "Proposition 65" which requires that clear and reasonable warnings be given to consumers who are exposed to certain chemicals deemed by the State of California to be dangerous, such as lead. We expect that our operations will be affected by other new environmental laws and regulations on an ongoing basis. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, and could require that we change the design and/or manufacturing of our products, any of which could have a material adverse effect on our business.
We are also subject to the regulations concerning the supply of minerals coming from the conflict zones in and around the Democratic Republic of Congo. This newer United States legislation includes disclosure requirements regarding the use of conflict minerals mined from the Democratic Republic of Congo and adjoining countries and procedures regarding a manufacturer's efforts to prevent the sourcing of such conflict minerals. The implementation of these requirements could affect the sourcing and availability of minerals used in the manufacture of semiconductor or other devices. As a result, there may only be a limited pool of suppliers who provide conflict-free metals, and we cannot assure you that we will be able to obtain products in sufficient quantities or at competitive prices.

Risks Related to Owning Our Stock

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

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

- Actual or anticipated variations in our operating results, including failure to achieve previously provided guidance;
- Announcements of technological innovations, new products or product enhancements, strategic alliances or significant agreements by us or by our competitors;
- Changes in recommendations by any securities analysts that elect to follow our common stock;
- The financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- The loss of a key customer;
- The loss of key personnel;
- Technological advancements rendering our products less valuable;
- Lawsuits filed against us;
- Changes in operating performance and stock market valuations of other companies that sell similar products;
- Price and volume fluctuations in the overall stock market;
- Market conditions in our industry, the industries of our customers and the economy as a whole; and
- Other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

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

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

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

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

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

As of October 27, 2016, our executive officers, directors, current five percent or greater stockholders and affiliated entities together beneficially owned 44.9% of our common stock, net of treasury stock. As a result, these stockholders, acting together, will have significant influence over all matters that require approval by our stockholders, including the election of directors and approval of significant corporate transactions. Corporate action might be taken even if other stockholders oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial.

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

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

- establish a classified board of directors so that not all members of our board are elected at one time;
- require super-majority voting to amend some provisions in our certificate of incorporation and bylaws;
- authorize the issuance of “blank check” preferred stock that our board could issue to increase the number of outstanding shares and to discourage a takeover attempt;
- limit the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to adopt, or to alter or repeal our bylaws; and
- establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings.

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

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

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

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

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

Issuer Purchases of Equity Securities

In July 2016, our Board of Directors adopted a program to repurchase from time to time at management’s discretion up to $100,000,000 of our common stock in the open market or in private transactions during the next twelve months at prevailing market prices. During the three months ended September 30, 2016, we purchased 888,097 shares of our common stock in the open market at a weighted average price of $20.79 per share for $18.5 million.

The following table provides information regarding repurchases of our common stock during the three months ended September 30, 2016:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
July 1 - July 31, 2016	513,194	$ 19.99	513,194	$ 89,741
August 1 - August 31, 2016	204,570	$ 21.77	204,570	$ 85,288
September 1 - September 30, 2016	170,333	$ 22.01	170,333	$ 81,539
Total	888,097	$ 20.79	888,097	

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

On November 4, 2016, our board of directors (the “Board”) elected Saria Tseng to serve as a member of the Board, effective immediately. Ms. Tseng will serve as a Class III director, and will have a term that expires at the annual meeting of stockholders to be held in 2018. In addition, Ms. Tseng was appointed as a member of the Compensation Committee and Nominating and Corporate Governance Committee of the Board, effective immediately.

Ms. Tseng has served as Vice President of Strategic Corporate Development, General Counsel and Secretary of Monolithic Power Systems (Nasdaq:MPWR) since 2004, a leading fabless manufacturer of high-performance analog and mixed-signal semiconductors. Over the past 22 years, Ms. Tseng has accumulated a broad spectrum of legal expertise and business knowledge in the technology industry. From 2001 to 2004, Ms. Tseng served as Vice President, General Counsel and Corporate Secretary of MaXXan Systems, an enterprise class storage network system. Previously, Ms. Tseng was an attorney at Gray Cary (now DLA Piper) and Jones Day. Ms. Tseng is a member of the state bar in both California and New York and is a member of the bar association of the Republic of China, Taiwan. She holds Master of Law degrees from the University of California at Berkeley and the Chinese Culture University in Taipei.

As a member of the Board, Ms. Tseng will be entitled to participate in our non-employee director compensation program, under which she will receive (i) an annual retainer of $40,000 for her service as a director, (ii) an annual retainer of $2,500 for each of her committee memberships, (iii) an initial option to purchase 18,000 shares upon first becoming a member of the Board ("Initial Grant") and (iv) an annual grant of options to purchase 4,500 shares of our common stock ("Annual Grant"). The Initial Grant will vest and become exercisable over four years, with the first 25% of the shares subject to vesting on the first anniversary of the date of grant and the remainder vesting quarterly thereafter. The Annual Grant will vest and become exercisable on the first anniversary of the date of grant or immediately prior to our next annual meeting of stockholders, if earlier. The Initial Grant and Annual Grant have a per share exercise price equal to 100% of the fair market value of the underlying shares on the date of grant, and will become fully vested if we are subject to a change of control.

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There are no arrangements or understandings between Ms. Tseng and any other persons pursuant to which she was selected as a director. There are no related party transactions of the kind described in Item 404(a) of Regulation S-K in which Ms. Tseng is or was a participant.

Item 6. Exhibits

(a) Exhibits.

Exhibit Number	Description
31.1	Certification of Charles Liang, President and Chief Executive Officer of the Registrant pursuant to Section 302, as adopted pursuant to the Sarbanes-Oxley Act of 2002
31.2	Certification of Howard Hideshima, Chief Financial Officer of the Registrant pursuant to Section 302, as adopted pursuant to the Sarbanes-Oxley Act of 2002
32.1	Certification of Charles Liang, President and Chief Executive Officer of the Registrant pursuant to Section 906, as adopted pursuant to the Sarbanes-Oxley Act of 2002
32.2	Certification of Howard Hideshima, Chief Financial Officer of the Registrant pursuant to Section 906, as adopted pursuant to the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SUPER MICRO COMPUTER, INC.

Date:	November 7, 2016	/s/ CHARLES LIANG Charles Liang President, Chief Executive Officer and Chairman of the Board (Principal Executive Officer)
Date:	November 7, 2016	/s/ Howard Hideshima Howard Hideshima Senior Vice President, Chief Financial Officer (Principal Financial and Accounting Officer)