ISTAR FINANCIAL INC
Form DEF 14A
April 11, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934
(Amendment No. 1)

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material Pursuant to §240.14a-12

iSTAR FINANCIAL INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

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o Fee paid previously with preliminary materials.

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

1114 Avenue of the Americas, 39th Floor
New York, New York 10036
April 11, 2013

Dear Shareholder:

We cordially invite you to attend our 2013 annual meeting of shareholders. We will hold the meeting at the Sofitel Hotel, 45 West 44th Street, 2nd Floor, Trocadero Room, New York, New York on Tuesday, May 21, 2013 at 9:00 a.m. local time.

At the annual meeting, we will ask our shareholders to:

(1) elect six members to the board of directors;

(2) consider and vote upon a proposal to ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the year ending December 31, 2013;

(3) consider and vote upon a resolution to approve, on a non-binding, advisory basis, the Company's executive compensation, as described in this proxy statement; and

(4) transact such other business as may properly come before the meeting or any adjournment or postponement of the meeting.

The attached proxy statement contains details of the proposals to be voted on at the annual meeting and other important matters. We encourage you to read the proxy statement and attachments carefully.

YOUR BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE:

FOR THE ELECTION OF THE SIX NOMINEES AS DIRECTORS;

FOR THE RATIFICATION OF THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM; AND

FOR THE RESOLUTION APPROVING, ON A NON-BINDING, ADVISORY BASIS, EXECUTIVE COMPENSATION AS DESCRIBED IN THIS PROXY STATEMENT.

We cordially invite all shareholders to attend the annual meeting in person. Any shareholder attending the annual meeting may vote in person even if he or she previously returned a proxy.

Sincerely,

Jay Sugarman
Chairman and Chief Executive Officer

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

NOTICE IS HEREBY GIVEN that the annual meeting of shareholders of iStar Financial Inc., a Maryland corporation, will be held at the Sofitel Hotel, 45 West 44th Street, 2nd Floor, Trocadero Room, New York, New York on Tuesday, May 21, 2013 at 9:00 a.m. local time, for the following purposes as further described in the accompanying proxy statement:

1. To elect to the board of directors six members to hold office until the next annual meeting of shareholders and until their respective successors are duly elected and qualify. The nominees to the board are: Robert W. Holman, Jr., Robin Josephs, John G. McDonald, Dale Anne Reiss, Barry W. Ridings and Jay Sugarman.

2. To consider and vote upon a proposal to ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2013.

3. To consider and vote upon a resolution to approve, on a non-binding, advisory basis, the compensation of the Company's named executive officers and other named officers, as described in the Compensation Discussion and Analysis section, the tabular disclosure regarding such compensation, and the accompanying narrative disclosure set forth in the Company's 2013 proxy statement.

4. To transact such other business as may properly come before the annual meeting or any postponement or adjournment of the meeting.

The board has fixed the close of business on March 25, 2013 as the record date for the determination of shareholders entitled to receive notice of and to vote at the annual meeting or any postponement or adjournment of the meeting. Only holders of record of our common stock, par value $.001 per share (which includes both our regular common stock and our high performance common stock), and 8.00% Series D preferred stock, par value $.0001 per share, at the close of business on that date will be entitled to vote at the annual meeting.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON MAY 21, 2013:

We make proxy materials available to our shareholders on the Internet. You can access proxy materials at http://www.proxyvote.com. You also may authorize your proxy via the Internet or by telephone by following the instructions on that website. In order to authorize your proxy via the Internet or by telephone you must have the shareholder identification number that appears on the enclosed Notice of Internet Availability of Proxy Materials. You also may request a paper or an e-mail copy of our proxy materials and a paper proxy card by following the instructions included in the Notice of Internet Availability of Proxy Materials.

By Order of the Board of Directors,

Geoffrey M. Dugan
General Counsel, Corporate & Secretary
New York, NY
April 11, 2013

WHETHER OR NOT YOU EXPECT TO ATTEND THE ANNUAL MEETING, TO ENSURE YOUR REPRESENTATION AT THE ANNUAL MEETING, PLEASE MARK, SIGN, DATE AND RETURN THE ATTACHED PROXY CARD AS PROMPTLY AS POSSIBLE.

1114 Avenue of the Americas, 39th Floor
New York, New York 10036

PROXY STATEMENT

Annual Meeting of Shareholders
To Be Held May 21, 2013

We are making this proxy statement available to holders of our common stock, par value $.001 per share, and holders of our 8.00% Series D preferred stock, par value $.0001 per share, on or about April 11, 2013 in connection with the solicitation by our board of directors of proxies to be voted at our 2013 annual meeting of shareholders or at any postponement or adjournment of the annual meeting. Our common stock includes both our regular common stock and our high performance common stock. Our common stock is listed on the New York Stock Exchange, or the NYSE, and is traded under the symbol "SFI."

This proxy statement is accompanied by a copy of our Annual Report to Shareholders for the year ended December 31, 2012. Additional copies of the Annual Report, including our financial statements at December 31, 2012, may be obtained from our website at *www.istarfinancial.com*, or by contacting our Investor Relations department at (212) 930-9400, 1114 Avenue of the Americas, 39th Floor, New York, NY 10036. Copies will be furnished at no additional expense. The information found on, or accessible through, our website is not incorporated into, and does not form a part of, this proxy statement or any other report or document we file with or furnish to the Securities and Exchange Commission, or the SEC.

About the Meeting

Who is entitled to vote at the meeting?

Only holders of record of our common stock, our high performance common stock and our Series D preferred stock at the close of business on March 25, 2013 are entitled to receive notice of and to vote at the annual meeting or at any postponement or adjournment of the meeting. On the record date, there were 143,968,415 issued shares of common stock, 85,050,994 outstanding shares of common stock (58,917,421 shares were held in treasury), 14,887.50 issued and outstanding shares of high performance common stock and 4,000,000 issued and outstanding shares of Series D preferred stock.

What constitutes a quorum?

The presence, either in person or by proxy, of the holders of the outstanding common stock and Series D preferred stock entitled to cast a majority of all the votes entitled to be cast at the meeting, considered as a single class, on the record date is necessary to constitute a quorum at the annual meeting.

What are the voting rights of shareholders?

Each shareholder is entitled to one vote for each share of regular common stock registered in the shareholder's name on the record date and 0.25 votes for each share of high performance common stock and Series D preferred stock registered in the shareholder's name on the record date.

What vote is needed to approve each proposal?

Assuming a quorum is present in person or by proxy at the annual meeting:

- For the election of directors (Item 1), the vote of a plurality of all of the votes cast by the holders of our common stock and Series D preferred stock, all voting as one class, is required.

- For the ratification of the appointment of the independent registered public accounting firm (Item 2), the resolution to approve, on a non-binding, advisory basis, the compensation of our named executive officers and other named officers (Item 3), and the approval of any other matters properly presented at the meeting for shareholder approval, the affirmative vote of a majority of all of the votes cast by the holders of our common stock and Series D preferred stock, all voting as one class, is required.

What are "broker non-votes" and what is the effect of "broker non-votes" and abstentions?

A "broker non-vote" occurs when a broker, bank or other nominee returns a properly executed proxy, but indicates on the proxy that it does not have discretionary authority as to certain shares to vote on a particular matter and has not received voting instructions from the beneficial owner of such shares on that matter. Under current NYSE rules, a broker, bank or other nominee does not have discretionary authority to vote shares without specific voting instructions from the beneficial owner on (a) the election of directors or (b) the resolution, on a non-binding, advisory basis, on executive compensation. A broker, bank or other nominee does, however, have discretionary authority to vote shares for ratification of the appointment of the independent registered public accounting firm.

For purposes of votes on all matters described in this proxy statement to be presented at the annual meeting, broker non-votes and abstentions will not be counted as votes cast and will have no effect on the result of the vote, although they will be considered present for the purpose of determining the presence of a quorum.

How is my vote counted?

If you properly execute a proxy in the accompanying form, and if we receive it prior to voting at the annual meeting, the shares that the proxy represents will be voted in the manner specified on the proxy. If no specification is made, the common stock or Series D preferred stock will be voted FOR the election of directors, ratification of the appointment of the independent registered public accounting firm, approval of the resolution to approve, on a non-binding, advisory basis, executive compensation, and as recommended by the board with regard to all other matters in its discretion.

Votes cast in person or by proxy at the annual meeting will be tabulated by the election inspectors appointed for the meeting, who will determine whether or not a quorum is present. If your shares are held by a broker, bank or other nominee (i.e., in "street name"), you will receive instructions from your nominee which you must follow in order to have your shares voted. Such shareholders who wish to vote in person at the meeting will need to obtain a proxy from the broker, bank or other nominee that holds their shares of record.

Can I change my vote after I submit my proxy card?

If you authorize a proxy to vote your shares, you may revoke it at any time before it is voted by:

- giving written notice to our Secretary expressly revoking the proxy;

- by signing and forwarding to us a proxy dated later; or

- by attending the annual meeting and personally voting the common stock or Series D preferred stock owned of record by you.

Who pays the costs of soliciting proxies?

We will pay the costs of soliciting proxies from our shareholders. In addition to solicitation by mail, certain of our directors, officers and regular employees may solicit the return of proxies by telephone, facsimile, personal interview or otherwise without being paid additional compensation. We will also reimburse brokerage firms and other persons representing the beneficial owners of our shares for their reasonable expenses in forwarding proxy solicitation material to the beneficial owners in accordance with the proxy solicitation rules and regulations of the SEC and the NYSE. AST Phoenix Advisors has been engaged to solicit proxies on our behalf in connection with our 2013 annual meeting of shareholders and provide other advisory services for an annual fee of $10,000 plus expenses.

PROPOSAL 1:

ELECTION OF DIRECTORS

In accordance with the provisions of our charter, each member of our board is elected annually.

All of the nominees for election as a director are presently serving as directors. If a nominee becomes unavailable to serve as a director for any reason, the shares represented by any proxy will be voted for the person, if any, who may be designated by the board to replace that nominee. At this time, the board has no reason to believe that any nominee will be unavailable to serve as a director if elected.

Mr. George R. Puskar, who has served as one of our directors since 1999, is not standing for re-election as a director at the 2013 annual meeting. Mr. Puskar will continue to serve as a director through the date of the annual meeting. At this time, the board is not nominating a replacement director and the board intends to go forward with six members.

All of the nominees for election as a director, other than Mr. Sugarman, are independent within the standards prescribed by the NYSE.

The following table sets forth the name, age and the position(s) with us currently held by each person nominated for election as a director:

Name	Age	Title
Jay Sugarman	50	Chairman and Chief Executive Officer
Robert W. Holman, Jr.(1)(2)(3)	69	Director
Robin Josephs(2)(3)(4)(5)	53	Director
John G. McDonald(2)(3)	75	Director
Dale Anne Reiss(1)(4)	65	Director
Barry W. Ridings(2)(4)	61	Director

(1) Member of Asset Management and Investment Committee

(2) Member of Compensation Committee

(3) Member of Nominating and Governance Committee

(4) Member of Audit Committee

(5) Lead Director

We believe that the nominees for election as a director have the qualifications, skills and experience necessary to ensure that we are taking appropriate steps to address the complex issues confronting us in a challenging business and economic environment. As set forth in our corporate governance guidelines, the qualifications, skills and experience that we consider relevant include the following:

- Education and experience that provides knowledge of business, financial, governmental or legal matters that are relevant to our business or to our status as a publicly owned company;
- Reputation for integrity;
- Reputation for exercising good business judgment; and

Sufficient available time to be able to fulfill his or her responsibilities as a member of the board and of any committees to which he or she may be appointed.

The nominees for election as a director have held leadership positions in business (and in particular the real estate and financial services business sectors), finance and academia over an extended period of time. Each of the nominees has demonstrated a long record of professional integrity, intellectual acumen, analytic skills, a strong work ethic and the ability to maintain a constructive environment for discussion of matters considered by our board. Additionally, several of our directors have experience as board members of a diverse range of public companies.

The following section contains biographical and other information about the nominees. Following each nominee's biographical information, we have provided information concerning the particular experience, qualifications, attributes and/or skills that have led the Nominating and Governance Committee and the board to determine that each nominee should serve as a director.

Jay Sugarman is our Chairman and Chief Executive Officer. Mr. Sugarman has served as a director of iStar Financial Inc. (and our predecessor) since 1996 and chief executive officer since 1997. Prior to forming iStar Financial Inc. and its predecessors, Mr. Sugarman managed private investment funds on behalf of the Burden family, a branch of the Vanderbilts, and the Ziff family. Mr. Sugarman currently serves as Chairman of the Board of LNR Property LLC, the largest special servicer of commercial real estate assets in the United States and Europe. (As described below in "CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS," we presently have an equity interest of approximately 24% in LNR and have entered into a definitive agreement to sell our LNR interest.) Mr. Sugarman received his undergraduate degree *summa cum laude* from Princeton University, where he was nominated for valedictorian and received the Paul Volcker Award in Economics, and his M.B.A. with high distinction from Harvard Business School, graduating as a Baker Scholar and recipient of the school's academic prizes for both finance and marketing. As founder of iStar Financial Inc. and chief executive officer since 1997, Mr. Sugarman has demonstrated the leadership skills and extensive executive experience across a broad range of investment, financial and operational matters that are necessary to lead iStar, a fully-integrated finance and investment company focused on the commercial real estate industry.

Robert W. Holman, Jr. has served as one of our directors since November 1999. He is chairman of our Compensation Committee and a member of our Asset Management and Investment Committee and our Nominating and Governance Committee. Mr. Holman was co-founder of TriNet Corporate Realty Trust, Inc., or TriNet, a NYSE-listed company that we acquired in 1999, and served as its chief executive officer and chairman of the board. He was chief executive officer and chairman of TriNet's predecessor, Holman/Shidler Corporate Capital, Inc., for ten years. He has structured, acquired, financed and managed over $2.5 billion of commercial and corporate assets in 40 states and Canada. Mr. Holman co-founded and was a senior executive and director of Watkins Pacific Corporation, a public multi-national conglomerate. Mr. Holman currently serves as a director and member of the audit and investment committees of the Parasol Tahoe Community Foundation. Mr. Holman has previously served as a director of Amerivest Properties, Inc., an American Stock Exchange-listed company, and as a senior executive, director, owner or board advisor for investment and operating companies in the United States, Great Britain, Australia and Mexico. He holds a B.A. degree in international economics from the University of California at Berkeley, an M.A. degree with honors from Lancaster University in England, where he was a British Council Fellow, and did post-graduate work at Harvard University where he was awarded a Loeb Fellowship. Mr. Holman's qualifications for election to our board include his experience as a founder, chief executive and director of TriNet, a public real estate investment firm focused on corporate tenant leasing which remains a key aspect of our business, his involvement in leadership capacities in other companies and organizations engaged in a broad range of business, finance and investment activities and his experience as a private investor.

Robin Josephs has served as one of our (and our predecessor's) directors since March 1998. Ms. Josephs serves as our Lead Director, with duties that include presiding at all executive sessions of the independent directors and serving as principal liaison between the chairman and the independent directors. Ms. Josephs is a member of our Audit, Compensation and Nominating and Governance Committees. From July 2005 to March 2007, Ms. Josephs was a managing director of Starwood Capital Group L.P., a private equity firm specializing in real estate investments. Prior to that, Ms. Josephs was a senior executive with Goldman Sachs & Co. from 1986 to 1996 in various capacities. She currently serves as a director of Plum Creek Timber Company, Inc. (NYSE: PCL), which conducts operations in the land, wood products, natural resource and energy businesses, where she also serves on both the compensation and audit committees, and MFA Financial, Inc. (NYSE: MFA), which is primarily engaged in investing in residential mortgage-backed securities. Ms. Josephs is a trustee of the University of Chicago Cancer Research Foundation and executive vice president of the Tourette Syndrome Association. Ms. Josephs received a B.S. degree in economics *magna cum laude* from the Wharton School (Phi Beta Kappa) and an M.B.A. degree from Columbia University. Ms. Josephs' qualifications for election to our board include her experience as an executive with firms in the real estate, finance and investment industries and her extensive experience as a director of public real estate and investment companies.

John G. McDonald has served as one of our directors since November 1999. Previously, Professor McDonald served as a director of TriNet since June 1993. Professor McDonald is chairman of our Nominating and Governance Committee and a member of our Compensation Committee. He is the Stanford Investors Professor of Finance in the Graduate School of Business at Stanford University, where he has taught since 1968. Professor McDonald has taught M.B.A. courses and executive programs in subject areas including investment management, private equity, venture capital and corporate finance. He currently serves as a director of Scholastic Corporation (Nasdaq: SCHL), a global children's publishing, education and media company, Plum Creek Timber Company, Inc. (NYSE: PCL), QuinStreet, Inc. (Nasdaq: QNST), a vertical marketing and online media company. Professor McDonald previously served as a director of thirteen mutual funds managed by Capital Research and Management Company until December 2012 and as a director of Varian, Inc., which was acquired by Agilent Technologies, Inc. in 2010. Professor McDonald's qualifications for election to our board include his experience over an extended period as a professor of finance at a leading educational institution and as a director of public companies and mutual funds.

Dale Anne Reiss has served as one of our directors since July 2008. Ms. Reiss is chairperson of our Audit Committee and a member of our Asset Management and Investment Committee. Ms. Reiss is the chair of Brock Real Estate LLC and senior managing director of Brock Capital LLC. Until her retirement in 2008, she served as Global and Americas Director of Real Estate at Ernst & Young LLP and was a Senior Partner there from 1995 through 2008 in various capacities. She served as a Managing Partner at Kenneth Leventhal & Company from 1985 through its merger with Ernst & Young in 1995. From 1980 to 1985, Ms. Reiss was a Senior Vice President and Controller at Urban Investment & Development Company. She is also Managing Director of Artemis Advisors, LLC and a member of the board of directors of Post Properties, Inc. where she serves on the audit and the nominating and governance committees. Since 1998, Ms. Reiss has served as a Trustee and Governor of the Urban Land Institute and in various ULI officer and committee leadership positions. She also serves on the board of the Guttmacher Institute and previously served as a board member of the Pension Real Estate Association. In 2002, the New York Women Executives in Real Estate named Ms. Reiss Woman of the Year. Ms. Reiss is a Certified Public Accountant. She received a B.S. from the Illinois Institute of Technology and an M.B.A. from the University of Chicago. Ms. Reiss' qualifications for election to our board include her extensive expertise in financial and accounting matters from her experience over an extended period at several major public accounting firms, her leadership experience in management and operations at those firms and her experience as a director of other public and private companies.

Barry W. Ridings has served as one of our directors since August 2011. He is a member of our Audit and Compensation Committees. Mr. Ridings is Vice Chairman of Investment Banking of Lazard Frères & Co. LLC. He serves as Chairman of LFCM Holdings LLC, which includes the operations of Lazard Capital Markets, and Chairman of Lazard Middle Market LLC. Mr. Ridings served as Managing Director of Deutsche Banc Alex. Brown from March 1990 to June 1999 and Drexel Burnham Lambert from June 1986 to March 1990. He has over 35 years of experience in debt and equity offerings, mergers and acquisitions and corporate restructurings. Mr. Ridings serves as Chairman of the Committee on Securities of NYSE Amex LLC. He serves as a Director of Siem Industries Inc. He serves on the Advisory Council for the Cornell University Johnson Graduate School of Business. He serves as a Trustee of the Mu of Delta Kappa Epsilon Foundation, a charitable fraternal organization associated with Colgate University, a trustee of The Montclair Kimberley Academy and a director of the Catholic Charities of the Archdiocese of New York. Mr. Ridings has a B.A. in Religion from Colgate University and an M.B.A. in Finance from Cornell University. Mr. Ridings' qualifications for election to our board include his distinguished career in the finance industry, his experience in helping companies access debt and equity capital and navigate challenging market conditions, his service as a director of other public and private companies and his charitable activities.

Recommendation Regarding the Election of Directors

The board recommends that you vote FOR election of the six named nominees as our directors.

PROPOSAL 2:

RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee of the board of directors, with the concurrence of the board, has selected PricewaterhouseCoopers LLP, an independent registered public accounting firm, to be our auditors for the fiscal year ending December 31, 2013, subject to ratification by our shareholders. We expect a representative of PricewaterhouseCoopers LLP to attend the annual meeting to make a statement, if he or she desires, and to respond to appropriate questions.

Recommendation Regarding Ratification of Appointment of PricewaterhouseCoopers LLP

The board recommends that you vote FOR ratification of the appointment of PricewaterhouseCoopers LLP, an independent registered public accounting firm, to be our auditors for the fiscal year ending December 31, 2013.

PROPOSAL 3:

SHAREHOLDER ADVISORY (NON-BINDING) VOTE ON EXECUTIVE COMPENSATION

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, and rules adopted by the SEC thereunder, our shareholders are entitled to cast an advisory vote to approve the compensation of our named executive officers and other named officers as disclosed in this proxy statement, commonly referred to as the "Say on Pay" vote. At our 2011 Annual Meeting, the majority of our shareholders voted in favor of holding an annual, non-binding Say on Pay vote. Our board of directors adopted the shareholders' recommendation to conduct an annual Say on Pay vote.

Shareholders are urged to read the Executive Compensation section of this proxy statement, and especially the Compensation Discussion and Analysis, which discusses our compensation philosophy and how our compensation policies and practices implement our philosophy.

As described more fully in that discussion, our compensation programs are anchored in our pay-for-performance philosophy and have been designed to create a strong connection between executive pay and shareholder value creation and achieve the following objectives:

- To further our current and long-term strategic, business and financial goals in the creation of shareholder value by enabling us to attract, retain, motivate and reward key executives who contribute to achieving those goals.
- To encourage our key executives to increase shareholder value by providing a mix of current compensation and long-term rewards that is variable and balanced between salary and performance-based pay and includes cash, equity compensation and other benefits.
- To align shareholder and employee interests by compensating employees for increasing the value of the Company, to the benefit of our shareholders.

To promote these objectives, a significant part of executive compensation is based on accomplishing achievements that increase the value of the Company. We believe this approach helps us achieve our objectives and promote the interests of our shareholders.

2012 was a transitional year during which we made significant progress in strengthening our balance sheet and positioning for the future. Specifically:

- We generated $1.48 billion of proceeds from our portfolio and raised approximately $3.51 billion through secured and unsecured debt capital markets transactions. We used the proceeds of these

transactions to repay and/or refinance a significant portion of our debt that was due to mature before 2017. As a result of these steps, we expect to be able to increase our investment originations beginning in 2013.

Our performing loans, net lease assets and residential condominium projects performed well, and we continued to make progress reducing the balance of our non-performing loans and enhancing the value of our commercial operating properties and land assets through the investment of capital and intensive asset management.

Our total shareholder return, or TSR, for 2012 was 54%, reflecting the increase in our common stock price at 2012 year-end over our common stock price at 2011 year-end.

Our compensation actions during 2012 have taken into account our continuing progress in this transitional period, our executives' efforts and accomplishments towards achieving our current and long-term strategic, business and financial goals, as well as our continuing efforts to enhance the alignment between our executive incentives and results realized by our shareholders.

We are requesting your non-binding vote on the following resolution:

> "RESOLVED, that the Company's shareholders approve, on an advisory basis, the compensation of the named executive officers and other named officers as described in the Proxy Statement for the 2013 Annual Meeting of Shareholders pursuant to the compensation disclosure rules of the SEC, including the Compensation Discussion and Analysis, the 2012 Summary Compensation Table and the other related tables and narrative disclosure."

Although your vote is non-binding and advisory, the board of directors and the Compensation Committee will take into account the outcome of the vote when considering future executive compensation arrangements.

Recommendation Regarding Executive Compensation

The board of directors recommends that you vote FOR the Say on Pay resolution to approve the compensation of the named executive officers and other named officers as described in the Compensation Discussion and Analysis, the compensation tables and other narrative disclosure in this proxy statement.

INFORMATION REGARDING THE BOARD OF DIRECTORS AND ITS COMMITTEES

How often did the board meet during 2012?

During the fiscal year ended December 31, 2012, the board held 9 meetings, including meetings held in person and by telephone conference call. All directors are expected to attend a majority of the board meetings. All directors attended at least 75% of all of the board meetings and applicable committee meetings. In addition, all of the directors who were elected at the 2012 annual meeting were present in person at that annual meeting, with the exception of Professor John G. McDonald who was unable to attend the meeting due to health reasons.

What Committees has the board established?

Our board has standing Audit, Compensation, Nominating and Governance, and Asset Management and Investment Committees. The standing committees are comprised entirely of independent directors. Our board appoints special committees from time to time, as deemed necessary or appropriate.

How does the Company determine director independence?

Our board has determined that a majority of our directors are independent. In determining director independence, the board considers all relevant facts and circumstances and the NYSE listing standards. Under the NYSE listing standards, no director qualifies as independent unless the board affirmatively determines that the director has no material relationship with the Company, either directly or as a partner, stockholder or officer of an organization that has a relationship with the Company. The board has determined that the following directors qualify as independent: Mss. Josephs and Reiss and Messrs. Holman, McDonald, Puskar and Ridings.

The Audit Committee

The Audit Committee is responsible for, among other things, retaining or dismissing our independent registered public accounting firm, reviewing with the auditors the plan and scope of the audit and audit fees, monitoring the adequacy of reporting and internal controls and meeting periodically with management and our independent registered public accounting firm.

As of the date of this proxy statement, the members of the Audit Committee are Dale Anne Reiss (chairperson), Robin Josephs, George R. Puskar and Barry W. Ridings. Mr. George R. Puskar is not standing for re-election as a director at the annual meeting and will continue to serve as a director, and a member of the Audit Committee, only through the date of the annual meeting. The board has determined that each of the current members of the Audit Committee is independent, as defined by the Audit Committee's charter and the NYSE listing standards, and that the chairperson of the committee qualifies as an "audit committee financial expert" as defined by the SEC. In addition, the board has determined that each of the current members of the Audit Committee is financially literate and has accounting or related financial management expertise, as such qualifications are defined under the rules of the NYSE. The Audit Committee operates under a written charter, a copy of which may be found on our website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests a copy. The Audit Committee met 13 times during 2012, including meetings held in person and by telephone conference call.

The Compensation Committee

The Compensation Committee is responsible for overseeing our executive compensation programs. The principal responsibilities of the Compensation Committee are:

- To review management's recommendations and advise management and the board on broad compensation programs and policies such as salary ranges, annual incentive bonuses and long-term incentive plans, including equity-based compensation programs, as well as other group benefit programs offered to employees generally.

- To review performance objectives established for our senior executives and evaluate the performance of such executives relative to these objectives in connection with the Compensation Committee's overall review of executive compensation.

- To approve, either as a committee or together with the other independent directors based on a recommendation of the committee, the base salary, annual incentive award, long-term incentive awards and other compensation for our chief executive officer.

- To approve base salaries, annual incentive awards, long-term incentive awards and other compensation for our other officers and employees with base salaries in excess of $200,000 per year (which include all officers who are subject to Section 16(b) of the Securities Exchange Act of 1934, as amended).

- To administer the issuance of any award under our long term incentive plans and other equity compensation programs.

- To retain and oversee third party consultants to assist with the Compensation Committee's activities, from time to time.

- To oversee our performance evaluation practices and procedures.

- To consider and evaluate "Say on Pay" resolutions and recommend to the board the frequency with which "Say on Pay" resolutions should be voted on by the shareholders.

- To perform such other duties and responsibilities pertaining to compensation matters as may be assigned to the Compensation Committee by the board or the chairman of the board.

- To review the Compensation Discussion and Analysis for inclusion in this proxy statement.

As of the date of this proxy statement, the members of the Compensation Committee are Robert W. Holman, Jr. (chairman), Robin Josephs, John G. McDonald and Barry W. Ridings. Each of the current members of the Compensation Committee is independent as defined by the Compensation Committee's charter and the NYSE listing standards. The Compensation Committee operates under a written charter, a copy of which may be found on our website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests a copy. The Compensation Committee met 15 times during 2012, including meetings held in person and by telephone conference call.

The Nominating and Governance Committee

The Nominating and Governance Committee is responsible for, among other things, considering and recommending actions relating to corporate governance matters. In addition, the Nominating and Governance Committee considers and recommends to the board individuals to serve as our directors and executive officers. In making such recommendations, the Nominating and Governance Committee considers such factors as it deems appropriate. These factors may include judgment, skill and experience with businesses and other organizations comparable to us. The charter of our Nominating and Governance Committee also identifies diversity as one factor which the committee may consider

when nominating a candidate for election to the board. Diversity includes not only factors such as gender, race and age, but also background, experience, skills, accomplishments, personal qualities and other traits desirable in achieving an appropriate mix of qualified individuals.

The Nominating and Governance Committee may solicit and consider suggestions of the directors or management regarding possible nominees, may consider nominees suggested by shareholders and generally shall guide the process of recruiting new directors. The Nominating and Governance Committee may employ professional search firms or consultants (for which we pay a fee) to assist us in identifying potential members of the board with the desired skills and disciplines. Nominations made by shareholders should be made in accordance with the procedures set forth in this proxy statement under "Corporate Governance Matters Shareholder Nominations for the Board." Candidates proposed by shareholders will be considered using the same criteria and in the same manner as all other candidates are considered.

As of the date of this proxy statement, the members of the Nominating and Governance Committee are John G. McDonald (chairman), Robert W. Holman, Jr. and Robin Josephs. Each of the current members of the Nominating and Governance Committee is independent as defined by the applicable NYSE listing standards. The Nominating and Governance Committee operates under a written charter, a copy of which may be found on our website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests a copy. The Nominating and Governance Committee met three times during 2012, including meetings held in person and by telephone conference call.

The Asset Management and Investment Committee

The Asset Management and Investment Committee regularly reviews our significant loans and assets in each principal asset category, and discusses strategies for dealing with issues relating to portfolio management, asset dispositions and other negotiated resolutions, to complement the portfolio review conducted regularly by the board of directors.

The Asset Management and Investment Committee has been delegated the authority to approve our investment transactions involving commitments equal to $50 million or more but less than $75 million. Investment transactions of $75 million or more, and strategic investments such as a corporate merger or acquisition of another business entity (other than a corporate net lease financing) or any other material transaction involving our entry into a new line of business, must be approved by our board of directors. Investment transactions less than $50 million are subject to the approval of either an internal senior management investment committee or Jay Sugarman, our chairman and chief executive officer, and Nina Matis, our chief legal officer and chief investment officer, in accordance with the limits of investment authority established by the board.

The members of the Asset Management and Investment Committee are George R. Puskar (chairman), Robert W. Holman, Jr. and Dale Anne Reiss. Mr. George R. Puskar is not standing for re-election as a director at the annual meeting and will continue to serve as a director, and a member of the Asset Management and Investment Committee, only through the date of the annual meeting. Effective as of the annual meeting, this Committee will be reconstituted as the Investment Committee and will continue to review and consider for approval our potential investment transactions within the limits of authority described above. Our board as a whole will continue its regular review of our investment portfolio, including significant loans and assets in each asset category and strategies for dealing with issues relating to portfolio management. Barry W. Ridings, a current director, will be appointed to serve as chairman of the Investment Committee effective as of the date of the annual meeting. The Committee met four times during 2012.

Are there any special arrangements under which members of our board serve as directors?

No arrangement or understanding exists between any director or executive officer and any other person or persons pursuant to which any director or executive officer was, or is, to be selected as a director or nominee.

What is the board's role in risk oversight?

Our management is charged with assessing and managing risks associated with our business on a day-to-day basis. The board's role is to oversee management's execution of these responsibilities and to assess our approach to risk management. In our view, it is not possible or desirable to eliminate risk from our activities. We believe that, as a company, our focus should be on identifying, pricing, managing and monitoring risk with the objective of achieving attractive, long-term, risk-adjusted returns for the benefit of the Company and our shareholders. We have robust internal processes and a strong internal control environment designed to identify, manage and mitigate material risks and to communicate with the board. The board exercises its oversight role periodically as part of its regular meetings and also through its committees, which examine various elements of risk as part of their responsibilities. The full board, or the appropriate board committee in the case of risks under the purview of a particular committee, receives regular reports from members of senior management on areas of material risk to us, including operational, financial, legal, regulatory, strategic and reputational risk, in order to review and understand risk identification, risk management and risk mitigation strategies. The board's role in risk oversight is consistent with our leadership structure generally, with the chief executive officer and other members of senior management having responsibility for assessing and managing our risk exposure, and the board and its committees providing oversight in connection with those efforts.

EXECUTIVE OFFICERS AND OTHER NAMED OFFICERS

Who are our executive officers and other named officers?

Information for Jay Sugarman, our chairman and chief executive officer, is contained above under the heading "PROPOSAL 1: ELECTION OF DIRECTORS." Information with regard to our named executive officers and other named officers is set forth below. All of our officers serve at the pleasure of the board of directors and are customarily appointed as officers at the annual organizational meeting of the board held following each annual meeting of shareholders.

David DiStaso serves as our chief financial officer, having assumed this position in December 2010. He previously served as our chief accounting officer since June 2008. Mr. DiStaso is responsible for managing our financial reporting, accounting, treasury, investor relations and other corporate finance functions, and is involved in the execution of all capital markets activities. Before joining us, Mr. DiStaso previously spent 11 years with the CIT Group, Inc., most recently as chief financial officer of the Consumer Finance Division. He spent the first 10 years of his career in public accounting with KPMG, serving as a senior manager within the audit group and providing audit and consulting services to clients within the financial services industry. Mr. DiStaso received a bachelor's degree from Rutgers College and is a certified public accountant. Mr. DiStaso is 48 years old.

Nina Matis currently serves as our chief legal officer and chief investment officer. She assumed her current position in February 2008 after serving as our general counsel since 1996, executive vice president since November 1999 and chief investment officer since April 2007. Ms. Matis is responsible for overseeing and managing the strategic consideration and execution of our investment and financing transactions, restructurings and resolutions of loans and other problem assets, significant operational responsibilities and litigation and other legal matters. Ms. Matis previously served as a partner in the law firm of Katten Muchin Rosenman LLP, one of our principal outside law firms, and was an inactive special capital partner of the firm until her withdrawal from this position during 2010. From 1984 through 1987, Ms. Matis was an adjunct professor at Northwestern University School of Law where she taught real estate transactions. Ms. Matis previously served as a director of New Plan Excel Realty Trust, Inc. She is a director of Signature Theater Company and a member of the American College of Real Estate Lawyers, Ely Chapter of Lambda Alpha International, the Chicago Finance Exchange, the Urban Land Institute, REFF, the Chicago Real Estate Executive Women, The Chicago Network and The Economic Club of Chicago. Ms. Matis received a B.A. degree, with honors, from Smith College and a J.D. degree from New York University School of Law. Ms. Matis is 65 years old.

Michelle MacKay currently serves as our executive vice president, serving in this position since February 2003. Ms. MacKay is head of capital markets, with responsibility for evaluating and executing capital markets initiatives, subject to the oversight of our chief executive officer, and works on strategic investments. She joined us from UBS Warburg, where she was an executive director in commercial real estate and a senior member of the commercial real estate approval committee. Ms. MacKay was also responsible for mezzanine structuring and distribution. From 1996 to 1998, Ms. MacKay was vice president at Chase Bank where she oversaw commercial mortgage-backed securities trading and real estate products distribution. Prior to Chase, Ms. MacKay worked in real estate investments at The Hartford. Ms. MacKay holds an M.B.A. from the University of Hartford and a B.A. from the University of Connecticut. Ms. Mackay is 46 years old.

Barbara Rubin currently serves as our executive vice president and, since September 1998, has served as president of iStar Asset Services, our loan asset management and servicing operation. Ms. Rubin has primary responsibility for our asset management, risk management, construction, and information technology functions, subject to the oversight of our chief executive officer. Prior to joining us, Ms. Rubin was president and chief operating officer of Phoenix Realty Securities, Inc., a real estate advisory operation that managed portfolios of real estate securities (including mortgage loan investments and real estate equity securities). She previously served as head of investment and development for Phoenix Home Life. Ms. Rubin is currently chair of the Connecticut Health and Education Facilities Authority, Chair of Connecticut Higher Education Supplemental Loan Authority and is a member of the board of the Hartford Stage. Ms. Rubin received a B.A. from Williams College and an M.B.A from the University of Connecticut. Ms. Rubin is 59 years old.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee oversees the financial reporting process of iStar Financial Inc. (the Company), on behalf of the Board of Directors of the Company in accordance with our Audit Committee charter. The Board, in its judgment, has determined that all members of our Audit Committee meet the independence requirements of the Securities and Exchange Commission (the SEC) and the New York Stock Exchange (the NYSE). The Board has also determined that the chairperson of the Audit Committee is an "audit committee financial expert" within the meaning of the rules of the SEC and that each member of our Audit Committee is financially literate and has accounting or related financial management expertise, as such qualifications are defined under the rules of the NYSE. We operate under a written charter approved by the Board, consistent with the corporate governance rules issued by the SEC and the NYSE. Our charter is available on the Company's website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests a copy.

The Company's management is responsible for the financial reporting process and preparation of the quarterly and annual consolidated financial statements, including maintaining a system of internal controls over financial reporting, as well as disclosure controls and procedures. We are directly responsible for the appointment, compensation, retention, oversight and termination of the Company's external auditors, PricewaterhouseCoopers LLP, an independent registered public accounting firm. The independent registered public accounting firm is responsible for auditing the effectiveness of the Company's internal controls over financial reporting and for expressing their opinion thereon, in addition to auditing the annual consolidated financial statements and expressing an opinion on the conformity of those financial statements with generally accepted accounting principles in the United States. We also review the performance of the Company's internal audit function. We do not prepare financial statements or conduct audits.

In connection with the December 31, 2012 audited consolidated financial statements, we have:

reviewed and discussed with management and the independent registered public accounting firm the Company's internal controls over financial reporting, including a review of management's and the independent registered public accounting firm's assessments of and reports on the effectiveness of internal controls over financial reporting and any significant deficiencies or material weaknesses;

reviewed and discussed with management and the independent registered public accounting firm the Company's audited financial statements, including discussions regarding critical accounting policies, other financial accounting and reporting principles and practices appropriate for the Company, the quality of such principles and practices, and the reasonableness of significant judgments;

discussed with the independent registered public accounting firm the items that are required to be discussed by Statement on Auditing Standards No. 61, Communication with Audit Committees, as amended by Statement on Auditing Standards No. 90, Audit Committee Communications; and

reviewed and considered the written disclosures in the letter received from PricewaterhouseCoopers LLP, as required by the PCAOB regarding the independent accountant's communications with the Audit Committee regarding independence, including a discussion about their independence from the Company and management.

Based on the reviews and discussions above, and subject to the limitations on the role and responsibilities of the Audit Committee referred to above and in the Audit Committee charter in effect in 2012, we recommended to the board that the audited consolidated financial statements for 2012 be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, for filing with the SEC. The board approved our recommendation.

Submitted by the Audit Committee:

Dale Anne Reiss (Chairperson)
Robin Josephs
George R. Puskar
Barry W. Ridings

The above report will not be deemed to be incorporated by reference into any filing by us under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate the same by reference.

CORPORATE GOVERNANCE MATTERS

Corporate Governance Guidelines

Our board has approved a set of guidelines that provide the framework for our corporate governance. The board reviews these guidelines and other aspects of our corporate governance periodically, as necessary. Our corporate governance guidelines may be found on our website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests a copy.

Board Leadership Structure

Our board has the authority to select the leadership structure it considers appropriate for us. In making leadership structure determinations, the board considers many factors, including the specific needs of our business and what is in the best interests of our shareholders. Our current leadership structure consists of a combined chairman of the board and chief executive officer position, a lead independent director, or Lead Director, an active and involved board, a majority of whom are independent directors, and board committees chaired by independent directors.

Under our bylaws, the chairman of the board presides over the meetings of the board and of the shareholders. The chairman of the board shall perform such other duties as may be assigned to him by the board of directors. The chief executive officer has general responsibility for implementation of our policies, as determined by the board, and for the management of our business and affairs. Jay Sugarman serves as both chairman of the board and chief executive officer.

Our board, by vote of its independent members, has designated a Lead Director, whose duties include the following:

- preside at all meetings of the board at which the chairman is not present and all executive sessions of the independent directors;
- serve as principal liaison between the chairman and the independent directors;
- advise the chairman on the quality, quantity and timeliness of the information presented to the board;
- advise the chairman on the agendas for board meetings;
- advise the chairman on the schedule of meetings of the board to assure that there is sufficient time for discussion of agenda items;
- call meetings of the independent directors, if deemed necessary or appropriate by the Lead Director;
- if requested by major shareholders, be available for consultation and direct communication with major shareholders and their representatives; and
- such other duties as the board may determine from time to time.

Robin Josephs currently serves as our Lead Director.

The board believes that this leadership structure a combined chairman and chief executive officer, a lead independent director, active and involved independent directors, and board committees led by independent directors is the most appropriate and effective arrangement for us at this time. Due to the varied and complex nature of our business, the board believes the chief executive officer is in the best position to lead most effectively and to serve in the critical role of chairman of the board. Having a chairman who also serves as chief executive officer facilitates timely communication with directors on critical business matters. The board believes that leadership of both the board and the

Company by Mr. Sugarman is the optimal structure to guide us and maintain the focus needed to achieve our business goals. The board also believes there is an effective balance between strong Company leadership and appropriate oversight by independent directors and that the current board leadership structure functions very well. The board recognizes that circumstances may change, however, and will periodically review its leadership structure.

Executive Sessions

Our board of directors meets in executive session without management present at least quarterly. Our audit committee also meets in executive session without management present but with representatives of our independent registered public accounting firm present at least quarterly.

Committee Charters

Our Audit, Compensation and Nominating and Governance Committees have adopted charters that meet the standards established by the NYSE. Copies of these charters are available on our website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests copies.

Service on Other Boards

In view of the commitment of time and effort that is required of a director of a public company, our board has established a guideline that its directors should not serve on the boards of more than six public companies. For this purpose, we treat service on the boards of mutual funds having the same investment adviser as service on the board of one company.

Code of Conduct

Our Code of Conduct documents the principles of conduct and ethics to be followed by our directors, officers and employees. The purpose of the Code of Conduct is to promote honest and ethical conduct, compliance with applicable governmental rules and regulations, full, fair, accurate, timely and understandable disclosure in periodic reports, prompt internal reporting of violations of the Code of Conduct and a culture of honesty and accountability. A copy of the Code of Conduct has been provided to each of our directors, officers and employees, who are required to acknowledge that they have received and will comply with the Code of Conduct. Among its many features, the Code of Conduct describes how employees can report any matter that may be of concern to a named Compliance Officer, any other member of our Compliance Committee, our chief executive officer or the Chairman of the Audit Committee. This reporting may be done on an anonymous basis. We have also established an independent "hotline" telephone service that may be used by employees who wish to report any concerns or suspected violations of our standards of conduct, policies or laws and regulations, on an anonymous basis or otherwise. We will disclose any material changes to the Code of Conduct, and any waivers that are approved for directors or executive officers, in our public SEC filings and on our website within four business days of such an event. A copy of our Code of Conduct may be found on our website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests a copy.

Disclosure Committee

We maintain a Disclosure Committee consisting of members of our executive management and senior staff. The purpose of the Disclosure Committee is to oversee our system of disclosure controls and assist and advise the chief executive officer and chief financial officer in making the required certifications in SEC reports. The Disclosure Committee was established to bring together on a regular basis representatives from our core business lines and employees involved in the preparation of our financial statements to discuss any issues or matters of which the members are aware that should be considered for disclosure in our public SEC filings and review our draft periodic SEC reports prior to filing. The Disclosure Committee reports to our chief executive officer and, as appropriate, to our Audit Committee. The Disclosure Committee meets quarterly and otherwise as needed. The Disclosure Committee has adopted a written charter to memorialize the Committee's purpose and procedures. A copy of the charter may be found on our website at *www.istarfinancial.com* and will be provided in print, without charge, to any shareholder who requests a copy.

Communications with the Board

We provide the opportunity for interested parties, including shareholders, to communicate with members of the board. Interested parties may communicate with our Lead Director, the other independent board members or the chairperson of any of the committees of the board by e-mail or regular mail. All communications by e-mail should be sent to *CorporateSecretary@istarfinancial.com*. Communications sent by regular mail should be sent to the attention of the Lead Director, the independent directors, the Audit Committee chairperson, the Compensation Committee chairman or the Nominating and Governance Committee chairman, as the case may be, in each instance in care of the secretary of the Company at our headquarters at 1114 Avenue of the Americas, 39th Floor, New York, NY 10036.

Our chief legal officer and our secretary will review each communication received in accordance with this process to determine whether the communication requires immediate action. These officers will forward all appropriate communications received, or a summary of such communications, to the appropriate board member(s). However, we reserve the right to disregard any communication that our chief legal officer and our secretary determine is unduly hostile, threatening, or illegal, does not reasonably relate to the Company or its business, or is similarly inappropriate. These officers have the authority to disregard any inappropriate communications or to take other appropriate actions with respect to any such inappropriate communications.

Shareholder Nominations for the Board

Shareholder nominations for election to the board should be sent to the attention of the secretary of the Company at the address appearing on the notice accompanying this proxy statement, describing the candidate's qualifications and accompanied by the candidate's written statement of willingness and affirmative desire to serve in a manner representing the interest of all shareholders. Shareholders may also make nominations directly by following the procedure specified in our Bylaws.

Candidates proposed by shareholders will be considered using the same criteria and in the same manner utilized by the Nominating and Governance Committee of the board in considering all candidates for election to the board. See "INFORMATION REGARDING THE BOARD OF DIRECTORS AND ITS COMMITTEES The Nominating and Governance Committee."

Minimum Stock Ownership Guidelines for Non-Employee Directors and Senior Officers

We have minimum stock ownership guidelines that require each non-employee director to own a number of shares of our common stock (including common stock equivalents or other equity awards) having a value at least equal to five times the amount of the annual cash retainer payable to non-employee directors, which is presently $50,000. Each non-employee director has three years from the adoption of these guidelines, or the date of his or her election to the board, whichever is later, to satisfy the ownership guidelines. Taking into account any permitted transition period, all of our non-employee directors are currently in compliance with the guidelines.

We also have adopted minimum stock ownership guidelines that require our chief executive officer, other named executive officers and other senior officers to own a number of shares of our common stock having a value at least equal to a specified multiple of the officer's base salary, which varies from five times to one times the officer's salary based on the officer's title. Each officer has three years from the adoption of these guidelines, or the date of his or her appointment to an officer position, whichever is later, to satisfy the ownership guidelines.

For purposes of these stock ownership guidelines, unvested equity incentive awards that have time-based vesting are counted and unearned performance-based equity incentive awards are not counted.

Clawback Policy

We have a "clawback" policy that is reflected in the provisions of our incentive compensation awards. If we determine that an employee has engaged in fraud, willful misconduct or violation of a company policy that causes or contributes to a material restatement or adjustment of financial results within two years after the period presented, or causes a material negative revision of a financial measure used to award incentive compensation, the Compensation Committee will review performance-based compensation awarded to the employee and, if appropriate, seek recoupment of an appropriate portion of such performance-based compensation.

Anti-Hedging Policy

We have adopted a policy that prohibits directors, officers and other employees from trading in financial instruments or engaging in hedging transactions involving our securities that are designed to hedge or offset the risks of price fluctuations in the value of our securities (including but not limited to collars or forward sale contracts, puts, calls or other exchange traded options, or short sales of our shares).

Prohibition on Pledged Securities and Margin Accounts

We prohibit directors, officers and other employees from pledging our securities as collateral for a loan or holding iStar securities in a margin account, except with prior approval in accordance with guidelines approved by our board from time to time. Exceptions may be granted and approval given on a case-by-case basis in circumstances where an individual clearly demonstrates the financial capacity to meet a margin call or repay the loan without resort to the pledged shares, or where the amount of pledged shares or shares held in a margin account is not significant in comparison to the individual's total ownership of our shares, or where the aggregate amount of pledged shares by all insiders is not significant compared to our total outstanding shares.

"Double Trigger" Change in Control Provision for Long-Term Incentive Compensation

Going forward, our long-term incentive compensation awards for our executive officers include a "double trigger" change in control provision, meaning that, in the event of a change in control of the Company, the incentive compensation awards will receive accelerated vesting only if the change in control transaction is followed by termination of the executive's employment or effective termination, such as material reduction in position, responsibilities, compensation or other significant terms of employment.

Holding Period for Equity Portion of Annual Incentive Awards

The portion of an annual incentive award that is delivered to an employee in the form of shares of our common stock (net of statutory minimum required tax withholdings) is subject to holding period requirements. The employee may not sell one-half of such shares for at least one full year and may not sell the remaining half of such shares for at least two full years from the date the shares are awarded.

No Poison Pill

We do not currently have a shareholder rights plan, commonly known as a "poison pill," in effect.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

This compensation discussion and analysis describes the key principles and factors underlying our executive compensation policies and decisions for 2012 for our named executive officers and other named officers. The following discussion should be read in conjunction with the other information presented in this proxy statement, including the information in the compensation tables and the footnotes to those tables.

Executive Summary

2012 Company Performance

2012 was a transitional year during which we made significant progress in strengthening our balance sheet and positioning for the future. We executed several capital markets transactions that extended our debt maturities, including three senior notes issuances which marked our return to the unsecured debt markets for the first time since 2008. The rates associated with the financings that we completed in the latter half of the year, following an upgrade of our corporate credit ratings, were materially lower than the rates associated with our financings earlier in the year.

Within our real estate and loan portfolios, our performing loans, net lease assets and residential condominium projects performed well, and we continued to make progress reducing the balance of our non-performing loans and enhancing the value of our commercial operating properties and land assets through the investment of capital and intensive asset management. We intend to continue these efforts, with the objective of having these assets contribute positively to earnings.

Here are some of our specific accomplishments during 2012:

We generated $1.48 billion of proceeds from our portfolio and we raised approximately $3.51 billion through secured and unsecured debt capital markets transactions. We used the proceeds of these transactions to repay and/or refinance a significant portion of our debt that was due to mature before 2017. As a result of these steps, we expect to be able to increase our investment originations beginning in 2013.

Our total shareholder return, or TSR, was 54%, reflecting the increase in our common stock price at 2012 year-end over the common stock price at 2011 year-end.

We achieved Adjusted EBITDA for 2012 of $349.8 million. Adjusted EBITDA represents net income (loss) plus the sum of interest expense, income taxes, depreciation and amortization, provision for loan losses, impairment of assets and stock-based compensation expense, less the non-cash portion of gain (loss) on early extinguishment of debt. We believe Adjusted EBITDA is a useful measure of our core operating performance for shareholders to consider.

Executive Compensation Decisions Driven by Business Performance

Our compensation programs have been designed to achieve the following objectives:

To further our current and long-term strategic, business and financial goals in thes) for the year in which the shift in ownership occurred. If we elect to forego the benefit of section 382(l)(5)(A), our ability to utilize our NOL s in future years may be limited. As a result, if in any given future fiscal period our taxable profits are in excess of the restricted losses available for offset, this limitation would reduce our after tax income, thereby negatively affecting our cash balances and liquidity.

We operate in a highly competitive industry. The computer industry is highly competitive, with rapid technological advances and constantly improving price/performance. Most of our competitors have substantially greater technical, marketing and financial resources. They also generally have a larger installed base of customers and a wider range of available applications software. In addition, a significant percentage of the high-performance computing market is now dominated by cluster computing solutions, and more vendors are competing for this growing share of the market. Also, as our Linux-based systems business grows, the number of our competitors may grow commensurate with the increased market opportunity. Competition may result in significant discounting and lower gross margins.

We are subject to the risks of international operations. We generate a significant portion of our revenue outside the United States, and as a result, our business is subject to the risks associated with doing business internationally. International transactions frequently involve increased financial and legal risks arising from stringent contractual terms and conditions and the widely differing legal systems and customs in foreign countries. War, terrorism or public health issues in the regions of the world in which we do business have caused and may continue to cause damage or disruption to commerce by creating economic and political uncertainties. Such events could adversely affect our business in any number of ways, such as decreasing demand for our products, increasing our costs of operations, making it difficult to deliver products to customers, and causing delays and other problems in our supply chain. Our future revenue, gross margin, expenses and financial condition could also suffer due to other international factors, including but not limited to: changes in a country s economic and labor conditions; currency fluctuations; compliance with a variety of foreign laws, as well as U.S. laws affecting the activities of U.S. companies abroad; changes in tax laws; changes in the regulatory or legal environment; fluctuations in transportation costs; natural and medical disasters; and trade protection measures.

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Many of our international sales require export licenses. Our sales to customers outside the United States are subject to U.S. export regulations. Sales of many of our high-end products require clearance and export licenses from the U.S. Department of Commerce under these regulations. Our international sales would be adversely affected if such regulations were tightened, or if they are not modified over time to reflect the increasing performance of our products. Delay or denial in the granting of any required licenses could make it more difficult to make sales to foreign customers. In addition, we could be subject to regulations, fines and penalties for violations of import and export regulations if we were found in violation of these regulations. Such violations could result in penalties, including prohibiting us from exporting our products to one or more countries, and could materially and adversely affect our business.

Compliance or the failure to comply with environmental laws could impact our future net earnings. Certain of our products and operations are regulated under various laws in the U.S., Europe and other parts of the world relating to the environment, including laws and regulations that limit the use of certain substances in our products or require us to recycle our products when they become waste. While it is our policy to ensure that our operations and products comply with environmental laws at all times, any failure to so comply with environmental laws or customer requirements relating to such laws could require us to stop producing or selling certain products, recall noncompliant products, or otherwise incur substantial costs in order to acquire costly equipment to make other operational changes in order to achieve compliance. Although environmental costs and liabilities have not materially affected us to date, due to the nature of our operations and legal developments affecting our products and operations, environmental costs and liabilities could have a material adverse affect on our business and financial position in the future.

Increasingly, new regulations are enacted in various jurisdictions at the local, state and country level, and it is difficult to anticipate how such regulations will interact with each other and how they will be implemented and enforced. We track regulatory developments that may impact our business and devote substantial resources toward developing strategies for compliance with new requirements as they are enacted.

For example, we face increasing complexity in our product design and procurement operations as we adjust to new and anticipated requirements relating to the materials composition of our products, including the EU s RoHS initiative, which regulates the use of lead and other hazardous substances in electrical and electronic equipment put on the market in the European Union on or after July 1, 2006. Due to these restrictions, we have decided not to ship our remarketed products from the United States to Europe after July 1, 2006, and we have completed our work with our suppliers to assure RoHS compliance with respect to our other products. If a regulatory authority determines that one of our products is not RoHS-compliant, we may have to redesign and re-qualify certain components to meet RoHS requirements, which could subject us to increased engineering expenses in this process, and could face shipment delays, penalties and possible product detentions or seizures.

We may face significant costs and liabilities in connection with product take-back legislation, such as the European Union Directive on WEEE, which makes producers of electrical and electronic equipment, including computers, responsible for the collection, recycling, treatment and disposal of past and future covered products. Legislation similar to RoHS and WEEE has been or may be enacted in other jurisdictions, including in the United States, Japan and China. These and other environmental laws may become stricter over time and require us to incur substantial compliance costs. RoHS and WEEE are being implemented by individual countries in the European Union and it is likely that each jurisdiction will implement, interpret or enforce RoHS and WEEE somewhat differently. In addition, final guidance from individual jurisdictions may impose different or additional responsibilities on us. Our failure to comply with WEEE and RoHS, contractual obligations relating to WEEE and RoHS or other environmental laws could result in our being directly or indirectly liable for costs, fines or penalties and third-party claims, and could jeopardize our ability to conduct business in countries in the European Union.

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Our business is subject to market risk. In the normal course of business, our financial position is routinely subject to a variety of risks, including market risk associated with interest rate movements and currency rate movements on non-U.S. dollar denominated assets and liabilities, as well as collectibility of accounts receivable. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of these and other potential exposures. As a result, we do not anticipate material losses in these areas.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We own and lease sales, service, research and development and administrative offices worldwide and have our principal facilities in California, Wisconsin, Minnesota, and Maryland, United States and in Reading, United Kingdom. At June 29, 2007, our worldwide facilities represented aggregate floor space of approximately 867,000 square feet, of which 778,000 square feet is used in our operations. Approximately 89,000 square feet is currently vacant. We have two reportable segments, Products and Global Services. Because of the relationship between these segments, substantially all of our properties are used at least in part by both of these segments and we have the flexibility to use each of the properties in whole or in part for each of the segments.

Information about our leased and owned facilities at June 29, 2007 is as follows:

	Square Feet		Lease Terms	Square Feet Not Used in	
	Leased	Owned	End	Operations	Primary Uses
Sunnyvale and Mountain View, California	172,000		2011		Research and development, sales, administration
Chippewa Falls, Wisconsin	88,000	303,000	2008	34,000	Manufacturing, service, research and development
Eagan, Minnesota	85,000		2010	23,000	Research and development, sales, administration
Reading, United Kingdom	20,000		2009		Research and development, sales, service, administration
Silver Springs, Maryland	18,000		2009		Research and development, sales, administration
Other international	157,000			32,000	Sales
Other domestic	24,000				Sales
	564,000	303,000		89,000	

Our leased facilities in Sunnyvale, California include our corporate headquarters.

ITEM 3. LEGAL PROCEEDINGS

Information regarding legal proceedings is set forth in Note 25 in Notes to Consolidated Financial Statements in Part II, Item 8 of this Report, which information is hereby incorporated by reference.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market information, Dividend Policy and Price Range of Common Stock

Our common stock is traded on the NASDAQ Global Market under the symbol SGIC. On August 31, 2007, we had 11,250,000 shares of common stock outstanding that were held by eleven holders of record. This number does not include beneficial owners of the common stock whose shares are held in the names of various dealers, clearing agencies, banks, brokers and other fiduciaries. We have not paid any cash dividends on our common stock and do not anticipate paying cash dividends to common stockholders in the foreseeable future.

From November 7, 2005 through emergence from bankruptcy protection on October 17, 2006, the Predecessor Company common stock was quoted on the Over-The-Counter Bulletin Board, or OTCBB, under the ticker symbol SGI and Pink Sheets Electronic Quotation Service under the ticker symbol SGID.PK. Prior to November 7, 2005, the Predecessor Company common stock was listed under, and traded on, the New York Stock Exchange or NYSE, under the trading symbol SGI. Upon our emergence from bankruptcy protection, all Predecessor Company common stock, stock options and restricted stock awards were canceled.

The following table sets forth the high and low sales price for the periods indicated for the Successor Company common stock as reported on the NASDAQ Global Market for a portion of the second quarter and the third and fourth quarters of fiscal 2007.

Successor Company

	Fiscal 2007		
	Low	**High**	**Close**
First Quarter	$ N/A	$ N/A	$ N/A
Second Quarter	$ 17.50	$ 20.76	$ 20.00
Third Quarter	$ 19.28	$ 30.59	$ 30.14
Fourth Quarter	$ 25.26	$ 30.66	$ 26.54

The following table sets forth (1) the high and low sales price for the periods indicated for the Predecessor Company common stock as reported on the NYSE for the first quarter and a portion of the second quarter of fiscal 2006, and (2) the high and low bid quotation for the period indicated for the Predecessor Company common stock as reported on the OTCBB and Pink Sheets for the first quarter and a portion of the second quarter of fiscal 2007 and a portion of the second quarter and the third and fourth quarters of fiscal 2006. These quotations reflect inter-dealer prices, without retail markup, markdown or commissions, and may not necessarily represent actual transactions.

Predecessor Company

	Fiscal 2007			Fiscal 2006		
	Low	High	Close	Low	High	Close
First Quarter	$ 0.01	$ 0.07	$ 0.02	$ 0.56	$ 0.97	$ 0.78
Second Quarter	$ N/A	$ N/A	$ N/A	$ 0.35	$ 0.77	$ 0.35
Third Quarter	$ N/A	$ N/A	$ N/A	$ 0.32	$ 0.49	$ 0.44
Fourth Quarter	$ N/A	$ N/A	$ N/A	$ 0.04	$ 0.44	$ 0.05

Recent Sales of Unregistered Securities

Other than the shares issued pursuant to the Plan of Reorganization, there were no unregistered sales of equity securities during fiscal 2007.

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Stock Performance Graph

This performance graph shall not be deemed filed with the SEC and is not incorporated by reference into any filing of Silicon Graphics, Inc. under the Securities Act of 1933, as amended or the Exchange Act.

The following graph shows the total return of an investment of $100 in cash on October 23, 2006 (the date our common stock commenced trading on the Nasdaq Global Market) through June 29, 2007 for (a) our common stock, (b) the S&P 500 Index and (c) the S&P Computer Hardware Index. All values assume reinvestment of the full amount of all dividends.

Research Data Group

	10/23/06	10/06	11/06	12/06	1/07	2/07	3/07	4/07	5/07	6/07
Silicon Graphics, Inc.	100.00	97.44	92.05	102.56	139.74	146.15	154.56	144.96	148.72	137.10
S&P 500	100.00	103.26	105.22	106.70	108.31	106.19	107.38	112.14	116.05	114.12
S&P Computer Hardware	100.00	108.24	113.05	113.63	117.11	110.09	113.36	120.36	131.21	131.10

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

As discussed above, we emerged from Chapter 11 and adopted fresh-start reporting on September 29, 2006. References to Predecessor Company refer to Silicon Graphics, Inc. prior to September 29, 2006. References to Successor Company refer to Silicon Graphics, Inc. on and after September 29, 2006, after giving effect to the cancellation of existing common stock and the issuance of new securities in accordance with the Plan, and application of fresh-start reporting. As a result of the application of fresh-start reporting, the Successor Company s financial statements are not comparable with the Predecessor Company s financial statements. However, for purposes of discussion of the results of operations, the combined three months ended September 29, 2006 and the nine months ended June 29, 2007 (fiscal 2007) have been compared to the twelve months ended June 30, 2006 as included in our consolidated statements of operations (which are contained in Part II, Item 8 of this Report). In this discussion, we will disclose the fresh-start and other impacts on our results of operations that vary from historical Predecessor Company periods to aid in the understanding of our financial performance.

The following selected financial information has been derived from our audited consolidated financial statements (except statistical data). The information set forth in the table below is not necessarily indicative of results of future operations, and should be read in conjunction with Part II, Item 7 of this Report, Management's Discussion and Analysis of Financial Condition and Results of Operations , and our consolidated financial statements and related footnotes included in Part II, Item 8 of this Report in order to fully understand factors that may affect the comparability of the information presented below. Results of continuing operations for all years presented in this Report exclude the operating results of our Alias application software business which is classified as discontinued operations (see Note 9 in Notes to Consolidated Financial Statements in Part II, Item 8 of this Report) (in thousands, except per share amounts and employee data):

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	Successor Company	Predecessor Company				
	Nine Months Ended June 29, 2007	Three Months Ended Sept. 29, 2006	Years ended June 30, 2006	June 24, 2005	June 25, 2004	June 27, 2003
Statement of Operations:						
Total revenue	$ 341,064	$ 121,805	$ 518,805	$ 729,965	$ 842,002	$ 896,605
Costs and expenses:						
Cost of revenue	253,808	74,975	320,433	465,076	492,845	563,480
Research and development	44,040	16,007	83,677	92,705	108,763	157,924
Selling, general, and administrative	125,320	42,359	211,731	244,568	257,742	282,359
Impairment of Goodwill			8,386			
Other operating expense (1)	3,601	3,926	21,155	24,083	47,825	30,046
Operating loss	(85,705)	(15,462)	(126,577)	(96,467)	(65,173)	(137,204)
Interest and other income (expense), net (2)	(9,234)	3,703	(15,437)	12,721	(44,600)	(24,664)
Loss from continuing operations before reorganization items and income taxes	(94,939)	$ (11,759)	$ (142,014)	$ (83,746)	$ (109,773)	$ (161,868)
Net (loss) income from continuing operations	(103,642)	$ 326,256	$ (146,194)	$ (75,732)	$ (100,246)	$ (135,203)
Net (loss) income	$ (103,642)	$ 326,256	$ (146,194)	$ (76,008)	$ (45,770)	$ (129,704)
Net (loss) income per share from continuing operations:						
Basic	$ (9.32)	$ 1.20	$ (0.54)	$ (0.29)	$ (0.44)	$ (0.67)
Diluted	$ (9.32)	$ 0.77	$ (0.54)	$ (0.29)	$ (0.44)	$ (0.67)
Net (loss) income per share basic and diluted:						
Basic	$ (9.32)	$ 1.20	$ (0.54)	$ (0.29)	(0.20)	(0.64)
Diluted	$ (9.32)	$ 0.77	$ (0.54)	$ (0.29)	(0.20)	(0.64)
Shares used in the calculation of net loss per share:						
Basic	11,125	271,563	269,367	263,430	227,837	201,424
Diluted	11,125	423,875	269,367	263,430	227,837	201,424

	Successor Company	Predecessor Company				
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005	June 25, 2004	June 27, 2003
Balance Sheet Data:						
Cash, cash equivalents and unrestricted investments	$ 70,110	$ 53,546	$ 54,876	$ 64,286	$ 156,865	$ 136,468
Restricted investments	7,065	50,232	48,498	40,170	24,494	36,728
Total assets	409,058	362,659	380,058	452,145	569,924	649,854
Long-term debt and other	141,732	70,409	73,616	375,852	372,048	400,124
Stockholders' equity (deficit)	84,459	(346,977)	(330,454)	(191,188)	(122,678)	(164,891)
			320,230			

Liabilities subject to compromise (3)						
Statistical Data:						
Number of employees	1,588	1,605	1,752	2,423	2,655	3,714

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(1) Successor Company amount for the nine months period ended June 29, 2007, represents $0.4 million of severance and related charges, $1.1 million of facilities-related restructuring expenses and $2 million of bankruptcy-related charges. Predecessor Company amount for the three months period ended September 29, 2006, represents $4 million of severance-related charges. Fiscal 2006 amount represents net restructuring charges ($10 million) and asset impairment charges ($11 million). Fiscal 2005 amount represents net restructuring charges. Fiscal 2004 amounts include net restructuring charges ($45 million) and asset impairment charges ($3 million). Fiscal 2003 amounts include net restructuring charges ($26 million) and asset impairment charges ($4 million).

(2) Successor Company amount for the nine months period ended June 29, 2007, includes net interest expense of $9 million. Predecessor Company amount for the three months period ended September 29, 2006, includes a pre-tax gain of approximately $10 million on the sales of portion of the investment in SGI Japan and net interest expenses of $8 million. Fiscal 2006 amounts include net interest expense of $16 million. Fiscal 2005 amounts include a gain of $21 million on the sale of a portion of our equity investment in SGI Japan, Ltd. (SGI Japan). Fiscal 2004 amounts include a $31 million non-cash loss resulting from the extinguishment of the exchanged 5.25% Senior Convertible Notes due in 2004. Fiscal 2003 amounts include net interest expense of $23 million and a $3 million other than temporary decline in the value of an investment.

(3) As a result of our Chapter 11 filing, our debt obligations and certain other liabilities existing at May 8, 2006, were classified as liabilities subject to compromise on our balance sheet at June 30, 2006. These obligations were extinguished as of the Emergence Date. For further information, see Note 4 to our Notes to Consolidated Financial Statements in Part II, Item 8 of this Report.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a leading provider of products, services, and solutions for use in HPC and data management. We sell solutions based on a complete range of scalable servers and storage products, from entry-level to high-end, together with associated software products. These solutions enable our customers in the scientific, technical and business communities to solve their most challenging data management and analysis problems providing them with strategic and competitive advantages. Our products are also among the best in the industry in energy efficiency. Whether studying global climate changes, accelerating the engineering of new automotive designs, providing technologies for homeland security, or gaining business intelligence through data-mining, our solutions are designed to store, manage, access, analyze and transform vast amounts of data to provide insights and intelligence in real time or near-real time. We also offer a range of services, including professional services, customer support, and education. Our solutions, products and services are used in a range of markets including defense and intelligence, sciences, engineering analysis, digital content management and both commercial and government enterprise.

Business Strategy

The following overview describes key elements of our business strategy and our results achieved during fiscal 2007:

Leadership in High-Performance Computing. During the past several years, we have transitioned our focus from our legacy systems based on our MIPS processors and IRIX operating system to our core systems based on industry-standard processors and the Linux operating system. Our goal is to be the leading provider of Linux Compute platforms, and a leading provider of performance data management and analysis solutions. Our revenue growth prospects, and our ability to return to profitability, depend on our ability to grow our Altix Compute and Data Management Solutions revenues at a rate that will more than offset the expected continued decline of our traditional MIPS/IRIX product and maintenance business. See Risk Factors .

Maintain Gross Margins to Support R&D and Other Investments. Our strategy is to develop differentiated products that provide our customers with strategic and competitive advantages. However, this requires continued substantial investments in research and development. In addition, maintaining acceptable gross margins will require achieving an overall revenue level adequate to absorb our fixed costs, striking the appropriate balance between large lower margin transactions and our more normal sales transactions, and working with suppliers to continue to structure favorable component pricing. It also involves augmenting our hardware sales with revenues from software and services, which generally carry higher gross margins.

Targeting our Product Portfolio on New Business Opportunities. SGI has traditionally focused in technical and scientific computing. We are expanding into targeted areas of the enterprise segment that are well served by our high-performance systems, and are expanding our product portfolio to include X86-based products. We concentrate our development efforts in software and hardware differentiators for our computer systems and storage to better capitalize on requirements of the high-performance compute market. In June 2006, SGI introduced a new line of x86-based cluster products, the Altix XE family, to more effectively address the expanding market for cluster computing. In June 2007, we introduced what we believe is the first high-performance engineered cluster, further enabling our customers to meet their hybrid computing demands.

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Focus on Expense Management. Over the past few years, we undertook significant restructuring activities targeted at reducing our expense structure to be more in line with our revenues. We benefited during fiscal year 2007 and will continue to benefit from the lower cost structure achieved through these efforts. While we do not have plans for further comprehensive restructuring activities, we will undertake to continuously improve our cost structure wherever possible, in order to ensure we can continue to invest in the sales, marketing and R&D initiatives that will fuel revenue growth.

Leadership Transition

On April 9, 2007, the Board of Directors appointed Mr. Robert Bo Ewald as our new Chief Executive Officer. This leadership change marks a shift from our restructuring phase, to a focus on growth and profitability. Mr. Ewald s arrival is part of our business strategy to achieve sustained improvement and growth in our business and financial performance.

Chapter 11 Reorganization

On May 8, 2006, the Predecessor Company and certain of its subsidiaries filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. For further information regarding these petitions, see Note 2 to our Notes to Consolidated Financial Statements in Part II, Item 8 of this Report.

While under bankruptcy protection, we continued to operate our business without interruption as debtor-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, applicable court orders, as well as other applicable laws and rules. In general, a debtor-in-possession is authorized under Chapter 11 to continue to operate as an ongoing business, but may not engage in transactions outside the ordinary course of business without the prior approval of the Court.

In the latter part of fiscal 2006 and through the first half of fiscal 2007, we allocated a substantial amount of resources to bankruptcy restructuring, which included resolving claims disputes and contingencies, determining enterprise value and capital structure, negotiating a Plan of Reorganization with key creditor constituents and evaluating the impact of and implementing fresh-start accounting. On September 19, 2006, the Court entered its Confirmation Order confirming the Plan and we emerged from bankruptcy protection on October 17, 2006 (Emergence Date). Under the Plan, all of the Predecessor Company s existing common stock, stock options and restricted stock awards were cancelled upon emergence and the equity holders received no recovery. Accordingly, the Predecessor Company s common stock has no value. Our emergence from bankruptcy protection on the Emergence Date resulted in a new reporting entity and new shares of common stock in the Successor Company were issued to the bondholders of the Predecessor Company. These shares began trading on the NASDAQ Global Market under the symbol SGIC on October 23, 2006. We adopted fresh-start accounting in accordance with SOP 90-7 as of September 29, 2006. As required by fresh-start accounting, our assets and liabilities were adjusted to fair value at that date, and certain assets and liabilities not previously recognized in the Predecessor Company s financial statements were recognized, at that date under fresh-start accounting. The consolidated financial statements as of June 30, 2006 do not give effect to any adjustments in the carrying values of assets or liabilities that were recorded upon implementation of the Plan and the adoption of fresh-start accounting on September 29, 2006. Accordingly, our financial condition and results of operations as of and after

September 29, 2006 are not comparable to the financial condition and results of operations reflected in the historical condensed consolidated financial statements of the Predecessor Company. In addition, the adoption of fresh-start accounting, will have a significant non-cash impact on our future results of operations, has had and will continue to have no impact on the underlying cash, working capital assumptions or the underlying operation of the business. While all amounts reflected in this Form 10-K are reported in accordance with accounting principles generally accepted in the United States, we

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explain our results of operations excluding the impact of fresh-start accounting in this report and in our other public disclosures of our results of operations and financial condition in order to provide transparency in our financial reporting. We believe that such a presentation is necessary to facilitate period-to-period comparisons of our performance.

Fresh-Start Accounting Adjustments. As more fully described in Note 4 in Notes to the Consolidated Financial Statements included in this Report, as a result of our emergence from bankruptcy, the assets and liabilities of the Successor Company were adjusted to their relative fair values in conformity with SFAS No. 141 as of September 29, 2007, *Business Combinations* (SFAS 141). The fresh-start accounting adjustments that had the most significant impact on our financial results for the fiscal year ended June 29, 2007 and will continue to affect our financial results going forward are as follows:

Deferred Revenue valuation. Deferred revenue was revalued to actual cost, which will be incurred to service the liability in the future, plus a reasonable margin. Deferred Revenue is a liability that in the normal course of business would be expected to convert to revenue in the future. Customer support deferred revenue and product and professional services deferred revenue were the two primary components of deferred revenue of the Predecessor Company that were significantly reduced by fresh-start accounting and which will have an unfavorable impact on revenue over the next four years. We concluded that effective as of the beginning of fiscal 2006 certain multiple-element sales transactions, where software was more than incidental to the overall solution, should be recorded under Statement of Position (SOP) 97-2, Software Revenue Recognition. Thirty-seven million dollars of deferred revenue and $17 million of deferred cost of sales related to our accounting under SOP 97-2 that had previously been deferred was reduced to zero through the fresh-start accounting adjustments and this impact will have an unfavorable impact on both revenue and gross margin in future periods primarily through at least the remainder of fiscal 2008.

Inventory valuation. SGI has raw materials, work-in-progress, finished goods, delivered systems and demonstration inventory. At September 29, 2006, a write-up of $28 million was required to record these inventories at fair value. The result of the valuation adjustment on our results of operations is that costs of goods sold will increase by the magnitude of the valuation adjustment as the revalued inventory is sold and recorded as cost of goods sold. We expect the impact of the inventory valuation write-up to unfavorably impact cost of sales through the second quarter of fiscal 2008. At June 29, 2007, approximately $5 million of the write-up remains to be recognized to cost of sales.

Intangibles. As a result of fresh-start accounting, new intangibles assets were established. Other Intangible Assets, net of accumulated amortization, were approximately $71 million as of June 29, 2007, and approximately $87 million as of September 29, 2006. We are required to amortize the value of these intangible assets over varying periods up to 17 years impacting both cost of sales and selling, general and administrative expense.

Results of Operations

As discussed above, we emerged from Chapter 11 and adopted fresh-start reporting on September 29, 2006. References to Predecessor Company refer to Silicon Graphics, Inc. prior to September 29, 2006. References to Successor Company refer to Silicon Graphics, Inc. on and after September 29, 2006, after giving effect to the cancellation of existing common stock and the issuance of new securities in accordance with the Plan, and application of fresh-start reporting. As a result of the application of fresh-start reporting, the Successor Company s financial statements are not comparable with the Predecessor Company s financial statements.

However, for purposes of discussion of the results of operations, the combined three months ended September 29, 2006 and the nine months

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ended June 29, 2007 (fiscal 2007) have been compared to the twelve months ended June 30, 2006 as included in our consolidated statements of operations (which are contained in Part II, Item 8 of this Report). In this discussion, we will disclose the fresh-start and other impacts on our results of operations that vary from historical Predecessor Company periods to aid in the understanding of our financial performance.

The financial information and the discussion below should be read in conjunction with the accompanying consolidated financial statements and notes thereto. The following tables and discussion present certain financial information on a comparative basis. (dollars in millions, except per share amounts; amounts may not add due to rounding):

	Successor Company	Predecessor Company		
		Three Months Ended	Years ended	
	Nine Months Ended June 29, 2007	June 30, 2006	June 30, 2006	June 24, 2005
Total revenue	$ 341	$ 122	$ 519	$ 730
Cost of revenue	254	75	320	465
Gross profit	87	47	198	265
Gross profit margin	25.6%	38.4%	38.2%	36.3%
Total operating expenses (1)	173	62	325	361
Operating loss	(86)	(15)	(127)	(96)
Interest and other income (expense), net	(9)	4	(15)	13
Loss from continuing operations before reorganization items and income taxes	(95)	$ (12)	$ (142)	$ (84)
Net loss	$ (104)	$ 326	$ (146)	$ (76)
Net (loss) income per common share:				
Basic	$ (9.32)	$ 1.20	$ (0.54)	$ (0.29)
Diluted	$ (9.32)	$ 0.77	$ (0.54)	$ (0.29)

(1) Total fiscal 2006 operating expenses include: (i) charges of approximately $9 million for the acceleration of depreciation associated with changes in the estimated useful lives of certain leasehold improvements and furniture and fixtures associated with two of our buildings at our U.S. corporate headquarters that were vacated in fiscal 2006; (ii) approximately $2 million of operating asset write downs for fixed assets and demonstration units associated with the end of production of existing Silicon Graphics Prism and Prism Deskside products and the cancellation of future Prism products; and (iii) approximately $8 million for the impairment of Goodwill. These charges represent increases in net loss per share basic and diluted of $0.04 in fiscal 2006.

Revenue

The following discussion of revenue is based on the results of our reportable segments, as described in Note 21 to our Consolidated Financial Statements in Part II, Item 8 of this Report. Total revenue is principally derived from two reportable segments, Products and Global Services. We have realigned our Products segment into our Core Systems, comprised of our high-performance servers and visualization systems based on Intel Xeon and Intel Itanium 2 microprocessors and the Linux operating system, and storage solutions, and our Legacy Systems, comprised of our high-performance servers and visualization systems based on MIPS microprocessors and the IRIX operating system. This change was made in order to align reportable segments with the process by which our chief

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operating decision maker makes operating decisions and evaluates performance. Prior year amounts have been reclassified to conform to the current year presentation.

Total revenue decreased $56 million or 11% in fiscal 2007 compared with fiscal 2006, and decreased $211 million or 29% in fiscal 2006 compared with fiscal 2005. The overall decline in revenue from fiscal 2006 to fiscal 2007 was due to declines in sales of Global Services and, to a lesser extent, sales of our Legacy Systems. These declines were partially offset by significant increases in sales of Core Systems. The impact from fresh-start accounting resulted in unfavorable revenue adjustments of $20 million to Products and $25 million to Global Services and was a major factor in the decline in revenue for fiscal 2007 compared with fiscal 2006. In conjunction with the completion of our fiscal 2006 audit, we concluded that certain fiscal 2006 multiple-element sales transactions, where software was more than incidental to the overall solution, should have been more appropriately recorded under Statement of Position (SOP) 97-2, *Software Revenue Recognition.* In conjunction with business turnaround activities initiated during fiscal 2006, we shifted our sales and marketing efforts for certain of our products that include SGI proprietary software to drive a total solution sales approach. We evaluated this shift in strategy against the indicators offered in footnote 2 of SOP 97-2, along with other considerations, in reaching the conclusion that, effective as of the beginning of fiscal 2006, these same products should be accounted for under the provisions of SOP 97-2. This change resulted in revenue adjustments, primarily to product revenue, of approximately $32 million and also contributed to the decline in revenue for fiscal 2006 compared with fiscal 2005. The decline in revenue from fiscal 2005 to fiscal 2006 was also due to declines in sales across all reportable segments, principally declines in sales of both our Core Systems and Legacy Systems and to a lesser extent in sales of Global Services. We expect that our MIPS/IRIX-based and related maintenance revenues will continue to decline. As discussed in Part I Item 1 of this Report, we will continue to develop and implement our business strategies to improve the profitability of our Core Systems revenues. See Risk Factors .

The following table presents total revenue by reportable segment (dollars in millions; numbers may not add due to rounding):

	Successor Company	Predecessor Company		
	Nine Months Ended	Three Months Ended	Years ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Core Systems	$ 159	$ 48	$ 174	$ 271
Legacy Systems	37	13	78	165
Total Products	$ 196	$ 61	$ 252	$ 436
% of total revenue	58%	50%	49%	60%
Global Services	$ 145	$ 61	$ 267	$ 294
% of total revenue	42%	50%	51%	40%

Products. Revenue from our Products segment increased $5 million or 2% in fiscal 2007 compared with fiscal 2006 and declined $184 million or 42% in fiscal 2006 compared with fiscal 2005.

Revenue from *Core Systems* in fiscal 2007 increased $33 million or 19% compared with fiscal 2006. The increase is primarily a result of higher volumes across all Core systems product lines and greater large dollar transactions for our Altix servers, offset in part by the unfavorable impact from fresh-start accounting, and decreased volume of our Prism family of visualization systems. Storage solutions revenue increased slightly in fiscal 2007 compared with fiscal 2006, offset in part by an increase in revenue adjustments noted above.

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Revenue from *Core Systems* in fiscal 2006 decreased $97 million or 36% compared with fiscal 2005. The decline is primarily a result of reduced volumes and fewer large dollar transactions for our Altix servers, coupled with a fiscal 2006 change in how we account for certain transactions where software was more than incidental to the overall solution, offset in part by increased volume of our Prism family of visualization systems. Storage solutions revenue declined in fiscal 2006 compared with fiscal 2005 despite an increase in average selling prices, primarily due to reduced sales volumes coupled with the accounting change related to SOP 97-2 noted above.

Revenue from *Legacy Systems* in fiscal 2007 decreased $28 million or 36% compared with fiscal 2006, principally due to a decrease in sales associated with all our MIPS/IRIX-based systems. The continuing long-term decline in the overall UNIX workstation market, an industry-wide trend that we expect will continue as lower-cost personal computers continue to gain market share, also contributed significantly to the revenue decline. The decline in both our MIPS/IRIX-based servers and graphics systems revenue was principally due to reduced volumes due to customers transitioning away from the legacy system technology into Linux based systems. Revenue from our remarketed products decreased compared with fiscal 2006 primarily due to a decrease in sales of our remarketed MIPS/IRIX-based workstation and graphics systems.

Revenue from *Legacy Systems* in fiscal 2006 decreased $87 million or 53% compared with fiscal 2005, principally due to a decrease in sales associated with all our MIPS/IRIX-based systems. The continuing long-term decline in the overall UNIX workstation market, an industry-wide trend that we expect will continue as lower-cost personal computers continue to gain market share, also contributed significantly to the revenue decline. The decline in both our MIPS/IRIX-based servers and graphics systems revenue was principally due to reduced volumes due to customers transitioning away from the legacy system technology into Linux based systems, and to a lesser extent from the impact of the accounting change related to SOP 97-2 referenced above. Revenue from our remarketed products decreased compared with fiscal 2005 primarily due to a decrease in sales of our remarketed MIPS/IRIX-based server systems.

Global Services. Revenue from our Global Services segment is comprised of hardware and software support, maintenance and professional services. Professional services revenue includes revenue generated from the sale of third party products and SGI consulting and managed services.

Revenue from Global Services in 2007 decreased $61 million or 23% compared with fiscal 2006. The decline was primarily due to the impact from fresh-start accounting resulting in unfavorable revenue adjustments. In addition, our traditional customer support revenue decreased as a result of lower pricing for new contracts compared with existing contracts, coupled with a decline in the overall installed base resulting in fewer contract renewals. To a lesser extent, a decline in revenue generated from professional services contracts also contributed to the overall decline in Global Services revenue.

Revenue from Global Services in 2006 decreased $27 million or 9% compared with fiscal 2005. This decline was largely attributable to the same factors described in the preceding paragraph (except for the impact from fresh-start accounting).

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Total revenue by geographic area for fiscal 2007, 2006 and 2005 was as follows (dollars in millions):

Area	Successor Company Nine Months Ended June 29, 2007		Predecessor Company Three Months Ended Sept. 29, 2006		Predecessor Company Years Ended June 30, 2006		Predecessor Company Years Ended June 24, 2005	
Americas	$ 194	57%	$ 76	62%	$ 306	59%	$ 448	61%
Europe	121	36%	21	17%	131	25%	177	24%
Rest of World	26	7%	25	21%	82	16%	105	15%
Total revenue	$ 341		$ 122		$ 519		$ 730	

The shift in geographic revenue mix in fiscal 2007 compared with fiscal 2006 is primarily a result of one large transaction, accounting for 9% of total revenue in fiscal 2007, to the Leibniz Computing Center (LRZ) in Germany. Geographic revenue mix in fiscal 2006 remained relatively unchanged compared with fiscal 2005.

Our backlog is calculated in accordance with our internal performance measurements or non-GAAP financial measures, and at June 29, 2007 our consolidated backlog was $66 million, down from $127 million at June 30, 2006. Backlog is comprised of committed purchase orders for products and professional services deliverable within nine months. Backlog decreased within the *Core Systems* segment, specifically with regard to our Linux-based Altix servers and storage systems due primarily two large deals in Germany included in the backlog at June 30, 2006, that were recognized as revenue in fiscal 2007. Backlog decreased within the *Legacy Systems* segment, primarily related to our Origin products. Backlog also decreased in professional services. See Business Seasonality and Backlog in Part I, Item 1 of this Report.

We generally do not maintain sufficient backlog to meet our quarterly objectives for product revenue without obtaining significant new orders that are booked and shipped within the quarter. Our backlog reflects only orders for which a firm purchase order has been issued or a contract has been made, although orders in backlog are subject to customer cancellation or rescheduling in certain circumstances, and government customers typically have rights of cancellation for convenience. SGI systems have also been selected for a number of multi-year U.S. government programs, with expected purchases that are not reflected in our current backlog. In addition, we may enter into longer delivery-cycle contracts for which a portion of the value is not reflected in our current backlog, since a portion of such orders may be scheduled to ship outside the time provided in our bookings policy. These types of orders generally also require us and our partners to develop and deliver future products, and are subject to performance guarantees collateralized by letters of credit and additional penalties for delays in delivery or non-performance.

Gross Profit Margin

Cost of product and other revenue includes costs related to product shipments, including materials, labor, overhead and other direct or allocated costs involved in their manufacture and delivery. Costs associated with engineering service revenue are included in cost of service revenue, unless the engineering effort meets the criteria for government funded research, as outlined in SFAS 2, *Accounting for Research and Development Costs*. If the contract meets the criteria for a government funded research arrangement, the costs to deliver the contract are included in research and development expense. Cost of service revenue includes all costs incurred in the support and maintenance of our products, as well as costs to deliver professional services including the costs associated with third-party products.

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Product and other gross profit margin in fiscal 2007 decreased 9.4 percentage points compared with fiscal 2006. The decline in product and other gross profit margin primarily resulted from the unfavorable impact of fresh-start accounting, which accounted for 8.2 percentage points of the decline. Service gross profit margin in fiscal 2007 decreased 6.5 percentage points compared with fiscal 2006. The decline in service gross profit margins primarily resulted from the unfavorable impact of fresh-start accounting. The unfavorable impact of fresh-start accounting resulted in 6.0 percentage points of this decline.

Overall gross profit margin increased to 38.2% in fiscal 2006 from 36.3% in fiscal 2005. Product and other gross profit margin in fiscal 2006 decreased 4.9 percentage points compared with fiscal 2005. As a result of fixed manufacturing costs, cost of sales did not decline in proportion to our lower sales volumes in fiscal 2006 compared with fiscal 2005. Competitive pricing pressures from low cost commodity cluster systems also contributed to the decline in gross profit margin. In addition, we continue to see a shift in revenue mix from our MIPS/IRIX-based systems, which typically carry higher gross margins to our Intel/Linux-based systems, which have lower gross margins. The decline in product and other gross profit margin in fiscal 2006 compared with fiscal 2005 was offset in part by fewer large low margin transactions, which are typically negotiated with high discount rates due to very competitive bidding processes.

Service gross profit margin in fiscal 2006 increased 7.5 percentage points compared with fiscal 2005. The improvements in service gross profit margins primarily resulted from the positive impact of our restructuring actions resulting from headcount reductions and other cost control measures coupled with improved margins on professional services contracts.

Operating Expenses

Operating expenses were as follows (dollars in millions):

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years Ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Research and development	$ 44	$ 16	$ 84	$ 93
% of total revenue	13%	13%	16%	13%
Selling, general and administrative	$ 125	$ 42	$ 212	$ 245
% of total revenue	36%	35%	41%	34%
Impairment of Goodwill			8	
% of total revenue			2%	
Other operating expenses	$ 4	$ 4	$ 21	$ 24
% of total revenue	1%	3%	4%	3%

Operating Expenses (excluding Other Operating Expenses). Fiscal 2007 operating expenses (excluding other operating expenses) decreased $77 million or 25% compared with fiscal 2006 and decreased as a percentage of total revenue from 59% to 49%. Fiscal 2006 operating expenses (excluding other operating expenses) decreased $34 million or 10% compared with fiscal 2005, but increased as a percentage of total revenue from 47% to 59%. The significant decline in operating expenses (excluding other operating expenses) in both years was primarily attributable to lower headcount resulting from our restructuring activities and employee attrition and the impact of our overall expense control measures aimed at bringing expenses in line with revenue. Included in fiscal 2006 was $13 million in professional advisory fees for outside consulting and legal expenses that occurred prior to our bankruptcy that did not recur in fiscal 2007. In addition, we recorded an $8 million non-cash charge for the impairment of Goodwill in the third quarter of fiscal 2006. The slight reduction in operating expenses was due to our 2007 accounting calendar having 52 weeks compared with 53 weeks in fiscal 2006.

Research and Development. Fiscal 2007 research and development spending decreased $24 million or 29% compared with fiscal 2006. Decreases were primarily due to a 19% reduction in headcount from restructuring and attrition, credits to expense received from research and development funding arrangements of approximately $7 million, lower facilities and information technology-related costs resulting from restructuring actions and other cost saving measures, and lower materials and depreciation costs. Fiscal 2006 research and development spending decreased $9 million or 10% compared with fiscal 2005. The decrease was primarily due to a 15% reduction in headcount and lower facilities and information technology-related costs, offset in part by increased non-recurring engineering expenses. We will continue to focus our research and development investments on potential growth areas, including investments in our Altix family of servers while leveraging the research and development efforts of our industry partners, as we continue to move to product lines that incorporate industry standard technologies.

Selling, General and Administrative. Selling, general, and administrative expenses decreased by $45 million or 21% compared with fiscal 2006. Decreases were primarily due to a 30% reduction in headcount from restructuring and attrition, lower professional advisory fees, lower facilities and information technology-related costs resulting from restructuring actions and other cost saving measures, and credits to expense received from marketing funding arrangements of approximately $4 million. Decreases were offset in part by an increase of $6 million associated with the amortization of intangibles recorded as a result of fresh-start accounting. Expense of approximately $1 million included in the third quarter of fiscal 2007 was associated with the Restricted Stock Unit Award and Separation Agreement with our former President and Chief Executive Officer. Fiscal 2006 selling, general and administrative expenses decreased $33 million or 13% compared with fiscal 2005. The decrease was primarily due to a 22% reduction in headcount and other cost savings measures, offset in part by an increase of $8 million in professional advisory fees driven primarily by fees incurred in connection with our cost reduction and strategic planning initiatives and an increase of $5 million for legal expenses that occurred prior to our bankruptcy filing.

Impairment of Goodwill. We review Goodwill for impairment in the fourth quarter of each fiscal year, or more frequently if events or circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS 142. We perform this test separately for each of our two reporting units. Our reporting units are consistent with the reportable segments identified in Note 21 in Notes to Consolidated Financial Statements in Part II, Item 8 of this Report. During the fourth quarter of fiscal 2007, based on a combination of factors, we concluded there were sufficient indicators to require us to assess whether any portion of our recorded Goodwill balance was impaired. Based on our estimates of forecasted discounted cash flows as well as our current market capitalization, at that time, we concluded that Goodwill was not impaired for any of our reporting units. Additionally, during the fourth quarter of 2007, we eliminated all accrued Goodwill from our balance sheet as a result of fresh-start accounting fair value and tax adjustments.

Other Operating Expenses. Over the past several years in response to declining revenues, we have initiated a number of restructuring actions, under various plans, aimed at reducing the level of cash consumed in operations and restoring long-term profitability. These actions have resulted in both headcount reductions and facility closures. Other operating expense for fiscal 2007 consisted mainly of a $4 million charge for severance and related costs and a $1 million charge for accretion and other costs related to vacated leased facilities. Other operating expense for fiscal 2006 represented a charge of $20 million for estimated restructuring costs and charges of $2 million related to the cancellation of our Prism and Prism Deskside products. These charges were offset in part by a net credit of $1 million

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related to our vacated leased facilities. Other operating expense for fiscal 2005 represented a charge of $18 million for estimated restructuring costs and charges of $10 million for accretion expense related to vacated leased facilities. These charges were partially offset by $4 million of adjustments to previously recorded restructuring charges. As of June 29, 2007, as a result of the restructuring actions undertaken through that date, we anticipate operating cash outflows of $1 million in fiscal 2008 for both severance and related charges and facility-related charges, with the remainder of our restructuring obligations to be paid through fiscal 2011.

Reorganization Items, Net. Reorganization items, net represents amounts incurred as a direct result of our Chapter 11 filing and are presented separately in our consolidated statements of operations. See Note 2 to the consolidated financial statements, in Part II, Item 8 of this Report.

Interest and Other

Interest and other income (expense) were as follows (in thousands):

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Years Ended	
	June 29, 2007	**Sept. 29, 2006**	**June 30, 2006**	**June 24, 2005**
Interest expense	$ (8,879)	$ (7,688)	$ (16,445)	$ (16,052)
Investment gain (loss)	$ (41)	$ 10,100	$ (227)	$ 20,703
Foreign exchange (loss) gain	(1,978)	23	(197)	2,774
Miscellaneous (expense) income	(393)	526	(1,780)	876
Interest income	2,057	637	2,357	1,908
Interest and other (expense) income, net	$ (355)	$ 11,286	$ 153	$ 26,261
Income from equity investment	$	$ 105	$ 855	$ 2,512

Interest Expense. Interest expense for fiscal 2007 increased to $16.6 million from $16.4 million compared with fiscal 2006. The increase was due to the amortization of short-term loan costs during the first quarter of fiscal 2007 associated with our new financing arrangement that resulted in higher financing costs and a higher interest rate in order to restructure our debt. Interest expense increased 2% in fiscal 2006 compared with fiscal 2005 primarily due to an increase in our outstanding debt associated with a term loan that was part of a new two-year asset-backed credit facility completed in the second quarter of fiscal 2006 coupled with a higher rate of interest on this term loan than interest rates on our existing debt, offset in part by interest expense incurred on various non-debt transactions in the ordinary course of business in fiscal 2005.

Interest and Other (Expense) Income, Net. Interest and other (expense) income, net includes interest income on our cash investments, gains and losses on other investments, and other non-operating items. Interest income and other, net, for the twelve months ended June 29, 2007 is primarily due to a pre-tax investment gain of $10 million resulting from the sale of a portion of our equity interest in SGI Japan.

Income from Equity Investment. Income from equity investment represents our share of the results of operations of SGI Japan. In August 2006, the Predecessor Company completed the sale of a portion of its equity investment in SGI Japan to SGI Japan, Ltd. As a result of the sale, our ownership interest was reduced to approximately 10%. Due to the decline in our ownership percentage, we began to account for this investment under the cost method of accounting in accordance with APB 18, *The Equity Method of Accounting for Investments in Common Stock* in the second quarter of fiscal 2007.

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Under the requirements of the cost method, we will record any dividends received from SGI Japan as income and will no longer record our proportionate share of the results of operations of SGI Japan.

Provision for Income Taxes

The Successor Company s net provision for income taxes of $8.7 million for the nine months ended June 29, 2007 arose principally from net income taxes payable in foreign jurisdictions. $5 million of the $8.7 million of the Successor Company s net provision for income taxes resulted from releasing the Predecessor Company s valuation allowance when the Successor Company utilized tax net operating loss carryovers from the Predecessor Company. Fresh Start accounting requires that the release of the Predecessor Company s valuation allowance be credited to noncurrent intangibles instead of the current tax provision. If the Successor Company had not adopted fresh-start accounting, the Successor Company s net provision for income taxes would have been $3.7 million for the nine months ended June 29, 2007. The Predecessor Company s net provision for income taxes of $ 2.4 million for the first three months of the fiscal 2007 arose principally from withholding taxes paid on the gain on the sale of equity interest in SGI Japan and net income taxes payable in foreign jurisdictions. The Predecessor Company s net benefit for income taxes from continuing operations for fiscal 2006 and fiscal 2005 totaled $3.6 million and $8 million, respectively. The net tax benefit provision in fiscal 2006 and fiscal 2005 arose principally from the reassessment of global tax exposures, and refunds associated with certain U.S. Federal, state, and foreign income taxes paid in prior years, partially offset by net income tax expense incurred in foreign jurisdictions. The Successor Company did not recognize a tax benefit for fiscal 2007 losses, and the Predecessor Company did not recognize a tax benefit for fiscal 2006 and fiscal 2005 losses, since the resulting deferred tax asset does not meet the criteria for realization under SFAS 109.

At June 29, 2007, the Successor Company had gross deferred tax assets arising from deductible temporary differences, tax operating losses, and tax credits of $822 million. The gross deferred tax assets were offset by a valuation allowance of $821 million and deferred tax liabilities of $3 million. The valuation allowance of $821 million included $32 million attributable to tax benefits of stock option deductions, which, if recognized, would be allocated directly to additional paid-in capital. $799 million of the total valuation allowance of $821 million originated from the predecessor company, for which any subsequently recognized tax benefits will be applied to reduce Goodwill and/or other intangibles or directly to additional paid-in-capital, rather than adjustments to our future statement of operations, as they existed before we adopted fresh-start accounting as of September 29, 2006. Although we have established a valuation allowance against the carrying value of certain deferred tax assets, the underlying net operating loss carryforwards would still be available to us in order to offset future taxable income in the United States subject to applicable tax laws and regulations.

At June 29, 2007, the Successor Company had United States federal, California State, and foreign jurisdictional net operating loss carryforwards of $1.4 billion, $277 million, and $167 million, respectively. The net operating loss carryforwards incurred prior to SGI s Chapter 11 reorganization for United States federal, California State, and foreign are $1.2 billion, $243 million, and $163 million, respectively. To the extent that the Successor Company utilizes foreign or domestic net operating loss carryforwards to reduce taxable income, such amount will be recorded as tax expense with a corresponding reduction to intangible assets. The federal losses will begin expiring in fiscal 2010, the California State losses will begin expiring in fiscal 2011, and the foreign losses will begin to expire in fiscal 2008. At June 29, 2007, the Successor Company also had general business credit carryovers of $29 million for United States federal tax purposes, which will begin to expire in fiscal 2008, and alternative minimum tax credits of $5 million, which do not have fixed expirations dates. The Successor Company had California State research and development credits of $29 million, which do not have expiration dates, and California State manufacturing investment tax credits of $2 million which will begin to expire in fiscal 2008. As a result of the bankruptcy reorganization, there is expected to be a

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greater than 50% cumulative shift in SGI s stock ownership and thus the Successor Company may not be able to utilize a significant portion of our net operating loss and credit carryforwards to offset income tax liabilities from future profits. See "Risk Factors".

Discontinued Operations

On June 15, 2004, we completed the sale of our Alias application software business to a technology-focused private equity firm. As a result of this transaction, we have presented the operating results of Alias as a discontinued operation for all periods presented. We received $58.4 million in gross proceeds from the sale and recorded a net gain of $50.5 million. We transferred approximately 430 employees to the buyer as a result of the sale and has no remaining liability related to Alias that would impact our results of operations or liquidity. See Note 9 in Notes to Consolidated Financial Statements in Part II, Item 8 of this Report for further information.

Off-Balance Sheet Arrangements

In the ordinary course of business, we enter into off-balance sheet arrangements as defined by the SEC Final Rule 67 (FR-67), *Disclosure in Management s Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations*, including certain guarantees. None of these off-balance sheet arrangements either has, or is reasonably likely to have, a material current or future effect on our financial condition, results of operations, liquidity, or capital resources. See Note 15 in Notes to Consolidated Financial Statements in Part II, Item 8 of this Report for further information regarding these guarantees.

Contractual Obligations

The following table summarizes our significant contractual obligations at June 29, 2007, and the effect these obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

		Payments Due by Period			
	Total	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Long-term debt obligations (1)	85,261	261	29,750	55,250	
Capital lease obligation	434	241	193		
Operating lease obligations (2)	27,879	9,308	13,508	4,689	374
Purchase obligations (3)	19,124	19,124			
Restructuring-related obligations (4)	609	609			
Total	$ 133,307	$ 29,543	$ 43,451	$ 59,939	$ 374

Except for long-term debt, capital lease, and certain restructuring-related obligations, this table does not include contractual obligations that have been recorded on our balance sheet as liabilities. We also have approximately

$19.6 million of potential unrecognized tax benefit liabilities not included in the contractual obligations table presented in our Annual Report on Form 10-K, as amended, for the fiscal year ended June 29, 2007.

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(1) Assumes that no additional conversions or early redemptions occur.

(2) Operating lease obligations consist primarily of non-cancelable operating leases, including facilities vacated as part of our restructuring activities, and do not include the offsetting effect of projected or contractual sublease income

(3) Purchase obligations, as presented in this table, are defined as off-balance sheet agreements to purchase goods or services that are enforceable and legally binding on us and that specify all

significant terms, which include the following: fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction. As a result, purchase obligations include all commitments to purchase goods or services of either a fixed or minimum quantity that are non-cancelable, that would cause us to incur a penalty if the agreement was cancelled, or that require us to make specified minimum payments even if we do not take delivery of the contracted goods or services (take-or-pay contracts). If the obligation to purchase goods or services is non-cancelable, we consider the entire value of the contract to be the amount of the purchase obligation. If the obligation is cancelable, but we would incur a penalty upon cancellation, we consider the amount of the penalty to be the amount of the purchase obligation. We consider the contracted minimum amounts of take-or-pay contracts to be the amount of the purchase obligation, since that represents the portion of the contract that is a firm commitment. We have estimated the expected timing and amounts of payment of the purchase obligations based on current information; the actual timing and amounts paid may be different due to timing of the receipt of the goods or services or changes to the agreed-upon amounts for obligations.

(4) As a result of our approved restructuring plans, we expect to make these future cash payments, which are primarily for employee severance and all of which have been recorded as liabilities on our consolidated balance sheet at June 29, 2007. This amount excludes obligations related to non-cancelable operating leases for facilities vacated as part of our restructuring activities, which are included in the operating lease obligations amount disclosed above.

Financial Condition

Cash Balances. At June 29, 2007, our unrestricted cash and cash equivalents and marketable investments totaled $70 million, compared with $55 million at June 30, 2006. Included in our net cash inflows are the effects of our debt and equity financings of $29 million. Included in our net cash outflows are the payment of approximately $48 million in Plan related obligations. In addition, upon emergence from bankruptcy we had $30 million of capacity available under the exit financing revolver, which we may utilize up to the full availability under the revolver to fund intra-quarter cash needs. During the second quarter and the fourth quarter of fiscal 2007, the maximum amount drawn on the revolver and subsequently repaid was $5 million within 20 days and $5 million within 7 days, respectively. During the third quarter of fiscal 2007, we made no draws on the revolver. At June 29, 2007 and June 30, 2006, we also held $7 million and $48 million, respectively, of restricted investments. Restricted investments consist of short- and long-term investments held under a security agreement or pledged as collateral against letters of credit and other bank facilities. The increase in cash and cash equivalents compared with June 30, 2006 is primarily the result of cash provided by net proceeds from maturities of restricted investments, net proceeds from our rights offering and sale of Overallotment shares, and the sale of a portion of the equity investment in SGI Japan to SGI Japan, Ltd, offset in part by payment of Plan related obligations and cash used in operations during fiscal 2007 (see Note 2 and Note 27 to the consolidated financial statements, in Part II, Item 8 of this Report).

Cash Consumption Trends. Primarily as a result of net losses and costs associated with the Chapter 11 proceedings, operating activities used $77 million during fiscal 2007, compared with $91 million during fiscal 2006. The operating cash flows in fiscal 2007 were on plan and additional use of cash was primarily due to our reorganization costs. During fiscal 2007, accounts receivable decreased $12 million compared to the $35 million decrease that was generated during fiscal 2006. Inventory increased $5 million during fiscal 2007 compared to the $3 million increase in inventory reported in fiscal 2006. Accounts payable decreased $38 million in fiscal 2007 primarily due to the settlement of bankruptcy obligations compared with a decrease of $49 million in fiscal 2006. Other assets and liabilities (primarily other liabilities) decreased $62 million net in fiscal 2007 primarily due to revenue recognition of customers advance payments compared to the $77 million decrease in the same period of fiscal 2006. During fiscal 2007, accrued compensation increased $6 million compared with the $5 million decrease in accrued compensation in fiscal 2006 primarily due to the timing of the

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payment of payroll as well as fluctuations in headcount due to planned reductions and attrition. Deferred revenue increased $71 million in fiscal 2007 compared with an increase of $34 million in fiscal 2006, primarily resulting from the timing of revenue recognition of sales transactions. Included in the cash used in operating activities from continuing operations are cash payments related to past restructuring actions. Cash payments for severance and contractual and facilities obligations related to these actions totaled approximately $10 million and $57 million in fiscal 2007 and fiscal 2006, respectively. In the first quarter of fiscal 2007, we made adjustments to cash flow from operations to reflect the effect of the Plan of Reorganization and the associated revaluation of assets and liabilities.

Investing activities provided $52 million in cash during fiscal 2007, compared with using $20 million during fiscal 2006. The positive cash flows in fiscal 2007 were primarily due to net proceeds from maturities of restricted investments and the sale of a portion of our equity investment in SGI Japan to SGI Japan, Ltd. Principal investing activities in both fiscal 2007 and fiscal 2006 primarily consisted of purchases of property and equipment of $11 million and $7 million, respectively.

Financing activities provided $40 million in cash during fiscal 2007, compared with $101 million during fiscal 2006. During fiscal 2007, we repaid debt principal of $147 million and received proceeds of $30 million from DIP financing issued while under Chapter 11 and $101 million from our new exit financing. During fiscal 2007, we received net proceeds of $57 million from the rights offering and sale of Overallotment shares. During fiscal 2006, the Predecessor Company repaid debt principal of $78 million and received proceeds of $178 million from DIP funding issued while under Chapter 11. The Predecessor Company also received $3 million from stock issued under the Predecessor Company s employee stock plans.

The Predecessor Company incurred net losses and negative cash flows from operations during each of the past several fiscal years. At June 29, 2007, our principal sources of liquidity included unrestricted cash and marketable investments of $70 million, up from the Predecessor Company s balance of $55 million at June 30, 2006. Currently, we expect to consume cash from operations through at least the first half of fiscal 2008. We also experience significant intra-quarter fluctuations in our cash levels, with the result that our cash balances are generally at their highest point at the end of each quarter and significantly lower at other times. These intra-quarter fluctuations reflect our business cycle, with significant requirements for inventory purchases in the early part of the quarter and most sales closing in the last few weeks of the quarter. To maintain adequate levels of unrestricted cash within each quarter, we offer certain customers discounted terms for early payment and hold certain vendor payments until the beginning of the following quarter. Additionally, we have borrowed funds under our $30 million revolver credit facility. Our largest borrowing was $5 million during the second quarter, no borrowing during the third quarter and $5 million during the fourth quarter of fiscal 2007. At June 29, 2007, we have no outstanding principal balance under this facility. We also continue to focus on cost controls, margin improvement initiatives and working capital efficiencies. However, it is essential to our operating plan for fiscal 2008 that we maintain a focus on cost control, complete acceptance of key customer arrangements and that we meet the goals of our exit financing agreement for fiscal 2008.

DIP Financing. On May 10, 2006, the Predecessor Company entered into the Interim DIP Agreement with the Interim DIP Lenders. The Interim DIP Agreement provided a $70 million term loan to the Borrowers secured by certain of the Borrowers assets. In June 2006, the Debtors entered into the DIP Agreement with the DIP Lenders providing up to $130 million of debtor-in-possession financing consisting of a $100 million term loan and a $30 million revolving line of credit. This DIP Agreement was approved by the Court on June 26, 2006 and replaced the $70 million Interim DIP Financing and the pre-petition credit agreement. The DIP Agreement was secured by certain assets of the Borrowers.

The DIP Agreement terminated upon emergence from Chapter 11 and the $113 million outstanding balance was paid in full with proceeds from the rights offering and sale of Overallotment shares and funds from the exit financing facility described below.

Exit Financing. On the Emergence Date, the Successor Company entered into a credit agreement with Morgan Stanley Senior Funding, Inc and General Electric Capital Corporation to provide exit liquidity financing as part of our plan to emerge from bankruptcy. The exit financing facility provides up to $115 million of financing consisting of an $85 million term loan from Morgan Stanley Senior Funding, Inc. and a $30 million line of credit from General Electric Capital Corporation. The new facility is secured by substantially all of the assets of SGI and its domestic subsidiaries and has customary terms and conditions, including covenants related to minimum levels of Consolidated EBITDA as defined in the credit agreement and minimum levels of cash and cash equivalents, and limits on capital expenditures. See Note 27. This facility, combined with net proceeds of $57 million from the rights offering and sale of Overallotment shares, was used to pay off $113 million due under our existing DIP Agreement, to fund payments, including closing costs and related fees, required to be made on the Emergence Date pursuant to the Plan, and to provide working capital for our ongoing operations. The exit financing facility matures in October 2011. The annual payments, including estimated interest, over the next five years are as follows (in millions): fiscal 2008 $11; fiscal 2009 $23; fiscal 2010 $25; fiscal 2011 $23 and fiscal 2012 $40.

On September 11, 2007, the lenders under our $85 million term loan facility, including Quadrangle Master Funding Ltd and Watershed Technology Holdings, LLC, or their affiliates, which are significant stockholders of SGI, purchased and assumed the position of General Electric Capital Corporation (GE) under the Senior Secured Credit Agreement (the Agreement), and substituted themselves as the lenders under the $30 million line of credit provided in the Agreement. On the same day, we entered into a Second Amendment to the Agreement (the Second Amendment) with Morgan Stanley Senior Funding, Inc., as agent for the lenders. The Second Amendment reduces the total revolver capacity to $20 million, for a total borrowing capacity of $105 million when combined with the $85 million term loan provided under the Agreement, and eliminated the minimum liquidity requirement, thereby increasing the total availability under the facility. See Note 27 to our Consolidated Financial Statements included elsewhere in this report for additional information.

Forecasts of future events are inherently uncertain, and there are significant risks associated with the achievement of our goals for fiscal 2008. While we are continuing to implement initiatives aimed at improving revenue and margins for our core systems products, we expect to consume cash from operations in fiscal 2008. We expect the combination of our cash balance and the $105 million exit financing facility to provide adequate liquidity to meet our operating needs through fiscal 2008. We cannot be certain however, that the funds provided by the asset-based lending facility will be adequate to achieve our objectives. We still may choose to raise additional money to provide more flexibility with regards to the working capital requirements of large deal opportunities, as well as for strategic investment opportunities. If we are unable to achieve the goals of our going-forward business plan, we may be unable to meet our debt covenants, be forced to develop and implement further restructuring plans or evaluate other strategic alternatives.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. On an on-going basis, we evaluate these estimates, including: those related to customer programs and incentives; bad debts;

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inventory; lease residual values; warranty obligations; restructuring; incomes taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates.

Management has discussed the development and selection of the following critical accounting policies and estimates with the audit committee of our board of directors and the audit committee has reviewed our disclosures relating to them.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. For all of these policies, we caution that future events often do not develop exactly as forecasted, and that even the best estimates routinely require adjustment.

Revenue Recognition. We recognize revenue from sales when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectibility is reasonably assured. Certain revenue is generated from contracts where we are obligated to deliver multiple products and/or services. In these instances, we must assess the arrangement to determine whether the elements of the arrangement should be treated as separate units of accounting for revenue recognition purposes and if so, how the total contract price should be allocated among the elements and when revenue should be recognized for each element. We recognize revenue for delivered elements only when there is objective and reliable evidence of the fair value of the undelivered items and customer acceptance, if applicable, has been obtained. Allocation of the total contract price between each element of the arrangement may impact the timing of revenue recognition, but will not change the total revenue recognized on the contract. For revenue arrangements that include or represent software products and services as well as any non-software deliverables for which a software deliverable is more than incidental to its functionality, we apply the accounting guidance in SOP 97-2, *Software Revenue Recognition* in determining the timing of revenue recognition.

Occasionally, we enter into arrangements in which substantial modification of software is required. Percentage of completion revenue recognition is applied when we can reasonably estimate costs and progress toward completion. We recognize revenue in accordance with SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* as work progresses based on the percentage that incurred costs to date bear to estimated total costs.

Fresh-Start Accounting. Although we emerged from bankruptcy on October 17, 2006, we adopted fresh-start accounting as of September 29, 2006 in accordance with SOP 90-7. Fresh-start accounting was required because holders of existing voting shares immediately before filing and confirmation of the plan received less than 50% of the voting shares of the emerging entity and its reorganization value was less than its post petition liabilities and allowed claims. Fresh-start accounting required us to allocate our reorganization value to our assets and liabilities in a manner similar to that which is required under Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations.* Under the provisions of fresh-start accounting, a new entity has been deemed created for financial reporting purposes. For further information on fresh-start accounting see Note 4.

At September 29, 2006 we preliminarily allocated the reorganization value to our tangible assets and liabilities and identifiable intangible assets established upon emergence. Any residual reorganization value was recorded as Goodwill. Subsequent to September 29, 2006, adjustments were made to the preliminary fresh-start valuation adjustments previously disclosed in our Quarterly Report on Form 10-Q for the first quarter of fiscal 2007. The allocation of the reorganization value requires management to make significant estimates in determining the fair values of Predecessor Company assets and liabilities as well as with respect to new intangible assets. These estimates are based on historical experience and information obtained from management. These estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future and the appropriate weighted average cost of capital. These estimates are inherently uncertain and unpredictable. In addition, unanticipated events and circumstances may occur which may affect the accuracy or validity of such estimates.

Product Warranties. We provide for the estimated cost to warrant our products against defects in materials and workmanship at the time revenue is recognized. We estimate our warranty obligation based on factors such as product life cycle analysis and historical experience, and our estimate is affected by data such as product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from our estimates, revisions to the estimated warranty liability would be required. On a quarterly basis, these estimates are reviewed and adjusted as considered necessary based on the factors noted above. Changes in product warranty estimates increased our product warranty liability by approximately $0.2 million in fiscal 2007, decreased by approximately $1 million in fiscal 2006, and increased by approximately $1.2 million in fiscal 2005.

Manufacturing Inventory and Spare Parts. We write down the value of our manufacturing inventory for estimated excess, obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value. At the end of each quarter, we perform an in depth excess and obsolete analysis of all manufacturing inventory parts on order and on hand based upon assumptions about future demand and current market conditions. For all spare parts on hand, our analysis is based on assumptions about product life cycles, historical usage, current production status and installed base. Additional adjustments to manufacturing inventory and spare parts may be required if actual market conditions are less favorable than those projected by us during our analyses.

Lease Residual Values. We retain an estimated unguaranteed residual value interest in the products sold under certain sales-type lease arrangements, representing the estimated fair market value of the equipment at the end of the lease term. The residual value is derived for each significant product family based upon the following factors: historical data regarding recovery of residual values; current assessment of market conditions for used equipment; and any forward-looking projections deemed significant, particularly those relating to upcoming technology or changing market conditions. Residual values are evaluated periodically to determine if other-than-temporary declines in estimated residual values are indicated. Any anticipated increase in future residual values is not recognized until the used equipment is remarketed. Factors that could cause actual results to differ materially from the estimates include significant changes in the used equipment market and unforeseen changes in technology.

Bad Debts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. When we become aware of a specific customer's inability to pay their outstanding obligation for reasons such as deterioration in their operating results or financial position or bankruptcy proceedings, we record a specific reserve for bad debt to reduce their receivable to an amount we reasonably believe is collectible. If the financial condition of specific customers were to change, our estimates of the recoverability of receivables could be further adjusted. We also record allowances for doubtful accounts for all other customers based on a variety of factors including the length of time the receivables are past due and historical experience. On a quarterly basis, these estimates are reviewed and adjusted as considered necessary based on the criteria noted above.

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Valuation of Goodwill and other intangible assets. We review Goodwill for impairment in the fourth quarter of each year, or more frequently if events or circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS 142, *Goodwill and Other Intangible Assets*. The provisions of SFAS 142 require that a two-step impairment test be performed on Goodwill. In the first step, we compare the fair value of each reporting unit to its carrying value. Our reporting units are consistent with the reportable segments identified in Note 21 of the Consolidated Financial Statements in Part II, Item 8 of this Report. We determine the fair value of our reporting units using both an income approach and market approach. Under the income approach, we calculate the fair value of a reporting unit based on the present value of estimated future cash flows. Under the market approach, we estimate fair value based on what investors are paying for similar interests in comparable companies through the development of ratios of market prices to various earnings indications of comparable companies taking into consideration adjustments for growth prospects, debt levels and overall size. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, Goodwill is not impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit s Goodwill. If the carrying value of a reporting unit s Goodwill exceeds its implied fair value, then we record an impairment loss equal to the difference. We recorded an $8 million non-cash charge for the impairment of Goodwill in the third quarter of fiscal 2006. We have not recorded any impairment of Goodwill in fiscal 2007 and our Goodwill balance is zero as of June 29, 2007.

The process of evaluating the potential impairment of Goodwill is subjective and requires significant estimates and assumptions at many points during the analysis. In determining the fair value of a reporting unit we make estimates and assumptions about these reporting units. Our estimated future cash flows are based on assumptions that are consistent with our annual planning process and include estimates for revenue and operating margins and future economic and market conditions. We base our fair value estimates on assumptions we believe to be reasonable at the time, but that are unpredictable and inherently uncertain. In addition, we make certain judgments and assumptions in allocating shared assets and liabilities to determine the carrying values for each of our reporting units. Actual future results may differ from those estimates.

For identifiable intangible assets, we assess for impairment whenever events or changes in circumstances indicate that an asset s carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Such impairment loss would be measured as the difference between the carrying amount of the asset and its fair value. Our cash flow assumptions are based on historical and forecasted revenue, operating costs, and other relevant factors. If management s estimates of future operating results change, or if there are changes to other assumptions, the estimate of the fair value of our identifiable intangible assets could change significantly. Such change could result in impairment charges in future periods, which could have a significant impact on our consolidated financial statements.

Impairment of Long-Lived Assets. Carrying values for our long-lived tangible assets are assessed for possible impairment in accordance with the requirements of SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* Impairment tests are conducted when our management team identifies events or when it believes that changes in circumstances that indicate that the carrying amount of a long-lived asset may not be recoverable. Such events or changes in circumstances may include the discontinuation of a product or product line, a sudden or consistent decline in the forecast for a product, changes in technology or in the way an asset is being used, a history of operating or cash flow losses or an adverse change in legal factors or in the business climate. Our impairment review to determine if a potential impairment charge is required is based on an undiscounted cash flow analysis. This analysis requires judgment with respect to many factors, including future cash flows,

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changes in technology, the continued success of product lines and future volume and revenue and expense growth rates. It is possible that our estimates of undiscounted cash flows may change in the future resulting in the need to reassess the carrying value of our long-lived assets for impairment.

Stock-Based Compensation Expense. We account for stock-based compensation in accordance with the provisions of SFAS 123(R), *Accounting for Shared-Based Payment*. Under the fair value recognition provisions of SFAS 123(R), stock-based compensation cost is estimated at the grant date based on the value of the award and is recognized as expense ratably over the requisite service period of the award. Determining the appropriate fair value model and calculating the fair value of stock-based awards at the grant date requires judgment, including estimating stock price volatility, forfeiture rates and expected option life. The actual results may differ from the estimates which could cause future operating results to differ from expectations.

Restructuring. In recent fiscal years, we have recorded significant accruals in connection with our restructuring programs. These accruals include estimates of employee separation costs and the settlements of contractual obligations, including lease terminations resulting from our actions. Accruals associated with employee termination costs are estimated in accordance with SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities.* Accruals associated with vacated facilities and related asset impairments are estimated in accordance with SFAS 5, *Accounting for Contingencies,* and SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* respectively. Estimates may be adjusted upward or downward upon occurrence of a future triggering event. Triggering events may include, but are not limited to, changes in estimated time to sublease, sublease terms and sublease rates. Due to the extended contractual obligations of certain of these leases and the inherent volatility of commercial real estate markets, we expect to make future adjustments to these vacated facilities accruals. Over the past three years, various triggering events have caused our estimates to decrease by $0.4 million in fiscal 2007, increase by $1 million in fiscal 2006, and decrease by $5 million in fiscal 2005, respectively.

Income Taxes. Estimates and judgments occur in the calculation of certain tax liabilities and in the determination of the recoverability of certain deferred tax assets, which arise from temporary differences and carryforwards. We regularly assess the likelihood that our deferred tax assets will be realized from recoverable income taxes or recovered from future taxable income based on the realization criteria set forth under SFAS 109, *Accounting for Income Taxes*, and we record a valuation allowance to reduce our deferred tax assets to the amount that we believe to be probable of realization. In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will probably be due. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer probable. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

As a result of fresh-start accounting, on a GAAP basis, we are unable to utilize our pre-bankruptcy net operating losses against our tax provisions. However, a substantial portion of our net operating losses carried forward will continue to be usable against our future tax expenses from a cash standpoint.

In addition, the Successor Company was required to adopt FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, as of September 29, 2006. The Successor Company has completed its review of this accounting pronouncement for impact on its consolidated results of operations. The early adoption of this pronouncement did not have a material effect on our consolidated financial position, results of operations, or cash flows.

Other Significant Accounting Policies. Other significant accounting policies not involving the same level of measurement uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. Policies regarding financial instruments and consolidation require difficult judgments on complex matters that are often subject to multiple sources of authoritative guidance. Certain of these matters are among topics currently under reexamination by accounting standards setters and regulators. Specific conclusions reached by these standards setters may cause a material change in our accounting policies.

Recent Accounting Pronouncements

See Note 3 to our Consolidated Financial Statements in Part II, Item 8 of this Report for a description of recent accounting pronouncements, including our expected adoption dates and estimated effects on our results of operations, financial condition, and cash flows.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, our financial position is routinely subject to a variety of risks, including market risk associated with interest rate movements, market risk associated with currency rate movements on non-U.S. dollar denominated assets and liabilities, and credit risk related to the collectibility of accounts receivable. We regularly assess these risks and have established policies and business practices to protect against the adverse effects of these and other potential exposures. As a result, we do not anticipate material losses in these areas.

Our exposure to interest rate risk relates primarily to our cash investment portfolio and our debt portfolio. Fixed rate securities may have their fair market value adversely impacted due to fluctuations in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates. The interest expense on our current debt portfolio would be adversely impacted due to an increase in interest rates and favorably impacted due to a decrease in interest rates.

Our exposure to foreign currency exchange rate risk relates to sales commitments, anticipated sales, purchases and other expenses, and assets and liabilities denominated in foreign currencies. For most currencies, we are a net receiver of the foreign currency and are adversely affected by a stronger U.S. dollar relative to the foreign currency. To protect against reductions in value caused by adverse changes in currency exchange rates, we have established balance sheet and forecasted transaction risk management programs.

We primarily use forward contracts to hedge our foreign currency balance sheet exposures. We recognize the gains and losses on foreign currency forward contracts in the same period as the re-measurement losses and gains of the related foreign currency-denominated exposures.

We use a combination of forward contracts and options designated as cash flow hedges to protect against the foreign currency exchange rate risks inherent in our forecasted net revenue denominated in currencies other than the U.S. dollar. We record the portion of the gain or loss in the fair value of our cash flow hedges that is determined to be an effective hedge as a component of other comprehensive loss, and we recognize this amount in our earnings as revenue in the same period or periods in which the hedged transaction affects earnings. We recognize in other income (expense), net on our consolidated statement of operations any remaining, ineffective portion of the gain or loss on a hedging instrument during the period of the change.

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest our excess cash in high quality money market instruments and debt instruments and, by policy, restrict our exposure to any single corporate issuer by imposing concentration limits. To minimize the exposure due to adverse shifts in interest rates, we maintain investments at an average maturity of generally one year or less.

For purposes of specific risk analysis, we use sensitivity analysis to determine the impact that market risk exposures may have on the fair values of our debt and financial instruments. The financial instruments included in the sensitivity analysis consist of all of our cash and cash equivalents, marketable investments, short-term and long-term debt, and all derivative financial instruments. Currency forward contracts and currency options constitute our portfolio of derivative financial instruments.

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To perform sensitivity analysis, we assess the risk of loss in fair values from the impact of hypothetical changes in interest rates and foreign currency exchange rates on market sensitive instruments. We compute the market values for interest risk based on the present value of future cash flows as impacted by the changes in rates attributable to the market risk being measured. We selected the discount rates used for the present value computations based on market interest rates in effect at June 29, 2007 and June 30, 2006. We computed the market values for foreign exchange risk based on spot rates in effect at June 29, 2007 and June 30, 2006. The market values that result from these computations are compared to the market values of these financial instruments at June 29, 2007 and June 30, 2006. The differences in this comparison are the hypothetical gains or losses associated with each type of risk.

The results of the sensitivity analyses at June 29, 2007 and June 30, 2006 were as follows:

Interest Rate Risk: A percentage point decrease in the levels of interest rates with all other variables held constant would have resulted in no increase in the aggregate fair value of our financial instruments at June 29, 2007 and at June 30, 2006. A percentage point increase in the levels of interest rates with all other variables held constant would have resulted in no decrease in the aggregate fair value of our financial instruments at June 29, 2007 and at June 30, 2006.

Foreign Currency Exchange Rate Risk: A 10% strengthening of foreign currency exchange rates against the U.S. dollar with all other variables held constant would have resulted in a decrease in the aggregate fair value of our financial instruments of $6 million at June 29, 2007 and $5 million at June 30, 2006. A 10% weakening of foreign currency exchange rates against the U.S. dollar with all other variables held constant would have resulted in an increase in the aggregate fair value of our financial instruments of $6 million at June 29, 2007 and $5 million at June 30, 2006.

The financial instruments measured in the foreign currency exchange rate sensitivity analysis are used in our hedging program to reduce our overall corporate exposure to changes in foreign currency exchange rates.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements

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Report of Independent Registered Public Accounting Firm

To The Board of Directors and Stockholders of Silicon Graphics, Inc.:

We have audited the accompanying consolidated balance sheets of Silicon Graphics, Inc. and subsidiaries as of June 29, 2007 (Successor Company) and June 30, 2006 (Predecessor Company) and the related consolidated statements of operations, stockholders equity (deficit), and cash flows for the nine months ended June 29, 2007 (Successor Company), the three months ended September 29, 2006 (Predecessor Company), and the year ended June 30, 2006 (Predecessor Company). In connection with our audits of the consolidated financial statements, we also have audited the related financial statement schedule. These consolidated financial statements and financial statement schedule listed at Part IV, Item 15 are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Silicon Graphics, Inc. and subsidiaries as of June 29, 2007 (Successor Company) and June 30, 2006 (Predecessor Company), and the results of their operations and their cash flows for the nine months ended June 29, 2007 (Successor Company), the three months ended September 29, 2006 (Predecessor Company), and the year ended June 30, 2006 (Predecessor Company), in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, on September 19, 2006, the United States Bankruptcy Court for the Southern District of New York confirmed the Company s Plan of Reorganization (the Plan). The Confirmation Order became a final order on September 29, 2006 and the Company emerged from Chapter 11 on October 17, 2006. In connection with its emergence from Chapter 11, the Company adopted fresh-start reporting pursuant to Statement of Position 90-7, Financial Reporting by Entities in Reorganization Under the Bankruptcy Code as of September 29, 2006 as further described in Note 4 to the consolidated financial statements. As a result, the consolidated financial statements of the Successor Company are presented on a different basis than those of the Predecessor Company and, therefore, are not comparable in all respects.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Silicon Graphic, Inc. s internal control over financial reporting as of June 29, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated September 12, 2007 expressed an adverse opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Mountain View, CA

September 12, 2007

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Report of Independent Registered Public Accounting Firm

To The Board of Directors and Stockholders of Silicon Graphics, Inc.:

We have audited Silicon Graphics, Inc. and subsidiaries internal control over financial reporting, as of June 29, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Silicon Graphics, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Silicon Graphics, Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis. A material weakness related to accounting for income taxes has been identified and included in management's assessment.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) , the consolidated balance sheets of Silicon Graphics, Inc. and subsidiaries as of June 29, 2007 (Successor Company) and June 30, 2006 (Predecessor Company), and the related consolidated statements of operations, stockholders equity (deficit), and cash flows for the nine months ended June 29, 2007 (Successor Company), the three months ended September 29, 2006 (Predecessor Company), and the year ended June 30, 2006 (Predecessor Company). This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 consolidated financial statements, and this report does not affect our report

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dated September 12, 2007, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, because of the effect of the aforementioned material weakness on the achievement of the objectives of the control criteria, Silicon Graphics, Inc. has not maintained effective internal control over financial reporting as of June 29, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ KPMG LLP

Mountain View, CA

September 12, 2007

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Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Silicon Graphics, Inc.:

We have audited the accompanying consolidated statement of operations, stockholders deficit, and cash flows for the year ended June 24, 2005. Our audit also included the financial statement schedule listed in the index at Item 15(a) as of June 24, 2005. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated results of Silicon Graphics, Inc. s operations and its cash flows for the year ended June 24, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule at June 24, 2005, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The accompanying financial statements and schedule have been prepared assuming that Silicon Graphics, Inc. will continue as a going concern. As more fully described in Note 1, Silicon Graphics, Inc. has incurred recurring operating losses, negative cash flows and has a stockholders deficit. These conditions raise substantial doubt about Silicon Graphics, Inc. s ability to continue as a going concern. (Management s plans in regard to these matters are also described in Note 1.) The financial statements and schedule do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

/s/ Ernst & Young LLP

San Jose, California

September 15, 2005

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SILICON GRAPHICS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years Ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Product and other revenue	$ 187,805	$ 45,229	$ 223,259	$ 391,322
Product revenue from related party	8,706	15,377	28,836	44,658
Service revenue	144,553	61,199	266,710	293,985
Total revenue	341,064	121,805	518,805	729,965
Costs and expenses:				
Cost of product and other revenue	162,362	42,710	177,328	285,428
Cost of service revenue	91,446	32,265	143,105	179,648
Research and development	44,040	16,007	83,677	92,705
Selling, general, and administrative	125,320	42,359	211,731	244,568
Impairment of Goodwill			8,386	
Other operating expenses, net	3,601	3,926	21,155	24,083
Total costs and expenses	426,769	137,267	645,382	826,432
Operating loss	(85,705)	(15,462)	(126,577)	(96,467)
Interest expense (contractual interest of $7,841 for the three month period ended September 29, 2006 and $18,735 in 2006)	(8,879)	(7,688)	(16,445)	(16,052)
Interest and other income (expense), net (1)	(355)	11,286	153	26,261
Income from equity investment		105	855	2,512
Loss from continuing operations before reorganization items and income taxes	(94,939)	(11,759)	(142,014)	(83,746)
Reorganization items, net		340,397	(7,826)	
(Loss) income from continuing operations before income taxes	(94,939)	328,638	(149,840)	(83,746)
Income tax provision (benefit)	8,703	2,382	(3,646)	(8,014)
Net (loss) income from continuing operations	$ (103,642)	$ 326,256	$ (146,194)	$ (75,732)
Discontinued operations:				
Loss on disposition of discontinued operations, net of tax				(276)
Net (loss) income	$ (103,642)	$ 326,256	$ (146,194)	$ (76,008)

Net (loss) income per common share:								
Basic continuing and discontinued operations	$	(9.32)	$	1.20	$	(0.54)	$	(0.29)
Diluted continuing and discontinued operations	$	(9.32)	$	0.77	$	(0.54)	$	(0.29)
Weighted-average shares used to compute net (loss) income per share:								
Basic		11,125		271,563		269,367		263,430
Diluted		11,125		423,875		269,367		263,430

(1) The three-month period ended September 29, 2006 includes a pre-tax gain of approximately $10 million on the sale of a portion of the Predecessor Company s investment in SGI Japan. See Note 10.

See accompanying notes to consolidated financial statements.

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SILICON GRAPHICS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except shares and par value)

	Successor Company June 29, 2007	Predecessor Company June 30, 2006
Assets:		
Current assets:		
Cash and cash equivalents	$ 69,887	$ 54,673
Short-term marketable investments	223	203
Short-term restricted investments	6,763	32,539
Accounts receivable, net of allowance for doubtful accounts of $2,012 at 2007 and $3,117 at 2006	47,643	58,417
Inventories	54,354	49,997
Prepaid expenses	6,153	10,457
Other current assets	49,576	54,723
Total current assets	234,599	261,009
Restricted investments	302	15,959
Property and equipment, net of accumulated depreciation and amortization	43,392	27,873
Goodwill		4,515
Other intangibles	71,264	
Other non-current assets, net	59,501	70,702
	$ 409,058	$ 380,058
Liabilities and Stockholders Equity (Deficit):		
Current liabilities:		
Accounts payable	$ 14,387	$ 8,951
Accrued compensation	35,382	29,224
Income taxes payable	2,209	1,596
Other current liabilities	44,420	43,325
Current portion of long-term debt	261	103,124
Current portion of deferred revenue	84,798	124,379
Current portion of restructuring liability	1,410	6,067
Total current liabilities	182,867	316,666
Long-term debt	85,000	397
Non-current portion of deferred revenue	32,362	45,538
Other non-current liabilities	24,370	27,681
Total liabilities not subject to compromise	324,599	390,282
Liabilities subject to compromise		320,230
Total liabilities	324,599	710,512
Commitments and contingencies		
Stockholders equity (deficit):		

New preferred stock, $0.01 par value; 5,000,000 shares authorized;		
New common stock, $0.01 par value, and additional paid-in capital; 25,000,000 shares authorized; 11,125,000 shares issued and outstanding	188,101	
Old common stock, $.001 par value, and additional paid-in capital; 750,000,000 shares authorized; shares issued: 274,887,761; shares outstanding: 274,247,196;		1,564,504
Accumulated deficit	(103,642)	(1,868,201)
Treasury stock, at cost: 640,565 shares in 2006		(6,760)
Accumulated other comprehensive loss		(19,997)
Total stockholders equity (deficit)	84,459	(330,454)
Total liabilities and stockholders equity	$ 409,058	$ 380,058

See accompanying notes to consolidated financial statements.

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SILICON GRAPHICS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Cash Flows From Operating Activities of Continuing Operations:				
Net loss	$ (103,642)	$ 326,256	$ (146,194)	$ (76,008)
Income from discontinued operations				
Loss on disposition of discontinued operations				(276)
Net loss from continuing operations	(103,642)	326,256	(146,194)	(75,732)
Adjustments to reconcile net loss to net cash used in operating activities:				
Effect of plan of reorganization and revaluation of assets and liabilities		(342,996)		
Depreciation and amortization	31,780	10,202	48,343	59,062
Amortization of premium and discount on long-term debt, net			(3,147)	(3,441)
Write-off of in-process R&D	500			
Amortization of inventory fair value adjustment to cost of sales	22,114			
Utilization of pre-petition foreign tax loss carryforwards	4,969			
Non-cash recovery for reorganization items			(6,214)	
Impairment of Goodwill			8,386	
Share-based compensation expense	2,213	122	2,184	
Gain on sale of equity investment		(9,848)		(20,541)
Non-cash restructuring charges (recoveries)		(174)	(1,587)	(1,479)
Other	(679)	(1,300)	(110)	(2,692)
Changes in operating assets and liabilities:				
Accounts receivable	3,386	8,187	34,917	20,566
Inventories	8,868	(13,639)	(3,324)	(20,408)
Accounts payable	(44,589)	6,361	(49,123)	(7,167)
Accrued compensation	3,542	2,616	(4,838)	(2,734)
Deferred revenue	89,384	(18,189)	34,445	(4,233)
Accounts payable and accrued liabilities subject to compromise			72,490	
Other assets and liabilities	(67,953)	5,844	(76,893)	(37,044)
Total adjustments	53,535	(352,814)	55,529	(20,111)
Net cash used in operating activities of continuing operations	(50,107)	(26,558)	(90,665)	(95,843)

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SILICON GRAPHICS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(In thousands)

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Cash Flows From Investing Activities of Continuing Operations:				
Marketable investments:				
Purchases	(186)	(168)	(666)	(185)
Maturities	126	107	503	2,156
Restricted investments:				
Purchases	(19,736)	(6,686)	(43,524)	(53,900)
Maturities	64,897	5,580	35,278	55,119
Proceeds from the sale of equity investment		18,690		29,085
Purchases of property and equipment	(9,970)	(1,064)	(7,028)	(12,444)
Increase in other assets	2,653	(2,327)	(4,679)	(4,813)
Net cash provided by (used in) investing activities of continuing operations	37,784	14,132	(20,116)	15,018
Cash Flows From Financing Activities of Continuing Operations:				
Payments of debt principal and exit financing	(16,561)	(130,007)	(78,678)	(17,684)
Proceeds from debt principal			50,000	1,677
Proceeds from debtor-in-possession financing		29,825	128,000	
Proceeds from exit financing	16,000	85,000		
Payments of debt issuance costs		(896)	(1,547)	
Net proceeds from financing arrangements	73		559	2,210
Proceeds from employee stock plans			2,873	4,014
Proceeds from issuance of stock		56,529		
Net cash provided by (used in) financing activities of continuing operations	(488)	40,451	101,207	(9,783)
Net (decrease) increase in cash and cash equivalents	(12,811)	28,025	(9,574)	(90,608)
Cash and cash equivalents at beginning of period continuing operations	82,698	54,673	64,247	154,855
Cash and cash equivalents at end of period continuing operations	$ 69,887	$ 82,698	$ 54,673	$ 64,247

See accompanying notes to consolidated financial statements.

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SILICON GRAPHICS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

(In thousands, except per share amounts)

	Common Stock and Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Loss	Total Stockholders Equity (Deficit)
Predecessor Company					
Balance at June 25, 2004	$ 1,550,425	$ (1,645,970)	$ (6,774)	$ (20,359)	$ (122,678)
Components of comprehensive loss:					
Net loss		(76,008)			(76,008)
Currency translation adjustments				1,047	1,047
Change in unrealized loss on derivative instruments designated and qualifying as cash flow hedges				1,864	1,864
Total comprehensive loss					(73,097)
Issuance of common stock (402,400 shares) through debt conversions	503				503
Issuance of common stock (3,611,119 shares) and treasury stock (2,257 shares) net of treasury stock purchases (18,557 shares) under employee stock plans net	4,105	(3)	(18)		4,084
Balance at June 24, 2005	1,555,033	(1,721,981)	(6,792)	(17,448)	(191,188)
Components of comprehensive loss:					
Net loss		(146,194)			(146,194)
Currency translation adjustments				(982)	(982)
Change in unrealized loss on derivative instruments designated and qualifying as cash flow hedges				(1,567)	(1,567)
Total comprehensive loss					(148,743)
Issuance of common stock (9,054,401 shares) and treasury stock (12,037shares) under employee stock plans net	2,942	(26)	32		2,948
Stock-based compensation	2,184				2,184
	4,345				4,345

Increase in interest in equity investment					
Balance at June 30, 2006	1,564,504	(1,868,201)	(6,760)	(19,997)	(330,454)

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SILICON GRAPHICS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) (Continued)

(In thousands, except per share amounts)

	Common Stock and Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Loss	Total Stockholders Equity (Deficit)
Components of comprehensive loss:					
Net income		326,256			326,256
Currency translation adjustments				95	95
Total comprehensive loss					326,351
Cancellation of Predecessor Company common stock (274,247,196 shares) and treasury stock (640,565 shares)	(1,568,607)	1,541,945	6,760	19,902	
Stock-based compensation	4,103				4,103
Issuance of Successor Company common stock (11,125,000 shares) to creditors	185,888				185,888
Successor Company					
Balance at September 29, 2006	185,888				185,888
Net loss		(103,642)			(103,642)
Stock-based compensation	2,213				2,213
Balance at June 29, 2007	$ 188,101	$ (103,642)	$	$	$ 84,459

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Operations

SGI is a leading provider of products, services, and solutions for use in HPC and data management. We sell solutions based on a complete range of scalable servers and storage products, from entry-level to high-end, together with associated software products. These solutions enable our customers in the scientific, technical and business communities to solve their most challenging data management and analysis problems providing them with strategic and competitive advantages. Our products are also among the best in the industry in energy efficiency. Whether studying global climate changes, accelerating the engineering of new automotive designs, providing technologies for homeland security, or gaining business intelligence through data-mining, our solutions are designed to store, manage, access, analyze and transform vast amounts of data to provide insights and intelligence in real time or near-real time. We also offer a range of services, including professional services, customer support, and education. Our solutions, products and services are used in a range of markets, including defense and intelligence, sciences, engineering analysis, digital content management and both commercial and government enterprise.

Our products are manufactured in Chippewa Falls, Wisconsin. We distribute our products through our direct sales force and through indirect channels including resellers, distributors and system integrators. Product and other revenue consist primarily of revenue from computer system and software product shipments and from system leasing, technology licensing agreements, and non-recurring engineering contracts. Service revenue results from customer support and maintenance contracts and from delivery of professional services.

While our cash balance and working capital position is significantly improved in fiscal 2007, we have incurred operating losses and negative cash flows from operations during each of the past several fiscal years. Our working capital surplus as of June 29, 2007 was $52 million, compared to a deficit of $56 million at June 30, 2006, down from working capital of $49 million at June 24, 2005. Additionally, we had stockholders equity of $84 million as of June 29, 2007, compared to a stockholders deficit of $330 million at June 30, 2006. Our unrestricted cash and marketable investments at June 29, 2007 were $70 million, compared to $55 million at June 30, 2006, down from $64 million at June 24, 2005.

On October 17, 2006, we successfully completed a reorganization and emerged from bankruptcy. As more fully described in Note 2 below, the emergence from bankruptcy resulted in a new reporting entity and adoption of fresh-start accounting in accordance with Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7).

The accompanying audited consolidated financial statements have been prepared assuming we will continue as a going concern, which assumes continuity of operations and realization of assets and satisfaction of liabilities in the ordinary course of business. The consolidated financial statements do not include any adjustments that might be required should we be unable to continue to operate as a going concern.

Note 2. Proceedings Under Chapter 11 of the Bankruptcy Code

Chapter 11 Reorganization

On May 8, 2006 (the Petition Date), the Predecessor Company and certain of its subsidiaries (collectively, the Debtors), filed voluntary petitions for reorganization under Chapter 11 of the

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SILICON GRAPHICS, INC., et al.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York (the Court) (Case Nos. 06-10977BRL through 06-10990BRL) (the Chapter 11 Cases). The Predecessor Company filed jointly with the following direct and indirect subsidiaries: Silicon Graphics Federal, Inc., Cray Research, LLC, Silicon Graphics Real Estate, Inc., Silicon Graphics World Trade Corporation, Silicon Studio, Inc., Cray Research America Latina Ltd., Cray Research Eastern Europe Ltd., Cray Research India Ltd., Cray Research International, Inc., Cray Financial Corporation, Cray Asia Pacific, Inc., ParaGraph International, Inc. and WTI-Development, Inc. Certain subsidiaries of the Predecessor Company, consisting principally of international subsidiaries, were not debtors (collectively, the Non-Debtors) in this bankruptcy proceeding. The Debtors remained in possession of their assets and properties as debtors-in-possession under the jurisdiction of the Court and in accordance with the provisions of the Bankruptcy Code. In general, as debtors-in-possession, each of the Debtors was authorized to continue to operate as an ongoing business, but was not allowed to engage in transactions outside the ordinary course of business without the prior approval of the Court.

The Predecessor Company sought and obtained Court approval through its first day and subsequent motions to pay certain foreign vendors, meet its pre- and post-petition payroll obligations, maintain its cash management systems, pay its taxes, continue to provide employee benefits, honor certain pre-petition customer programs, and maintain its insurance programs. In addition, the Court approved certain trading notification and transfer procedures designed to allow restrictions in the trading of its common stock (and related securities) which could have negatively impacted its accrued net operating losses and other tax attributes.

On May 10, 2006, the Predecessor Company, Silicon Graphics Federal, Inc. and Silicon Graphics World Trade Corporation (collectively, the Borrowers) entered into a Post-Petition Loan and Security Agreement (the Interim DIP Agreement) dated as of May 8, 2006 with Quadrangle Master Funding Ltd., Watershed Technology Holdings, LLC and Encore Fund, L.P. (collectively, the Interim DIP Lenders). The Interim DIP Agreement provided $70 million of debtor-in-possession (DIP) financing (the $70 million interim DIP Financing) to the Borrowers secured by certain of the borrowers assets. The interest rate under the Interim DIP Agreement was the per annum rate equal to the greater of (i) the rate of interest published in the Wall Street Journal from time to time as the Prime Rate plus seven percentage points or (ii) 250 basis points higher than the rate at which cash interest was then payable under the Predecessor Company s pre-petition credit agreement, provided that upon an event of default, the then current interest rate under the Interim DIP Agreement would be increased by two percentage points.

On May 26, 2006, the Predecessor Company reached a settlement with its landlord to restructure its lease obligations at Amphitheatre Technology Center (ATC) and Crittenden Technology Center (CTC) and received Court approval of the settlement on June 15, 2006. This settlement terminated the Predecessor Company s lease obligations at ATC and terminated its lease obligations for two buildings at CTC as of June 30, 2006. It also amended the lease obligations for a third building at CTC. Pursuant to the settlement, the Predecessor Company vacated the two buildings at CTC by June 30, 2006 and we vacated the third building on December 31, 2006.

In June 2006, the Debtors entered into a replacement Post-Petition Loan and Security Agreement (the DIP Agreement) with Morgan Stanley Senior Funding, Inc., (the Administrative Agent), Wells Fargo Foothill, Inc., the Interim DIP Lenders and certain other lenders party thereto (collectively, the DIP Lenders), providing up to $130 million of debtor-in-possession financing. The DIP Agreement was approved by the Court on June 26, 2006. The Order approving the DIP Agreement (i) authorized

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Debtors to incur post-petition secured indebtedness in the amount of up to $130 million while granting to the Administrative Agent and lenders thereunder, subject to specified permitted prior liens and a carve-out for specified professional fees and other costs and expenses, superpriority administrative expense claims and first priority priming liens against, and security interests in, substantially all of the Debtors then-owned and after-acquired property, (ii) authorized the Debtors to repay amounts owed under their pre-petition credit agreement, which was repaid on June 28, 2006, (iii) authorized the Debtors to repay amounts borrowed under the Interim DIP Agreement, and (iv) authorized the Debtors use of cash collateral of their secured notes and granted to the secured note holders certain adequate protection of their interests therein.

At a hearing held on July 27, 2006, the Court approved the Predecessor Company s Disclosure Statement, ruling that it contained adequate information for soliciting creditor approval of the Predecessor Company s Plan of Reorganization. At a hearing held on September 19, 2006 (the Confirmation Date), the Court confirmed the Predecessor Company s Plan of Reorganization, as amended (the Plan). This Confirmation Order became a Final Order on September 29, 2006 and we emerged from Chapter 11 on October 17, 2006.

Subject to certain exceptions in the Bankruptcy Code, the Chapter 11 filings automatically stayed the initiation or continuation of most actions against the Debtors, including most actions to collect pre-petition indebtedness or to exercise control over the property of the bankruptcy estates. As a result, absent an order of the Court, creditors were precluded from collecting pre-petition debts and substantially all pre-petition liabilities were subject to compromise under the Plan.

Under the Bankruptcy Code, the Debtors also had the right to assume, assume and assign, or reject certain executory contracts and unexpired leases, subject to the approval of the Court and certain other conditions. Generally, the assumption of an executory contract or unexpired lease requires a debtor to cure certain existing defaults under the contract, including the payment of all or a portion of the accrued but unpaid pre-petition liabilities. Rejection of an executory contract or unexpired lease is typically treated as a breach of the contract or lease, immediately prior to the Chapter 11 filing. Subject to certain exceptions, this rejection relieves the debtor from performing its future obligations under that contract but entitles the counterparty to assert a pre-petition general unsecured claim for damages. Parties to executory contracts or unexpired leases rejected by a debtor were able to file proofs of claim against that debtor s estate for damages.

Emergence from Chapter 11

After satisfying all conditions precedent to emergence under the Plan, we emerged from Chapter 11 effective as of October 17, 2006 (Emergence Date). On the Emergence Date, we entered into a credit agreement with Morgan Stanley Senior Funding, Inc and General Electric Capital Corporation to provide exit liquidity financing as part of our plan to emerge from bankruptcy. The exit financing facility provides up to $115 million of financing consisting of an $85 million term loan from Morgan Stanley Senior Funding, Inc. and a $30 million line of credit from General Electric Capital Corporation. The new facility was secured by substantially all of the assets of the Successor Company and its domestic subsidiaries and has customary terms and conditions, including covenants related to minimum levels of Consolidated EBITDA as defined in the credit agreement and minimum levels of cash and cash equivalents, and limits on capital expenditures. See Note 27. This facility, combined with net proceeds of $57 million from the rights offering and sale of Overallotment shares described below were used to pay off $113 million due under the DIP Agreement, to fund payments, including closing costs and

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

related fees, required to be made on the Emergence Date pursuant to the Plan, and to provide working capital for our ongoing operations. The exit financing facility matures in October 2011.

On the Emergence Date, we received $50 million in gross proceeds from the offering of common stock subscription rights to the holders of the Predecessor Company s 6.50% Senior Secured Convertible Note claims, 11.75% Senior Secured Note claims and the Cray 6.125% Convertible Subordinated Debenture claims (the Rights Offering), guaranteed by a backstop agreement (Backstop Purchase Agreement) put in place with certain of these holders (the Backstop Purchasers). In consideration for the Backstop Purchase Agreement, the Backstop Purchasers were paid a fee and were offered subscription rights to purchase the Overallotment shares, which upon exercise provided an additional $7.5 million in gross proceeds to the Successor Company.

As of the Emergence Date, the authorized capital stock of the reorganized company consists of 25,000,000 shares of new common stock, par value $0.01 per share, and 5,000,000 shares of undesignated preferred stock, par value $0.01 per share. Pursuant to the Plan, we issued 11,125,000 shares of new common stock to certain of the Predecessor Company s creditors in satisfaction of claims and upon exercise of stock purchase rights and Overallotment options. Of the 11,125,000 shares of outstanding new common stock, 10,000,000 shares were issued and distributed to holders of Allowed Secured Note Claims and Allowed Cray Unsecured Debenture Claims and 1,125,000 shares were issued and distributed as Overallotment shares pursuant to the Backstop Purchasers to the Backstop Purchase Agreements. In addition, 1,250,000 shares of the new common stock were reserved for issuance pursuant to the terms of the new Management Incentive Plan in accordance with the Plan. Awards under the Plan have been approved and began being issued as of December 2006. See Note 5 for further information regarding this Management Incentive Plan. No shares of preferred stock are outstanding.

As of the Emergence Date, Dr. Lewis S. Edelheit, Dr. Robert M. White, Anthony R. Muller and Mr. Robert R. Bishop ceased being directors of SGI (Dr. White and Mr. Money are still directors of Silicon Graphics Federal, Inc.) and the following persons became members of the Board of Directors pursuant to and by operation of the Plan: Eugene I. Davis, Anthony Grillo, Kevin D. Katari, and Chun Won Yi. James A. McDivitt remains as a director of the Successor Company. Dennis P. McKenna remained as a director of the Successor Company from the date of emergence until his resignation from SGI and our Board of Directors on April 6, 2007. On October 18, 2006, Mr. Katari was elected as Chairman of the Board. On January 31, 2007, the Board of Directors elected Ms. Joanne O Rourke Isham as a member of our Board to serve a term expiring at its 2008 Annual Meeting of Stockholders. On April 9, 2007, we named Robert Bo Ewald as our Chief Executive Officer, effective immediately, to replace Mr. McKenna, who served as our Chief Executive Officer since January 31, 2006. The Board appointed Mr. Ewald as a Class I director of the Board, serving until the expiration of the Class I director term at our 2007 annual meeting of stockholders.

Since October 23, 2006, our new common stock has traded on the NASDAQ Global Market under the symbol SGIC.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Reorganization items

Reorganization items, net represents expense or income amounts incurred as a direct result of the Predecessor Company s Chapter 11 filing and are presented separately in our consolidated statements of operations. Such items consisted of the following (in thousands):

	Predecessor Company	
	Three Months Ended	Year Ended
	Sept. 29, 2006	June 30, 2006
Professional fees	$ 8,942	$ 13,285
Pre-petition liability claim adjustments	(6,343)	755
Write-off of unamortized debt premium and discount, net		(9,381)
Write-off of unamortized debt issuance costs		3,167
Effects of the plan of reorganization	(142,033)	
Fresh-start valuation of assets and liabilities	(200,963)	
	$ (340,397)	$ 7,826

Professional fees are those related to legal, accounting and other professional costs directly associated with the reorganization process.

Included in the effects of the Plan is a charge of $4 million for the acceleration of stock-based compensation resulting from the cancellation of Predecessor Company stock options and restricted stock awards.

Liabilities Subject to Compromise

Liabilities subject to compromise represent the liabilities of the Debtors incurred prior to the Petition Date, except those that will not be impaired under the Plan. Liabilities subject to compromise consisted of the following (in thousands):

	Predecessor Company June 30, 2006
6.50% Senior Secured Convertible Notes due June 1, 2009	$ 188,578
6.125% Convertible Subordinated Debentures due February 1, 2011	56,776
11.75% Senior Secured Notes due June 1, 2009	2,386
Accounts payable	55,447
Accrued liabilities	17,043
Liabilities subject to compromise	$ 320,230

Interest expense

The Debtors discontinued recording interest on liabilities subject to compromise during the Chapter 11 proceedings. Contractual interest on liabilities subject to compromise in excess of reported interest was approximately $200 thousand and $2 million, for the three-months ended September 29, 2006 and fiscal 2006, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3. Summary of Significant Accounting Policies

Basis of Presentation. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The accompanying consolidated financial statements include the accounts of SGI and our wholly- and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. The accompanying audited consolidated financial statements have been prepared assuming we will continue as a going concern, which assumes continuity of operations and realization of assets and satisfaction of liabilities in the ordinary course of business. Our ability to continue as a going-concern is dependent upon, among other things: our ability to achieve profitability; our ability to maintain adequate cash on hand; our ability to generate cash from operations; and our ability to continue implementing our revenue stabilization initiatives. We may be unable to achieve these objectives in order to continue as a going concern. The consolidated financial statements do not include any adjustments that might be required should we be unable to continue to operate as a going concern.

For the period subsequent to the Petition Date and prior to emergence, the accompanying consolidated financial statements were prepared in accordance with Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7). Accordingly, all pre-petition liabilities subject to compromise were segregated in the condensed consolidated balance sheet and classified as liabilities subject to compromise at the estimated amounts of allowable claims. Interest was not accrued on debt subject to compromise subsequent to the Petition Date. Reorganization items, which included the expenses, realized gains and losses, and provisions for losses resulting from the reorganization under the Bankruptcy Code, were reported separately as reorganization items in the Predecessor Company s consolidated statements of operations.

Fresh-Start Accounting

Although we emerged from bankruptcy on October 17, 2006, we adopted fresh-start accounting as of September 29, 2006 in accordance with SOP 90-7. Fresh-start accounting was required because holders of existing voting shares immediately before filing and confirmation of the plan received less than 50% of the voting shares of the emerging entity and its reorganization value was less than its post petition liabilities and allowed claims. Fresh-start accounting requires the Successor Company to allocate its reorganization value to its assets and liabilities in a manner similar to that which is required under SFAS No. 141, *Business Combination.* Under the provisions of fresh-start accounting, a new entity was deemed created for financial reporting purposes. Accordingly, our financial information disclosed under the heading Successor Company is presented on a basis different from, and is therefore not comparable to, our financial information disclosed under the heading Predecessor Company . While all amounts reflected in this Form 10-K are reported in accordance with accounting principles generally accepted in the United States, in Item 7, of this Report we explain our results of operations excluding the impact of fresh-start accounting in order to provide transparency in our financial reporting. We believe that such a presentation is necessary to facilitate period-to-period comparisons of our performance. For further information on fresh-start accounting, see Note 4.

The consolidated balance sheet as of June 29, 2007 includes the remaining effect of adjustments to the carrying value of assets or amounts and classifications of liabilities that were necessary when adopting fresh-start accounting. The statements of operations and cash flows for the three-month period ended September 29, 2006 reflect the operations of the Predecessor Company, which includes the gain from the effects of the Plan of Reorganization and the application of fresh-start accounting.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The adoption of fresh-start accounting had a material effect on the consolidated financial statements as of June 29, 2007 and September 29, 2006 and will have a material impact on the consolidated statements of operations for periods subsequent to June 29, 2007.

In addition, the Successor Company was required to adopt changes in accounting principles that will be required in the consolidated financial statements of the Successor Company within the 12 months following the adoption of fresh-start reporting. As a result, we were required to early adopt SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140, SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), Emerging Issues Task Force (EITF) Issue No. 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences (EITF 06-2), and EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement. The Successor Company has completed its review of these accounting pronouncements to determine the impact on its consolidated results of operations. The early adoption of these pronouncements did not have a material effect on our financial position, results of operations, or cash flows.

Reclassifications. Certain revisions have been made to all periods presented in the consolidated financial statements to conform to the current year presentation. As described in Note 9, we have classified the financial results of our Alias application software business as discontinued operations for all periods presented. These notes to our consolidated financial statements relate to continuing operations only, unless otherwise indicated.

We revised our statements of cash flows for fiscal 2005, fiscal 2006 and the first three months of fiscal 2007. The changes related to the classification of net changes in selected other long-term assets as operating or financing activities instead of investing activities. These changes resulted in a $2.4 million decrease in net cash used in operating activities and a $2.4 million decrease in cash provided by investing activities in fiscal 2005. These changes resulted in a $2.1 million decrease in net cash used in operating activities, a $1.5 million increase in cash used in financing activities, and a $0.6 million increase in net cash used in investing activities in fiscal 2006. These changes resulted in a $2.3 million increase in net cash provided by operating activities and a $2.3 million increase in net cash used in investing activities in the first three months of fiscal 2007. These revisions to the statements of cash flows had no impact on the company s cash and cash equivalents, balance sheet or statement of operations.

Foreign Currency Translation. We translate the assets and liabilities of our foreign subsidiaries stated in local functional currencies to U.S. dollars at the rates of exchange in effect at the end of the period, except for inventory, property, plant and equipment and certain other assets and deferred revenue, which we remeasure at their historical exchange rates. We translate revenues and expenses using rates of exchange in effect during the period, except for those expenses related to the previously noted balance sheet amounts, which are remeasured at historical exchange rates. We are a U.S. dollar functional currency company and the functional currency for our international operations is the U.S. dollar. As such, translation adjustments resulting from remeasuring the financial statements of subsidiaries into the U.S. dollar are included in our results of operations. For the three months ended September 29, 2006 and the nine months ended June 29, 2007, fiscal 2006, and fiscal 2005, currency transaction gains or losses net of hedging gains or losses, were not significant to our results of operations. Investments accounted for using the equity method in an investee that reports in a foreign

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

currency are translated in conformity with SFAS No. 52, *Foreign Currency Translation,* at the rate of exchange in effect at the end of the period with the resulting translation adjustment recorded directly to accumulated other comprehensive loss, a separate component of stockholders deficit.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses as presented in our consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

Cash Equivalents and Marketable and Restricted Investments. Cash equivalents consist of high credit quality money market instruments with an original maturity date less than 90 days Short-term marketable investments and restricted investments consist of both high credit quality money market instruments and high credit quality debt securities with maturities of one year or less, and are stated at fair value.

At June 29, 2007 and June 30, 2006, our restricted investments consist of short- and long-term investments that are pledged as collateral against letters of credit or held under a security agreement. The majority of our restricted investments was pledged as collateral against letters of credit and were primarily associated with two specific customer arrangements for significant multi-year contracts with long-term delivery and installation commitments. Restricted investments are held in SGI's name by major financial institutions (see Note 8).

The cost of securities when sold is based upon specific identification. We include realized gains and losses and declines in value of available-for-sale securities that we judge to be other-than-temporary in interest income and other, net. We include unrealized gains and losses, net of tax, on securities classified as available-for-sale in accumulated other comprehensive loss, a component of stockholders' deficit.

Fair Values of Financial Instruments. The carrying values of short-term debt and cash equivalents approximate fair value due to the short period of time to maturity. The fair values of marketable investments, long-term debt, foreign exchange forward contracts, and currency options are based on quoted market prices or pricing models.

Derivative Financial Instruments. We use derivative financial instruments to moderate the financial market risks of our business operations by hedging the foreign currency market exposures underlying certain assets and liabilities and certain commitments related to customer transactions. We do not invest in derivative financial instruments for speculative or trading purposes. See Note 8 for more information about our derivative financial instruments and the accounting policies that we apply to them.

Accounts Receivable and Allowance for Doubtful Accounts. Our accounts receivable consists of short-term, non-interest-bearing trade receivables, which we record at the amounts due to us from our customers, less an allowance for doubtful accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. When we become aware of a specific customer's inability to pay their outstanding obligation, for reasons such as deterioration in their operating results or financial position or bankruptcy proceedings, we record a specific reserve to reduce their receivable to the amount that we reasonably believe is collectible. We

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

also record general allowances for doubtful accounts for our entire customer population based on a variety of factors, including the length of time the receivables are past due and historical experience.

Inventories. Manufacturing inventories are stated at the lower of cost (first-in, first-out) or market. Demonstration systems are stated at cost less depreciation, generally based on a fifteen-month life. Costs include material, labor and manufacturing overhead.

Property and Equipment. We state property and equipment at cost and compute depreciation expense using the straight-line method. We depreciate machinery and equipment and furniture and fixtures over useful lives of two to five years, and we amortize leasehold improvements over the shorter of their useful lives or the term of the lease. We depreciate our buildings over forty (40) years and improvements over the remaining life of the building.

Capitalized Software. In accordance with SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* we capitalize certain costs incurred to acquire or create internal use software, principally related to software license fees, software coding, designing system interfaces, and installation and testing of the software. Capitalized costs are included in property and equipment and are amortized over periods of three years.

Long-Lived Assets. We account for our long-lived tangible assets and definite-lived intangible assets in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* As a result, we assess long-lived assets classified as held and used , including property and equipment, assets under capital leases, spares inventory and long term prepaid assets subject to amortization, for impairment whenever events or changes in business circumstances arise that may indicate that the carrying amount of a long-lived asset may not be recoverable, such as a significant current period operating or cash flow loss combined with a history of such losses. Under SFAS 144, an impairment loss would be calculated when the sum of the estimated future undiscounted cash flows expected to result from the use of an asset and its eventual disposition is less than the carrying amount of the asset. Because of our fiscal 2007 operating and cash flow losses and our history of such losses, we evaluated our long-lived assets for impairment during fiscal 2007; based on the results of this evaluation, the carrying value of these assets were determined to be recoverable. Nonetheless, it is possible that our estimates of undiscounted cash flows may change in the future resulting in the need to reassess the carrying value of our long-lived assets for impairment.

Other Assets. Included in other assets are spare parts that are generally depreciated on a straight-line basis over an estimated useful life of five years.

Goodwill. Our Goodwill in 2006 resulted from the acquisition of Silicon Graphics World Trade Corporation in fiscal 1991. Predecessor Company Goodwill was eliminated and Successor Company Goodwill was established in connection with our adoption of fresh-start accounting (see Note 4 and Note 13). As required by SFAS 142, *Accounting for Goodwill and Other Intangible Assets*, we ceased amortizing Goodwill and began annually testing Goodwill for impairment. We perform this test separately for each of our two reporting units, which correspond to our two reportable segments. We perform our annual impairment test as of the last day of the first day of our fourth fiscal quarter. We would also test Goodwill for impairment if an event occurs or a circumstance changes that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

We perform the Goodwill impairment test using a two-step approach. First, we compare the carrying amount of each reporting unit to its fair value, which we estimate using a present value

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technique. If the carrying value of a reporting unit exceeds its fair value, we perform the second step of the impairment test. In this step, we recognize an impairment loss for the excess, if any, of the carrying amount of the reporting unit s Goodwill over the implied fair value of the Goodwill. The implied fair value of a reporting unit s Goodwill is the amount by which the fair value of the entire reporting unit exceeds the sum of the individual fair values of its assets, except Goodwill, less the sum of the individual fair values of its liabilities. As of June 29, 2007, fresh-start adjustments resulted in the elimination of the Successor Company s Goodwill.

*Leases and leasehold improvements***.** We record leases as capital or operating leases and account for leasehold improvements in accordance with SFAS No. 13, *Accounting for Leases* and related literature. Rent expense for operating leases is recorded in accordance with Financial Accounting Standards Board (FASB) Technical Bulletin (FTB) No. 88-1, *Issues Relating to Accounting for Leases*. This FTB requires lease agreements that include periods of free rent or other incentives, specific escalating lease payments, or both, to be recorded on a straight-line or other systematic basis over the initial lease term and those renewal periods that are reasonably assured. The difference between rent expense and rent paid is recorded as deferred rent in non-current liabilities in the consolidated balance sheets.

Income taxes. We estimate our income tax provision or benefit in each of the jurisdictions in which we operate, including estimating exposures related to examinations by taxing authorities. We must also make judgments regarding the realizability of deferred tax assets. The carrying value of our net deferred tax asset is based on our belief that it is more likely than not that we will generate sufficient future taxable income in certain jurisdictions to realize these deferred tax assets. A valuation allowance has been established for deferred tax assets which do not meet the more likely than not criteria established by SFAS No. 109, *Accounting for Income Taxes*. Our judgments regarding future taxable income may change due to changes in market conditions, changes in tax laws, tax planning strategies or other factors. If our assumptions and consequently our estimates change in the future, the valuation allowances we have established may be decreased, impacting future income tax expense. The effective tax rate is highly dependent upon the geographic distribution of our worldwide earnings or loss, tax regulations in each geographic region, the availability of tax credits and carryforwards, and the effectiveness of our tax planning strategies. We regularly monitor the assumptions used in estimating our annual effective tax rate and adjust our estimates accordingly. If actual results differ from our estimates, future income tax expense could be materially affected.

Revenue Recognition. SGI enters into revenue arrangements to sell products and services for which we are obligated to deliver multiple products and/or services. A typical multiple-element arrangement includes SGI product, third party product or services, SGI consulting services and SGI maintenance services.

We apply Emerging Issues Task Force Issue (EITF) No. 00-21, *Revenue Arrangements with Multiple Deliverables*. Under EITF 00-21, multiple-element arrangements are assessed to determine whether they can be separated into more than one unit of accounting. In performing the assessment, we first apply the separation criteria within FTB 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts* to separate the deliverables falling within the scope of FTB 90-1. Multiple-element arrangements are separated into more than one element if all of the following are met:

The delivered item(s) has value to the customer on a standalone basis.

There is objective and reliable evidence of the fair value of the undelivered item(s).

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If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially within our control.

If all of the above criteria are not met, revenue associated with the arrangement is deferred until the criteria are met on all undelivered elements, or the entire arrangement has been delivered. If objective and reliable evidence of fair value is available for all elements of the arrangement, revenue is allocated to each element based upon the relative fair value of each element to the total arrangement value. The price charged when an element is sold separately generally determines fair value. In the absence of fair value for a delivered element, we allocate revenue first to the fair value of the undelivered elements and then allocate the residual value to the delivered elements. In the absence of fair value for an undelivered element, the entire arrangement is accounted for as a single unit of accounting and revenue for the delivered elements is deferred until the undelivered elements have been delivered.

In multiple element revenue arrangements that include software that is more than incidental to the products or services as a whole, software and software-related elements are accounted for in accordance with AICPA Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. Software-related elements include software products and services, as well as any non-software deliverable for which a software deliverable is essential to its functionality. We allocate revenue to each element based upon vendor-specific objective evidence (VSOE) of the fair value of the element or, if VSOE is not available, by application of the residual method. VSOE of fair value for an element is based upon the price charged when the element is sold separately.

Effective for fiscal 2006, and for certain of our storage solution arrangements whereby software is essential to the functionality, we are applying the accounting guidance in SOP 97-2, in determining the timing of revenue recognition. In conjunction with business turnaround activities initiated during fiscal 2006, we shifted our sales and marketing efforts for certain of our products that include SGI proprietary software to drive a total solution sales approach. We evaluated this shift in strategy against the indicators offered in footnote 2 of SOP 97-2, along with other considerations, in reaching the conclusion that, effective for fiscal 2006, these same products should be accounted for under the provisions of SOP 97-2. We are not able to establish VSOE on our post-contract customer support (PCS") services for all arrangements. Accordingly, when PCS is an element of these sale arrangements, revenue and the related costs (product and third-party consulting) on the entire arrangement will generally be deferred and recognized over the initial customer support period. However, we are able to establish a VSOE value on PCS services on some arrangements based on a stated renewal price for PCS services and in these instances the Company allocates revenue to each element using the residual method.

Occasionally, we enter into a multiple-element arrangement in which substantial modification of software is one element of the arrangement and that software does not provide separate value to the customer. In this instance, the entire arrangement is accounted for in accordance with SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Percentage of completion revenue recognition is applied when we can reasonably estimate costs and progress toward completion. We recognize revenue as work progresses based on the percentage that incurred costs to date bear to estimated total costs. If we are unable to reasonably estimate costs and progress toward completion, we utilize the completed contract method of revenue recognition. Notwithstanding the recognition of revenue using this method, the contracts are reviewed on a regular basis to

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determine whether a loss contract exists. A loss will be accrued in the period in which estimated contract revenue is less than the current estimate of total contract costs. Revenue recognized under these arrangements are not significant for any periods presented.

After application of the appropriate accounting guidance to our multiple element arrangements, the revenue policies described below are then applied to each unit of accounting.

Product (hardware and software) Revenue. We recognize product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectibility is reasonably assured. The product is considered delivered to the customer (including distributors, channel partners and resellers) once it has been shipped, and title and risk of loss have transferred. Sales of certain high-performance systems may be made on the basis of contracts that include acceptance criteria. In these instances, we recognize revenue upon acceptance by the customer or independent distributor. We defer the fair value of products that have been shipped to the customer but for which the appropriate revenue recognition criteria (e.g. customer acceptance) have not yet been met. We reduce product revenue for certain stock rotation and price protection rights that may occur under contractual arrangements we have with certain resellers. Estimated sales returns are also provided for as a reduction to product revenue and were not material for any period presented in the consolidated financial statements.

Certain of our customers prefer to acquire our products under a sales type lease arrangement. We recognize revenue on these arrangements when the criteria under SFAS 13, *Lease Accounting,* and SAB 104 have been met. The resulting receivables generated under these arrangements are generally sold to unrelated financing companies and are accounted for in accordance with SFAS 140, *Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. In accordance with the criteria set forth in SFAS 140, a transfer of such receivables are recorded as a sale of assets. We do maintain an unguaranteed residual value in the products sold under sales-type lease arrangements. We record this unguaranteed residual value as an asset on our balance sheet and measure it based on the estimated fair market value of the equipment at the end of the lease term. We separately estimate this residual value for each significant product family considering the following factors: historical data regarding recovery of residual values, our current assessment of market conditions for used equipment, and any forward-looking projections we deem significant, particularly those relating to upcoming technology or changing market conditions. We periodically evaluate the residual values for indicators of other-than-temporary decline, in which case we would adjust the recorded residual values; we would not recognize any increase in residual values until the used equipment is resold. The estimated amounts of our unguaranteed residual value interests in leases were $1.3 million at June 29, 2007

Service Revenue. We recognize service revenue when persuasive evidence of an arrangement exists, the service has been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Revenue related to future commitments under customer support contracts is deferred and recognized ratably over the related contract term. Consulting and installation revenue is generally recognized when the service has been performed. Service revenue includes third-party product and is subject to the revenue policies that apply to product revenue.

Royalty Revenue. We recognize royalty revenue under fixed fee arrangements the quarter in which the revenue is earned in accordance with the contractual terms and conditions. Under volume-based technology agreements, where we are unable to reliably estimate licenses volume, we recognize revenue in the quarter in which we receive reports from licensees detailing the shipments of

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products incorporating our intellectual property components. The reports are generally received on a one-quarter lag basis from when the royalty revenues were earned.

Engineering Service Revenue. We recognize engineering services revenue when services are rendered, or when an identifiable portion of the contract is completed, no significant post-delivery obligations exist, and collectibility is reasonably assured.

Royalty and engineering service revenues were not significant for any periods presented.

Shipping and Handling Costs. Shipping and handling costs are classified as a component of cost of sales. Customer payments of shipping and handling costs are recorded as product and other revenue.

Product Warranty. At the time of sale, we provide for an estimated cost to warrant our products against defects in materials and workmanship for a period of up to one year on UNIX and Linux systems and up to three years on storage systems.

Advertising Costs. We record advertising costs as expense of the period in which they are incurred. Advertising expense from continuing operations was $0.5 million for the three months ended September 29, 2006, $0.6 million for the nine months ended June 29, 2007, $1.6 million for fiscal 2006, and $0.5 million for fiscal 2005.

Per Share Data. Basic earnings per share is based on the weighted effect of all common shares issued and outstanding, and is calculated by dividing net loss by the weighted average shares outstanding during the period. Diluted earnings per share is calculated by dividing net income, adjusted for the effect, if any, from assumed conversion of all potentially dilutive common shares outstanding, by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive common shares outstanding.

Impact of *Recent Accounting Pronouncements.* In June 2006, the FASB issued Interpretation No. 48 (FIN No. 48), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. The Interpretation provides a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under FIN No. 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for us beginning September 29, 2006. The adoption of FIN No. 48 did not have a material impact on our financial statements.

In June 2006, the FASB ratified the consensus on EITF Issue No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43* (EITF 06-2). EITF 06-2 requires companies to accrue the costs of compensated absences under a sabbatical or similar benefit arrangement over the requisite service period. EITF Issue No. 06-2 is effective for us beginning

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September 29, 2006. The cumulative effect of the application of this consensus on prior period results should be recognized through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. Elective retrospective application is also permitted. The early adoption of this consensus resulted in a $1.7 million increase in our liability for sabbatical leave and was included as part of the fresh-start valuation adjustment. The adoption of EITF Issue No. 06-2 did not have an impact to our financial statements.

In fiscal year 2007, we adopted the Emerging Issues Task Force consensus on Issue No. 06-3, *How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement* (EITF 06-3). EITF 06-3 provides guidance on an entity's disclosure of its accounting policy regarding the gross or net presentation of certain taxes and provides that if taxes included in gross revenues are significant, a company should disclose the amount of such taxes for each period for which an income statement is presented. Taxes within the scope of EITF 06-3 are those that are imposed on and concurrent with a specific revenue-producing transaction. The disclosures are required for annual and interim financial statements for each period for which an income statement is presented. Since the Company presents revenues net of any taxes collected from customers and intends to continue this presentation in the future, therefore the adoption of EITF 06-3 will not require additional disclosures and will have no impact on our financial statements.

In fiscal year 2007, we adopted SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements*. SAB No. 108 requires companies to quantify misstatements using both a balance sheet (iron curtain) and an income statement (rollover) approach to evaluate whether either approach results in an error that is material in light of relevant quantitative and qualitative factors, and provides for a one-time cumulative effect transition adjustment. The adoption of SAB No. 108 did not have a material impact on our financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. During fiscal year 2007 we adopted the provision of this pronouncement and there was no impact to our financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers' *Accounting for Defined Benefit Pension and Other Postretirement Plans* An Amendment of FASB No. 87, 88, 106 and 132(R) (SFAS 158). SFAS 158 requires that the funded status of defined benefit postretirement plans be recognized on the company's balance sheet, and changes in the funded status be reflected in comprehensive income, effective fiscal years ending after December 15, 2006, which we adopted during fiscal year 2007. There was no impact to our financial statements as a result of adopting this pronouncement.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 gives us the irrevocable option to carry many financial assets and liabilities at fair values, with changes in fair value recognized in earnings. SFAS No. 159 is effective for us in fiscal year beginning June 28, 2008, although early adoption is permitted. We are currently assessing the potential impact that adoption of SFAS No. 159 will have on our financial statements.

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Note 4. Fresh-Start Reporting

On September 19, 2006, the Court entered its Confirmation Order confirming the Plan. Our emergence from Chapter 11 proceedings on the Emergence Date resulted in a new reporting entity and adoption of fresh-start accounting in accordance with SOP 90-7 as of September 29, 2006, as reflected in the following financial information. Reorganization adjustments have been made in the financial information to reflect the discharge of certain pre-petition liabilities and the adoption of fresh-start accounting.

Reorganization adjustments resulted primarily from the:

i. changes in the carrying values of assets and liabilities to reflect fair values, including the establishment of certain intangible assets;

ii. discharge of the Predecessor Company s pre-petition liabilities in accordance with the Plan;

iii. addition of new financing;

iv. cash distributions paid or payable to pre-petition creditors; and

v. issuance of Successor Company, or new common stock and cancellation of Predecessor Company, or old common stock.

We engaged an independent financial advisor to assist in the determination of our reorganization value as defined in SOP 90-7. In June 2006, we determined a reorganization value, together with the financial advisor, using various valuation methods including: (i) publicly traded company analysis, (ii) discounted cash flow analysis and (iii) precedent transactions analysis. These analyses are based on a variety of estimates and assumptions, which, though considered reasonable by management, may not be realized and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. Changes in these estimates and assumptions may have a significant effect on the determination of our reorganization value. The assumptions used in the calculations for the discounted cash flow analysis regarding projected revenue, costs and cash flows, for fiscal 2007-2022 were provided by management based on our best estimate at the time the analysis was performed. Management s estimates implicit in the cash flow analysis included increases in net revenue of 2.5% to 5.0% per year over the 16-year period. In addition, the analysis includes estimated cost reductions, primarily in selling, general and administrative costs through our plans for headcount reductions and other cost efficiencies. The analysis also includes anticipated levels of reinvestment in our operations through capital expenditures ranging from $12.0 million to $20.0 million per year. We did not include in our estimates the potential effects of litigation, on either the company or the industry. The foregoing estimates and assumptions are inherently subject to uncertainties and contingencies beyond our control. Accordingly, there can be no assurance that the estimates, assumptions and values reflected in the valuations will be realized, and actual results could vary materially.

Our enterprise value was calculated to be within an approximate range of $210 million to $275 million. We selected the midpoint of the range, $242.5 million, to be used in the determination of reorganization value. On September 19, 2006 (the Confirmation Date), this value was confirmed by the Court and the Creditors Committee. The equity value of $185.9 million as of September 29, 2006 represents the reorganization value of $242.5 million reduced by $56.6 million representing the value of the new debt of $85 million and further adjusted primarily for estimated excess cash upon emergence and the issuance of 1,125,000 shares of common stock in accordance with the Backstop Purchase Agreements.

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The fair value allocated to the assets and liabilities of the Successor Company is in conformity with SFAS No. 141. These adjustments were based upon the work of management and their outside consultants to determine the relative fair values of our assets and liabilities.

As a result of the adoption of fresh-start reporting, our post-emergence financial statements are not comparable with our pre-emergence financial statements, because they are, in effect, those of a new entity. Subsequent to September 29, 2006, adjustments were made to the preliminary fresh-start valuation adjustments previously disclosed in our Quarterly Report on Form 10-Q for the first quarter of fiscal 2007. The effects of the Plan and fresh-start reporting on our condensed consolidated balance sheet as of September 29, 2006 are as follows:

SILICON GRAPHICS, INC.

CONDENSED CONSOLIDATED BALANCE SHEET (a)

(In thousands, audited)

	Predecessor Company Sept. 29, 2006	Plan Reorganization Adjustments	Fresh-Start Valuation Adjustments	Successor Company Sept. 29, 2006
Assets:				
Current assets:				
Cash and cash equivalents	$ 53,280	$ 29,418 (b),(j)	$	$ 82,698
Short-term marketable investments	266			266
Short-term restricted investments	34,044			34,044
Accounts receivable, net of allowance for doubtful accounts of $3,213	50,230		1,077	51,307
Inventories	62,382		28,332 (g)	90,714
Prepaid expenses	10,577	(1,000)(e)		9,577
Other current assets	42,550		(20,907)(g)	21,643
Total current assets	253,329	28,418	8,502	290,249
Restricted investments	16,188			16,188
Property and equipment, net of accumulated depreciation and amortization	25,818		15,232 (g)	41,050
Goodwill	4,515		(188)(i)	4,327
Other Intangibles			86,700 (g)	86,700
Other non-current assets, net	62,809	2,255 (c)	10,907 (g)	75,971
Total assets	$ 362,659	$ 30,673	$ 121,153	$ 514,485

Liabilities and stockholders equity (deficit):				
Current liabilities:				
Accounts payable	$ 23,677	$ 35,446 (d),(j)	$	$ 59,123
Accrued compensation	31,840			31,840
Income taxes payable	806		1,712	2,518
Other current liabilities	54,441	2,505 (d),(j)	848 (g)	57,794
Current portion of long-term debt	114,179	(113,111)(b),(f)	(352)(g)	716
Current portion of deferred revenue	103,214		(71,927)(g)	31,287
Total current liabilities	328,157	(75,160)	(69,719)	183,278
Long-term debt	139	85,000 (b)	(139)(g)	85,000
Non-current portion of deferred revenue	14,795		(6,583)(g)	8,212
Other non-current liabilities	55,475		(3,368)(g)	52,107
Total liabilities not subject to compromise	398,566	9,840	(79,809)	328,597
Liabilities subject to compromise	311,070	(311,070)(d)		
Total liabilities	709,636	(301,230)	(79,809)	328,597

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Predecessor Company Sept. 29, 2006	Plan Reorganization Adjustments	Fresh-Start Valuation Adjustments	Successor Company Sept. 29, 2006
Stockholders equity (deficit):				
Common stock	1,564,627	183,110(e)	(1,561,849)(h)	185,888
Accumulated deficit	(1,884,941)	142,033(e)	1,742,909 (h)	
Treasury stock	(6,760)	6,760(e)		
Accumulated other comprehensive loss	(19,902)		19,902 (h)	
Total stockholders equity (deficit)	(346,977)	331,902	200,963	185,888
Total liabilities and stockholders deficit	$ 362,659	$ 30,673	$ 121,153	$ 514,485

a. The condensed consolidated balance sheet estimates the effect of implementing the Plan and fresh-start reporting which was adopted on September 29, 2006. Under fresh-start reporting, which is required by SOP 90-7, reorganization enterprise value of $242.5 million based on the Disclosure Statement which, after reduction for the new debt and remaining non-Debtor interest bearing liabilities and the addition of the proceeds from the Overallotment shares and excess borrowings, results in a reorganization equity value of $185.9 million.

b. Reflects net cash received associated with repayment of the DIP facility of $113.1 million, proceeds from the new term loan of $85 million, the issuance of 7.5 million shares issued through the Rights Offering for $49 million, net of backstop and rights offering fees, and the issuance of 1.125 million Overallotment shares for $7.5 million.

c. Reflects the capitalization of the exit financing fees associated with the acquisition of the new term loan of $85 million and the new working capital facility of $30 million. There were no borrowings against the working capital facility as of the Emergence Date.

d. Reflects the discharge of the Predecessor Company s pre-petition liabilities in accordance with the Plan and the reclassification of remaining liabilities subject to compromise to the appropriate liability accounts in accordance with the Plan. No adjustments are reflected for the actual payments of these remaining liabilities subject to compromise. Discharge of the Predecessor Company s pre-petition liabilities is summarized as follows (in thousands):

To be exchanged for stock	$ 196,374
To be paid in cash	114,696
	$ 311,070

Additionally, in accordance with the Plan, under the Rights Offering, holders of the Cray Unsecured Notes received the right to purchase 700,000 shares of new Successor Company common stock for $6.67 per share, and holders of the Predecessor Company s Senior Secured Notes and Senior Secured Convertible Notes received the right to purchase an additional 6.8 million shares of new Successor Company common stock for $6.67 per share. In addition, certain pre-petition creditors exercised an option to purchase an additional 1.125 million Overallotment shares for $6.67 per share.

e. Reflects the issuance of new Successor Company common stock to pre-petition creditors, the cancellation of old common stock and treasury stock, the gain on the discharge of liabilities subject to compromise and the acceleration of stock-based compensation resulting from the cancellation of Predecessor Company stock options and restricted stock awards.

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f. Reflects the repayment of the $113.1 million due under the $130 million DIP Agreement.

g. Reflects changes to the carrying values of assets and liabilities to reflect fair values in accordance with SFAS No. 141 as well as the $1.7 million impact from the early adoption of EITF 06-02.

h. Reflects the elimination of historical accumulated deficit and other equity accounts and an adjustment to shareholders equity to result in the estimated reorganized equity value in accordance with SOP 90-7 (see note a. above).

i. Reflects the elimination of historical Goodwill and the recording of Goodwill for the amount of reorganization value in excess of the amount allocable to specifically identifiable assets and liabilities.

j. The condensed consolidated balance sheet does not give effect to cash payments estimated at $47.7 million to unsecured creditors and for taxes, interest and other costs pursuant to the Plan. Such amounts were included in current liabilities as of September 29, 2006. As of June 29, 2007, all payments have been made.

Note 5. Share-Based Compensation

Successor Company

The Plan became effective and we emerged from bankruptcy on October 17, 2006. We applied fresh-start accounting effective September 29, 2006 and, as a result, the Predecessor Company s common stock was cancelled as of the Emergence Date, with no distribution made to holders of such stock. The equity structure of the Successor Company as of September 29, 2006 is discussed below.

Successor Company Common Stock

On the Emergence Date, the Successor Company, a Delaware corporation, filed a restated certificate of incorporation (New Certificate). The New Certificate authorized 25,000,000 shares of new Successor Company common stock (common stock) with $0.01 par value per share. Pursuant to the Plan, the Successor Company issued 11,125,000 shares of common stock to certain creditors in satisfaction of claims and upon exercise of stock purchase rights and Overallotment options.

Successor Company Preferred Stock

The New Certificate authorized 5,000,000 shares of undesignated preferred stock, $0.01 par value per share. Currently, no shares of preferred stock have been designated or issued.

Successor Company Management Incentive Plan

On the Emergence Date, the Silicon Graphics, Inc. Management Incentive Plan (MIP) became effective pursuant to the Plan. Under the MIP, the Compensation and Human Resources Committee of our Board of Directors (the Committee) is authorized to grant stock options, stock appreciation rights (SARs), stock awards, stock units, other stock based awards, dividend equivalents and cash awards. Employees, non-employee directors, and consultants of the Successor Company and its subsidiaries who are selected by the Committee are eligible to participate in the MIP. The MIP will terminate ten years after the Effective Date unless terminated sooner. The maximum number of shares of common stock of the Successor Company issuable under the MIP is 1,250,000 shares. Of the shares reserved, only 312,500 may be issued for full value benefits . Full value benefits are stock awards designed to

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provide equity compensation based on the full value of a share of stock. The MIP also imposes per-participant award limits. As noted below, with the exception of stock units issued to our former Chief Executive Officer and stock units and stock options issued in April 2007 to our current Chief Executive Officer, our stock units generally have a vesting period of up to 36 months and our stock options generally vest over 48 months. All grants under the MIP will be issued at fair value.

On March 30, 2007, we entered into an agreement to issue 20,619 shares of restricted stock units to Dennis McKenna, then President and Chief Executive Officer in recognition of past services rendered to us, including leading the company through bankruptcy and its emergence out of bankruptcy and to compensate him for the loss of Predecessor Company stock options that he forfeited pursuant to the bankruptcy process. Under the terms of this agreement, the award vested immediately on the grant date, but the shares are not issuable until the earlier of the date that is six months following the date of his separation of service (April 6, 2007) or the date of his death. Until such time, these will be considered restricted stock units. The grant date fair value of Mr. McKenna s fully vested restricted stock units was $30.22 per unit. Mr. McKenna does not have any stockholder rights, including voting or dividend rights, with respect to the shares subject to the award until he becomes the record holder of those shares following their actual issuance. This award is non-transferable except as defined by the terms of the agreement.

Awards for shares are counted against the total shares authorized only to the extent they are actually issued. As of June 29, 2007, 1,410,762 awards were granted, of which 311,815 were restricted stock units and 1,098,947 were stock options. Awards for shares that terminate by expiration, forfeiture, cancellation, or otherwise, or are settled in cash in lieu of shares, will result in shares being again available for grant. Also, if the exercise price or tax withholding requirements of any award are satisfied by tendering shares to the Successor Company, or if a stock appreciation right is exercised, only the number of shares issued, net of the shares tendered, will be deemed issued under the MIP. Each award agreement will specify the effect of a holder s termination of employment with, or service for, the Successor Company, including the extent to which unvested portions of the award will be forfeited and the extent to which options, SARs, or other awards requiring exercise will remain exercisable. Such provisions will be determined in the Committee s sole discretion. The Committee may at any time alter, amend, modify, suspend, or terminate the MIP or any outstanding award in whole or in part.

On April 9, 2007, we named Robert Bo Ewald our Chief Executive Officer to replace Mr. McKenna. On April 16, 2007, Mr. Ewald was granted an option to purchase 241,142 shares of our common stock (at $30.26 per share) under the MIP, provided however, that any shares subject to the option in excess of 147,500 are subject to stockholder approval of an increase in the maximum number of shares of common stock, available under the MIP within nine months following the option grant date so as to cover those shares. The shares under the option vest over 48 equal monthly installments.

On April 17, 2007, Mr. Ewald also received 46,358 restricted stock units (authorized as a non-MIP Plan grant). The grant-date fair value of Mr. Ewald s restricted stock units was $30.26 per unit. The restricted stock units vest over 48 equal monthly installments.

Successor Company Share-based Compensation

Determining Fair Value of Stock Options

The fair value of each option is estimated on the date of grant using the Black-Scholes-Merton closed-form option valuation model that uses the assumptions noted in the following table. Expected

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volatility is primarily a weighted average of peer companies historical and implied volatility. We used the simplified method to calculate our expected term, which represents the period of time that options granted are expected to be outstanding. For purposes of performing our valuation, we combined the employees and directors into one group; the amounts below represent the weighted average. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Nine Months Ended June 29, 2007
Expected volatility	41.39%
Expected term (in years)	4.5
Risk-free rate	4.49%
Expected dividends	0%

Summary of Stock Options

A summary of options under all of our share-based compensation plans as of June 29, 2007 and changes during the nine months ended June 29, 2007 are as follows (in thousands, except exercise price and contractual term):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Options outstanding at September 29, 2006	0	$ 0	0	$ 0
Options granted	1,098,947	$ 21.84		
Options exercised	0			
Options forfeited or expired	(63,774)	$ 18.69		
Options outstanding at June 29, 2007	1,035,173	$ 22.04	6.4	$ 5,959,085
Options vested and exercisable at June 29, 2007	10,048	30.26	6.8	$ 0
Options expected to vest at June 29, 2007	806,068	$ 21.92	6.36	$ 4,713,245

The aggregate intrinsic value represents the difference between the closing price on the last trading day of the fiscal period ended June 29, 2007, which was $ 26.54, and the exercise price, multiplied by the number of shares that would have been received by the option holders had all option holders exercised their in the money options on June 29, 2007. The weighted-average fair value of options granted during the nine-month period ended June 29, 2007 was $8.78.

As of June 29, 2007, there was $6.1 million of total unrecognized compensation expense, net of forfeitures, related to unvested stock options that are expected to vest over a weighted-average period of 3.3 years.

Summary of Restricted Stock Units

Restricted stock units are independent of option grants and are generally subject to forfeiture if employment terminates prior to the release of the restrictions. We recognize the expense associated

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with the restricted stock units, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse.

Non-vested restricted stock units outstanding as of June 29, 2007 and changes during the nine months ended June 29, 2007 were as follows (in thousands, except weighted average grant date fair value):

	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at September 29, 2006		$
Granted	311,815	$ 21.33
Vested & Issued	(0)	$
Forfeited	(22,792)	$ 19.45
Outstanding at June 29, 2007	289,023	$ 21.48

As of June 29, 2007, there was $3.9 million of unrecognized share-based compensation expense related to outstanding and non-vested restricted stock awards expected to vest. That cost is expected to be recognized over a weighted-average period of 2.7 years. At June 29, 2007, there were approximately 217,000 restricted stock awards expected to vest.

Stock Compensation Expense

The compensation costs that have been included in our results of operations and the total income tax benefit, if any, that we recognized in our statements of operations for these share-based compensation arrangements were as follows (in thousands):

	Nine Months Ended June 29, 2007
Share-based compensation cost included in:	
Cost of product and other revenue	$ 51
Cost of service revenue	63
Research and development	514
Selling, general, and administrative	1,585

Total share-based compensation cost		2,213
Income tax benefit recognized		
	$	2,213

Because the amount of share-based compensation associated with the cost of production is not significant, the Successor Company has not capitalized any share-based compensation cost as part of inventory and fixed assets during fiscal 2007. The nine-month period ended June 29, 2007 includes $0.7 million in expense for Mr. McKenna s restricted stock units that are vested and outstanding but not issued.

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Other Disclosures Pertaining to All Share-Based Compensation Plans

There was no cash received from option exercises under any share-based payment arrangements during the nine months ended June 29, 2007. Because of our net operating losses, we did not realize any tax benefits for the tax deductions from share-based payment arrangements during the nine months ended June 29, 2007.

Predecessor Company

The equity structure of the Predecessor Company prior to emergence from Chapter 11 is discussed below.

Predecessor Company Common Stock

The Predecessor Company authorized 750,000,000 shares of common stock $0.001 par value per share. At September 29, 2006, 274,247,196 shares were issued and outstanding. All Predecessor Company common stock was cancelled as of the Emergence Date in accordance with the Plan.

During fiscal 2005, holders converted $0.5 million principal amount of our 6.50% Senior Secured Convertible Notes, resulting in the issuance of 402,400 shares of Predecessor Company common stock.

Share-based Compensation Plans

During the three-month period ended September 29, 2006 and for fiscal 2006 and fiscal 2005, we had three active share-based compensation plans, and two Board approved share-based agreements as described below. The Predecessor Company s accounting for stock-based compensation expense continued to be recorded in its results of operations during the Chapter 11 proceedings. All existing share-based compensation plans and agreements, including outstanding common stock, stock options, and restricted stock awards issued under these plans were cancelled on the Emergence Date in accordance with the Plan, and the prior equity-holders received no recovery.

The Predecessor Company s Amended and Restated 1993 Long-Term Incentive Stock Plan (the 1993 Plan) permitted the grant to its employees of up to 3,800,000 restricted shares of Predecessor Company common stock and up to 30,938,808 of share options on Predecessor Company common stock. The 1993 Plan also permitted the issuance of stock appreciation rights (SARs). Option awards are generally granted with an exercise price equal to the market price of Predecessor Company common stock at the date of grant; those awards generally vest based on four years of continuous service and have seven-year contractual terms. Restricted share awards generally vest in four annual installments.

The Predecessor Company s Amended and Restated 1996 Supplemental Non-Executive Equity Incentive Plan (the 1996 Plan) permits the grant of shares of Predecessor Company common stock or equivalent instruments to its employees (which were subject to conditions and restrictions) and/or of share options on up to a total of 22,500,000 shares of Predecessor Company common stock. Option awards are generally granted with an exercise price equal to the market price of Predecessor Company common stock at the date of grant; those awards generally vest based on four years of continuous service and have seven-year contractual terms. Restricted share awards generally vest in four annual installments.

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The Predecessor Company s Amended and Restated 1998 Employee Stock Purchase Plan (ESPP) allows eligible employees to purchase Predecessor Company stock through payroll deductions at 85% of the lower of the closing price for the stock at the beginning or the end of the six-month purchase period. Purchases are limited to 10% of each employee's compensation and cannot exceed an amount set by the Board of Directors. On January 26, 2006, the Board of Directors suspended new offering periods under the ESPP until otherwise determined by the Board.

On January 26, 2006, the Board approved certain minor amendments to the 1993 Plan, 1996 Plan and ESPP program required to qualify the grant of options and issuance of shares under the plans under applicable state securities laws.

On February 1, 2006, the Predecessor Company entered into an agreement to issue 5,368,044 non-qualified stock options to Dennis McKenna, President, Chief Executive Officer, and then Chairman of the Board. These options would have cliff vested 25% on February 1, 2007 and then in equal quarterly installments over the remaining 36 months. The exercise price was $0.35 per share and would have expired in seven years from the date of grant. The terms of this option were similar to the 1993 Plan described above and vesting of these options may be accelerated on the conditions set forth in the employment agreement dated January 27, 2006. All 5,368,044 shares were cancelled upon emergence from bankruptcy on the Emergence Date in accordance with the Plan and he received no recovery.

Also February 1, 2006, the Predecessor Company entered into an agreement to issue 2,684,022 shares of restricted common stock to Mr. McKenna. Under the terms of this agreement, the shares would have vested and would have been non-forfeitable over a two-year period ending February 1, 2008. Three-eighths of the shares would have vested on December 31, 2006, with the remaining five-eighths to vest in quarterly installments beginning February 1, 2007. During the vesting period, ownership of the shares could not be transferred. The unvested shares had the same voting rights as other common stock and were considered to be issued and outstanding. All 2,684,022 shares were cancelled upon emergence from bankruptcy on the Emergence Date in accordance with the Plan and he received no recovery.

As a result of the cancellation of the Predecessor Company share-based compensation plans and Board approved share-based agreements upon emergence from Chapter 11 we accelerated approximately $4 million in unrecognized compensation expense as of September 29, 2006 related to unvested share-based compensation arrangements previously granted under various Predecessor Company plans. The charge was recorded as a reorganization item during the first quarter of fiscal 2007.

Predecessor Company Share-based Compensation

Adoption of SFAS 123(R)

Effective June 25, 2005, the Predecessor Company adopted the fair value recognition provisions of SFAS 123(R), *Share-Based Payment*, using the modified-prospective transition method and therefore the Predecessor Company has not restated its financial results for prior periods. Under that transition method, compensation cost recognized during fiscal 2006 included the following: (a) compensation cost related to any share-based payments granted through, but not yet vested as of June 24, 2005, and (b) compensation cost for any share-based payments granted subsequent to June 24, 2005, based on the grant-date fair value estimated in accordance with the provisions of

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SFAS 123(R). The Predecessor Company recognized compensation expense for the fair values of these options and awards, which have graded vesting, on a straight-line basis over the requisite service period of each of these options and awards.

Predecessor Company Compensation Costs

The compensation costs that have been included in the Predecessor Company results of operations and the total income tax benefit, if any, that the Predecessor Company recognized on its statement of operations for these share-based compensation arrangements for the three months ended September 2006 and fiscal 2006 were as follows (in thousands):

	Predecessor Company Three Months Ended September 29, 2006	Predecessor Company Year Ended June 30, 2006
Share-based compensation cost included in:		
Cost of product and other revenue	$	$ 88
Cost of service revenue		242
Research and development		611
Selling, general, and administrative	122	1,243
Reorganization items	3,981	
	4,103	2,184
Income tax benefit recognized		
Total share-based compensation cost	$ 4,103	$ 2,184

Because the amount of share-based compensation associated with Predecessor Company cost of production is not significant, the Predecessor Company did not capitalize any share-based compensation cost as part of inventory and fixed assets during fiscal 2006 or for the three months ended September 29, 2006. In the three months ended September 29, 2006, there were no cash proceeds from the exercise of stock options. Net cash proceeds from the exercise of stock options were $0.4 million and $4.0 million during fiscal 2006 and fiscal 2005, respectively. No income tax benefit was realized from stock option exercises during the three months ended September 29, 2006 and fiscal 2006. In accordance with SFAS 123(R), the Predecessor Company presented excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows. The incremental share-based compensation expense associated with the adoption of SFAS 123(R) in fiscal 2006 was $2 million. As a result of the cancellation of our Predecessor Company share-based compensation plans and Board approved share-based agreements upon emergence from Chapter 11, we accelerated approximately $4 million in unrecognized compensation expense as of September 29, 2006 related to unvested share-based compensation arrangements previously granted under our various plans. The charge was recorded as a reorganization item during the first quarter of fiscal 2007. There was additional expense in the first quarter of fiscal 2007 that was not significant.

Prior to June 25, 2005, the Predecessor Company accounted for its share-based compensation plans under the recognition and measurement provisions of APB Opinion No. (APB) 25, Accounting for Stock Issued to Employees, and related guidance, as permitted by SFAS 123, amended by SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148 *)*. The Predecessor Company did not recognize any significant share-based employee compensation costs in its statements of operations prior to fiscal 2006, as all options granted under those plans had an

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exercise price equal to the market value of the underlying common stock on the date of grant. As required by SFAS 148 prior to the adoption of SFAS 123(R), the Predecessor Company provided pro forma net loss and pro forma net loss per common share disclosures for stock-based awards, as if the fair-value-based method defined in SFAS 123 had been applied.

The following table presents the pro forma effect on net loss from continuing operations and net loss per share if the Predecessor Company had applied the fair value recognition provisions of SFAS 123 to options granted under its share-based compensation arrangements during fiscal 2005 (in thousands, except per share amounts):

	Predecessor Company Year Ended June 24, 2005
Net loss from continuing operations, as reported	$ (75,732)
Add:	
Share-based employee compensation expense included in net income/(loss) from continuing operations	49
Deduct:	
Share-based employee compensation expense determined under fair value method	(6,222)
Net income/(loss) from continuing operations, pro forma	$ (81,905)
Net income/(loss) per share from continuing operations basic and diluted:	
As reported	$ (0.29)
Pro forma	$ (0.31)

For purposes of this pro forma disclosure, the Predecessor Company estimated the value of the options using a Black-Scholes-Merton closed-form option pricing formula and amortized that value to expense over the options vesting periods. The Predecessor Company allocated this fair value to the pro forma compensation expense of its fiscal period using the accelerated expense attribution method specified in FASB Interpretation No. (FIN) 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.*

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Predecessor Company Valuation of Stock Options

The fair value of each option is estimated on the date of grant using the Black-Scholes-Merton closed-form option valuation model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of our stock. We use historical data to estimate the options expected term, which represents the period of time that options granted are expected to be outstanding. For purposes of performing our valuation, we separated our employees into two groups, within which the employees have similar historical exercise behavior; the ranges given below result from certain groups of employees exhibiting different behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Predecessor Company Years Ended	
	June 30, 2006	June 24, 2005
Expected volatility	110% - 126%	100%
Expected term (in years)	2.34 - 3.67	5.37
Risk-free rate	3.96% - 4.90%	3.89%
Expected dividends	0%	0%

Summary of Stock Options

A summary of options under all of the Predecessor Company share-based compensation plans as of September 29, 2006 and changes during the first three months ended September 29, 2006 and fiscal 2006 and fiscal 2005 are as follows (in thousands, except exercise price and contractual term):

	Predecessor Company			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Options outstanding at June 25, 2004	34,621	$ 2.80	6.92	$ 21,338
Options granted	5,355	$ 1.63		
Options exercised	(641)	$ 0.80		
Options forfeited or expired	(3,894)	$ 3.53		
Options outstanding at June 24, 2005	35,441	$ 2.58	6.10	$ 841
Options granted	5,788	$ 0.37		
Options exercised	(746)	$ 0.54		

Options forfeited or expired	(9,492)	$	2.40		
Options outstanding at June 30, 2006	30,991	$	2.27	5.33	$
Options granted		$			
Options exercised		$			
Options forfeited or expired	(7,328)	$	3.64		
Options cancelled upon emergence from bankruptcy	(23,663)	$	1.85		
Successor Company options outstanding at September 29, 2006					

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Aggregate intrinsic value represents the difference between the Predecessor Company s closing stock price on the last trading day of the reporting period, which was $0.046, and the exercise price, multiplied by the number of in the money options that would have been received by the option holders had all option holders exercised their options on the last day of the reporting period. The weighted-average grant-date fair value of options granted during fiscal 2006 and fiscal 2005 was $0.27 and $1.26, respectively. The total intrinsic value of options exercised during fiscal 2006 was $0.2 million.

Predecessor Company Summary of Restricted Stock Awards

Restricted stock awards are independent of option grants and are generally subject to forfeiture if employment terminates prior to the release of the restrictions. The Predecessor Company expensed the cost of the restricted stock awards, which was determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapsed.

Non-vested restricted stock awards as of September 29, 2006 and changes during the three months then ended, fiscal 2006 and fiscal 2005 were as follows (in thousands, except weighted average grant date fair value):

	Predecessor Company	
	Number of Shares	Weighted-Average Grant Date Fair Value
Non-vested at June 25, 2004	49	$ 4.77
Granted		
Vested		
Forfeited	(49)	$ 4.77
Non-vested at June 24, 2005		
Granted	2,684	$ 0.35
Vested		
Forfeited		
Non-vested at June 30, 2006	2,684	$ 0.35
Granted		
Vested		
Forfeited		
Restricted stock awards cancelled upon emergence	(2,684)	$ 0.35

Successor company stock awards outstanding at September 28, 2006

As of June 30, 2006, there was $0.8 million of unrecognized share-based compensation expense related to non-vested restricted stock awards. As a result of the cancellation of the Predecessor Company s share-based compensation plans upon emergence from Chapter 11 we accelerated unrecognized compensation expense as of September 29, 2006 related to unvested share-based compensation arrangements previously granted under various Predecessor Company plans. The charge was recorded as a reorganization item during the first quarter of fiscal 2007.

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Predecessor Company Employee Stock Purchase Plan

The fair value of each option element of the Predecessor Company s ESPP was estimated on the date of grant using the Black-Scholes-Merton closed-form option valuation model that used the assumptions noted in the following table. Expected volatilities were based on historical volatility of the Predecessor Company s stock. Expected term represented the six-month offering period for the Predecessor Company s ESPP. The risk-free rate for periods within the contractual life of the option was based on the U.S. Treasury yield curve in effect at the time of grant.

	Predecessor Company Years Ended	
	June 30, 2006	June 24, 2005
Expected volatility	72%	83%
Expected term	6 months	6 months
Risk-free rate	3.79%	2.10%
Expected dividends	0%	0%

As of June 30, 2006, we had issued 49,238,398 shares over the life of the ESPP and its predecessor plans. 5,615,464 and 2,985,583 shares were issued during fiscal 2006 and fiscal 2005, respectively. As of June 30, 2006, we had 3,399,545 shares in reserve for future issuance under the plan; however, on January 26, 2006, the Board of Directors suspended new offering periods under the ESPP until otherwise determined by the Board.

Predecessor Company Disclosures Pertaining to All Share-Based Compensation Plans

Cash received from option exercises and ESPP contributions under all share-based payment arrangements during fiscal 2006 and fiscal 2005 was $2.9 million and $4.0 million, respectively. Because of the Predecessor Company s net operating losses, it did not realize any tax benefits for the tax deductions from share-based payment arrangements during fiscal 2006 and fiscal 2005.

Note 6. Other Operating Expense

Other operating expense was as follows (in thousands):

	Successor Company Nine Months Ended June 29, 2007	Predecessor Company Three Months Ended Sept. 29, 2006	Years ended June 30, 2006	June 24, 2005
Restructuring and impairment charges, net	$ 1,505	$ 3,926	$ 21,155	$ 24,083
Bankruptcy-related charges	2,096			
	$ 3,601	$ 3,926	$ 21,155	$ 24,083

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Successor Company

Restructuring Nine Months Ended June 29, 2007

Other operating expenses, net represents the costs associated with our restructuring plans and charges associated with changes in estimated useful lives of certain leasehold improvements related to vacated facilities. These actions, by plan, were as follows during the nine-month period ended June 29, 2007 (in thousands):

	Balance at Sept. 29, 2006	Costs Incurred	Non-cash Settlements and Other	Cash Payments	Balance at June 29, 2007
Fiscal 2001 through 2005 plans:					
Severance and related charges	$ 20	$	$	$	$ 20
Vacated facilities	(7)		4	3	
	13		4	3	20
Fiscal 2006 plan 1:					
Severance and related charges	261		(227)	(34)	
Vacated facilities	1,111	156		(419)	848
	1,372	156	(227)	(453)	848
Fiscal 2006 plan 2:					
Severance and related charges	1,808	65	48	(1,640)	281
Vacated facilities	30		(30)		
	1,838	65	18	(1,640)	281
Fiscal 2006 plan 3:					
Severance and related charges	2,085	289	300	(2,366)	308
Vacated facilities	239	696	(222)	(484)	229
Accelerated depreciation		192	(192)		
Other		107		(107)	
	2,324	1,284	(114)	(2,957)	537
All restructuring plans:					
Severance and related charges	4,174	354	121	(4,040)	609
Vacated facilities	1,373	852	(248)	(900)	1,077

Accelerated depreciation		192	(192)		
Other		107		(107)	
Total of all restructuring plans	$ 5,547	$ 1,505	$ (319)	$ (5,047)	$ 1,686

During the nine-month period ended June 29, 2007, we made $5.0 million in payments related to all of our restructuring plans and actions, primarily for severance and related charges. We recognized costs of $1.5 million, primarily for accretion and other costs related to our vacated leased facilities. In addition, in the second quarter of fiscal 2007, we made a $0.3 million adjustment to decrease our estimates of severance and related costs and vacated facilities costs related to fiscal 2006 and prior plans. In accordance with SFAS No. 141 *Business Combinations* (SFAS 141), these were recorded as fresh-start valuation adjustments and are reflected in the balances at September 29, 2006.

The restructuring liability balance of $1.7 million at June 29, 2007 includes $0.6 million in severance obligations and $1.1 million of facility-related liabilities. We expect to pay the majority of the

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accrued severance and related charges during the six months following June 29, 2007. The facility-related liabilities represent $3.0 million in future non-cancelable rental payments due, less estimated sublease income of $1.7 million, $1.2 million of which is under contract, and $0.2 million in accretion expense that will be recognized through fiscal 2011. We expect to pay $0.8 million of facility-related charges during the 12 months following June 29, 2007, with the remainder of our restructuring obligations to be paid through fiscal 2011.

As of June 29, 2007, we have completed the execution of our fiscal 2000 through fiscal 2005 restructuring plans, with the exception of certain severance obligations for one of our international subsidiaries.

Bankruptcy-Related Charges

Bankruptcy-related charges represent post-emergence charges incurred, primarily for professional fees, as a direct result of the Predecessor Company s Chapter 11 filing.

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Predecessor Company

Restructuring Three Months Ended September 29, 2006

Our restructuring and impairment activities, by plan or action, were as follows during the three months ended September 29, 2006 (in thousands):

	Predecessor Company					Successor Company
	Balance at June 30, 2006	Costs Incurred	Adjust-ments	Non-cash Settlements and Other	Cash Payments	Balance at Sept. 29, 2006
Fiscal 2001 through 2005 plans:						
Severance and related charges	$ 158	$	$ (40)	$ (100)	$ 2	$ 20
Vacated facilities	16		(1)	(7)	(15)	(7)
	174		(41)	(107)	(13)	13
Fiscal 2006 plan 1:						
Severance and related charges	511		5	37	(292)	261
Vacated facilities	963	40	223		(115)	1,111
	1,474	40	228	37	(407)	1,372
Fiscal 2006 plan 2:						
Severance and related charges	2,093	720	235	(67)	(1,173)	1,808
Vacated facilities	107	11		(87)	(1)	30
Other			(193)	193		
	2,200	731	42	39	(1,174)	1,838
Fiscal 2006 plan 3:						
Severance and related charges	2,083	3,322	(174)	(102)	(3,044)	2,085
Vacated facilities	751		(241)	153	(424)	239
Accelerated depreciation		19		(19)		
	2,834	3,341	(415)	32	(3,468)	2,324
All restructuring plans:						
Severance and related charges	4,845	4,042	26	(232)	(4,507)	4,174

Vacated facilities	1,837	51	(19)	59	(555)	1,373
Accelerated depreciation		19		(19)		
Other			(193)	193		
Total of all restructuring plans	$ 6,682	$ 4,112	$ (186)	$ 1	$ (5,062)	$ 5,547

During the first quarter of fiscal 2007, the Predecessor Company made $5.1 million in payments related to all restructuring plans and actions, $4.5 million of which was for severance and related charges and $0.6 million of which was for vacated facilities obligations, primarily rent.

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The Predecessor Company recognized costs of $4.1 million for severance and related charges. The Predecessor Company made minor adjustments to estimates of severance and related costs, vacated facilities costs and operating asset write-downs for fixed assets associated with the end of production of existing Prism and Prism Deskside products related to fiscal 2006 and prior plans. These adjustments included a credit of $0.3 million for commissions expenses related to the settlement that terminated and amended the lease obligations at Amphitheatre Technology Center (ATC) and Crittenden Technology Center (CTC) in the fourth quarter of fiscal 2006, an increase in estimated costs of $0.2 million for a leased facility that the Predecessor Company vacated under the fiscal 2006 plan 1 due to a change in sublease assumptions and changes in estimated severance and related charges associated with the fiscal 2006 plans 2 and 3 for one international location that had no net impact on restructuring expense.

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Restructuring Fiscal 2006

Other operating expenses, net represents the costs associated with the Predecessor Company s restructuring and impairment activities. These activities, by plan or action, were as follows during fiscal 2006 (in thousands, numbers may not add due to rounding):

	Balance at June 24, 2005	Costs Incurred	Adjust-ments	Non-cash Settlements and Other	Cash Payments	Balance at June 30, 2006
Fiscal 2000 plan:						
Vacated facilities	$ 1,282	$	$ (13)	$	$ (1,269)	$
Fiscal 2001 plan:						
Vacated facilities	1,404		(83)		(1,321)	
Fiscal 2002 plan:						
Severance and related charges	142		(23)		(20)	99
Vacated facilities	329		49	(141)	(237)	
	471		26	(141)	(257)	99
Fiscal 2003 plan:						
Severance and related charges	114		(59)		(36)	19
Vacated facilities	127		99		(226)	
	241		40		(262)	19
Fiscal 2004 plan:						
Severance and related charges	258		(243)		(15)	
Vacated facilities	33,489	7,025	(31,713)	(23)	(8,762)	16
	33,747	7,025	(31,956)	(23)	(8,777)	16
Fiscal 2005 plan:						
Severance and related charges	1,891	289	(47)		(2,093)	40
Vacated facilities	6,482	1,105	(4,856)		(2,731)	
Accelerated depreciation						
	8,373	1,394	(4,903)		(4,824)	40
Fiscal 2006 plan 1:						
Severance and related charges		9,194	757		(9,440)	511
Vacated facilities		1,336	(5,415)	6,776	(1,734)	963

Accelerated depreciation	4,654	408	(5,062)		
	15,184	(4,250)	1,714	(11,174)	1,474
Fiscal 2006 plan 2:					
Severance and related charges	7,938	79	(1,778)	(4,146)	2,093
Vacated facilities	392		(222)	(63)	107
Other	1,900		(1,900)		
	10,230	79	(3,900)	(4,209)	2,200

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	Balance at June 24, 2005	Costs Incurred	Adjust-ments	Non-cash Settlements and Other	Cash Payments	Balance at June 30, 2006
Fiscal 2006 plan 3:						
Severance and related charges		2,154			(71)	2,083
Vacated facilities		21,794		3,555	(24,598)	751
Accelerated depreciation		4,432		(4,432)		
		28,380		(877)	(24,669)	2,834
All restructuring plans:						
Severance and related charges	2,405	19,575	466	(1,778)	(15,821)	4,845
Vacated facilities	43,113	31,652	(41,932)	9,945	(40,941)	1,837
Accelerated depreciation		9,086	408	(9,494)		
Other		1,900		(1,900)		
Total of all restructuring plans	$ 45,518	$ 62,213	$ (41,058)	$ (3,227)	$ (56,762)	$ 6,682

During fiscal 2006, the Predecessor Company made $56.8 million in payments related to all of its restructuring plans and actions, $15.8 million of which was for severance and related charges and $41.0 million of which was for vacated facilities obligations, including $25.0 million in settlement costs for the termination of its lease obligations at ATC and CTC. The $25.0 million cost was due to a June 27, 2006 settlement with the landlord pursuant to which our lease obligations at ATC and two of the buildings at CTC were terminated. This settlement also amended the Predecessor Company s lease obligations for a third building at CTC. Pursuant to the agreement, the Predecessor Company vacated the two buildings at CTC by June 30, 2006 and vacated the third building by December 31, 2006.

During fiscal 2006, the Predecessor Company recognized costs of $21.2 million, of which $20.0 million was for severance and related charges and $1.9 million was for operating asset write downs for fixed assets and demonstration units and release of purchase commitments, both of which were associated with the end of production of existing Prism and Prism Deskside products. Total vacated facilities and accelerated depreciation cost was a net $0.7 million credit to other operating expense. Costs related to the Predecessor Company s vacated leased facilities included a $28.0 million charge for the ATC and CTC settlement costs including termination fees, commissions and legal expenses, a $7.0 million accretion expense associated with its fiscal 2004 Mountain View, California headquarters ATC relocation, a $1.0 million accretion expense associated with one building at CTC which the Predecessor Company partially vacated in fiscal 2005 and fully vacated in fiscal 2006, a $5.0 million charge for the fair value of future remaining obligations and accretion expense associated with one building at CTC fully vacated in fiscal 2006, and a $2.0 million charge related to the vacating of other leased facilities throughout the world in fiscal 2006. In addition the Predecessor Company recognized $15.0 million of credits related to the write off of deferred rent and tenant improvement allowances on these vacated facilities, $10.0 million in charges for the acceleration of depreciation associated with changes in the estimated lives of certain leasehold improvements and furniture and fixtures and $2.0 million in write offs for prepaid rent. Upon execution of the settlement for the termination of the Predecessor Company s lease obligations at ATC and CTC, it recorded a reversal of liabilities of $41.0 million of future rental payments for the ATC and CTC buildings. These included $32.0 million, $5.0 million and $4.0 million related to fiscal 2004, fiscal 2005 and fiscal

2006, respectively.

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The restructuring liability balance of $6.7 million at June 30, 2006 included $4.9 million in severance obligations and $1.8 million of facility-related liabilities. The facility-related liabilities represented $4.4 million in future non-cancelable rental payments due, less estimated sublease income of $2.2 million, $1.4 million of which is under contract, and $0.4 million in accretion expense that will be recognized through fiscal 2011. The Predecessor Company expects to pay all the accrued severance and related charges and $1.5 million of facility-related payments during fiscal 2007, with the remainder of our restructuring obligations to be paid through fiscal 2011.

In an effort to further reduce operating expenses, the Predecessor Company implemented restructuring activities under three fiscal 2006 restructuring plans during fiscal 2006. Under these restructuring plans, the Predecessor Company recognized costs of $19.6 million for the elimination of approximately 500 positions across all levels and functions. In addition to the ATC and CTC settlement, under the fiscal 2006 restructuring plans, the Predecessor Company also recorded a charge of $3.0 million for costs related to vacating approximately 51,000 square feet of sales and administrative facilities throughout the world, with lease terms expiring through fiscal 2011. The Predecessor Company completed substantially all facilities related actions under the fiscal 2006 restructuring plans by the end of fiscal 2006, but will continue to make payments on the associated leases through the end of their lease terms. As required by SFAS 146, the Predecessor Company calculated and accrued the fair value of our future contractual obligations under these operating leases using its credit-adjusted risk-free interest rate as of the date the Predecessor Company ceased to use the leased properties. As of June 30, 2006, the fair value of the Predecessor Company s future remaining obligations for the leased properties was $1.8 million. On a quarterly basis over the periods from the respective cease-use dates to the end of the lease terms, the Predecessor Company is required to accrete these discounted future obligations for the leased property up to their contractually obligated amount of $4.0 million using the effective interest method. In fiscal 2006, the Predecessor Company began to record restructuring accretion expense, which it expects to be less than $1.0 million annually through fiscal 2011. The Predecessor Company s obligation associated with the fiscal 2006 restructuring plans as of June 30, 2006 included $4.9 million in severance and related charges and the aforementioned $4.4 million of vacated leased facility obligations, net of estimated sublease income of $2.2 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restructuring Fiscal 2005

The Predecessor Company restructuring and impairment activities, by plan or action, were as follows during fiscal 2005 (in thousands):

	Balance at June 25, 2004	Costs Incurred	Adjust-ments	Non-cash Settlements and Other	Cash Payments	Balance at June 24, 2005
Fiscal 2000 plan:						
Vacated facilities	$ 5,898	$	$ (367)	$	$ (4,249)	$ 1,282
Fiscal 2001 plan:						
Vacated facilities	4,225		(342)		(2,479)	1,404
Fiscal 2002 plan:						
Severance and related charges	52	61	(436)	533	(68)	142
Vacated facilities	450		229		(350)	329
	502	61	(207)	533	(418)	471
Fiscal 2003 plan:						
Severance and related charges	288	104	(317)	52	(13)	114
Vacated facilities	959		286		(1,118)	127
	1,247	104	(31)	52	(1,131)	241
Fiscal 2004 plan:						
Severance and related charges	1,086	193			(1,021)	258
Vacated facilities	46,966	9,867	(3,422)		(19,922)	33,489
	48,052	10,060	(3,422)		(20,943)	33,747
Fiscal 2005 plan:						
Severance and related charges		9,766			(7,875)	1,891
Vacated facilities		8,461		1,221	(3,200)	6,482
		18,227		1,221	(11,075)	8,373
All restructuring plans:						
Severance and related charges	1,426	10,124	(753)	585	(8,977)	2,405
Vacated facilities	58,498	18,328	(3,616)	1,221	(31,318)	43,113
Total of all restructuring plans	$ 59,924	$ 28,452	$ (4,369)	$ 1,806	$ (40,295)	$ 45,518

During fiscal 2005, the Predecessor Company made payments of $9.0 million for severance and related charges and $31.3 million for our vacated facilities obligations, primarily rent.

The Predecessor Company recognized restructuring and asset impairment costs of $28.5 million during fiscal 2005. These costs included $10.1 million for severance, primarily associated with its fiscal 2005 restructuring plan, and $18.3 million related to accretion and other costs related to vacated leased facilities. The vacated facilities costs included $8 million in expenses related to vacating

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approximately 198,000 square feet of sales and administrative facilities throughout the world, with lease terms expiring through fiscal 2014. Also included in vacated facilities costs was $10 million in restructuring accretion expense for the ATC, which was part of the fiscal 2004 restructuring plan. In fiscal 2005 the Predecessor Company recorded a $3 million adjustment to reduce the estimated future vacated facilities costs for the fiscal 2004 restructuring plan based on a reduction in the base rent the Predecessor Company received for a facility vacated as part of that restructuring plan.

Note 7. Income (Loss) per Share

Set forth below is a reconciliation of basic and diluted (loss) or income per share from continuing operations (in thousands, except per share amounts):

	Successor Company	Predecessor Company		
	Nine Months Ended June 29, 2007	Three Months Ended Sept. 29, 2006	Years Ended June 30, 2006	Years Ended June 24, 2005
Net (loss) income from continuing operations	$ (103,642)	$ 326,256	$ (146,194)	$ (75,732)
Weighted average shares outstanding basic	11,125	271,563	269,367	263,430
6.50% Senior Secured Convertible Notes		150,862		
6.125% Convertible Subordinated Debentures		1,450		
Weighted average shares outstanding diluted	11,125	423,875	269,367	263,430
Net (loss) income per share:				
Basic	$ (9.32)	$ 1.20	$ (0.54)	$ (0.29)
Diluted	$ (9.32)	$ 0.77	$ (0.54)	$ (0.29)
Potentially dilutive weighted securities excluded from computations because they are anti-dilutive	845	26,344	153,710	155,848

Potentially dilutive weighted securities include the assumed exercise of stock options and the assumed vesting of restricted stock awards and units as well as the assumed conversion of debt using the if-converted method.

Earnings per share information reported by the Predecessor Company is not comparable to earnings per share information reported by the Successor Company because all existing equity interests of the Predecessor Company were eliminated (without a distribution) upon the consummation of the Plan.

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Note 8. Financial Instruments

Cash Equivalents and Marketable and Restricted Investments

The following table summarizes by major security type the fair value of our cash equivalents and marketable and restricted investments at June 29, 2007 and June 30, 2006 (in thousands):

	Successor Company 2007	Predecessor Company 2006
Money market funds	$	$ 2,060
Time deposits	9,101	51,024
Total	9,101	53,084
Less amounts classified as cash equivalents	(1,813)	(4,383)
Total marketable and restricted investments	$ 7,288	$ 48,701

Gross realized gains and losses on sales and unrealized gains and losses on our securities were not significant in any one fiscal period presented.

Derivative Instruments and Hedging Activities

Risk Management. In the normal course of business, our financial position is exposed to a variety of risks, including market risk associated with interest rate movements and currency rate movements on non-U.S. dollar denominated assets and liabilities. We regularly assess risks and have established policies and business practices to protect against the adverse effects of these and other potential exposures. We use derivative financial instruments to moderate the financial market risks of our business operations by hedging the foreign currency market exposures underlying certain assets and liabilities and certain commitments related to customer transactions. We do not invest in derivative financial instruments for speculative or trading purposes.

Accounting Policies. We report our derivative financial instruments at their fair value in the other current assets and other current liabilities lines of our consolidated balance sheet. Our accounting for changes in the fair values of the derivative financial instruments depends on whether they qualify for accounting as a hedging instrument and, if so, whether they are fair value hedges or cash flow hedges.

We designate derivative financial instruments as hedges based in part on their effectiveness in risk reduction and one-to-one matching of the instruments to the hedged transactions. We test the hedging effectiveness of currency forward contracts using a forward-to-forward rate comparison, which makes same-currency hedges perfectly effective. We test the hedging effectiveness of currency option contracts using changes in the option s intrinsic value and the effect of discounting. As a result, we exclude the change in the volatility value of the option contract from the assessment and immediately recognize that amount in interest and other income (expense), net on our statement of operations. We will designate derivative financial instruments as fair value hedges or cash flow hedges based on the type of risk that they are hedging. At June 29, 2007 and June 30, 2006, we did not have any derivative financial instruments designated as fair value hedges.

Cash Flow Hedges. A cash flow hedge is a derivative financial instrument that hedges the exposure to variability in expected future cash flows attributable to a particular risk. This exposure may be associated with an existing recognized asset or liability or a forecasted transaction. Our cash flow

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hedging instruments are primarily currency options and currency forward contracts, generally expiring within one year, purchased as hedges of anticipated sales that are denominated in foreign currencies. These contracts are entered into to mitigate the risk that the eventual cash flows resulting from the transactions will be adversely affected by changes in exchange rates.

We record the portion of the gain or loss in the fair value of our cash flow hedges that is determined to be an effective hedge as a component of other comprehensive loss, and we recognize this amount in our earnings as revenue in the same period or periods in which the hedged transaction affects earnings. We recognize in other income (expense), net on our statement of operations any remaining, ineffective portion of the gain or loss on a hedging instrument during the period of the change. During the three months ended September 29, 2006 and nine months ended June 29, 2007, fiscal 2006, and fiscal 2005, we did not identify any material ineffectiveness in our cash flow hedges, and we did not exclude any gains or losses related to our cash flow hedges from our assessments of hedge effectiveness.

Other Derivative Financial Instruments. We also use derivative financial instruments to hedge the foreign currency market exposures underlying certain of our assets and liabilities that are denominated in foreign currencies. These derivative financial instruments are not designated as fair value or cash flow hedges. As a result, we recognize in other income (expense), net on our statement of operations any change in the fair value of these instruments, and we also recognize in other income (expense), net any changes in the value of the hedged assets or liabilities resulting from fluctuations in foreign currency exchange rates.

Accumulated Derivative Gains or Losses. The following table summarizes activity in other comprehensive loss related to derivative financial instruments held by us and classified as cash flow hedges (in thousands):

	Successor Company	Predecessor Company	
	Nine Months Ended June 29, 2007	Three Months Ended Sept. 29, 2006	Year Ended June 30, 2006
Opening Balance	$	$ 152	$ 1,719
Reclassified into earnings from other comprehensive loss, net		(152)	1,047
Changes in fair value of derivatives, net			(2,614)
Unrealized gain (loss) on derivative instruments included in other comprehensive loss	$	$	$ 152

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Fair Value of Financial Instruments

The carrying amounts and estimated fair values of our financial instruments were as follows (in thousands):

	Successor Company		Predecessor Company	
	June 29, 2007		June 30, 2006	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Cash and cash equivalents	$ 69,887	$ 69,887	$ 54,673	$ 54,673
Marketable investments	7,288	7.288	48,701	48,701
Debt instruments	85,261	85,261	103,521	103,521
Currency forward contracts	6	6	132	132

We estimated these fair values using quoted market prices. These estimated fair values may not be representative of the actual values of the financial instruments that could have been realized as of our fiscal year end or that will be realized in the future.

Note 9. Discontinued Operations

On June 15, 2004, we received $58.4 million in gross proceeds for the sale of our Alias application software business (Alias) to Accel-KKR, a technology-focused private equity investment firm, and recorded a net gain of $50.5 million on the transaction. As a result of this transaction, we have shown the operating results of Alias as a discontinued operation. During fiscal 2005, we recorded an additional loss of $276 thousand on the disposition.

Note 10. Sale of Interest in SGI Japan

In August 2006, the Predecessor Company completed the sale of a portion of its equity investment in SGI Japan to SGI Japan, Ltd. The Predecessor Company received cash proceeds of approximately $18.6 million, net of withholding taxes, and recorded a net gain of approximately $8 million in the first quarter of fiscal 2007. As a result of the sale, our ownership interest was reduced to approximately 10%.

On March 30, 2005, the Predecessor Company completed the sale of a portion of its equity investment in SGI Japan, Ltd. (SGI Japan) to Canon Sales Co., Inc., NIWS Co., Ltd., and SOFTBANK Media & Marketing Corp. The Predecessor Company received net cash proceeds of $29 million and recorded a net gain of $21 million, included as a component of interest and other income (expense), net, in the fourth quarter of fiscal 2005. No tax liability was incurred as a result of this transaction.

For further information regarding our related party relationship with SGI Japan, see Note 23.

Note 11. Concentration of Credit and Other Risks

Credit Risk. Financial instruments that potentially subject SGI to concentration of credit risk consist principally of cash equivalents, investments, currency forward and option contracts, and trade receivables. We place our investments and transact our currency forward and option contracts with high-credit-quality counterparties and, by policy, limit the amount of credit exposure to any single

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counterparty. The credit risk on receivables due from counter-parties related to currency forward contracts was immaterial at June 29, 2007 and June 30, 2006. We perform ongoing credit evaluations of our customers and generally do not require collateral. We maintain reserves for potential credit losses and such losses have been within our expectations.

Production. Most of our products incorporate components that are available from only one or from a limited number of suppliers. Many of these components are custom designed and manufactured, with lead times from order to delivery that can exceed 90 days. Shortages of various essential materials could occur due to interruption of supply or increased demand in the industry. If we were unable to procure critical components or sustain our outsourced production capacity, our ability to meet demand for our products may be affected, which would have an adverse effect on our financial results.

International Operations. We derive approximately 46% of our revenue from sales outside the United States. Therefore, our results could be affected by events such as changes in foreign currency exchange rates, trade protection measures, longer accounts receivable collection patterns, and changes in regional or worldwide economic or political conditions. However, the risks of our international operations are mitigated in part by our foreign exchange hedging program and by the extent to which our sales are geographically distributed.

Government Sales. A significant portion of our revenue is derived from sales to the U.S. government, either directly by us or through system integrators and other resellers. Any disruption or limitation in our ability to do business with the U.S. government could have an adverse impact on us.

Export Compliance. Our sales to foreign customers are subject to export regulations. Sales of many of our products require clearance and export licenses from the U.S. Department of Commerce under these regulations. Our international sales could be adversely affected if such regulations were tightened, or if they are not modified over time to reflect the increasing performance of our products.

Note 12. Consolidated Financial Statement Details

Inventories

Inventories at June 29, 2007 and June 30, 2006 were as follows (in thousands):

	Successor Company June 29, 2007	Predecessor Company June 30, 2006
Components and subassemblies	$ 19,310	$ 22,308
Work-in-process	21,270	17,187
Finished goods	9,268	3,783
Demonstration systems	4,506	6,719
Total inventories	$ 54,354	$ 49,997

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Other Current Assets

Other current assets at June 29, 2007 and June 30, 2006 were as follows (in thousands):

	Successor Company June 29 2007	Predecessor Company June 30, 2006
Deferred cost of goods sold	$ 24,150	$ 29,081
Value-added tax receivable	7,846	7,569
Other	17,580	18,073
Total other current assets	$ 49,576	$ 54,723

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Property and Equipment

Property and equipment at June 29, 2007 and June 30, 2006 were as follows (in thousands):

	Successor Company June 29, 2007	Predecessor Company June 30, 2006
Land and buildings	$ 15,291	$ 42,266
Machinery and equipment (including capitalized software)	18,548	242,410
Furniture and fixtures	1,651	20,609
Leasehold improvements	16,636	34,370
	52,126	339,655
Accumulated depreciation and amortization	(8,734)	(311,781)
Net property and equipment	$ 43,392	$ 27,873

Other Non-Current Assets, net

Other non-current assets at June 29, 2007 and June 30, 2006 were as follows (in thousands):

	Successor Company June 29, 2007	Predecessor Company June 30, 2006
Spare parts, net of accumulated depreciation of $6,207 in 2007 and $53,586 in 2006	$ 17,563	$ 19,876
Equity Investment, principally SGI Japan, a related party	20,869	18,604
Non-current deferred cost of good sold	10,824	14,667
Other, net of accumulated amortization of $1,649 in 2007 and $2,834 in 2006	10,245	17,555
Total other non-current assets, net	$ 59,501	$ 70,702

Note 13. Goodwill

We review Goodwill for impairment in the fourth quarter of each year, or more frequently if events or circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS 142, *Goodwill and Other Intangible Assets*. We perform this test separately for each of our two reporting units. Our reporting units are consistent with the reportable segments identified in Note 21. As a result of our Goodwill Impairment testing, we determined that an impairment of the Successor Company Goodwill is not required for the fiscal year ended June 29, 2007.

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Predecessor Company Goodwill at June 30, 2006 represented the remaining portion of Goodwill established as a result of its acquisition of Silicon Graphics World Trade Corporation in fiscal 1991. Predecessor Company Goodwill was eliminated and Successor Company Goodwill was established in connection with our adoption of fresh-start accounting (see Note 4). Subsequent fresh-start adjustments, primarily due to the resolution of certain uncertainties in the fourth quarter of fiscal 2007, eliminated Successor Company Goodwill. The adjustments were primarily due to settlement of tax issues relating to our investment in Cray Research. The following table summarizes the changes in the carrying amount of Goodwill for fiscal 2006 and fiscal 2007 (in thousands):

	Products	Global Services	Total
Goodwill balance at June 24, 2005 (Predecessor Company)	$ 8,386)	$ 4,515	$ 12,901
Impairment of Predecessor Company Goodwill	(8,386)		(8,386)
Goodwill balance at June 30, 2006 (Predecessor Company)		4,515	4,515
Fresh-start valuation adjustments at September 29, 2006		(188)	(188)
Goodwill balance at September 29, 2006 (Successor Company)		4,327	4,327
Adjustments to valuation		(4,327)	(4,327)
Goodwill balance at June 29, 2007 (Successor Company)	$	$	$

Note 14. Other Intangible Assets

Other Intangible Assets, net of accumulated amortization, were approximately $71 million as of June 29, 2007. Other Intangible Assets were established in connection with our adoption of fresh-start accounting (see Note 4). Subsequent to September 29, 2006 adjustments were made to the preliminary fresh-start valuation adjustments previously disclosed in our Quarterly Report on Form 10-Q for the first quarter of fiscal 2007 and are reflected in the table below. The adjustments were principally due to utilization of the Predecessor Company s foreign tax net operating loss carryforwards. Other Intangible Assets consist of the following (in thousands, except years):

		Gross Carrying Amount			Accumulated Amortization			Net Carrying Amount
	Weighted Average Remaining Amortization Period (Years)	Sept. 29, 2006	Adjustments	June 29, 2007	Sept. 29, 2006	Additions	June 29, 2007	June 29, 2007
Developed product technology	6	$ 27,700	$	$ 27,700	$	$ (3,463)	$ (3,463)	$ 24,237
In Process R&D		500	(500)					
Customer backlog	3	2,700		2,700		(1,652)	(1,652)	1,048
Royalty license agreements	5	1,900		1,900		(285)	(285)	1,615
	17	6,400		6,400		(282)	(282)	6,118

Trademark/trade name portfolio								
Customer relationships	6	47,500	(3,316)	44,184		(5,938)	(5,938)	38,246
		$ 86,700	$ (3,816)	$ 82,884	$	$ (11,620)	$ (11,620)	$ 71,264

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In accordance with FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, in-process research and development of $0.5 million was expensed by the Successor Company during the second quarter of fiscal 2007 and recorded to research and development expense.

In the event that the Successor Company Goodwill has been eliminated or is non-existent, we would instead amortize intangible assets by that amortization amount corresponding to Goodwill had a Goodwill balance existed.

Total amortization expense for other intangible assets for the nine months ended June 29, 2007 was approximately $11.6 million. Annual amortization expense for other intangible assets is estimated to be as follows (in thousands):

Fiscal 2008	$ 13,005
Fiscal 2009	12,908
Fiscal 2010	12,878
Fiscal 2011	12,830
Fiscal 2012	12,454
Thereafter	7,189
	$ 71,264

Note 15. Guarantees

Financial Guarantees

Currently, we have issued financial guarantees to cover rent on leased facilities and equipment, in favor of government authorities and certain other parties to cover liabilities associated with the importation of goods and to support payments in advance of future delivery on our goods and services. The majority of our financial guarantees have terms of one year or less. Our maximum potential obligation under financial guarantees at June 29, 2007 was $6 million for which we had $7 million of assets held as collateral.

Assets held as collateral closely approximate fair value. At June 29, 2007, we did not have any obligations associated with our guarantees that met the criteria to be recorded as liabilities on our statement of financial position.

Product Warranty

At the time of sale of our products, we provide for an estimated cost to warrant these products against defects in materials and workmanship for a period of up to three years.

Product warranty activity for the Successor Company was as follows (in thousands):

	Nine Months Ended June 29, 2007
Product warranty beginning balance at September 29, 2006	$ 4,942
New warranties issued	6,508
Warranties paid	(5,747)
Changes in warranty rate estimates	(57)
Product warranty ending balance	$ 5,646

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Product warranty activity for the Predecessor Company was as follows (in thousands):

	Three Months Ended Sept. 29, 2006	Year Ended June 30, 2006
Product warranty beginning balance	$ 5,481	$ 6,442
New warranties issued	1,195	7,359
Warranties paid	(1,735)	(8,049)
Changes in warranty rate estimates	1	(271)
Product warranty	$ 4,942	$ 5,481

Note 16. Debt and Other Financing Arrangements

Debt at June 29, 2007 and June 30, 2006 was as follows (in thousands):

	Successor Company 2007	Predecessor Company 2006
Term Loan due October 17, 2011	$ 85,000	$
Debtor-in-Possession (DIP) Financing due November 10, 2006		100,000
Other	261	3,521
	85,261	103,521
Less amounts due within one year	(261)	(103,124)
Amounts due after one year	$ 85,000	$ 397

Asset Based Credit Facility

On the Emergence Date, the Successor Company entered into a credit agreement with Morgan Stanley Senior Funding, Inc. and General Electric Capital Corporation to provide exit liquidity financing as part of our plan to emerge from bankruptcy. The exit financing facility provides up to $115 million of financing consisting of an $85 million term loan from Morgan Stanley Senior Funding, Inc. and a $30 million line of credit from General Electric

Capital Corporation. The term loan bears interest payable at the one, two or three-month LIBOR rate plus 7.00%. The revolving line of credit bears interest payable monthly at the LIBOR rate plus 3.00%. During fiscal 2007, the maximum amount drawn on the revolver and subsequently paid within 20 days of being drawn was $5 million. We plan to utilize up to the full availability under the revolver to fund intra-quarter cash needs. The new facility is secured by substantially all of the assets of the Successor Company and its domestic subsidiaries and has customary terms and conditions, including covenants related to minimum levels of Consolidated EBITDA as defined in the credit agreement and minimum levels of cash and cash equivalents, and limits on capital expenditures. See Note 27. This facility, combined with net proceeds of $57 million from the rights offering and sale of Overallotment shares, was used to pay off $113 million due under the existing $130 million DIP Agreement, to fund payments, including closing costs and related fees, required to be made on the Emergence Date pursuant to the Plan, and provide working capital for our ongoing operations. The exit financing facility matures in October 2011. Annual principal payments over the next five years are as follows (in millions): fiscal 2008 $0; fiscal 2009 $13; fiscal 2010 $17; fiscal 2011 $17 and fiscal 2012 $38. See Note 27 to our Consolidated Financial Statements for information on modifications to the Asset Based Credit Facility made subsequent to June 29, 2007.

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DIP Financing

In June 2006, the Debtors entered into the DIP Agreement with the DIP Lenders, which provided up to $130 million of debtor-in-possession financing and consisted of a $100 million term loan and a $30 million revolving line of credit. The DIP Agreement was secured by certain assets of the Borrowers. This DIP Agreement was approved by the Court on June 26, 2006. The Order approving the DIP Agreement (i) authorized the Debtors to incur post-petition secured indebtedness in the amount of $130 million while granting to the Administrative Agent and lenders thereunder, subject to specified permitted prior liens, and a carve-out for specified professional fees and other costs and expenses, super priority administrative expense claims and first priority priming liens against, and security interests in, substantially all of the Debtors then-owned and after-acquired property, (ii) authorized the Debtors to repay amounts owed under their pre-petition credit agreement, which was repaid on June 28, 2006, (iii) authorized the Debtors to repay amounts borrowed under the Interim DIP Agreement, and (iv) authorized the Debtors use of cash collateral of their secured notes and granted to the secured note holders certain adequate protection of their interests therein. We borrowed $113 million against this facility. On the Effective Date, all amounts due under the DIP Agreement were repaid and the agreement was terminated in accordance with its terms.

Other Debt

Other debt at June 29, 2007 represents a $0.2 million loan secured by a receivable. The loan bears interest at a fixed annual rate of 5.22% and is repayable in quarterly installments ending in fiscal 2008. At June 30, 2006 this loan represented $1 million of the $4 million in other debt. Other debt at June 30, 2006 also included $3 million of proceeds received in connection with products sold under certain sales-type lease arrangements, after which we sold the lease receivables to certain financial institutions. These debt amounts represented future revenue streams for customer support contracts on those leased products that we were required under EITF 88-18, *Sales of Future Revenue*, to classify as debt. These future revenue streams were written off as part of the fresh-start accounting valuation process.

Note 17. Leasing Arrangements as Lessee

We lease certain of our facilities and equipment under non-cancelable operating lease arrangements. Some of these leases include rental escalation clauses, renewal options, and, in certain cases, purchase options. Some of the facilities leases also require us to make additional payments to the landlords for common costs of operating and maintaining the facilities.

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Future minimum annual lease payments under non-cancelable operating leases and contractual receipts from non-cancelable subleases, substantially all of which relate to facilities in restructuring, are as follows at June 29, 2007 (in thousands):

	Non-cancelable Operating Leases				
	Facilities and Equipment Not in Restructuring	Facilities in Restructuring	Total	Non-cancelable Subleases	Net Payments
Fiscal 2008	$ 8,677	$ 833	$ 9,510	$ (202)	$ 9,308
Fiscal 2009	7,634	649	8,283	(124)	8,159
Fiscal 2010	5,010	339	5,349		5,349
Fiscal 2011	3,395	113	3,508		3.508
Fiscal 2012	1,181		1,181		1,181
Thereafter	374		374		374
	$ 26,271	$ 1,934	$ 28,205	$ (326)	$ 27,879

Aggregate operating lease rent expense in fiscal 2007, fiscal 2006, and fiscal 2005, was $10 million, $14 million, and $20 million, respectively.

Note 18. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net were as follows (in thousands):

	Successor Company	Predecessor Company	
	Nine Months Ended June 29, 2007	Three Months Ended Sept. 29, 2006	Year Ended June 30, 2006
Beginning balance	$	$ (19,997)	$ (17,448)
Unrealized gain (loss) on derivative instruments designated and qualifying as cash flow hedges			(1,567)
Foreign currency translation adjustments		95	(982)
Elimination of other comprehensive income upon emergence from bankruptcy		19,902	

Ending balance	$	$	$ (19,997)

Note 19. Income Taxes

The components of (loss) income from continuing operations before income taxes were as follows (in thousands):

	Successor Company	Predecessor Company		
	Nine Months Ended	Three Months Ended	Years ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
United States	$ (123,341)	$ 313,646	$ (137,912)	$ (109,009)
International	28,402	14,992	(11,928)	25,263
	$ (94,939)	$ 328,638	$ (149,840)	$ (83,746)

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The (benefit) provision for income taxes consisted of the following (in thousands):

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Federal:				
Current	$ 222	$ 111	$ 388	$ (4,113)
Deferred				
State:				
Current	(200)	(4)	(758)	246
Deferred				
Foreign:				
Current	8,841	2,375	(3,016)	(4,059)
Deferred	(160)	(100)	(260)	(88)
	$ 8,703	$ 2,382	$ (3,646)	$ (8,014)

The (benefit) provision for income taxes reconciles to the amounts computed by applying the statutory federal tax rate to our (loss) income from continuing operations before income taxes as follows (in thousands):

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Tax at U.S. federal statutory	$ (33,229)	$ 115,023	$ (52,444)	$ (29,311)
Fresh Start and Reorganization	21,563	(120,049)		
State taxes, net of federal tax benefit	(130)	(3)	(493)	160
Net operating loss with no tax benefit	11,844	5,090	55,772	27,598
Utilization of predecessor company s foreign tax net operating loss carryovers credited to noncurrent intangibles due to Fresh Start Accounting	4,969			
Net foreign tax expense (benefit)	3,712	2,275	(3,276)	(4,147)
Earnings subject to foreign taxes at lower rates				(4,057)

Goodwill impairment			(2,935)	
Other	(26)	46	(270)	1,743
	$ 8,703	$ 2,382	$ (3,646)	$ (8,014)

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The tax effects of temporary differences and carryforwards that give rise to significant portions of deferred tax assets and liabilities at June 29, 2007 and June 30, 2006 (in thousands):

	Successor Company 2007	Predecessor Company 2006
Deferred tax assets:		
Net operating loss carryforwards	$ 548,113	$ 586,240
General business credit carryforwards	49,154	59,716
Capitalized research expenses	89,442	80,909
Inventory valuation	19,674	20,507
Reserves not currently deductible	20,434	20,418
Other	95,333	109,117
Subtotal	822,150	876,907
Valuation allowance	(820,504)	(791,426)
Total deferred tax assets	1,646	85,481
Deferred tax liabilities:		
U.S. residual taxes on unremitted foreign earnings	0	83,822
Other	3,392	3,665
Total deferred tax liabilities	3,392	87,487
Total	$ (1,746)	$ (2,006)

At June 29, 2007, the Successor Company had gross deferred tax assets arising from deductible temporary differences, tax operating losses, and tax credits of $822 million. The gross deferred tax assets were offset by a valuation allowance of $821 million and deferred tax liabilities of $3 million. The valuation allowance of $821 million included $32 million attributable to tax benefits of stock option deductions, which, if recognized, would be allocated directly to additional paid-in capital**.** $799 million of the total valuation allowance of $821 million originated from the predecessor company, for which any subsequently recognized tax benefits will be applied to reduce Goodwill and/or other intangibles or directly to additional paid-in-capital, rather than adjustments to our future statement of operations, as they existed before we adopted fresh-start accounting as of September 29, 2006. Although we have established a valuation allowance against the carrying value of certain deferred tax assets, the underlying net operating loss carryforwards would still be available to us in order to offset future taxable income in the United States subject to applicable tax laws and regulations.

The total valuation allowance increased $29 million in fiscal 2007. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of deferred tax assets will not be realized. The realization is based on several factors, including the Company s past earnings and the scheduling of deferred tax liabilities and projected income operating activities. As of June 29, 2007, management does not believe it is more likely than not that the deferred tax assets relating to U.S. federal, state, and foreign operations are realizable. Deferred income taxes are no longer provided on the undistributed earnings of foreign subsidiaries for the Successor Company. For nine-months ending June 29, 2007, the undistributed earnings of foreign subsidiaries were $5 million. In fiscal year 2007 in connection with the adoption of fresh-start accounting, we reevaluated our policies related to earnings from foreign subsidiaries. Based on this review, effective September 29, 2006, the Company has adopted a change in policy. We have no present intention of remitting or repatriating to the U.S. earnings of our foreign subsidiaries aggregating approximately

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$351 million as of June 29, 2007, and, accordingly no deferred tax liability has been established relative to these earnings. Determination of the amount of unrecognized deferred tax liability on these undistributed earnings is not practicable.

At June 29, 2007, the Successor Company had United States federal, California state, and foreign jurisdictional net operating loss carryforwards of $1.4 billion, $277 million, and $167 million, respectively. The net operating loss carryforwards incurred prior to SGI s Chapter 11 reorganization for United States federal, California state, and foreign are $1.2 billion, $243 million, and $163 million, respectively. Of these $5 million were recognized against intangible assets as the Company had no remaining Goodwill at June 29, 2007. There was no impact to cash as a result of this charge. To the extent that the Successor Company utilizes foreign or domestic net operating loss carryforwards to reduce taxable income, such amount will be recorded as tax expense with a corresponding reduction to intangible assets. The federal losses will begin expiring in fiscal 2010, the California state losses will begin expiring in fiscal 2011, and the foreign losses will begin to expire in fiscal 2008. At June 29, 2007, the Successor Company also had general business credit carryovers of $29 million for United States federal tax purposes, which will begin to expire in fiscal 2008, and alternative minimum tax credits of $5 million, which do not have fixed expirations dates. The Successor Company had California state research and development credits of $29 million, which do not have expiration dates, and California state manufacturing investment tax credits of $2 million which will begin to expire in fiscal 2008.

Most of these net operating loss carryforwards were incurred prior to SGI s Chapter 11 reorganization and therefore are subject to limitation under U.S. and state income tax laws. Pursuant to these loss limitation rules, the utilization of net operating loss and credit carryforwards are limited if, during a testing period (usually three years), there is greater than a 50% cumulative shift in the ownership of its stock. As a result of the bankruptcy reorganization, SGI exchanged some of its debt for common stock. This exchange is expected to result in more than a 50% cumulative shift in the stock ownership of SGI. Accordingly, SGI s ability to utilize its net operating losses may be significantly limited as provided under section 382 of the Internal Revenue Code.

We file income tax returns with the U.S. government, and various states and foreign jurisdictions. Our U.S. income tax returns for fiscal years 2004 to 2006 are open, and to date, we have not been notified of any pending audits or of any proposed adjustments to those returns. SGI has however established tax reserves associated with a liability that arose from an IRS refund payment to Cray Research in prior years. We are also negotiating the settlement of tax issues relating to our investment in Cray Research. We have reached a negotiated settlement, and Joint Committee of Tax has approved, of certain tax issues relating to deductions under section 172(f) of the Internal Revenue Code that affect the years 1984 through 1988. This settlement will result in approximately $7.5 million of tax refund/credit, including applicable interest. The actual amount of the interest on the refund upon receipt may be materially different than our estimate as the interest computation is complex. We have recognized the estimated benefit related to this potential credit as of June 29, 2007.

In addition, we have open income tax audits for fiscal years 1995 through 2005 in various foreign jurisdictions. The most significant of these audits surrounds proposed adjustments we made in April 2005 through a voluntary disclosure to our prior year Canadian federal tax returns for fiscal years 1996 through 2004. We previously established tax reserves associated with these historic Canadian federal tax returns on the basis of issued assessments for fiscal years 1996 through 2002 and submitted tax returns for fiscal years 2003 and 2004. Additionally, pursuant to the above referenced voluntary disclosure, we have requested certain adjustments to our Canadian federal tax returns for fiscal years

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1996 through 2004, which are being reviewed by the Canadian Revenue Authorities. The discussion with the Canadian tax authorities is at an early stage; therefore, it is uncertain as to whether our application will be accepted and as to the amount of the adjustments. If accepted however, it is anticipated that the adjustment will result in a benefit to us. We have not recognized any benefit related to this potential credit as of June 29, 2007.

We are also currently being audited by local tax authorities in Korea for fiscal years 2003 through 2005 for which we believe we have adequate reserves. The Korean government assessed additional income taxes to our Korean subsidiary for fiscal years 2003 through 2005 in the amount of approximately $1.7 million as a result of allocation of expenses from SGI pursuant to support services rendered by SGI. We are currently pursuing competent authority procedure to mitigate the resulting double taxation.

In France, the tax authority proposed an adjustment to our income taxes for the 2003 through 2005 fiscal years which we have settled through the administrative appeal channels. This adjustment again relates to the deductibility of services provided by SGI to its French subsidiary. The tax assessment is completely offset by our French net operating loss carry forward.

Unrecognized Tax Benefits

The Successor Company was required to adopt changes in accounting principles that will be required in the consolidated financial statements of the Successor Company within the 12 months following the adoption of fresh-start reporting. As a result, the Successor Company was required to early adopt FIN No. 48 on September 29, 2006. There was no material impact on the Successor Company s consolidated results of operations resulting from the implementation of FIN No. 48. A reconciliation of the beginning and ending amount of unrecognized tax benefits for the Successor Company is as follows (in thousands):

	Nine Months Ended June 29, 2007
Unrecognized tax benefits beginning balance at September 29, 2006	$ 23,270
Additions based on tax positions taken during a prior period	2,867
Additions for tax positions taken during the current period	244
Reductions due to settlements with taxing authorities	(6,801)
Reductions due to a lapse of the applicable statute of limitations	
Unrecognized tax benefits ending balance *	$ 19,580

* If the unrecognized tax benefits at June 29, 2007 were recognized, the effective tax rate would not be affected.

Substantially all unrecognized tax benefits are recorded in Other Non-current Liabilities.

Future settlement and adjustments to these unrecognized tax benefits will be adjustments to Goodwill and/or other intangibles or directly to additional paid-in-capital, rather than adjustments to our future statement of operations, as they existed before we adopted fresh-start accounting as of September 29, 2006.

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Interest and Penalties

Interest and penalties related to income taxes are recognized in the income tax provision. Penalties were not recorded during fiscal 2006 or during both the three months ended September 29, 2006 or the nine months ended June 29, 2007. In fiscal year 2006, the Predecessor Company recognized interest expense of $1.3 million.

During the three- and nine-month periods ended June 29, 2007, the Successor Company recognized $0.4 million and $1.1 million, respectively, in interest expense. The Successor Company had approximately $9.2 million for the payment of interest and penalties accrued at June 29, 2007.

Note 20. Research and Development Arrangements

During the first quarter of fiscal 2007, we entered into research and development arrangements with certain third parties for a period of 3 years. Currently, the value of these arrangements totals $28.0 million and cover periods through fiscal 2009. The objective of these arrangements is to help fund the development of technologies or products that meet specific operational needs for our business partners and lead towards the commercialization of new products that can be sold for incremental revenue. During the nine months ended June 29, 2007, we earned approximately $6.79 million in compensation. During the three months ended September 29, 2006, the Predecessor Company earned approximately $1.25 million in compensation. We recognize the funding on a percentage of completion basis. These amounts are recognized as an offset to research and development expense.

Note 21. Segment Information

We have two reportable segments, Products and Global Services. Our reportable segments are determined after assessment of factors such as quantitative thresholds of business components to be included into reportable segments, customer base, economic characteristics, homogeneity of products, technology, delivery channels, and other factors, and are aligned with the process by which executive management makes operating decisions and evaluates performance.

Products

Our Products segment is comprised of our Core Systems based on the Intel® Itanium® 2 microprocessor and Linux® operating system as well as our storage solutions and our Legacy Systems based on the MIPS® RISC microprocessor and IRIX® operating system including the remarketed versions of these workstations, graphics systems, high-performance servers and storage solutions. Our Products are distributed through our direct sales force and through indirect channels, including resellers, distributors, and systems integrators.

Our Core Systems are comprised of our high-performance servers and visualization systems based on Intel Itanium 2 microprocessors and the Linux operating system and storage solutions. Our Core Systems include the SGI® Altix® family of high-performance servers and the SGI® InfiniteStorage line of storage solutions. These are high-performance supercomputing systems designed for technical computing applications, and they are also used as storage management servers for managing very large data repositories that contain critical information and media servers for broadcast television applications. Our Core Systems also include the Silicon Graphics Prism family of visualization systems. These visualization systems are used in a variety of applications, including computer-aided design, medical imaging, 2D and 3D animation, broadcast, modeling, and simulation. Our graphics

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systems integrate high-performance computing, data management, and high-performance visualization into a single system. The Prism family of visualization systems has recently been discontinued.

Our Legacy Systems are comprised of our high-performance servers and visualization systems based on MIPS RISC microprocessors and the IRIX operating system. Our Legacy Systems include the SGI Origin family of high-performance servers. These are high-performance supercomputing systems designed for technical computing applications, and they are also used as storage management servers for managing very large data repositories that contain critical information and media servers for broadcast television applications. Our Legacy Systems also include the Silicon Graphics Tezro and Silicon Graphics Fuel workstations and the SGI® Onyx® family of graphics systems. These workstations are used in a variety of applications, including computer-aided design, medical imaging, 2D and 3D animation, broadcast, modeling, and simulation. Our graphics systems integrate high-performance computing, data management, and high-performance visualization into a single system. Our Legacy Systems also include the remarketed versions of the MIPS/IRIX-based workstations, graphics systems and high-performance servers as well as remarketed versions of our storage solutions.

Global Services

Our Global Services segment supports our computer hardware and software products and provides professional services and ongoing maintenance support arrangements to help customers realize the full value of their information technology investments. Our professional services organization provides technology consulting, education, managed services, and third-party products.

Revenue from external customers for similar classes of products and services was as follows (in thousands):

	Successor Company	Predecessor Company		
	Nine Months Ended	Three Months Ended	Years Ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Core Systems:				
Server products	$ 121,572	$ 34,914	$ 123,827	$ 206,995
Storage products	37,469	12,750	49,933	64,279
Total Core Systems	159,041	47,664	173,760	271,274
Legacy Systems:				
Server products	34,843	12,324	73,843	160,152

Storage products	2,627	618	4,492	4,554
Total Legacy Systems	37,470	12,942	78,335	164,706
Total Products revenue	$ 196,511	$ 60,606	$ 252,095	$ 435,980
Support services	$ 111,939	$ 48,396	$ 214,083	$ 236,185
Professional services and solutions	32,614	12,803	52,627	57,800
Total Global Services revenue	$ 144,553	$ 61,199	$ 266,710	$ 293,985

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Segment Results

We evaluate our segments based on the direct revenues, costs of sale and expenses that we can directly attribute to those segments. We do not routinely manage our business by identifying or allocating assets, corporate administrative costs, or depreciation by operating segment, nor do we evaluate segments on these criteria. On a quarterly basis, we utilize a robust set of assumptions to allocate indirect costs, which contribute to overall company profit and loss, to our segments. Operating segments do not sell products to each other, and accordingly, there is no inter-segment revenue to be reported.

Operating results for our reportable segments were as follows (in thousands):

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years Ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Revenue from external customers:				
Products	$ 196,511	$ 60,606	$ 252,095	$ 435,980
Global services	144,553	61,199	266,710	293,985
Total consolidated	$ 341,064	$ 121,805	$ 518,805	$ 729,965
Operating Income (loss):				
Products	$ (85,559)	$ (23,448)	$ (142,792)	$ (86,282)
Global services	3,455	11,912	37,370	13,896
Total reportable segments	(82,104)	(11,536)	(105,422)	(72,386)
Other operating expense	(3,601)	(3,926)	(21,155)	(24,083)
Total consolidated	$ (85,705)	$ (15,462)	$ (126,577)	$ (96,469)

Our revenue by geographic region, based on the location of the customer, was as follows (in thousands):

	Successor Company	Predecessor Company	
			Years Ended

	Nine Months Ended June 29, 2007	Three Months Ended Sept. 29, 2006	June 30, 2006	June 24, 2005
Americas	$ 194,216	$ 76,170	$ 306,156	$ 447,974
Europe	121,295	20,608	130,831	176,641
Rest of world	25,553	25,027	81,818	105,350
Total	$ 341,064	$ 121,805	$ 518,805	$ 729,965

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Our long-lived assets, except long-term restricted investments, other long-term investments, and net long-term deferred tax assets, were located in geographic regions as follows (in thousands):

	Successor Company June 29, 2007	Predecessor Company June 30, 2006
Americas	$ 163,655	$ 71,907
Europe	4,565	6,634
Rest of world	5,937	5,946
Total	$ 174,157	$ 84,487

No single customer represented 10% or more of our total revenue in any annual period presented. For the nine month period ending June 29, 2007, we recognized revenue from a single customer which amounted to 12% of the revenue of this period.

Note 22. Benefit Plans

401(k) Retirement Savings Plan. We provide a 401(k) investment plan covering substantially all of our U.S. employees. The plan provides for a minimum 25% employer match of an employee's contribution up to a specified limit, but allows for a larger matching subject to certain regulatory limitations. Our matching contributions were approximately $0.1 million for the three months ended September 29, 2007 and $1.0 million for the nine months ended June 29, 2007 and $1 million for fiscal 2006.

Deferred Compensation Plan. The Predecessor Company had a Non-Qualified Deferred Compensation Plan that allows eligible executives and directors to defer a portion of their compensation. The deferred compensation, together with employer matching amounts and accumulated earnings, was accrued but unfunded. Such deferred compensation is distributable in cash and amounted to approximately $2 million as of June 30, 2006. A participant may have elected to receive such deferred amounts in one payment or in annual installments no sooner than two years following each annual election. Participant contributions were always 100% vested and our matching contributions vested as directed by the board of directors. There have been no matching contributions to date. As a result of the bankruptcy, the funds held in the Non-Qualified Deferred Compensation Plan were distributed to the Debtor. The participants in this plan became general unsecured creditors under SGI s Plan of Reorganization. This plan was not assumed by part of the Reorganization, so it was automatically terminated as a result of our emergence from Bankruptcy on October 17, 2006.

Note 23. Related Party Transactions

Prior to the sale of our interest in SGI Japan, during the first quarter of 2007, we recorded our proportionate share of SGI Japan's financial results as non-operating income or loss in accordance with APB 18, *The Equity Method of Accounting for Investments in Common Stock*. Subsequent to the sale, we started utilizing the Cost Accounting Method in accordance with APB 18. We record product revenue sold to SGI Japan under SEC Staff Accounting Bulletin No. (SAB 104), *Revenue Recognition.*

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Revenue and cost of revenue associated with sales to SGI Japan, which represent substantially all of our sales to related parties, were as follows (in thousands):

	Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years Ended	
	June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005
Product revenue	$ 8,706	$ 15,377	$ 28,836	$ 44,658
Cost of product revenue	$ 5,504	$ 9,233	$ 17,613	$ 25,616

During fiscal 2006 SGI Japan issued new shares of their common stock and as a result, our ownership percentage was diluted from 24% to 20%. In accordance with SEC Staff Accounting Bulletin No. (SAB) 51, *Accounting for Sales of Stock by a Subsidiary*, we increased the value of our equity investment in SGI Japan by approximately $4 million which was recorded as a component of stockholders deficit.

We did not make any purchases from related parties during the three months ended September 29, 2007 and the nine months ended June 29,2007, fiscal 2006 and fiscal 2005. Aggregate amounts receivable from these related parties were immaterial at June 29, 2007 and amounted to $0.2 million at June 30, 2006. Aggregate amounts payable to these related parties were immaterial at each of June 29, 2007 and June 30, 2006.

Note 24. Supplemental Cash Flow Information

Supplemental disclosures of cash flow information (in thousands):

Successor Company Nine Months Ended	Predecessor Company Three Months Ended	Predecessor Company Years Ended	
June 29, 2007	Sept. 29, 2006	June 30, 2006	June 24, 2005

Cash paid during the year for:				
Interest	$ 7,256	$ 2,757	$ 13,453	$ 16,830
Income taxes, net of refunds	$ 2,573	$ 2,763	$ 2,302	$ (9,267)

Supplemental schedule of non-cash investing and financing activities (in thousands):

	Successor Company Nine Months Ended June 29, 2007	Predecessor Company Three Months Ended Sept. 29, 2006	Years Ended June 30, 2006	June 24, 2005
Conversion of 6.50% Senior Secured Convertible Notes into common stock	$	$	$	$ 503

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 25. Contingencies

We may, from time to time, be involved in lawsuits, claims, investigations and proceedings that arise in the ordinary course of business. In accordance with SFAS No. 5, *Accounting for Contingencies,* we record a provision for a liability when management believes that it is both probable that a liability has been incurred and we can reasonably estimate the amount of the loss. We believe we have adequate provisions for any such matters. We review these provisions at least quarterly and adjust these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case.

We are currently being audited for state sales and use tax matters for the years 2003 through 2006 in California. In addition, we have open income tax, VAT, and sales tax audits for years 2003 through 2005 in various foreign jurisdictions.

The outcome of any tax audits cannot be predicted with certainty, but we believe that any resulting audit adjustments to any of our open tax returns will not result in a material adverse impact on our financial condition, results of operations or cash flows.

As described in Note 2, Proceedings under Chapter 11 of the Bankruptcy Code, on the Petition Date, May 8, 2006, the Debtors filed voluntary petitions for relief under Chapter 11. As of the Petition Date, most pending litigation (including some of the actions described below) was stayed, and absent further order of the Court, no party, subject to certain exceptions, was permitted to take any action, again subject to certain exceptions, to recover on pre-petition claims against us. On the Emergence Date, we emerged from Chapter 11.

SCO Group, the successor to AT&T as the owner of certain UNIX system V intellectual property and as our licensor, has publicly claimed that certain elements of the Linux operating system infringe SCO Group s intellectual property rights The Predecessor Company received a notice from SCO Group purporting to terminate, as of October 14, 2003, our fully paid license to certain UNIX operating system-related code, under which we distribute our IRIX operating system, on the basis that we have breached the terms of such license. We believe that the SCO Group s allegations are without merit and that our fully paid license is non-terminable. SCO Group failed to assert a claim in our bankruptcy case and any pre-petition liability, if any existed, was discharged upon our emergence from bankruptcy.

On August 10, 2005, our German subsidiary, which was not a party to the Chapter 11 cases, filed a lawsuit with the LG Munich, a Higher Regional Court in Germany, against T-Systems International GmbH (TSI), a systems integrator, relating to a dispute regarding whether acceptance criteria were met with regard to an SGI system delivered in the spring of 2003. We are seeking full payment for the system in an amount equal to 4.6 million ($6.2 million based on the conversion rate as of June 29, 2007). On September 21, 2005, TSI filed a counterclaim contesting our claim and alleging damages of 9 million plus interest since April 2004 ($12.1 million based on the conversion rate as of June 29, 2007), which exceeds our contractual limit of liability of 2 million ($2.7 million based on the conversion rate as of June 29, 2007). On December 7, 2005, we responded to TSI s counterclaim and filed a motion seeking an additional 3.8 million ($5.2 million based on the conversion rate as of June 29, 2007) for lost profit relating to maintenance services. We cannot currently predict the outcome of this dispute.

On July 29, 2005, Syntegra (USA), Inc., a computer repair services vendor, filed a complaint against the Predecessor Company in the U.S. District Court, Northern District of California, in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

connection with the Predecessor Company s termination of its contract with Syntegra and transition of its business to an alternate vendor alleging, among other things, breach of contract, unfair competition and misappropriation of trade secrets. This complaint was dismissed from the federal court as improperly filed and on September 20, 2005, Syntegra re-filed a substantively similar complaint in the Superior Court of California, Santa Clara County. On November 7, 2005, the Predecessor Company filed its answer to Syntegra s complaint and, additionally, filed a cross complaint against Syntegra for, among other things, declaratory relief and breach of contract. This claim was settled within the Bankruptcy case.

The Predecessor Company received a notice from LG Electronics, Inc. (LGE) asserting that the Predecessor Company infringed certain LGE patents. During the bankruptcy proceeding, the parties entered into a stipulation wherein LGE agreed to withdraw the pending motion, agreed not to file any objection to confirmation of the Debtors' plan of reorganization, and agreed to withdraw all proofs of claim asserting pre-petition infringement except the one filed against the Predecessor Company. We agreed that LGE would receive a distribution of $375,000 from the General Unsecured Creditors Claim pool established as part of the Plan of Reorganization.

On September 28, 2006, we filed a lawsuit against LGE in the United States District Court for the Northern District of California seeking a declaratory judgment that we do not infringe LGE s patents. On May 31, 2007, the Company and LGE stipulated to a dismissal of all claims pending in the September 28, 2006 complaint. The action was dismissed without prejudice and defendant waived all damages that accrued or have accrued since May 8, 2006 with respect to the patents, up to the date that any complaint regarding the patents is refiled. Also, LGE must give counsel of record 30 days notice prior to pursuing any claims based on the patents in dispute, and the Company shall have 30 days to refile its claims for declaratory relief. Damages for any alleged infringement of the patents identified in the complaint begin to accrue from the date any complaint with respect to the patents is filed by either party.

On October 23, 2006, we filed a patent infringement lawsuit against ATI Technologies Inc. in U.S. District Court Western District of Wisconsin. In our complaint, we assert that products in ATI's line of Radeon graphics processors infringe our U.S. Patent No. 6,650,327. The Complaint seeks unspecified damages and a court ordered injunction against future infringement by ATI.

In late 2006, AMD announced the completion of its acquisition of ATI Technologies, Inc. We filed an amended complaint adding two additional patents to its claims on November 30, 2006. ATI filed an answer to the complaint on December 1, 2006. ATI filed its answer to the amended complaint on December 14, 2006, the trial has been set for February 4, 2008.

As a result of anonymous allegations and allegations by an ex-employee we conducted an internal investigation into whether certain systems were delivered to an entity in China in possible violation of U.S. export laws. We have voluntarily shared information with respect to the investigation with the U.S. Department of Commerce. We cannot be assured that the Department or other agencies of the U.S. government will not institute any proceedings against us in the future. In addition, from time to time, we receive inquiries from regulatory agencies informally requesting information or documentation. There can be no assurance in any given case that such informal review will not lead to further proceedings involving us in the future.

We also routinely receive communications from third parties asserting patent or other rights covering our products and technologies. Based upon our evaluation, we may take no action or we may

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

seek to obtain a license. We are in discussions with several parties that have asserted intellectual property infringement claims. There can be no assurance in any given case that a license will be available on terms we consider reasonable, or that litigation will not ensue.

On April 27, 2004, the Predecessor Company received a letter from counsel for Patriot Scientific Corporation listing six patents purportedly owned by Patriot concerning various microprocessor technologies. The letter did not name any specific products of the Predecessor Company but noted that Patriot had commenced litigation against six companies in two separate litigations, including Intel. On September 23, 2005, the Predecessor Company received a follow up letter from Alliacense, which purported to be a successor entity to Patriot. The September 2005 letter stated that Alliacense had reached agreement with several companies, including Intel and AMD, for licenses to the subject patents. The letter did not identify any specific products of the Predecessor Company that Alliacense believed to infringe any of the subject patents; however, the letter states Alliacense s belief that virtually every product manufactured today utilizing microprocessors or embedded microprocessors will require a portfolio license from Alliacense. We believe that Alliancense's assertions are without merit. Alliacense failed to assert a claim in our bankruptcy case and any pre-petition liability, if any exists, was discharged upon our emergence from bankruptcy.

On May 1, 2007, we received a letter from counsel for Bharat Heavy Electricals Ltd. (BHEL), located in India, alleging delay in and failure to deliver products and technical problems with our hardware and software. BHEL has asserted a claim for damages, reimbursement and interest of $1.9 million and has demanded arbitration. We are currently investigating the claim and considering arbitration options.

We are not aware of any pending disputes, including those disputes and settlements described above, that would be likely to have a material adverse effect on our consolidated financial condition, results of operations, or liquidity. However, litigation is subject to inherent uncertainties and costs and unfavorable outcomes could occur. An unfavorable outcome could include the payment of monetary damages, cash or other settlement, or an injunction prohibiting us from selling one or more products. If an unfavorable resolution were to occur, there exists the possibility of a material adverse impact on our consolidated financial condition, results of operations or cash flows of the period in which the resolution occurs or on future periods.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 26. Selected Quarterly Financial Data (unaudited)

	Fiscal 2007			
	(In thousands, except per share amounts)			
	Successor Company			Predecessor Company
	June 29	March 30	December 29	September 29
Total revenue	$ 122,295	$ 111,046	$ 107,723	$ 121,805
Costs and expenses:				
Cost of revenue	90,148	74,355	89,305	74,975
Research and development	14,870	14,186	14,984	16,007
Selling, general and administrative	41,697	42,017	41,606	42,359
Other operating expense (1)	358	358	2,885	3,926
Operating Loss	(24,778)	(19,870)	(41,057)	(15,462)
Interest and other income (expense) , net	(4,613)	(2,662)	(1,959)	3,703
Reorganization items (2)				340,397
Gain (Loss) before income taxes	$ (29,391)	$ (22,532)	$ (43,016)	$ 328,638
Net Gain (Loss)	$ (36,928)	$ (23,020)	$ (43,694)	$ 326,256
Net Income (Loss) per common share:				
Basic	$ (3.32)	$ (2.07)	$ (3.93)	$ 1.20
Diluted	$ (3.32)	$ (2.07)	$ (3.93)	$ 0.77
Shares used in the calculation of net income (loss) per common share:				
Basic	11,125	11,125	11,125	271,563
Diluted	11,125	11,125	11,125	423,875

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Predecessor Company

	Fiscal 2006			
	June 30	**March 31**	**December 30**	**September 30**
Total revenue	$ 115,708	$ 105,562	$ 136,796	$ 160,739
Costs and expenses:				
Cost of revenue	70,532	68,227	80,952	100,722
Research and development	18,220	20,838	21,254	23,365
Selling, general and administrative	42,903	51,336	57,627	59,865
Impairment of Goodwill		8,386		
Other operating expense (1)	(7,694)	11,550	10,114	7,185
Operating loss	(8,253)	(54,775)	(33,151)	(30,398)
Interest and other income (expense) , net	(3,615)	(4,292)	(2,226)	(5,304)
Reorganization items (2)	(7,826)			
Loss from continuing operations before income taxes	$ (19,694)	$ (59,067)	$ (35,377)	$ (35,702)
Net loss from continuing operations	$ (20,376)	$ (53,955)	$ (35,664)	$ (36,199)
Net loss from discontinued operations, net of tax				
Net loss	$ (20,376)	$ (53,955)	$ (35,664)	$ (36,199)
Net loss per common share basic and diluted:				
Continuing operations	$ (0.08)	$ (0.20)	$ (0.13)	$ (0.14)
Discontinued operations				
Net loss per common share basic	$ (0.08)	$ (0.20)	$ (0.13)	$ (0.14)
Shares used in the calculation of net loss per common share:				
Basic	271,563	270,452	268,383	267,036
Diluted	271,563	270,452	268,383	267,036

(1) Other operating expense is composed of estimated restructuring costs, related accretion and asset impairment charges in each quarter of fiscal 2007 and fiscal 2006. The last three quarter of fiscal 2007 also includes bankruptcy-related items incurred post-emergence.

	Quarters Ended	
	Dec 30, 2005	**Sept 30, 2005**

Total revenue (decrease)	$ (7,597)	$ (8,938)
Operating loss (increase) (3)	$ (4,231)	$ (4,128)
Net loss from continuing operations (increase)	$ (4,231)	$ (4,128)
Net loss per common share (increase)	$ (0.02)	$ (0.02)

(2) Reorganization items represent expenses for professional fees and the effects of our plan.

(3) Includes fourth quarter adjustments of $5 million related to Successor Company s net provision for income taxes resulting from releasing the Predecessor Company s valuation allowance when the Successor Company utilized tax net operating loss carryovers from the Predecessor Company.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 27. Subsequent Event

In October 2006, we entered into a Senior Secured Credit Agreement (the Agreement), providing us with an $85 million term loan from Morgan Stanley Senior Funding, Inc. and a $30 million line of credit from General Electric Capital Corporation (GE).

On September 11, 2007, the lenders under the $85 million term loan, including Quadrangle Master Funding Ltd and Watershed Technology Holdings, LLC, or their affiliates, which are significant stockholders of SGI, purchased and assumed the position of GE under the Agreement, and substituted themselves as the lenders under the $30 million line of credit. On the same day, we entered into a Second Amendment to the Agreement (the Second Amendment) with Morgan Stanley Senior Funding, Inc., as agent for the lenders. The Second Amendment eliminated our obligations to comply with the maximum leverage ratio and minimum consolidated EBITDA covenants originally set forth in the Agreement through December 2008. After December 2008, we must comply with maximum leverage ratio and minimum consolidated EBITDA requirements, which have been adjusted as set forth in the Second Amendment. The Second Amendment eliminated our obligation to comply with the minimum liquidity requirement set forth in the Agreement, and also set the total line of credit at $20 million. Under the Second Amendment, the interest rates on line of credit advances were increased to the LIBOR rate plus 4.75%. or the Alternative Base Rate plus 3.50%, at our option.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

a) Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of June 29, 2007. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were ineffective as of the end of the period covered by this report because of the material weakness in our internal control over financial reporting discussed below. This material weakness does not affect previously reported results.

b) Management s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have conducted an evaluation of the effectiveness of our internal control over financial reporting as of June 29, 2007 based on the framework set forth in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As a result of the material weakness described below, our Chief Executive Officer and Chief Financial Officer have concluded that the Company did not maintain effective internal control over financial reporting as of June 29, 2007.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis. A material weakness related to accounting for income taxes has been identified as of June 29, 2007. The material weakness was comprised of the following deficiencies: The Company did not have adequate resources with sufficient technical expertise to properly account for income taxes in accordance with generally accepted accounting principles, specifically under fresh start accounting. The Company did not have adequate policies and procedures in place to ensure that the schedules supporting the income tax provision were properly prepared and reviewed.

These deficiencies resulted in a material error in our income tax provision.

The effectiveness of our internal control over financial reporting as of June 29, 2007 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in its report which is included in Part II, Item 8 of this Form 10-K.

c) Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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We are in the process of implementing changes to respond to the aforementioned material weakness on an immediate and longer term basis. The immediate responsive action being taken includes the implementation of process improvements related to foreign tax subsidiary reporting, enhancing the training of our tax accounting personnel, and implementing additional procedures appropriate for the internal financial close process as it relates to the tax department. We will begin remediation immediately, and expect to continue to implement further improvements throughout the next 12 months.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information on directors appearing under the heading Directors and Nominees for Director in our Definitive Proxy Statement relating to the Annual Meeting of Stockholders (the 2007 Proxy Statement), is incorporated herein by reference. See Executive Officers of the Registrant in Part 1, Item 1 of this report for information about Executive Officers of the Company.

The information contained under the heading Section 16(a) Beneficial Ownership Reporting Compliance in the 2007 Proxy Statement is incorporated herein by reference.

The information contained under the heading Code of Business Conduct and Ethics in the 2007 Proxy Statement is incorporated herein by reference.

The information contained under the heading Audit Committee in the 2007 Proxy Statement is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information appearing under the headings Executive Compensation and Directors Compensation in the 2007 Proxy Statement is incorporated herein by reference.

The information contained under the heading Compensation and Human Resources Committee Interlocks and Insider Participation in the 2007 Proxy Statement is incorporated herein by reference.

The information contained under the heading Compensation and Human Resources Committee Report in the 2007 Proxy Statement is incorporated herein by reference. Pursuant to the rules and regulations of the SEC under the Exchange Act, the information under such caption incorporated by reference from the 2007 Proxy Statement shall not be deemed filed for purposes of Section 18 of the Exchange Act nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information contained under the heading Security Ownership of Certain Beneficial Owners and Management in the 2007 Proxy Statement is incorporated herein by reference.

The information contained under the heading Securities Authorized for Issuance Under Equity Compensation Plans in the 2007 Proxy Statement is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information appearing under the heading Board Operations in the 2007 Proxy Statement is incorporated by reference in this Annual Report on Form 10-K.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information appearing under the headings Fees Paid to the Independent Registered Public Accounting Firm and Audit Committee Pre-Approval Policies and Procedures in the 2007 Proxy Statement is incorporated by reference in this Annual Report on Form 10-K.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) The following documents are filed as a part of this Report:

1. FINANCIAL STATEMENTS: See "Index to Consolidated Financial Statements" under Item 8 of this Annual Report

2. FINANCIAL STATEMENT SCHEDULES: The following financial statement schedule of Silicon Graphics, Inc. is filed as part of this Report and should be read in conjunction with the Consolidated Financial Statements of Silicon Graphics, Inc. Schedules not listed have been omitted because they are not applicable or are not included in the consolidated financial statements or notes thereto.

Schedule II

Valuation and Qualifying Accounts

(in thousands)

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Other	(Write-offs)/ Recoveries	Balance at End of Period
Year ended June 24, 2005:					
Accounts receivable allowance	$ 4,575	$ 280	$ (1,120)(2)	$ (1,508)	$ 2,227
Deferred tax asset allowance	$ 743,524	$ 21,673	$ 8,504 (1)	$ (43,085)	$ 730,616
Year ended June 30, 2006:					
Accounts receivable allowance	$ 2,227	$ 877	$ (132)	$ 145	$ 3,117
Deferred tax asset allowance	$ 730,616	$ 59,795	$ 1,015 (1)	$	$ 791,426
Three months ended September 29, 2007:					
Accounts receivable allowance	$ 3,117	$ 190	$ (863)	$ 19	$ 2,463
Deferred tax asset allowance	$ 791,426	$ 7,332	$ 3,217 (1)	$ (3,342)	$ 798,883
Nine months ended June 29, 2007:					
Accounts receivable allowance	$ 2,463	$ (8)	$ (49)	$ (394)	$ 2,012
Deferred tax asset allowance (3)	$ 798,883	$ 25,764	$ (4,143)(1)	$	$ 820,504

(1) Reserve of paid-in capital benefits related to stock option activity and other activities, such as $4.9 million release of valuation allowance due to usage of Predecessor NOL that was charged against intangibles.

(2) In addition to the items noted in (1), includes approximately $1 million of accounts receivable allowance for discontinued operations and approximately $1 million of MCSI reserve reclassification to long term accounts receivable.

(3) Adjustments associated with our assessment of the uncertainty of realizing the full benefit of deferred tax assets (primarily related to net operating loss carryforwards). The activity in the deferred tax assets allowance accounts has no impact on our statement of operations.

3. EXHIBITS. The following Exhibits are filed as part of, or incorporated by reference into, this Report:

2.1	Debtors First Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, as Modified, dated September 15, 2006 (incorporated by reference to Exhibit 2.1 of registrant s Current Report filed on Form 8-K filed on September 19, 2006)
2.2	Disclosure Statement for Debtors First Amended Joint Plan of Reorganization under Chapter 11 of the Bankruptcy Code dated July 27, 2006 (incorporated by reference to Exhibit 2.2 of registrant s Current Report filed on Form 8-K filed on September 19, 2006)

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3.1	Amended and Restated Certificate of Incorporation of Silicon Graphics, Inc., dated as of October 17, 2006 (incorporated by reference to Exhibit 3.1 to the registrant s Current Report on Form 8-K filed on October 20, 2006)
3.2	Second Amended and Restated Bylaws of Silicon Graphics, Inc., dated as of October 17, 2006 (incorporated by reference to Exhibit 3.2 to the registrant s Current Report on Form 8-K filed on October 20, 2006)
4.1	Registration Rights Agreement, dated October 17, 2006, by and among Silicon Graphics, Inc. and certain stockholders of Silicon Graphics, Inc. , including Watershed Capital Partners, L.P., Watershed Capital Institutional Partners, L.P., Watershed Capital Partners (Offshore), Ltd., QDRF Master Ltd., Quadrangle Debt Recovery Income Fund Master Ltd., Quadrangle Debt Opportunities Fund Master Ltd., and Encore Fund, L.P. (incorporated by reference to Exhibit 10.1 to the registrant s Current Report on Form 8-K filed on October 20, 2006)
4.2	First Supplemental Indenture, dated September 18, 2006, between Silicon Graphics, Inc. and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.10 to the registrant s Annual Report on Form 10-K for the period ending on June 30, 2006) .
4.3	Second Supplemental Indenture, dated September 18, 2006, between Silicon Graphics, Inc. and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit4.11 to the registrant s Annual Report on Form 10-K for the period ending on June 30, 2006)
10.1	Software Agreement dated as of January 4, 1986, as supplemented June 6, 1986, and Sublicensing Agreement dated as of June 9, 1986 between the registrant and AT&T Information Systems Inc. (incorporated by reference to exhibits of registrant s Registration Statement on Form S-1 (No. 33-8892), which became effective October 29, 1986)
10.2	Software License Agreement dated January 24, 1986, between the registrant and AT&T Information Systems Inc. (incorporated by reference to exhibits of registrant s Registration Statement on Form S-1 (No. 33-12863), which became effective March 31, 1987)
10.3*	Form of Employment Continuation Agreement entered into between the registrant and its executive officers, as amended and restated as of April 25, 2001 (incorporated by reference to Exhibit 10.4 of registrant s Quarterly Report on Form 10-Q for the period ended March 25, 2005)
10.4*	Form of Agreement dated September 15, 2006, requiring acknowledgment by executive officers that no change of control will occur in connection with emergence from bankruptcy (incorporated by reference to Exhibit 10.5 of the registrant s Annual Report on Form 10-K for the periods ended June 30, 2006)
10.5*	Executive Incentive Plan Description and Summary Forms of Notice (incorporated by reference to Exhibit 10.1 of registrant s Form 8-K filed on November 8, 2005)
10.6*	Sales Executive Compensation Plan Description and Summary Form of Notice (incorporated by reference to Exhibit 10.2 of registrant s Form 8-K filed on November 8, 2005)
10.7	Post-Petition Loan and Security Agreement dated June 28, 2006 (incorporated by reference to Exhibit 10.1 of Registrant s Form 8-K filed on June 29, 2006)
10.8	Global Settlement Agreement dated June 23, 2006 (incorporated by reference to Exhibit 10.1 of registrant s Form 8-K filed on June 27, 2006)
10.9*	Forms of Notice of Restricted Stock Unit Award and Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.3 of registrant s Current Report on Form 8-K filed on December 7, 2007)
10.10*	Forms of Notice of Stock Option Award and Stock Option Agreement (incorporated by reference to Exhibit 10.2 of the registrant s Current Report on Form 8-K filed on December 7, 2006)

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10.11*	Silicon Graphics, Inc. Management Incentive Plan. (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on October 17, 2006)
10.12*	Employment Agreement between Silicon Graphics, Inc. and Dennis McKenna dated January 27, 2006 (incorporated by reference to Exhibit 10.1 of registrant s Form 8-K filed on February 2, 2006)
10.13*	Amended Employment Agreement between Silicon Graphics, Inc. and Dennis McKenna dated April 17, 2006 (incorporated by reference to Exhibit 10.3 of registrant s Form 8-K filed on April 20, 2006)
10.14*	Amended Restricted Stock Agreement between Silicon Graphics, Inc. and Dennis McKenna dated April 17, 2006 (incorporated by reference to Exhibit 10.4 of registrant s Form 8-K filed on April 20, 2006)
10.15*	Notice of Restricted Stock Unit Award to Dennis McKenna dated March 30, 2007 (incorporated by reference to Exhibit 10.39 of the registrant s Quarterly Report on Form 10-Q for the period ended March 30, 2007)
10.16*	Restricted Stock Unit Award Agreement between Silicon Graphics, Inc. and Dennis McKenna dated March 30, 2007 (incorporated by reference to Exhibit 10.40 of the registrant s Quarterly Report on Form 10-Q for the period ended March 30, 2007)
10.17*	Bonus Agreement between Silicon Graphics, Inc. and Dennis McKenna dated March 9, 2007 (incorporated by reference to Exhibit 10.41 of the registrant s Quarterly Report on Form 10-Q for the period ended March 30, 2007)
10.18*	Bonus Agreement between Silicon Graphics, Inc. and Dennis McKenna dated March 30, 2007 (incorporated by reference to Exhibit 10.42 of the registrant s Quarterly Report on Form 10-Q for the period ended March 30, 2007)
10.19	Release and Waiver of Claims Agreement between Silicon Graphics, Inc. and Dennis McKenna dated April 3, 2007 . (incorporated by reference to Exhibit 10.43 of the registrant s Quarterly Report on Form 10-Q for the period ended March 30, 2007)
10.20	Form of Indemnification Agreement between the registrant and its directors and executive officers (incorporated by reference to Exhibit 10.1 of the registrant s Quarterly Report on Form 10-Q for the period ended September 29, 2006)
10.21	Summary of November 7, 2006 Performance Bonus Awards (incorporated by reference to Exhibit 10.1 of the registrant s Quarterly Report on Form 10-Q for the period ended September 29, 2006)
10.22	Vice Presidents Severance Benefits Plan (incorporated by reference to Exhibit 10.1 of the registrant s Quarterly Report on Form 10-Q for the period ended March 31,2006)
10.23	Senior Secured Credit Facility, dated October 17, 2006, by and among Silicon Graphics, Inc., certain of its subsidiaries, Morgan Stanley Senior Funding, Inc., General Electric Capital Corporation and the lenders party thereto. (incorporated by reference to Exhibit 10.2 to the registrant s Current Report on Form 8-K filed on October 20, 2006)
10.24	Security Agreement, dated October 17, 2006, by and among Silicon Graphics, Inc., certain of its subsidiaries and General Electric Capital Corporation, in its capacity as the Collateral Agent under the Credit Agreement. (incorporated by reference to Exhibit 10.3 to the registrant s Current Report on Form 8-K filed on October 20, 2006)
10.25	Pledge Agreement, dated October 17, 2006, by and among Silicon Graphics, Inc., certain of its subsidiaries and General Electric Capital Corporation, in its capacity as the Collateral Agent under the Credit Agreement. (incorporated by reference to Exhibit 10.4 to the registrant s Current Report on Form 8-K filed on October 20, 2006)

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10.26	First Amendment to the Senior Secured Credit Agreement dated as June 5, 2007 (incorporated by reference to Exhibit 10.12 of the registrant s Current Report on Form 8-K filed on June 11, 2007)
10.27	Lease Agreement dated as of September 7, 2006, between Christensen Holdings, L.P. and Silicon Graphics, Inc. relating to the property at 1140-1154 East Arques Avenue, Sunnyvale, California (incorporate by reference to Exhibit 10.36 of the registrant s form 10-K for the period ended June 30, 2006)
10.28	Second Amendment to the Senior Secured Credit Agreement dated as of September 11, 2007
10.29	Employment Agreement between Silicon Graphics, Inc and Robert H. Ewald entered into on April 9, 2007
10.30	Mutual Separation and General Release Agreement between Silicon Graphics, Inc. and Dennis McKenna dated April 6, 2007
21.1	List of Subsidiaries (incorporated by reference to Exhibit 4.8 of registrant s Form 10-K for the year ended June 30, 2006).
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm.
23.2	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Robert Ewald and Kathy Lanterman.

* This exhibit is a management contract or compensatory plan required to be filed as an exhibit to this Form 10-K pursuant to Item 14(c).

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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.

SILICON GRAPHICS, INC.

Dated: September 12, 2007

By: /s/ ROBERT H. EWALD
Robert H. Ewald
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ ROBERT H. EWALD **Robert H. Ewald**	Chief Executive Officer and Director (Principal Executive Officer)	September 12, 2007
/s/ KATHY LANTERMAN **Kathy Lanterman**	Chief Financial Officer (Principal Financial Officer)	September 12, 2007
/s/ DAVID A. BARR **David A. Barr**	Chief Accounting Officer and Corporate Controller (Principal Accounting Officer)	September 12, 2007
/s/ KEVIN KATARI **Kevin Katari**	Chairman and Director	September 12, 2007
/s/ EUGENE I. DAVIS **Eugene I. Davis**	Director	September 12, 2007
/s/ ANTHONY GRILLO **Anthony Grillo**	Director	September 12, 2007
/s/ JOANNE O. ISHAM **Joanne O. Isham**	Director	September 12, 2007
/s/ JAMES A. McDIVITT	Director	September 12, 2007

James A. McDivitt

/s/ Chun Won Yi	Director	September 12, 2007

Chun Won Yi

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