SILICON GRAPHICS INC
Form 10-K
October 16, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the fiscal year ended June 30, 2006.

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the transition period ______ to ______

Commission File Number 1-10441

SILICON GRAPHICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2789662**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

1200 Crittenden Lane, Mountain View, California 94043-1351

(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: (650) 960-1980

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Title of each class
Common Stock, $0.001 par value
6.50% Senior Secured Convertible Notes

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes ¨ No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the Exchange Act). Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

The aggregate market value of the registrant s voting stock held by non-affiliates of the registrant, based upon the closing sale price of the Common Stock on December 30, 2005 on the Over-the-Counter Bulletin Board, was approximately $74 million. Shares of voting stock held by each executive officer and director and by each person who owns 5% or more of any class of registrant s voting stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of September 15, 2006, the registrant had 274,247,196 **shares of Common Stock outstanding.**

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K will be filed with the Securities and Exchange Commission as an amendment to this Form 10-K in accordance with General Instruction G(3).

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SILICON GRAPHICS, INC.

FORM 10-K

FOR FISCAL YEAR ENDED JUNE 30, 2006

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PART I

Cautionary Statement Regarding Forward-Looking Information

The Business section and other parts of this Annual Report on Form 10-K contain forward-looking statements about our business, objectives, financial condition, and future performance that involve risks and uncertainties. These forward-looking statements include, among others, statements relating to the following: expected emergence from Chapter 11, expected levels of revenue, gross margin, operating expense, future profitability, our expectations for new product introductions and market conditions, our assessment of the adequacy of our liquidity and capital resources, our belief regarding capital levels required for fiscal 2007, headcount reductions, and the expected impact on our business of restructuring actions, legal proceedings, and government actions. We have based these forward-looking statements on our current expectations about future events. In some cases, you can identify forward-looking statements by terminology such as may , will , should , expects , plans , anticipates , believes , estimates , predicts , potential , or continue or the negative of such terms and similar terms. These forward-looking statements are only predictions and are subject to risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in such statements. Factors that might cause such a difference in results include, but are not limited to: the effects of our Chapter 11 filing; our ability to maintain adequate liquidity; our ability to obtain and maintain normal terms with customers, suppliers and service providers; our ability to continue as a going concern; our ability to operate pursuant to the terms of our credit agreement; our ability to consummate our plan of reorganization with respect to our Chapter 11 Cases; our ability to maintain contracts that are critical to our operations; risks associated with the volatility of our stock price; risks associated with the timely development, production and acceptance of new products and services; increased competition; dependence on third party partners and suppliers; the failure to achieve expected product mix and revenue levels; failure to manage costs and generate improved operating results and cash flows; failure to maintain compliance with debt covenants; and failure to maintain adequate cash resources for the operation of our business. Additional risks and uncertainties include the following: risks related to liquidity and the adequacy of our capital resources; risks related to our ability to achieve profitable operations or limit losses; risks related to the impact on our business of the restructuring effected in fiscal 2005 and the significant restructuring effected in fiscal 2006 and to be effected in fiscal 2007; risks related to our compliance with debt covenants; changes in customer order patterns; the impact of employee attrition and our ability to hire certain key professionals in areas such as sales, marketing, finance, engineering and product management in order to execute our business strategies; adverse changes in general economic or business conditions; adverse changes in the markets for our products, including expected rates of growth and decline in our current markets; heightened competition, reflecting rapid technological advances and constantly improving price/performance, which may result in significant discounting and lower gross profit margins; continued success in technological advancements and the acceptance of new product introductions; risks related to dependence on our partners and suppliers; risks related to foreign operations (including weak or disrupted economies, unfavorable currency movements, and export compliance issues); risks associated with intellectual property disputes and other claims and litigation; and other factors, including, but not limited to, those discussed below under the heading Risk Factors in Item IA of this Form 10-K. We undertake no obligation to publicly update or revise any forward-looking statements, whether changes occur as a result of new information, future events, changed assumptions, or otherwise.

ITEM 1. BUSINESS

General

SGI is a leading provider of products, services, and solutions for use in high-performance computing and storage. We sell highly scalable servers, storage solutions, and associated software products that enable our customers in the scientific, technical and business communities to solve their most challenging problems and provide them with strategic and competitive advantages. Whether analyzing images to aid in brain surgery, studying global climate changes, accelerating the engineering of new automotive designs, providing technologies for homeland security, or gaining business intelligence from mining a company s databases, SGI s systems are designed to compute vast amounts of data, translate data into high-resolution images in a realistic timeframe and scale, and provide high-speed storage. We also offer a range of services and solutions, including professional services, customer support, and education. These products and services are used in a range of application segments including defense and intelligence, sciences, engineering analysis, and enterprise data management.

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Chapter 11 Reorganization

On May 8, 2006 (the Petition Date), Silicon Graphics, Inc. (the Company or SGI) and certain of its subsidiaries (collectively, the Debtors), filed voluntary petitions for reorganization under chapter 11 of Title 11 (Chapter 11) of the United States Code (the 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). Certain subsidiaries of SGI, consisting principally of international subsidiaries, are not debtors (collectively, the Non-Debtors) in this bankruptcy proceeding. The Debtors remain in possession of their assets and properties as debtors-in-possession (DIP) 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 is authorized 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. For further information regarding these petitions, see Note 1 to the consolidated financial statements in Part II, Item 8 of this Form 10-K.

On May 10, 2006, SGI, 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 DIP financing (the $70 million DIP Financing) to the Borrowers secured by certain of the Borrowers assets.

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 $130 million DIP Financing). This $130 million DIP Financing was approved by the Court on June 26, 2006 and we borrowed $100 million against this facility, of which a portion of the funds were used to repay our outstanding borrowings against the $70 million Interim DIP Financing and our pre-petition asset-backed credit facility.

At a hearing held on July 27, 2006, the Court approved the Company s Disclosure Statement, ruling that it contained adequate information for soliciting creditor approval of the Company s Plan of Reorganization. At a hearing held on September 19, 2006, the Court confirmed the Company s Plan of Reorganization as amended (the Plan). This Confirmation Order became a Final Order on October 2, 2006. We expect to emerge in October 2006 subject to the remaining conditions precedent to emergence:

- The conditions precedent to the effectiveness of the Exit Facility and the Backstop Commitment Agreement are satisfied or waived by the parties thereto and the Reorganized Debtors have access to funding under the Exit Facility;

- Allowed General Unsecured SGI Federal Claims and Allowed General Unsecured SGI World Trade Claims shall not aggregate more than $1 million;

- All actions, agreements, instruments or other documents necessary to implement the terms and provisions of the Plan are effected or executed and delivered, as applicable; and

- All authorizations, consents and regulatory approvals, if any, required by the Debtors in connection with the consummation of the Plan are obtained and not revoked.

Under Chapter 11, we are continuing to operate our business without interruption as a debtor-in-possession under the jurisdiction of the 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.

Although we cannot currently estimate the impact of the Chapter 11 filings on our future financial statements, we have determined that we will be required to review certain assumptions used in determining the fair values of our long-lived assets and other intangibles, deferred revenue and the realizability of our accounts receivable among other items. These charges will have a significant non-cash impact on our future results of operations, but will have no impact on the underlying cash, working capital assumptions or the underlying operation of the business.

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Proposed Business Plan

In connection with our Chapter 11 proceeding, we prepared a proposed business plan that was presented to our Court appointed Creditors Committee on June 30, 2006 and is described in our Disclosure Statement. Certain highlights of the business plan are provided below. The projections underlying the business plan were not prepared to conform to the guidelines established by the American Institute of Certified Public Accountants regarding financial forecasts, and were not audited, reviewed, or compiled by our independent registered public accounting firm. It should also be noted that the following highlights are forward looking and based on certain forecasts, market assumptions and many other factors and, as such, are inherently inaccurate and should not be relied upon. Further, our proposed business plan described in the Disclosure Statement and the assumptions utilized therein were determined prior to the finalization of our consolidated financial statements for fiscal 2006. A change in these assumptions or factors could significantly affect the projections contained in the business plan. Additionally, you should carefully read the Cautionary Statement Regarding Forward-Looking Information section of this Form 10-K for a list of some of the items that could affect our business and actual financial results.

The business plan projects pro forma year-over-year consolidated revenue growth of between approximately 2.5% to 5.0% given our strategies regarding new product development, penetration of new markets and the stabilization of our current core of revenue sources. Accordingly, the business plan projects consolidated revenue of $532 million in fiscal 2006 to increase to approximately $671 million in fiscal 2011. The business plan projects gross profit of between 38% and 40% with slight changes as the mix of products changes and as revenue increases while fixed costs of goods sold remains static. The business plan projects that we will continue to implement further restructuring actions to reduce costs in fiscal 2008 and as such, operating expenses, excluding restructuring, will continue to decline through fiscal 2008. For fiscal 2009 and beyond, the projections assume that operating expenses will increase for modest annual increases in employee compensation. The business plan projects an operating loss of approximately $22 million in fiscal 2007 as we continue to implement restructuring actions to achieve profitability in fiscal 2008 and beyond.

The business plan projects that, at emergence, we will obtain a term loan for approximately $70 million and will repay the outstanding debtor-in-possession (DIP) facility with part of the $50 million proceeds from the rights offering and the $70 million exit facility. Post-emergence projected interest expense represents interest expense associated with the $70 million exit facility.

Upon emergence, the business plan projects that our new common stock will consist of 25,000,000 authorized shares of the reorganized company with distributions including approximately 10,000,000 shares issued and distributed to holders of Allowed Secured Note Claims and Allowed Cray Unsecured Debenture Claims, 1,125,000 shares distributed as Overallotment Shares pursuant to the Backstop Purchasers pursuant to the Backstop Purchase Agreement, and a certain number of shares not to exceed 10% of the new common stock to be distributed pursuant to the terms of the New Management Incentive Plan.

In preparing the business plan, we made many assumptions, which, if changed, could significantly affect the results of operations against the business plan. Some of the major assumptions include: current and projected market conditions in each of our respective markets; successful implementation of our top-line growth strategies; successful execution of operational improvements including cost savings opportunities in our manufacturing operations and in administrative departments; and the ability to maintain sufficient working capital to self-fund our operations or gain access to financing sources to fund any deficiencies. We undertake no obligation to publicly update or revise any of the projections or information discussed in the business plan, whether changes occur as a result of new information, future events, changed assumptions, or otherwise.

Business Strategy

For more than 20 years, SGI systems have enabled discovery, innovation and information transformation for scientists, engineers and creative professionals who benefit from systems engineered to meet their specific needs. We are taking the knowledge that we have gained in our traditional markets, coupled with the services our customers rely on and are making that more broadly available across our customers organization or enterprise. The unique shared-memory architecture of our server product line enables enterprise customers dealing with bigger data sets to access, analyze and transform their data to improve their decision-making and their overall competitive advantage. Furthermore, we have expanded our product line to include servers with Intel Xeon processors and clusters. SGI s strategy, to incorporate

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leading-edge technology in point-solutions that target specific workflow requirements and package the technology in a unified solution, enables all customers to efficiently deploy a blended server solution to support multi-workflow requirements.

This strategy requires that we maintain industry leadership with our products and services and provide highly differentiated solutions to our customers. Accordingly, the core elements of our strategy are as follows:

Leading-Edge Innovation. Being at the forefront of high-performance computing, data management and services is core to our strategy, and accordingly we invest significantly in product development. SGI has introduced many important innovations to the world, including the first scalable NUMA (Non-Uniform Memory Access) system and work that led to the first storage area networks. Recent innovations in interoperability have brought to SGI a range of product lines that operate well together in customer environments, enabling SGI to solve a broader range of customer problems.

Support of Industry Standards. SGI is committed to the support of open standards for core elements of its new generation products, while focusing its proprietary component technology development to areas that deliver differentiated features and performance. Commitment to an open system platform is important for several reasons. First, it enables our customers to benefit from the superior price performance of today s best-of-breed components, such as commodity DRAMs and the Intel Itanium and Xeon families of processors. Second, it enables SGI to leverage the research and development of Intel and the Linux community and therefore to focus our resources on systems architecture, storage management and solution delivery, all of which we believe is differentiated in important respects in the marketplace. Third, our support of industry standards, such as the Linux operating system, enables SGI to assimilate easily into standards-based IT environments.

Direct Engagement with Our Customers. SGI benefits greatly from its close association with its customers, who are often among the leading experts in their fields. We maintain a program of regular contact and technical discourse with our customers. In addition to sponsoring many industry conferences and forums around the world, SGI engineers and executives meet regularly with the SGI User Group, an independent entity whose membership includes elite users of SGI solutions. This direct interaction between the leading edge of the computing world and SGI has influenced our architectural approach, and we consider this close association to be a core part of our ongoing strategy.

Market Focus. Leveraging our strengths in scalable high-performance computing, data management and deep domain expertise, we are developing solutions that map to customers enterprise and workflow environments. We have also aligned our marketing resources to address specific market needs and drive innovation to benefit our target markets.

Investing in ISV and Reseller Relationships. SGI depends on a strong ecosystem of software, hardware and partners. We are investing in a worldwide global developer program for independent software vendors, including porting and benchmarking support, direct interaction with our engineering staff, and sales and marketing resources. We understand that our success depends on theirs. We also engage in a variety of programs with OEM and reselling partners, who bring our technologies to a variety of customers not serviced directly by SGI. Investment in developing reseller channels and in software application partners joint marketing continues to be a key strategy for us, as it supports our ability to deliver a complete market-driven solution.

Products

SGI systems are developed to enable our customers to overcome the challenges of complex data-intensive workflows, and accelerate breakthrough discoveries, innovation, and information transformation. SGI systems are primarily based on the Linux operating system and Intel Itanium 2 and Xeon microprocessors; although we continue to offer systems based on the IRIX® operating system and MIPS® RISC microprocessors. The SGI server platform addresses specific workflow requirements with its Linux-based comprehensive family of SGI® Altix® products in a unified infrastructure that is based on industry-standard Linux operating system, a comprehensive storage offering, and common development and administrative toolsets across the platform.

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Scalable Servers. SGI offers a full range of scalable servers from our entry level SGI® Altix® 400 series of servers and clusters through the SGI® Altix® 4000 series of servers and supercomputers. These Altix product families feature Intel Itanium 2 processors, the Linux operating system, and SGI® NUMAflex , which enables customers to configure systems to meet their exact requirements, while maintaining optimum flexibility in meeting their changing needs over time. Altix 400 series systems combine SGI s NUMAflex architecture with entry-level pricing to deliver exceptional value as a scalable solution for departmental, database and cluster applications. The Altix 4000 systems are the most scalable systems in the industry and achieve this performance through the combination of the proven NUMAflex approach and the power of up to 1024 Itanium 2 processors running a single operating system. Altix systems can further be brought together in clusters to create supercomputers of 10,240 processors or more that are among the most powerful in the world today.

Altix XE. SGI Altix® XE is a value-priced entry-level server and integrated cluster solution that complements the Altix scalable server product lines. It offers superior performance and energy efficiency at a lower price point. The combination of the advanced Intel® Dual-Core Xeon® processor architecture delivered in a fully factory integrated cluster solution, backed by SGI s industry-leading service and support provides customers with exceptional value in the SGI Altix XE platform.

Storage Solutions. Customers across high-performance computing and enterprise markets desire ever increasing performance from their servers, creating a parallel need to manage the massive amounts of data generated by these servers. SGI InfiniteStorage is a line of scalable, high-performance storage solutions built specifically for data-intensive workflow management, faster cycle times, and higher levels of access, availability and security.

Within the InfiniteStorage line, SGI offers a broad range of disks and disk subsystems, ranging from entry-level disk arrays to complex enterprise-class storage systems, in either direct- or fabric-attached configurations. SGI offers industry-leading scalable network-attached storage (NAS) through a range of file-serving solutions bundles. SGI also offers storage area network (SAN) solutions based on tightly integrating our CXFS shared file system, along with SGI s FailSafe® high-availability software and Data Migration Facility (DMF) for hierarchical storage management. InfiniteStorage systems can be attached to SGI systems and a variety of platforms from other vendors. This approach is intended to allow these solutions to scale across storage architectures and operating systems in addition to scaling from megabytes to exabytes and from hundreds to millions of files in a single system.

Global Services

The quality and reliability of our products and our understanding of SGI customers technical and business challenges is critical to our success. SGI s Technology Solutions service portfolio offers system solution engineering services, professional and managed services, and traditional customer support and education. Through our Technology Solutions, we offer our customers service solutions tailored to meet their business objectives and maximize the return on their technology investment. We provide customer support services online, through SGI global support centers, and through authorized local service providers in countries where SGI does not have a local office. SGI s support offerings include both hardware and software support, and range from on-site and mission critical support to same-day and next-day support with response times based on the needs of the customer.

Support Services. SGI Support Services consist of a core set of offerings that are available worldwide. Our proven support offerings include hardware and software support and range from on-site and mission critical support to same day and next day support with response times based on the needs of the customer. In addition, SGI support customers receive excellent benefits from SGI Electronic Support tools such as Embedded Support Partner (ESP), SGI Knowledgebase, and Supportfolio.

Managed Services. SGI Managed Services include a broad range of product-focused services to maximize system performance and accelerate productivity. Services include hardware installation, system deployment, implementation, and on-site and remote system management. Specific implementation services include system administration, installation and configuration of SGI systems, SAN and CXFS Implementation, File Server Implementation and High-Availability Software Implementation.

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Professional Services. SGI Professional Services is a total solution provider operating worldwide. We design solutions to help our customers achieve their technology and business goals and overcome their greatest challenges. Our teams of solution architects, project managers, and technical engineers deliver comprehensive solutions as well as specific services that address the solution s life cycle from initial problem assessment to solution architecture, deployment, and integration through follow-on support and service. SGI delivers solutions focused around High Performance Computing (HPC), Storage and Media Solutions. Our Professional Services group maps solutions to the customer s workflow utilizing our extremely rich technology portfolio with a complete spectrum of industry best-in-class technology including servers, storage, interconnect, software and consulting. SGI has expertise in a broad range of industries for complete solution stacks including development, deployment and management.

Marketing, Sales, and Distribution

SGI sells system products and solutions through both a direct sales force and indirect channel partners. In fiscal 2006, SGI initiated a program to recruit and develop a stronger reseller channel in order to reach a greater number of customers and introduce our products to new markets**.** The SGI direct sales and support organization operates throughout the United States and in most significant international markets. We have channel partners in almost all the countries in which we have a presence; in other countries, we work through SGI authorized distributors.

Our indirect channel partners include service providers, systems integrators, value-added resellers, master resellers, and OEMs.

We maintain active programs to encourage independent software development for our systems. Through our Global Developer Program, we provide hardware, software, service, and marketing support benefits to attract and retain software developers and enable these developers to deliver the highest quality software on both our Linux and IRIX platforms.

Our Solutions Finance organization works with customers to arrange third party financing for sales-type lease transactions and assists in the remarketing of off-lease systems.

Information with respect to international operations and export sales is presented in Note 10 to the consolidated financial statements included in Part II, Item 8 of this Form 10-K. See also Risk Factors included in Item IA of this Form 10-K.

No single end-user customer accounted for 10% or more of our revenues in any of the last three fiscal years. While our sales in the U.S. government sector represent substantially more than that level, these sales are made to and through numerous government agencies and to integrators and resellers who work with those agencies. Information regarding revenue and operating profit by reportable segments and revenue from external customers by geographic region is presented in Note 18 to the consolidated financial statements included in Part II, Item 8 of this Form 10-K and in the Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of this Form 10-K.

Research and Development

SGI is concentrating its research and development efforts on products and technologies that it believes hold the highest potential, including global shared memory system architectures and storage. Our strategy is to derive maximum leverage from these efforts by using a foundation of industry-standard components, such as the Intel Itanium family of microprocessors and the Linux operating system. As a result, we have sharply reduced our investment in visualization technology and graphics as well as MIPS microprocessors and the IRIX operating system. There can be no assurance that we will maintain or create sufficient differentiation to achieve and sustain a competitive advantage.

During fiscal 2006, fiscal 2005 and fiscal 2004, SGI spent approximately $84 million, $93 million, and $109 million, respectively, on research and development, representing approximately 16% of total revenue in fiscal 2006 and 13% of total revenue in each of fiscal 2005 and fiscal 2004. We are committed to continuing innovation and differentiation, and as a result will most likely continue to make research and development investments consistent with historical levels. However, declines in total revenue over the last several fiscal years have led us to reduce the absolute dollar level of our investment in research and development.

Manufacturing

SGI s single point of manufacture and fulfillment is located in Chippewa Falls, Wisconsin. Our manufacturing operations primarily involve the assembly and test of high level subassemblies and subsystems, configured specifically to customer requirements. All finished products are subject to appropriate environmental and functional testing prior to shipment. We continually evaluate the allocation of manufacturing activities among our own operations and those of suppliers and subcontractors.

Most of our products incorporate components that are available from only one or limited sources. Key components that are sole-sourced include application specific integrated circuits (ASICs), microprocessors and certain cable, power and memory products. We have chosen to deal with sole sources in these cases because of unique technologies, economic advantages, or other factors. But reliance on single or limited source vendors involves several risks, including the possibility of shortages of key components. Continued availability of these components could be affected if producers were to discontinue supplying, or to change the payment terms for, components customized to meet our requirements. Risks also include limited bargaining flexibility, long lead times, reduced control over delivery schedules, and the possibility of charges for excess and obsolete inventory. We attempt to mitigate these potential risks by working closely with these and other key suppliers on product introduction plans, strategic inventories, and internal and external manufacturing schedules and levels. Consistent with industry practice, we acquire components through a combination of formal purchase orders, supplier contracts, and open orders based on projected demand information. These purchase commitments typically cover our requirements for periods ranging from 30 to 180 days.

We also have single sources for less critical components, such as peripherals, communications controllers, monitors, and chassis, but we believe that in most cases we could develop alternative sources for these components if necessary. However, unexpected reductions, interruptions or price increases would, at least in the short term, adversely affect our operating results.

Several of our suppliers are located outside the United States. Pricing from these suppliers can be strongly affected by such factors as trade protection measures and changes in currency exchange rates. In addition, the markets for memory modules, which are a significant component of our overall systems cost, can be volatile both in terms of pricing and availability.

Competition

The computer industry is highly competitive and is known for rapid technological advances. These advances result in frequent product introductions, short product life cycles and steadily improving price/performance. Customers make buying decisions based on many factors, including solution completeness, product features, price/performance, total cost of ownership, product quality and reliability, ease of use, capabilities of the system software, availability of third party applications, software, customer support, product availability, and corporate reputation. Significant discounting from list prices is prevalent in the industry.

Our focus on addressing a large portion of the workflow with high performance offerings in our key application segments provides advantages in being able to develop solutions specifically for these users. However, our competitors such as IBM, Hewlett-Packard, Sun Microsystems and Dell are generally far larger companies with much greater resources. We also compete with systems manufacturers and resellers of systems based on X86 class microprocessors. Because a computer system is a substantial investment requiring multi-year support, concerns as to our continued viability can have a significant competitive impact. In some instances, the diversified business of our competitors can support very deep discounting to gain market share in the high-performance computing business. We believe growth in the Linux-based systems market may also attract increased competition. An important competitive development in our market has been the emergence of networked clusters and commodity computers from suppliers like Dell Computer as an alternative to our midrange products. These clusters have grown at a faster than anticipated rate and are taking an increasing share of the high-performance computing market.

Proprietary Rights and Licenses

We currently own and have applied for more than 700 U.S. patents, and we intend to continue to protect our inventions with patents in the United States and abroad. We also hold various U.S. and foreign trademarks. Although we believe the ownership of patents, copyrights, trademarks, and service marks is an important factor in our business and that our success does depend in part on the ownership thereof, we rely primarily on the innovative skills, technical competence, and marketing abilities of our personnel to differentiate our products and services within the marketplace.

As is customary in our industry, we license from third parties a wide range of software, including the LINUX and UNIX operating systems, for internal use and use by our customers.

Our business will be affected by our success in protecting proprietary information and obtaining necessary licenses. We are in discussions with several parties regarding the potential use of our patents, which may result in licensing fees, royalties or a one-time settlement. If negotiations are not successful, we may need to litigate. If we were to litigate, we could incur significant costs and we might not prevail in our case. Litigation or changes in the interpretation of intellectual property laws could expand or reduce the extent to which we or our competitors are able to protect intellectual property or could require significant changes in product design. Because of technological changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents, it is possible certain components of our products and business methods may unknowingly infringe existing patents of others. The computer industry has seen a substantial increase in litigation with respect to intellectual property matters, and we have been engaged in several intellectual property disputes both as plaintiff and defendant. We are in discussions with several parties that have asserted intellectual property infringement claims, and we expect that litigation of this sort will reoccur from time to time. See Risk Factors .

Seasonality and Backlog

We do not consider our business to be highly seasonal, although in two of the past three years revenues in the second fiscal quarter ending in December have been higher than other quarters in our fiscal year, reflecting in part buying patterns of calendar year-end customers. Past performance should not be considered a reliable indicator of our future revenues or financial performance.

Our consolidated backlog at June 30, 2006 was $127 million, up from $120 million at June 24, 2005. Backlog is comprised of committed purchase orders for products and services deliverable within nine months. 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. In addition, we have not yet reflected in our backlog portions of longer delivery-cycle contracts we have been awarded, but which will not be delivered in the next nine months. The deliveries associated with these contracts are currently scheduled to ship outside the time frame provided in our bookings policy and will not be recognized as revenue in fiscal 2007. 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. Although the backlog reflects only orders for which a firm purchase order has been issued or a contract has been made, many orders in backlog are subject to customer cancellation or rescheduling in certain circumstances, and government customers typically have rights of cancellation for convenience. As a result, backlog should not be considered a reliable indicator of our ability to achieve any particular level of revenue or financial performance.

Environmental Laws

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 can 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 material or 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.

From time to time new regulations are enacted, and it is difficult to anticipate how such regulations will be implemented and enforced. We cannot estimate the possible loss exposure; therefore, no accrual for the costs to comply with these regulations has been recorded. We track regulatory developments that may impact our business and devote 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 European Union Directive on the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS), 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 to Europe after July 1, 2006, and we are completing 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 Waste Electrical and Electronic Equipment (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.

Employees

As of June 30, 2006, we had 1,738 regular employees compared with 2,423 at June 24, 2005. Our future success will require that we continue to retain and motivate highly qualified technical, sales, marketing and management personnel. We have never had a work stoppage, and no employees are represented by a labor union. We have workers councils where required by European Union or other applicable laws.

Corporate Data

SGI was originally incorporated as a California corporation in November 1981, and reincorporated as a Delaware corporation in January 1990. SGI s website address is *www.sgi.com*. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports are available, without charge, on the investor relations page of our website, *www.sgi.com*, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. Our Corporate Governance Guidelines, Code of Business Conduct and Ethics and the charters of the Audit Committee, Compensation and Human Resources Committee and Corporate Governance and Nominating Committee of our Board of Directors are also posted on our website at *www.sgi.com/company_info/*. Copies are also available, without charge, from the Corporate Secretary, Silicon Graphics, Inc., 1200 Crittenden Lane, Mountain View, CA 94043.

Trademarks Used in the Form 10-K

Silicon Graphics, SGI, Octane, Onyx, Origin, Tezro, Fuel, FailSafe, IRIX, and Altix are registered trademarks, and CXFS, NUMAflex and Prism are trademarks of Silicon Graphics, Inc. in the U.S. and/or other countries worldwide.

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EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of SGI and their ages as of September 15, 2006 are as follows:

Name	Age	Position and Principal Occupation	Executive Officer Since
Dennis McKenna	57	Chairman of the Board, Chief Executive Officer and President	2006
Kathy Lanterman	46	Senior Vice President, Chief Financial Officer and Corporate Controller	2002
Eng Lim Goh, PhD	46	Senior Vice President and Chief Technology Officer	2000
Barry Weinert	52	Vice President, General Counsel and Corporate Secretary	2006

Executive officers of SGI are elected annually by the Board of Directors and serve at the Board s discretion. There are no family relationships among any directors, nominees for director, or executive officers of SGI.

Mr. McKenna was appointed as the President and Chief Executive Officer of the Company in January 2006. On February 1, 2006, the Board of Directors appointed Mr. McKenna as a director and Chairman of the Board. Prior to joining the Company, Mr. McKenna served as the President and Chief Executive Officer of SCP Global Technologies, a private company that is a supplier of semiconductor capital equipment, from March to August 2005. From October 1997 to August 2004, Mr. McKenna served initially as President and Chief Executive Officer, and subsequently as President and Chief Executive Officer and Chairman, of ChipPAC, Inc., a public global semiconductor manufacturing and services company.

Ms. Lanterman became Senior Vice President, Chief Financial Officer and Corporate Controller in February 2006. She served as Vice President, Corporate Controller from April 2002 through February 2006 after joining SGI in July 2001 as Assistant Controller. She was a consultant to SGI from April 1999 until she was hired in 2001, working on projects including the implementation of our global Enterprise Resource Planning system.

Dr. Goh became Senior Vice President and Chief Technology Officer in May 2001. He was appointed Vice President and Chief Technology Officer in October 2000, Vice President of Global Systems Engineering in October 1999, and Chief Scientist in December 1998. He joined SGI in September 1989 and has held a variety of systems engineering positions since that time.

Mr. Weinert became Vice President and General Counsel in January 2006. He joined SGI in May 1995 as Commercial Counsel and served as the Associate General Counsel from March 2001 until January 2006.

ITEM 1A. RISK FACTORS

SGI operates in a rapidly changing environment that involves a number of risks, some of which are beyond our control.

We have been incurring losses and consuming cash in our operations and must reverse these trends. We have incurred net losses and negative cash flows from operations resulting from year over year declines in revenue during

each of the past several fiscal years. At June 30, 2006, our principal source of liquidity was unrestricted cash and marketable investments of $55 million, down from $64 million at June 24, 2005. Currently, we expect to continue consuming cash from operations through at least the first half of fiscal 2007. 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 to the beginning of the following quarter. We also continue to focus on expense controls, margin improvement initiatives and working capital efficiencies. However, it is essential to our operating plans for fiscal 2007 that our restructuring plan yields its anticipated savings and we meet the goals of our financing arrangements for both fiscal years. See Financial Condition .

To seek to improve our liquidity, we are continuing to implement restructuring actions aimed at substantial expense reductions and a revenue generation initiative aimed at reversing the decline in our revenues. In addition, our operating goals require us to maintain stable year-over-year revenue levels while realizing our targeted expense savings and margin improvements. If we fail to achieve these targets, we will likely consume further cash in our operations, which would further impair our liquidity. See Financial Condition .

Our future financial results will be affected by the adoption of fresh start accounting and may not reflect historical trends. The Company s emergence from Chapter 11 proceedings will result in a new reporting entity and adoption of fresh-start reporting in accordance with SOP 90-7. As required by fresh-start accounting, our assets and liabilities will be adjusted to fair value, and certain assets and liabilities not previously recognized in the Company s financial statements will be recognized under fresh-start accounting. Because we have not yet completed our reorganization and adopted fresh start accounting, the condensed consolidated financial statements as of June 30, 2006 do not give effect to any adjustments in the carrying values of assets or liabilities that will be recorded upon implementation of the Company s Plan. Accordingly, our financial condition and results of operations from and after the effective date will not be comparable to the financial condition and results of operations reflected in our historical consolidated financial statements. For further information about fresh start accounting, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, Fresh Start Reporting .

We face significant challenges in connection with our bankruptcy reorganization. On May 8, 2006, we and certain of our subsidiaries filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. See Note 1 to the consolidated financial statements in Part II, Item 8 of this Form 10-K for further information. Our ability, both during and after the Chapter 11 Cases, to continue as a going-concern is dependent upon, among other things, (i) our ability to successfully achieve required cost savings to complete our restructuring; (ii) our ability to maintain adequate cash on hand; (iii) our ability to generate cash from operations; (iv) the consummation of a plan of reorganization under the Bankruptcy Code; and (v) our ability to achieve profitability. There can be no assurance that we will be able to successfully achieve these objectives in order to continue as a going-concern. The accompanying consolidated financial statements do not include any adjustments that might result should we be unable to continue as a going-concern.

There is a risk of non-occurrence of the effective date. At a hearing held on September 19, 2006, the Court confirmed our Plan (the Confirmation Date). While the Plan has been confirmed by the Court, it has not yet been consummated. Although we believe that the effective date of the Plan (the Effective Date) will occur soon after the Confirmation Date, there can be no assurance as to such timing. Under the Plan, the Effective Date must occur within 30 days of the date of the Court s order confirming the Plan. Moreover, if each of the conditions to consummation and the occurrence of the Effective Date has not been satisfied or duly waived on or before October 20, 2006, or such later date as may be consented to by the parties, the Court may vacate the Confirmation Order, in which event the Plan would be deemed null and void. The failure of the Effective Date to occur on or before October 20, 2006, would (unless duly waived) constitute a termination event under the Restructuring Agreement that could allow parties to terminate their obligations to support the Plan. This, in turn, could cause an event of default under the Company s post-petition financing agreement and the post-petition financing order that could give rise to termination of the post-petition credit facility and the Debtors ability to use cash collateral as well as the exercise of remedies by the agent thereunder with respect to some or all of the Debtors assets.

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We may not achieve our operating goals and may not be in compliance with debt covenants. In June 2006, the Debtors entered into a replacement Post-Petition Loan and Security Agreement with Morgan Stanley Senior Funding, Inc., Wells Fargo Foothill, Inc., and certain other lenders party thereto, providing up to $130 million of debtor-in-possession financing. See Note 13 to the consolidated financial statements in Part II, Item 8 of this Form 10-K. Under the terms of the $130 million DIP Financing, we are required to comply with various terms and conditions. Although to date we have been in compliance, there can be no assurance that we will be able to comply with such terms and conditions in the future. In the event that we default under the DIP Agreement and the DIP Agreement is terminated, there can be no assurance that sufficient alternative financing arrangements will be available. Furthermore, in the event that cash flows, together with available borrowings under the $130 million DIP Financing or alternative financing arrangements, are not sufficient to meet the Company s cash requirements, we may be required to reduce planned capital expenditures, sell additional assets and seek other sources of capital. We can provide no assurance that such actions will be sufficient to cover any cash shortfalls. The need to comply with the terms of our debt obligations may also limit our ability to obtain additional financing and our flexibility in planning for or reacting to changes in our business and the industry. In addition, if we are unable to achieve the goals of our going-forward business plan and operational restructuring strategy, we may be forced to sell all or parts of our business, develop and implement further restructuring plans or become subject to further insolvency proceedings.

We may not be successful in closing our exit financing. We have received a commitment and paid a commitment fee to Morgan Stanley Senior Funding, Inc. and General Electric Capital Corporation to provide the Company with a credit facility adequate to meet our forecasted cash requirements. The commitment for financing is dependent on completing a definitive loan agreement, and other closing conditions. While we believe that we will be able to successfully meet these requirements, we cannot guarantee that the funds will be made available to us until all such conditions are met.

Our bankruptcy reorganization may negatively impact our future operations and the operations of our subsidiaries. As part of the first day relief requested in the Chapter 11 Cases, the Court entered orders allowing us to pay certain pre-petition key vendor trade claims in the ordinary course of business. However, we were not permitted to pay all of our vendors in full. As a result, while we have not yet experienced any significant disruption in our relationships with our suppliers or vendors, we may have difficulty maintaining existing relationships, or creating new relationships with suppliers or vendors. Our suppliers and vendors could stop providing supplies or services to us or provide such supplies or services only on terms such as cash on delivery, cash on order, or other terms that could have an adverse impact on our short-term cash flows. In addition, the filing of the Chapter 11 Cases may adversely affect our ability to retain existing customers, attract new customers and maintain contracts that are critical to our operations.

The filing of the Chapter 11 Cases and the publicity surrounding the filing might also adversely affect the businesses of our non-debtor subsidiaries. Because our business is closely related to the businesses of all of our subsidiaries, any downturn in the business of our subsidiaries could also affect our prospects. It remains uncertain whether the commencement of the Chapter 11 Cases and the associated risks will adversely affect the businesses of any of our subsidiaries. In addition, our non-debtor subsidiaries do not have the benefit of the automatic stay and other protections afforded by the Bankruptcy Code.

Upon consummation of the Plan, our existing common stock will be cancelled and have no value. Under the Plan, all of our existing common stock will be cancelled upon consummation of the Plan and the holders of such securities will receive no recovery. This has caused a significant negative reaction from our stockholders and may adversely affect our ability to attract new stockholders in the future.

The conduct of our business may be restricted under the Bankruptcy Code. The Debtors are operating their businesses as debtors-in-possession pursuant to the Bankruptcy Code. Under applicable bankruptcy law, during the pendency of the Chapter 11 Cases, the Debtors are required to obtain the approval of the Court prior to engaging in any transaction outside the ordinary course of business for the debtor entities. In connection with any such approval, creditors and other parties in interest may raise objections to such approval and may appear and be heard at any hearing with respect to any such approval. Accordingly, although the Debtors may seek the approval of the Court to sell assets and settle liabilities (including for amounts other than those reflected on the Company s consolidated financial statements), there can be no assurance that the Court will grant such approvals. The Court also has the authority to oversee and exert control over the Debtors ordinary course operations.

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As a result of the restrictions described above, prior to the Effective Date, our ability to respond timely to changing business and economic conditions may be significantly restricted, and we may be prevented from engaging in transactions that might otherwise be considered beneficial.

Our on-going restructuring activities may not reduce our losses and cash consumption. We have implemented several expense-related restructurings in recent years. In addition, in September 2005, March 2006, and June 2006 we began to implement restructuring plans aimed at further substantial expense reductions and continue to execute on these plans. See Overview Further Restructurings to Reduce Expenses . Although we will seek to implement these actions in a manner that does not materially reduce revenue or impair our ability to compete successfully, we cannot be certain that these outcomes will not occur or that these actions will accomplish their intended objective of reducing our losses and cash consumption. Substantially all of the restructuring charges have required or will require the outlay of cash.

We are operating under new leadership that will cause strategic and operational changes in our business. On January 27, 2006, the Board of Directors appointed Mr. Dennis McKenna as our new President and Chief Executive Officer in order to effectuate the turnaround of our business. In addition, our Board of Directors appointed Mr. McKenna as a director and Chairman of the Board on February 1, 2006. Also on February 27, 2006 Mr. Jeffery Zellmer, the Company s Senior Vice President and Chief Financial Officer and Mr. Warren Pratt, the Company s Executive Vice President and Chief Operating Officer, resigned. Ms. Kathy Lanterman, the Company s Vice President and Controller, was appointed the new Senior Vice President and Chief Financial Officer of the Company.

We are currently in a transition period as a result of these leadership changes. We may continue to have strategic, operational or leadership changes to our business in the future and we cannot assure you that such strategic, operational or leadership changes, if any, will lead to an improvement of our business and financial condition. There can also be no assurance that any such strategic, operational or leadership changes will not lead to a further deterioration of our business or financial condition.

We may not be able to raise additional capital in the future. In the future, we may need to obtain additional financing to fund our business or repay our debt, and we cannot assure you that financing will be available in amounts or on terms acceptable to us. In addition, if funds are raised by incurring further debt, our operations and finances may become subject to further restrictions and we may be required to limit our service or product development activities or other operations, or otherwise modify our business strategy. If we fail to comply with financial or other covenants required in connection with such a financing, our creditors may be able to exercise remedies that could substantially impair our ability to operate. In addition, if we obtain additional funds by selling any of our equity securities or if we issue equity derivative securities in connection with obtaining debt financing, the percentage ownership of our stockholders will be reduced, stockholders may experience additional dilution, or the equity securities may have rights, preferences or privileges senior to the common stock.

Our success is dependent on continued revenue growth from newer product families. The SGI Altix family of servers and superclusters based on the Intel Itanium 2 processor and the Linux operating system was introduced in January 2003 and additional products in this line were added during fiscal 2004. In addition, our SGI Altix XE family of cluster products was introduced in June 2006. Our Linux-based systems sales declined by 40% in fiscal 2006 compared with fiscal 2005. Risks associated with these newer product families include dependence on Intel in terms of price, supply, dependability, performance, product roadmaps and timely access to design specifications, and continued support for and development of the Itanium 2 and Xeon processor families; the availability of Linux applications optimized for the 64-bit Itanium platform or our scalable systems architecture; acceptance of the Linux operating system in demanding environments; and competition from other suppliers of Intel-based servers, including clusters of low-end servers. These clusters are rapidly increasing as an important competitive factor in the high performance server market and have had a negative effect on our revenues and our gross margins.

Future revenue growth from our newer product families is especially important because revenues from our

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traditional MIPS and IRIX products and maintenance business are expected to continue to decline. Our ability to achieve future revenue growth will depend significantly on the market success of these newer product families in servers and storage as well as our ability to generate sales to match or replace revenues generated from large sales transactions in prior periods. If one or more of the product lines were to fail in the market, it could have an adverse effect on our business and liquidity.

Our product strategy and business would be adversely affected by any delay, discontinuance or decreased competitiveness of the microprocessors we use. Our core products are based on system architectures that have been developed by working closely with partners for optimization on our products. Our product strategy and business depend on the continued availability and competitiveness of the microprocessors that we use and would be adversely affected by any further delays and/or discontinuance of these processor families. In addition, we may incur penalties under long-term contracts that require the delivery of future products. It is also important to our competitive position that our chosen microprocessors be competitive as to performance as well as price. Microprocessor technology changes rapidly, and in order to be competitive we must keep pace with those changes. Although we have taken steps with the introduction of new products to mitigate our dependence on a single microprocessor, the transition will take some time, and the migration may be expensive and time consuming.

Our results of operations would be adversely affected if the carrying value of our long-lived assets became impaired. We evaluate our long-lived assets, including property and equipment and goodwill, whenever events or circumstances occur that indicate that the carrying amount of a long-lived asset may not be recoverable. Such events or 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 long-lived asset impairment review would be based on a cash flow analysis and would require judgment with respect to many factors, including future cash flows, 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 cash flows may change within the next twelve months resulting in the need to reassess the carrying value of our long-lived assets for impairment. The process of evaluating the potential impairment of goodwill is subjective and requires significant estimates and assumptions at many points during the analysis. 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. Actual future results may differ from those estimates. As a result, we may incur substantial non-cash impairment charges, which could adversely affect our results of operations. For example, in the third quarter of fiscal 2006 our operating results were adversely impacted by an $8 million charge for the impairment of goodwill associated with our Products reporting unit. See Note 11 to the consolidated financial statements in Part II, Item 8 of this Form 10-K for further information on our goodwill impairment assessment.

Our financial reporting controls and procedures may be impaired by our restructuring activities and attrition. The uncertainties surrounding our business prospects, the Chapter 11 filing, and our continuing restructuring actions have increased the challenges of attracting and retaining qualified employees. Our annualized attrition rates have increased significantly in fiscal 2006 compared with fiscal 2005. There is no guarantee that we can retain highly qualified employees, or that we will be able to hire highly qualified candidates, as new skills are needed. In addition, while we will strive to ensure that material weaknesses do not develop in our internal controls due to headcount reductions or other factors, there is no guarantee that our internal controls will be unaffected by the restructuring actions or increasing attrition. If material weaknesses develop and we are unable to efficiently and effectively address these matters, investors could lose confidence in the reliability of our internal controls over financial reporting.

We are increasingly dependent on our key suppliers. Our strategy of developing system products based on industry-standard technologies has increased our technical dependence on Intel and other key suppliers. It is therefore important that we receive appropriate development cooperation from our suppliers, and that the products from these suppliers continue to evolve in ways that support the differentiation that we seek to bring to our products. In particular, our Altix family depends on continued component availability, dependability, quality, performance and price/performance. Our financial performance and business prospects would be adversely affected if our suppliers were to reduce their support, including to supply components on terms that enable us to compete effectively for sales with substantial price sensitivity.

The competitiveness of our system products, particularly our servers, is also significantly affected by the availability on our platform of third-party software applications that are important to customers in our target markets. The success of our Linux-based products and services depends on, among other things, the growth of the Linux market, the acceptance of Linux solutions by customers in demanding environments, the availability of Linux applications optimized for the 64-bit Itanium 2 platform or our scalable systems architecture and our dependence on acceptance of SGI-developed code by the open source community and by Linux distributors with whom we partner.

Our dependence on key suppliers, including sole source suppliers, may prevent us from delivering an acceptable product on a timely basis. We rely on both single source and sole source suppliers for many of the components we use in our products. For example, we currently utilize microprocessors from a sole source supplier in our Altix family of servers and superclusters and have designed our system architecture to optimize performance using their processors. If we were to utilize an alternative microprocessor, the transition would require an alternative design, which would be costly and cause significant delays in the development of future products, adversely affecting our business and operating results.

Our business is dependent on our ability to anticipate our needs for components and products and our suppliers ability to deliver such components and products in time to meet critical manufacturing and distribution schedules. In addition, we have benefited from favorable discounts on certain components from key suppliers for selected transactions. Our business could be adversely affected, for example, if suppliers fail to meet product release schedules, if we experience supply constraints, if we fail to negotiate favorable pricing or if we experience any other interruption or delay in the supply chain that interferes with our ability to manufacture our products or manage our inventory levels. Risks also include limited bargaining flexibility, the possibility of charges for excess and obsolete inventory and risks involved with end of life buys from single source and sole source suppliers. We are currently focused on maximizing our working capital by working closely with our suppliers and tightly managing our overall supply chain.

In addition, we are in the process of transitioning to an alternate supplier to act as our foundry for certain key integrated circuits for new products planned for 2008 and later. There can be no assurance that we will be able to complete the transition without significant incremental cash impact.

We may not be able to retain and attract qualified employees. Our success depends on our ability to continue to attract, retain and motivate highly qualified technical, sales and marketing and management personnel. The uncertainties surrounding our business prospects, the Chapter 11 Cases and our continuing restructuring actions have increased the challenges of retaining world-class talent. Our annualized attrition rates have increased significantly in fiscal 2006 compared with fiscal 2005. Although we have put programs in place to encourage employee retention, there is no guarantee that we can retain highly qualified employees or that we will be able to hire highly qualified candidates as new skills are needed.

We are dependent on sales to the U.S. government. 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. Sales to the government present risks in addition to those involved in sales to commercial customers, including potential disruptions due to changes in appropriation and spending patterns. Our U.S. government business is also highly sensitive to changes in the U.S. government s national and international priorities and budgeting. Events like Operation Iraqi Freedom and the continuing war on terrorism may affect funding for our programs or result in changes in government programs or spending priorities that may adversely affect our business. In addition, the U.S. government can typically terminate or modify its contracts with us at any time for its convenience. Our government business is also subject to specific procurement regulations and a variety of other requirements. Failure to comply with these or other applicable regulations and requirements could lead to suspension or debarment from government contracting or subcontracting for a period of time. Any disruption or limitation in our ability to do business with the U.S. government could have an adverse impact on us.

A portion of our business requires security clearances from the U.S. government. These arrangements are subject to periodic review by customer agencies and the Defense Security Service of the Department of Defense.

We expect our operating results to fluctuate for a variety of reasons. Our revenue and operating results may fluctuate for a number of reasons from period to period, and we have consistently fallen short of our forecasts in recent years. Decreases in revenue can arise from any number of factors, including decreased demand, supply constraints, delays in the availability of new products, transit interruptions, overall economic conditions, competitive factors, military or terrorist actions, or natural disasters. Demand can also be adversely affected by concerns specifically associated with our financial health and by product and technology transition announcements by us or our competitors. The timing of customer acceptance of certain large-scale server products may also have a significant effect on periodic operating results. Margins are heavily influenced by revenue levels, mix considerations, including geographic concentrations, the mix of product and service revenue, industry price trends, competitive pricing pressures (particularly for high visibility accounts) and the mix of server and desktop product revenue as well as the mix of configurations within these product categories. As a result of the concentration of sales in the third month of each quarter, developments late in a quarter can have a significant impact on that period s results.

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. Competition may result in significant discounting and lower gross margins. In addition, as our Linux-based systems business grows, the number of our competitors may grow commensurate with the increased market opportunity. An important competitive development in our market has been the emergence of networked clusters of commodity computers from suppliers like Dell Computer as an alternative to our midrange products. These clusters have grown at a faster than anticipated rate and are taking an increasing share of the high-performance computing market. These clustered systems may not be subject to U.S. export regulations, which may make them more attractive to certain international customers. See *Many of our international sales require export licenses* . Although we have introduced a cluster product, we face significant competition in this market.

Our typical concentration of sales at the end of our fiscal quarters makes period-to-period financial results less predictable. Over half of each quarter s product revenue results from orders booked and shipped during the third month, and disproportionately in the latter half of that month. This makes the forecasting of revenue inherently uncertain and can produce pressure on our internal infrastructure during the third month of a quarter. Because we plan our operating expenses, many of which are relatively fixed in the short term, on expected revenue, even a relatively small revenue shortfall may cause a period s results to be substantially below expectations.

We are subject to the risks of international operations. We generate a large 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; difficulties associated with repatriating cash generated abroad; fluctuations in transportation costs; natural and medical disasters; and trade protection measures.

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 such as our products being shipped directly or through a third-party to certain countries. 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.

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We may not be able to develop and introduce new products on a timely basis. Meeting our objectives for the future will require that our recently introduced products achieve success in the marketplace and that we succeed in the timely development and introduction of more successful new products. Product transitions are a recurring part of our business. A number of risks are inherent in this process.

The development of new technology and products is increasingly complex and uncertain, which increases the risk of delays. The introduction of new computer systems requires close collaboration and continued technological advancement involving multiple hardware and software design teams, internal manufacturing teams, outside suppliers of key components such as semiconductors and outsource manufacturing partners. The failure of any one of these elements could cause our products under development to fail to meet specifications or to miss the aggressive timetables that we establish. There is no assurance that development or acceptance of our new systems will not be affected by delays in this process. In addition, from time to time we receive co-funding for certain development efforts and reduction or elimination of such funding could adversely affect the development and introduction of new systems.

Our product strategy and business depend on the continued availability and competitiveness of the Itanium 2 processor family and would be adversely affected by any delays and/or discontinuance of this processor family. See *Our product strategy and business would be adversely affected by any delay, discontinuance or decreased competitiveness of the microprocessors we use* . In addition, we may incur penalties under long-term contracts that require the delivery of future products.

Short product life cycles place a premium on our ability to manage the transition to new products. We often announce new products in the early part of a quarter while the product is in the final stages of development and testing, and seek to manufacture and ship the product in volume during the same quarter. Our results could be adversely affected by such factors as development delays, the release of products to manufacturing late in any quarter, quality or yield problems experienced by suppliers, variations in product costs and excess inventories of older products and components. In addition, some customers may delay purchasing existing products in anticipation of new product introductions.

Most products are upgraded during their product life cycle. The ability to upgrade products in a timely fashion is necessary to compete in the computer industry. Delay in introducing updates and upgrades can adversely affect acceptance and demand for product.

We may become involved in intellectual property disputes. We 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 may seek to obtain a license. We are in discussions with several parties regarding the potential use of our patents, which may result in licensing fees, royalties or a one-time settlement. If negotiations are not successful, we may need to litigate. If we were to litigate, we could incur significant costs and we might not prevail in our case. We are in discussions with several parties that have asserted intellectual property infringement claims. In any given case there is a risk that a license will not be available on terms that we consider reasonable, or that litigation will ensue. We expect that, as the number of hardware and software patents issued continues to increase, and as competition in the markets we address intensifies, the volume of these intellectual property claims will also increase.

In addition, our growing visibility as a supplier of Linux-based systems and as a participant in the open source software community increases our risk of becoming embroiled in the intellectual property disputes concerning these subjects, such as the current widely reported litigations between SCO Group on the one hand and IBM and Red Hat on the other. We 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. Nonetheless, there can be no assurance that this dispute with SCO Group will not escalate into litigation, which could have a material adverse effect on us, or that SCO Group s intellectual property claims will not impair the market acceptance of the Linux operating system.

On August 3, 2006, LG Electronics, Inc. (LGE) filed a motion (the LGE Motion) in the Chapter 11 Cases of

the Debtors seeking relief from the automatic stay pursuant to section 362(d)(1) of the Bankruptcy Code so that LGE may proceed with certain patent infringement claims against the Company in the appropriate district court and seek damages for alleged pre- and post-petition infringements of certain of LGE s patents. The LGE Motion also requests that the Court determine that the automatic stay does not apply to LGE s ability to commence a proceeding against us in respect of our alleged continuing, post-petition infringement of LGE s patents. LGE also filed proofs of claims in the Chapter 11 Cases against each of the Debtors in connection with the alleged patent infringement. On August 25, 2006, the Debtors objected to LGE s proofs of claim. The Debtors and LGE resolved the LGE Motion by stipulation dated September 8, 2006, and entered by the Court on September 8, 2006. In the stipulation, LGE agreed to withdraw the LGE 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 Company. The Debtors agreed that LGE claims alleging patent infringement first arising after the commencement of the Chapter 11 Cases could be adjudicated in a court of competent jurisdiction other than the Court after confirmation of the plan of reorganization. On September 26, 2006, we filed a motion to estimate the LGE claims at $0.00 for purposes of allowance and distribution under the Plan. A hearing on this motion is scheduled for November 1, 2006. We do not believe that LGE s claims of patent infringement are meritorious and we intend to oppose them. See Legal Proceedings .

On April 27, 2004, SGI 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 SGI but noted that Patriot had commenced litigation against six companies in two separate litigations, including Intel. On September 23, 2005, SGI 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 SGI 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. See Legal Proceedings .

We will not be able to utilize a significant portion of our net operating loss and credit carryforwards. We currently have over $1 billion in U.S. net operating loss carryforwards due to prior period losses. 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 of a loss corporation 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 resulted in more than a 50% cumulative shift in the stock ownership of SGI. Accordingly, SGI s ability to utilize its net operating losses will be significantly limited as provided under section 382 of the Internal Revenue Code. This limitation would reduce our income after taxes, thereby affecting our cash balances and liquidity, if in any given future fiscal period taxable profits are in excess of the restricted losses available for offset.

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.

From time to time new regulations are enacted, and it is difficult to anticipate how such regulations 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 RoHS, 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 are completing 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 Waste Electrical and Electronic Equipment (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.

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

Not applicable.

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 30, 2006, our worldwide facilities represented aggregate floor space of approximately 1.0 million square feet, of which 0.9 million square feet is used in our operations, less than 0.1 million square feet is subleased to other tenants and 0.1 million 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 30, 2006 is as follows:

	Square Feet		Lease Terms	Square Feet Not Used	
	Leased	Owned	End	in Operations	Primary Uses
Mountain View, California	175,000		2006		Research and development, sales, administration
Chippewa Falls, Wisconsin	125,000	324,000	2008	55,000	Manufacturing, service, research and development
Eagan, Minnesota	85,000		2010	15,000	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	219,000		56,000	Sales
Other domestic	41,000		13,000	Sales
	683,000	324,000	139,000	

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Our leased facilities in Mountain View, California include our corporate headquarters. See Note 14 in the consolidated financial statements in Part II, Item 8 of this Form 10-K for additional information about these leases.

As a result of restructuring over the last several years, we own and lease space that we do not currently expect to use in our operations. See Note 5 to the consolidated financial statements in Part II, Item 8 of this Form 10-K for further information about lease payments for properties vacated under our restructuring actions.

ITEM 3. LEGAL PROCEEDINGS

Information regarding legal proceedings is set forth in Note 22 to the consolidated financial statements in Part II, Item 8 of this Form 10-K, 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

Our common stock is presently being quoted on the Pink Sheets Electronic Quotation Service (Pink Sheets) maintained by Pink Sheets LLC for the National Quotation Bureau, Inc. under the ticker symbol SGID.PK. Prior to November 7, 2005, our common stock was listed under, and traded on, the New York Stock Exchange (NYSE) under the trading symbol SGI. As a result of shares of our common stock not meeting the minimum per share price of $1.00 averaged over a thirty day trading period our common stock was suspended from trading by the NYSE and, thereafter, delisted by the NYSE.

As a result of our bankruptcy proceedings, certain restrictions in trading are imposed under a Court order that requires certain direct and indirect holders of claims, preferred securities and common stock to provide at least ten days advance notice of their intent to buy or sell claims against the Debtors or shares in SGI. In addition, as a result of the confirmation of our Plan by the Court on September 19, 2006, all of our existing common stock, stock options and restricted stock awards will be canceled upon emergence from Chapter 11, and the holders of such securities will receive no recovery.

As of September 15, 2006, we had 8,016 holders of record. This number does not include beneficial owners of the Company s 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. As a result of our accumulated deficit position and restrictions in certain debt instruments, we do not anticipate paying cash dividends to common stockholders.

The following table sets forth (1) the high and low close price on any given day within the quarter and the close price on the last day of the quarter for our common stock as reported on the NYSE for fiscal 2005 and for the first quarter and a portion of the second quarter of fiscal 2006, and (2) the high and low bid quotation on any given day within the quarter and the close bid quotation on the last day of the quarter for our common stock as reported on the Over-the-Counter Bulletin Board (OTCBB) and Pink Sheets for 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.

Price Range for Common Stock

	Fiscal 2006			Fiscal 2005		
	Low	**High**	**Close**	**Low**	**High**	**Close**
First Quarter	$ 0.56	$ 0.97	$ 0.78	$ 1.37	$ 2.26	$ 1.43
Second Quarter	$ 0.35	$ 0.77	$ 0.35	$ 1.26	$ 1.98	$ 1.79
Third Quarter	$ 0.32	$ 0.49	$ 0.44	$ 1.11	$ 1.78	$ 1.17
Fourth Quarter	$ 0.04	$ 0.44	$ 0.05	$ 0.68	$ 1.19	$ 0.73

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ITEM 6. SELECTED FINANCIAL DATA

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 Form 10-K, 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 Form 10-K 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 Form 10-K exclude the operating results of our Alias application software business which is classified as discontinued operations (see Note 8 to the consolidated financial statements in Part II, Item 8 of this Form 10-K) (in thousands, except per share amounts and employee data):

			Years ended		
	June 30, 2006	June 24, 2005	June 25, 2004	June 27, 2003	June 28, 2002
Operating Data:					
Total revenue	$ 518,805	$ 729,965	$ 842,002	$ 896,605	$ 1,277,274
Costs and expenses:					
Cost of revenue	320,433	465,076	492,845	563,480	760,319
Research and development	83,677	92,705	108,763	157,924	163,725
Selling, general, and administrative	211,731	244,568	257,742	282,359	409,561
Impairment of goodwill ating expense (1)	8,386				
Other operating expense (1)	21,155	24,083	47,825	30,046	44,476
Operating loss	(126,577)	(96,467)	(65,173)	(137,204)	(100,807)
Interest and other income (expense), net (2)	(15,437)	12,721	(44,600)	(24,664)	18,701
Loss from continuing operations before reorganization items and income taxes	$ (142,014)	$ (83,746)	$ (109,773)	$ (161,868)	$ (82,106)
Net loss from continuing operations	$ (146,194)	$ (75,732)	$ (100,246)	$ (135,203)	$ (49,436)
Net loss	$ (146,194)	$ (76,008)	$ (45,770)	$ (129,704)	$ (46,323)
Net loss per share basic and diluted:					
From continuing operations	$ (0.54)	$ (0.29)	$ (0.44)	$ (0.67)	$ (0.25)
Net loss	$ (0.54)	$ (0.29)	$ (0.20)	$ (0.64)	$ (0.24)
Shares used in the calculation of net loss per share basic and diluted	269,367	263,430	227,837	201,424	194,974
Balance Sheet Data:					
Cash, cash equivalents and unrestricted investments	$ 54,876	$ 64,286	$ 156,865	$ 136,468	$ 208,240
Restricted investments	48,498	40,170	24,494	36,728	44,689
Total assets	380,058	452,145	569,924	649,854	910,119
Long-term debt and other	73,616	375,852	372,048	400,124	455,312
Stockholders deficit	(330,454)	(191,188)	(122,678)	(164,891)	(54,641)
Statistical Data:					
Number of employees	1,738	2,423	2,655	3,714	4,443

(1) 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). Fiscal 2002 amounts include net restructuring charges ($33 million) and asset impairment charges ($12 million).

(2) 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. Fiscal 2002 amounts include a $64 million gain on the sale of a 60% interest in SGI Japan and $24 million in class action lawsuit settlement expense.

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

Chapter 11 Reorganization

On May 8, 2006, we and certain of our subsidiaries filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. For further information regarding these petitions, see Note 1 to the consolidated financial statements in Part II, Item 8 of this Form 10-K.

Under Chapter 11, we are continuing to operate our business without interruption as debtor-in-possession under the jurisdiction of the 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 have allocated or will allocate a substantial amount of resources to bankruptcy restructuring, which includes 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. In addition to financial restructuring activities, we are preparing to operate after our emergence from Chapter 11 protection. At a hearing held on September 19, 2006, the Court confirmed the Company s Plan. Under the Plan, all of SGI s existing common stock, stock options and restricted stock awards will be cancelled upon our exit from Chapter 11, and holders of such securities will receive no recovery. Accordingly, our existing common stock will have no value. We currently plan to emerge from Chapter 11 in October 2006.

Overview

SGI is a leading provider of products, services, and solutions for use in high-performance computing and storage. We sell highly scalable servers, storage solutions, and associated software products that enable our customers in the scientific, technical and business communities to solve their most challenging problems and provide them with strategic and competitive advantages. Whether analyzing images to aid in brain surgery, studying global climate changes, accelerating the engineering of new automotive designs, providing technologies for homeland security, or gaining business intelligence from mining a company s databases, SGI s systems are designed to compute vast amounts of data, translate data into high-resolution images in a realistic timeframe and scale, and provide high-speed storage. We also offer a range of services and solutions, including professional services, customer support, and education. These products and services are used in a range of application segments including defense and intelligence, sciences, engineering analysis, and enterprise data management.

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Business Strategy

The following overview describes key elements of our business strategy and our results achieved during fiscal 2006:

Leadership in High-Performance Standards-Based Computer Systems. 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. However, competition is putting pressure on the growth rates and gross margins for our Linux (or core systems) product families. These pressures include increasing acceptance of commodity clusters (large groups of low cost, small computers including connected PCs) in the high-performance computing market. Our revenue growth prospects, and our ability to return to profitability, depend on our ability to grow the server and storage (or core system) product families at a rate that will more than offset the expected continued decline of our traditional MIPS/IRIX product and maintenance business. In addition, our product strategy and business depend on the continued availability and competitiveness of our microprocessors and could be adversely affected by any delays and/or discontinuance of these microprocessors. 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.

Targeting our Product Portfolio on New Business Opportunities. While SGI has traditionally focused in technical and scientific computing, in addition we are expanding into targeted areas of the enterprise segment that are well served by SGI s high performance systems and expanding our product portfolio to include X86-based products. At the same time, we have made changes in our product strategy by ceasing development of future generations of differentiated visualization products and concentrating our development efforts in computer systems and storage to better capitalize on these trends. In June 2006, SGI introduced a new line of x86-based products, the Altix XE family, to more effectively address the expanding market for cluster computing.

Further Restructurings to Reduce Expenses. We continue to reduce our total operating cost structure, principally from headcount reductions and geographic consolidation of functions and facilities. Costs for fiscal 2006 for manufacturing and service, research and development, sales, marketing and administration declined 23% from the comparable prior year period. However, our revenue has continued to decline at a faster rate than anticipated, resulting in continued operating losses and cash consumption. In the fourth quarter of fiscal 2005, we retained the turnaround firm AlixPartners LLC to advise us regarding further expense reductions, increasing revenue, improving liquidity and our intentions to initiate restructuring actions in the first quarter of fiscal 2006.

During fiscal 2006, we implemented restructuring activities under three fiscal 2006 restructuring plans. These actions included headcount reductions; initiatives to reduce costs in other areas, including procurement costs for goods and services; consolidation and reorganization of operations in several locations; focusing marketing spending on the highest priority activities; renegotiated services contracts with vendors to improve terms and other spending controls. The original goal of our fiscal 2006 restructuring actions was to achieve $80 to $100 million in annualized cost savings when fully realized. In the third quarter of fiscal 2006, we increased our goal of $100 million in annualized savings to $150 million in annualized savings. We have taken actions during fiscal 2006 that we believe will achieve $150 million in annualized savings. We have seen considerable cost savings benefit during fiscal 2006 from these initiatives and expect to realize the remaining saving during fiscal 2007.

Leadership Transition

On January 27, 2006, the Board of Directors appointed Mr. Dennis McKenna as our new President and Chief Executive Officer in order to effectuate the turnaround of our business. In addition, our Board of Directors appointed Mr. McKenna as a director and Chairman of the Board on February 1, 2006. We are currently in a transition period as a result of this leadership change. Although we have announced changes to our overall business strategy, operations and leadership and we expect to have strategic, operational or leadership changes to our business in the future, we cannot assure you that such strategic, operational or leadership changes, if any, will lead to an improvement of our business and financial condition.

Results of Operations

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. We sold our Alias application software business in June 2004 (see Note 8 to our consolidated financial statements in Part II, Item 8 of this Form 10-K) and have excluded its operating results from continuing operations and reflected them as discontinued operations for all periods presented in this Form 10-K (dollars in millions, except per share amounts; amounts may not add due to rounding):

		Years ended	
	June 30,	June 24,	June 25,
	2006	2005	2004
Total revenue	$ 519	$ 730	$ 842
Cost of revenue	320	465	493
Gross profit	198	265	349
Gross profit margin	38.2%	36.3%	41.5%
Total operating expenses (1)	325	361	414
Operating loss	(127)	(96)	(65)
Interest and other income (expense), net	(15)	13	(45)
Loss from continuing operations before reorganization items and income taxes	$ (142)	$ (84)	$ (110)
Net loss from continuing operations (2)	$ (146)	$ (76)	$ (100)
Net income from discontinued operations			54
Net loss	$ (146)	$ (76)	$ (46)
Net income (loss) per share basic and diluted:			
Continuing operations	$ (0.54)	$ (0.29)	$ (0.44)
Discontinued operations	(0.00)	(0.00)	0.24
Net loss per share basic and diluted	$ (0.54)	$ (0.29)	$ (0.20)

(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.

(2) Net loss from continuing operations includes $8 million of reorganization expense.

Revenue

The following discussion of revenue is based on the results of our reportable segments, as described in Note 18 to our consolidated financial statements in Part II, Item 8 of this Form 10-K. 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 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 operating decision maker makes operating decisions and evaluates performance. Prior year amounts have been reclassified to conform to the current year presentation.

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Total revenue decreased $211 million or 29% in fiscal 2006 compared with fiscal 2005, and decreased $112 million or 13% in fiscal 2005 compared with fiscal 2004. The overall decline in revenue from fiscal 2005 to fiscal 2006 was 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. 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 for fiscal 2006, these same products need to 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. Excluding any impairment impact from Fresh Start Accounting, this revenue reduction in fiscal 2006 would be expected to amortize into revenue in future periods. The decline in revenue from fiscal 2004 to fiscal 2005 was due to declines in sales of our proprietary MIPS/IRIX-based products that more than offset growth in sales of our Intel/Linux-based Altix servers and Prism visualization systems, coupled with declines in our storage solutions and global services revenue. We expect that our MIPS/IRIX-based and related maintenance revenues will continue to decline. As discussed in Part I Item 1 of this Form 10-K, 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):

		Years ended	
	June 30,	June 24,	June 25,
	2006	2005	2004
Core Systems	$ 173	$ 270	$ 200
Legacy Systems	78	165	296
Total Products	$ 251	$ 435	$ 496
% of total revenue	48%	60%	59%
Global Services	$ 268	$ 295	$ 346
% of total revenue	52%	40%	41%

Products. Revenue from our Products segment decreased $184 million or 42% in fiscal 2006 compared with fiscal 2005 and declined $61 million or 12% in fiscal 2005 compared with fiscal 2004.

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 noted above.

Revenue from *Core Systems* in fiscal 2005 increased $70 million or 35% compared with fiscal 2004. The increase is primarily due to the increase in Altix sales and to a lesser extent, to the increase in Prism sales, offset in part by declines in Storage solutions revenues. Altix server volumes increased while average selling prices for Altix servers declined due to competitive pressures from commodity cluster systems. The lower average selling prices of the entry level Altix product, introduced in the latter half of fiscal 2004, also contributed to the decline in the aggregate average selling prices for the Altix server product family in fiscal 2005. The Storage solutions revenue decline in fiscal 2005 was primarily due to relatively flat volume coupled with lower average selling prices.

Revenue from *Legacy Systems* in fiscal 2006 decreased $87 million or 52% 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 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.

Revenue from *Legacy Systems* in fiscal 2005 decreased $131 million or 44% compared with fiscal 2004, primarily due to 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. Our workstations revenue has declined steadily over the past few years as we discontinued several product families and as our medical OEM business deteriorated. Reduced volumes of our Silicon Graphics® Octane® family of visual workstations, as we completed its end of life, and reduced volumes of both our Silicon Graphics® Fuel® and Silicon Graphics® Tezro® visual workstations were the primary contributors to the decline in workstation revenue in fiscal 2005. Also contributing to this decline was a higher mix of Fuel visual workstations which carry a lower average selling price than Tezro workstations. The decline in our MIPS/IRIX-based graphics systems revenue in fiscal 2005 was principally due to reduced volumes despite an increase in the overall average selling prices. Both volume and average selling prices for SGI® Origin® servers declined. During the second quarter of fiscal 2005, we expanded our graphics systems product family with the introduction of Silicon Graphics Prism, our graphics system based on Linux, Itanium 2, and SGI s scalable graphics technology. However, the decline in MIPS/IRIX-based graphics systems revenue in fiscal 2005 compared with fiscal 2004 exceeded the revenue generated by the Prism graphics 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 2006 decreased $27 million or 9% compared with fiscal 2005. The decline was primarily due to a reduction in our traditional customer support revenue 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 2005 decreased $50 million or 15% compared with fiscal 2004. This decline was largely attributable to the same factors described in the preceding paragraph.

Total revenue by geographic area for fiscal 2006, 2005 and 2004 was as follows (dollars in millions):

	Years ended					
	June 30,		June 24,		June 25,	
Area	**2006**		**2005**		**2004**	
Americas	$ 306	59%	$ 448	61%	$ 548	65%
Europe	131	25%	177	24%	211	25%
Rest of World	82	16%	105	15%	83	10%
Total revenue	$ 519		$ 730		$ 842	

Geographic revenue mix in fiscal 2006 remained relatively unchanged compared with fiscal 2005. The shift in geographic revenue mix in fiscal 2005 compared with fiscal 2004 is primarily a result of two large transactions, accounting for 4% of total revenue in fiscal 2005, to SGI Japan, a related party that is also our exclusive distributor in Japan.

Our consolidated backlog at June 30, 2006 was $127 million, up from $120 million at June 24, 2005. Backlog is comprised of committed purchase orders for products and professional services deliverable within nine months. Backlog

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increased within the *Core Systems* segment, specifically with regard to our Linux-based Altix servers and storage systems, offset in part by a decrease in professional services. Backlog decreased within the *Legacy Systems* segment, primarily related to our Origin products. See Business - Seasonality and Backlog in Part I, Item 1 of this Form 10-K.

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 such as a current order from a European supercomputing center for which a portion of the value is not reflected in our current backlog. A portion of this order is currently scheduled to ship outside the time provided in our bookings policy and the contract is not expected to be recognized as revenue until fiscal 2008. 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.

As described in the paragraphs below, overall gross profit margin increased to 38.2% in fiscal 2006 from 36.3% in fiscal 2005. This increase was primarily due to an improvement in service gross profit margin, offset in part by a decline in product and other gross profit margin.

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.

Overall gross profit margin declined to 36.3% in fiscal 2005 from 41.5% in fiscal 2004. Product and other gross profit margin in fiscal 2005 decreased 6.8 percentage points compared with fiscal 2004. As a result of fixed manufacturing costs, cost of sales did not decline in proportion to our lower sales volumes in fiscal 2005 compared with fiscal 2004. Also, we continued to see a shift in mix from our MIPS/IRIX-based systems which typically carry a higher gross margin to our Intel/Linux-based systems which have lower gross margins. These negative impacts on gross margin were offset slightly by favorable manufacturing variances resulting from manufacturing efficiencies and procurement cost controls. Our results in fiscal 2005 also reflected a higher percentage of revenue from a relatively small number of large transactions, especially in the Altix product family. In particular, approximately 9% of our fiscal 2005 revenue resulted from two individual large transactions. These transactions typically are negotiated with high discount rates due to very competitive bidding processes, resulting in lower gross margins, offset to some extent by favorable component pricing

provided to us by certain vendors for these transactions. Increasing competitive pricing pressures from low cost commodity cluster systems also contributed to the decline in gross profit margin. We expect to continue to generate a portion of our revenue from large, high visibility transactions which are typically very complex, tend to have lower gross margins and represent unpredictable sales cycles. We also plan to continue to work with suppliers such as Intel to structure favorable component pricing to support these types of anticipated sales. However, there is no assurance that we will be able to moderate the gross margin impact of larger, low margin transactions in any particular period.

Service gross profit margin in fiscal 2005 decreased 2.7 percentage points compared with fiscal 2004 as service costs did not decline in proportion to revenue due to fixed cost elements. Fixed costs associated with professional services coupled with lower margins on sales of third party product were the primary causes for the decline. Also contributing to the margin decline was a large sales transaction involving a significant portion of professional services at lower than average gross margin.

Operating Expenses

Operating expenses were as follows (dollars in millions):

		Years ended	
	June 30, 2006	**June 24, 2005**	**June 25, 2004**
Research and development	$ 84	$ 93	$ 109
% of total revenue	16%	13%	13%
Selling, general and administrative	$ 212	$ 245	$ 258
% of total revenue	41%	34%	31%
Impairment of goodwill	$ 8	$	$
% of total revenue	2%		
Other operating expenses	$ 21	$ 24	$ 48
% of total revenue	4%	3%	6%

Operating Expenses (excluding Other Operating Expenses). 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 46% to 59%. Fiscal 2005 operating expenses (excluding other operating expenses) decreased $29 million or 8% compared with fiscal 2004, but increased as a percentage of total revenue from 44% to 46%. The significant decline in operating expenses (excluding other operating expenses) in both years was primarily attributable to lower headcount resulting from our restructuring activities, employee attrition, and the impact of our overall expense control measures aimed at bringing expenses in line with revenue. Although we expect to realize significant long-term cost savings resulting from our restructuring actions, the savings reflected in our operating expenses (excluding other operating expenses) in fiscal 2006 were partially offset by $13 million in outside services incurred primarily in connection with our cost reduction and strategic planning initiatives. Additionally we recorded an $8 million non-cash charge for the impairment of goodwill in the third quarter of fiscal 2006, which also offset our cost savings from our restructuring actions. The decrease in our 2006 operating expenses (excluding other operating expenses) was also offset slightly by the fact that our accounting calendar had 53 weeks during fiscal 2006 compared with 52 weeks during fiscal 2005.

Adoption of SFAS 123(R)

We have three share-based compensation plans: two stock option programs and an employee stock purchase plan (ESPP). Our accounting for our current stock-based compensation plans will continue to be recorded in our results of operations during our bankruptcy proceedings. Under the Plan, all of our existing common stock, stock options, and restricted stock awards will be cancelled upon consummation of the Plan by the Court and our exit from Chapter 11, and the holders of such securities will receive no recovery.

Prior to fiscal 2006, we accounted for these 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,

Accounting for Stock-Based Compensation. Accordingly, we did not recognize any significant amounts of share-based employee compensation expense in our statements of operations prior to fiscal 2006; instead, we provided footnote disclosure of our pro forma results of operations as if we had recognized compensation expense in accordance with SFAS 123.

Beginning in the first quarter of fiscal 2006, we adopted the fair value recognition provisions of SFAS 123(R), *Share-Based Payment*, using the modified-prospective transition method. Under that transition method, compensation cost recognized in fiscal 2006 includes 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 SFAS 123(R).

As a result of adopting SFAS 123(R), we recognized share-based employee compensation expense of $2.2 million during fiscal 2006, which primarily affected our reported research and development and selling, general, and administrative expenses. We calculated this expense based on the fair values of the share-based compensation awards as estimated using the Black-Scholes-Merton closed-form option valuation model. Use of this model requires us to make assumptions about expected future volatility of our stock price and the expected term of the options that we grant. Calculating share-based compensation expense under SFAS 123(R) also requires us to make assumptions about expected future forfeiture rates for our option awards. As of June 30, 2006, total unrecognized compensation expense related to unvested share-based compensation arrangements already granted under our various plans was $4.1 million, which we expect will be recognized over a weighted-average period of 2.3 years. However, it is difficult to predict the actual amount of share-based compensation expense that we will recognize in future periods because that expense can be affected by changes in the amount or terms of our share-based compensation awards issued in the future, changes in the assumptions used in our model to value those future awards, including estimated forfeiture rates, changes in our stock price, and changes in interest rates, among other factors.

Research and Development. Fiscal 2006 research and development spending decreased $9 million or 10% compared with fiscal 2005. The fiscal 2006 decrease resulted primarily from a 15% reduction in headcount and lower facilities and information technology-related costs, offset in part by increased outside services costs. The decline in headcount related primarily to the discontinuation of our custom visualization efforts, although attrition also contributed to the decline. Fiscal 2005 research and development spending decreased $16 million or 15% compared with fiscal 2004. The fiscal 2005 decrease reflected similar factors as the fiscal 2006 decrease, including a 14% reduction in headcount. We will continue to focus our research and development investments toward 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. 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 outside consulting expenses driven primarily by professional advisory 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 filing for bankruptcy under Chapter 11. Fiscal 2005 selling, general and administrative expenses decreased $13 million or 5% compared with fiscal 2004. The fiscal 2005 decrease resulted primarily from a 16% decline in headcount as a result of restructuring and personnel attrition, and the impact of our overall expense control measures.

Impairment of 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. We perform this test separately for each of our two reporting units. Our reporting units are consistent with the reportable segments identified in Note 18 to our consolidated financial statements in Part II, Item 8 of this Form 10-K. At the end of the third quarter of fiscal 2006, 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 market capitalization, at that time, we concluded that the goodwill in our Products reporting unit was impaired. As a result, we concluded that all of the recorded goodwill in the Products reporting unit ($8 million) was impaired and expensed as a non-cash charge to continuing operations during the third quarter of 2006. See Note 11 to our consolidated financial statements in Part II, Item 8 of this Form 10-K for further information regarding our goodwill impairment assessment.

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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 to SGI. These actions have resulted in both headcount reductions and facility closures. Other operating expense for fiscal 2006 consisted mainly of a $20 million charge for severance and related costs, $2 million in costs associated with the cancellation of our Prism and Prism Deskside products offset in part by a net credit of $1 million related to our vacated leased facilities. In addition, on June 27, 2006 we reached an agreement with our landlord, including $25 million in settlement costs, that terminated our lease obligations at Amphitheatre Technology Center (ATC) and terminated our lease obligations for two buildings at Crittenden Technology Center (CTC). We also amended the lease obligations for a third building at CTC. Upon execution of the settlement for the termination of the lease obligations at ATC and CTC, we recorded a reversal of liabilities of $41 million representing the net present value of future rental payments for the ATC and CTC buildings in the fourth quarter of fiscal 2006 which largely offset previous charges to this category during the year. Other operating expense for fiscal 2005 represented a charge of $18 million for estimated restructuring costs and charges of $10 million for accretion expense on vacated properties still under lease to us. These charges were partially offset by $4 million of adjustments to previously recorded restructuring charges. Other operating expense for fiscal 2004 represented a charge for estimated restructuring costs of $49 million and charges of $3 million related to the impairment of assets. These charges were partially offset by $4 million of adjustments to previously recorded restructuring charges. As of June 30, 2006, as a result of the restructuring actions we have undertaken through June 30, 2006, we anticipate operating cash outflows of $6 million in fiscal 2007 for both severance and related charges and facility-related charges, with the remainder of our restructuring obligations to be paid through fiscal 2011. See Note 5 to our consolidated financial statements in Part II, Item 8 of this Form 10-K for further information regarding our restructuring activities.

Reorganization Items, Net. Reorganization items, net represents amounts incurred as a direct result of the Company s Chapter 11 filing and are presented separately in our Consolidated Statements of Operations. Such items consist of the following (dollars in thousands):

	2006
Professional fees	$ 13,285
Pre-petition liability claim adjustments	755
Write-off of unamortized debt premium and discount, net	(9,381)
Write-off of unamortized debt issuance costs	3,167
	$ 7,826

Interest and Other

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

		Years ended	
	June 30,	June 24,	June 25,
	2006	2005	2004
Interest expense	$ (16,445)	$ (16,052)	$ (19,234)
Investment gain (loss)	$ (227)	$ 20,703	$ 194
Foreign exchange gain (loss)	(197)	2,774	2,402
Miscellaneous income (expense)	(1,780)	876	1,807
Interest income	2,357	1,908	1,664
Interest and other income (expense), net	$ 153	$ 26,261	$ 6,067
Loss on extinguishment of tendered debt	$	$	$ (30,915)
Earnings (loss) from equity investment	$ 855	$ 2,512	$ (518)

Interest Expense. Interest expense increased 2% in fiscal 2006 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 expense decreased 17% in fiscal 2005 primarily due to a reduction in outstanding debt and a $4 million credit to interest expense related to premium amortization on our 6.50% Senior Secured Convertible Notes. Interest expense decreased 25% in fiscal 2004 primarily due to a $7 million credit to interest expense related to premium amortization on our 6.50% Senior Secured Convertible Notes, offset in part by $3 million in interest expense associated with the induced conversion of a portion of these same convertible notes.

Interest Income and Other, Net. Interest income and other, net includes interest income on our cash investments, gains and losses on other investments, and other non-operating items. The Miscellaneous income (expense) component of Interest and other income, net for fiscal 2006 includes $3 million in bank charges primarily associated with our pre-petition credit facility that remained outstanding through June 27, 2006. Interest income and other, net for fiscal 2005 is primarily composed of a $21 million gain on the sale of a portion of our 40% interest in SGI Japan, which after this transaction, reduced our remaining interest to 24% in fiscal 2005. Interest income and other, net for fiscal 2004, excluding the loss on extinguishment of tendered debt, primarily includes the receipt of $2 million in settlement for the termination of a contractual arrangement.

Loss on Extinguishment of Tendered Debt. During the second quarter of fiscal 2004, we successfully completed an exchange offer for 98% of our 5.25% Senior Convertible Notes due to mature in September 2004. We accounted for the exchange offer as a debt extinguishment, resulting in a non-cash loss of approximately $31 million, primarily representing the difference between the fair value of the new debt instruments and the net carrying value of the extinguished debt. The difference was treated as a premium on the new Senior Secured Convertible Notes and was expected to be amortized as an offset to interest expense over the term of the notes. The remaining balance was written off as a reorganization item in the fourth quarter of fiscal 2006 as a result of our bankruptcy proceeding under Chapter 11. See Note 4 to the consolidated financial statements in Part II, Item 8 of this Form 10-K for information related to reorganization items.

Earnings (Loss) from Equity Investment. Earnings (loss) from equity investment represents our share of the earnings of SGI Japan. As noted above, we sold a portion of this investment during fiscal 2005. In fiscal 2006, our ownership percentage was diluted by approximately 4% as a result of new shares issued by SGI Japan.

Provision for Income Taxes

Our net benefit for income taxes from continuing operations for fiscal 2006, fiscal 2005, and fiscal 2004 totaled $4 million, $8 million, and $10 million, respectively. The net tax benefit provision in these years arose principally from the reassessment of our 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. We did not recognize a tax benefit for our fiscal 2006, fiscal 2005, and fiscal 2004 losses, since the resulting deferred tax asset does not meet the criteria for realization under SFAS 109.

At June 30, 2006, we had gross deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of $877 million. The gross deferred tax assets are offset by a valuation allowance of $791 million and deferred tax liabilities of $87 million. The valuation allowance of $791 million included $35 million attributable to tax benefits from stock option deductions, which, if recognized, will be allocated directly to paid-in-capital.

At June 30, 2006, we had U.S. federal, state, and foreign jurisdictional net operating loss carryforwards of $1.4 billion, $386 million, and $171 million, respectively. The federal losses will begin expiring in fiscal 2010, the state losses will begin expiring in fiscal 2007, and the foreign losses will begin to expire in fiscal 2007. At June 30, 2006, we also had general business credit carryovers of $38 million for United States federal tax purposes, which will begin to expire in fiscal 2007, and alternative minimum tax credits of 5 million, which do not have fixed expirations dates. We had state research and development credits of $29 million, which do not have fixed expiration dates, and state manufacturing investment tax credits of $4 million which will begin to expire in fiscal year 2007. As a result of the bankruptcy reorganization, there is expected to be a greater than 50% cumulative shift in SGI s stock ownership and thus we will 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 .

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We have submitted a claim for a significant refund of U.S. federal income tax relating to the years 1986 through 1988. The recognition of the refund was deferred pending the settlement of two Tax Court cases that were decided in November 2003. Since then we have been in negotiations with the Internal Revenue Service to settle the refund and these negotiations continue. It is unclear what amount of refund, if any, will be obtained and in accordance with SFAS 5, *Accounting for Contingencies*, as of June 30, 2006, we have not recognized a gain contingency for this refund claim in our consolidated statement of operations or consolidated balance sheet.

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. SGI 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 8 to the consolidated financial statements in Part II, Item 8 of this Form 10-K 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 12 to the consolidated financial statements in Part II, Item 8 of this Form 10-K for further information regarding these guarantees.

Contractual Obligations

The following table summarizes our significant contractual obligations at June 30, 2006, 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):					
$130 Million Debtor In Possession Financing due 2007	$ 103,706	$ 103,706	$	$	$
Other	913	735	178		
Capital lease obligation	775	300	475		
Operating lease obligations (2)	27,142	10,516	12,165	4,410	51
Purchase obligations (3)	14,165	12,559	1,606		
Restructuring-related obligations (4)	4,845	4,845			
Total	$ 151,546	$ 132,661	$ 14,424	$ 4,410	$ 51

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 or amounts we are financing under our DIP Agreement to support $5 million in letters of credit for rent deposits for our corporate headquarters building in the Crittenden Technology Center campus in Mountain View, California. For further information regarding our DIP Agreement, see Financial Condition included in Part II, Item 7, and Note 13 to the consolidated financial statements in Part II, Item 8 of this Form 10-K.

(1) Includes estimated interest payments. 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. The significant decrease in our operating lease obligations compared with fiscal 2005 was primarily due to the settlement with our landlord to restructure our lease obligations at Amphitheatre Technology Center (ATC) and Crittenden Technology Center (CTC) campuses in Mountain View, California.

(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 30, 2006. 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.

On August, 30 2006, SGI entered into a commitment letter with Morgan Stanley Senior Funding, Inc. and General Electric Capital Corporation to provide exit liquidity financing as part of the Company s plan to emerge from bankruptcy in fiscal 2007. The exit financing facility consists of an $85 million term loan from Morgan Stanley Senior Funding, Inc. and a $30 million line of credit from General Electric Capital Corp. that will be used to pay off the existing $130 million DIP Financing, make distributions pursuant to the Plan, and provide working capital for the Company s ongoing operations. The exit financing facility is expected to mature in five years after the final credit agreement is executed. The estimated annual payments, including estimated interest, over the next five years is as follows (in thousands): fiscal 2007 $11,269; fiscal 2008 $12,179; fiscal 2009 $23,991; fiscal 2010 $26,727; fiscal 2011 $24,086 and $39,609 thereafter.

On September 7, 2006 we entered into a Lease Agreement with Christensen Holdings, L.P. for a replacement headquarters facility in Sunnyvale, California. The lease is for approximately 128,154 square feet with an initial five year lease term at $0.977 per square foot in the first year, increasing to $1.137 per square foot by the fifth year. We expect to occupy the new facility by the end of calendar 2006.

Financial Condition

To the extent the matters described below relate to future events or expectations, they may be significantly affected by the Chapter 11 filings. The Chapter 11 filings will involve, or may result in, various restrictions on the Company s activities, limitations on financing, the need to obtain Court approval for various matters, the discharge of certain obligations and uncertainty as to relationships with vendors, suppliers, customers and others with whom the Company may conduct or seek to conduct business.

Cash Balances. At June 30, 2006, our unrestricted cash and cash equivalents and marketable investments totaled $55 million compared with $64 million at June 24, 2005. At June 30, 2006 and June 24, 2005, we also held approximately $48 million and $40 million, respectively, of restricted investments. Restricted investments at June 30, 2006 and June 24, 2005 consisted of short- and long-term investments pledged as collateral against bank credit facilities or held under a security agreement. The decrease in our cash and cash equivalents compared with the prior year is primarily the result of cash used in our operations and investment activities during fiscal 2006, offset in part by cash provided by our borrowings.

Cash Consumption Trends. Primarily as a result of net losses, operating activities from continuing operations used $93 million during fiscal 2006, compared with using $98 million during fiscal 2005. The negative operating cash flows from continuing operations in fiscal 2006 were primarily due to our net losses and low revenue levels. We generated $35 million from our accounts receivable during fiscal 2006, an increase from the $21 million that was generated during the same period of fiscal 2005. During fiscal 2006, inventory increased $3 million compared to the $20 million increase in inventory reported in fiscal 2005 resulting from lower revenue levels coupled with continued focus on inventory management. Our accounts payable decreased $49 million in fiscal 2006 compared with a decrease of $7 million in the same period of fiscal 2005 primarily due to $55 million in pre-petition liabilities reclassified to liabilities subject to compromise as a result of our filing for bankruptcy under Chapter 11. During fiscal 2006 deferred revenue increased $34 million compared with a decrease of $4 million in the same period of fiscal 2005, primarily resulting from the timing of revenue recognition of sales transactions. During fiscal 2006, our accrued compensation decreased $5 million compared with the $3 million decrease in accrued compensation in the same period of fiscal 2005 primarily due to headcount reductions. During fiscal 2006, we reduced our days sales outstanding from 49 days at June 24, 2005 to 45 days at June 30, 2006.

Cash used in our operating activities from continuing operations increased by $36 million from fiscal 2004 to fiscal 2005, which is primarily due to our revenue decreasing more rapidly than we were able to adjust our operating expenses. This increase was not reflected in our net loss from continuing operations, which decreased by $25 million, because some items included in the computation of our fiscal 2005 and fiscal 2004 net losses do not affect operating cash flow. The most significant of these items are as follows: the inclusion in the fiscal 2004 net loss of a $31 million loss on the early extinguishment of debt, which does not affect operating cash flow; the reduction of the fiscal 2005 net loss by a $21 million gain on the sale of an equity investment, which does not affect operating cash flow; and the benefit to the fiscal 2005 net loss from a $17 million reduction in depreciation and amortization charges, which are non-cash expenses. Our operating cash flow did benefit from a $14 million increase from fiscal 2004 to fiscal 2005 for prepayments we have received from our customers for customer support contracts and longer delivery-cycle contracts, for which revenue recognition is deferred. During fiscal 2005, we maintained our focus on customer cash collections, as our days sales outstanding were 49 days at both June 24, 2005 and June 25, 2004.

Included in our cash used in operating activities from continuing operations are cash payments related to our past restructuring actions. Cash payments for severance and contractual and facilities obligations related to these actions totaled approximately $57 million, $40 million, and $53 million in fiscal 2006, fiscal 2005, and fiscal 2004, respectively. We expect these past restructuring actions to result in cash outlays of approximately $10 million subsequent to June 30, 2006, of which approximately $6 million are projected to occur in fiscal 2007.

Investing activities, other than changes in our marketable and restricted investments, used $11 million in cash during fiscal 2006. Our principal investing activity during fiscal 2006 was the purchase of $7 million of property and equipment. Investing activities, other than changes in our marketable and restricted investments, generated $14 million in cash during fiscal 2005. Our principal investing activity during fiscal 2005 was the sale of 40% of our investment in SGI Japan, which generated $29 million of cash. This was partially offset by purchases of property and equipment of $12 million. Investing activities, other than changes in our marketable and restricted investments, provided $42 million in cash during fiscal 2004. Our principal investing activity was the sale of our manufacturing facility in Cortaillod, Switzerland for proceeds of $11 million. These proceeds were partially offset by $18 million in purchases of property and equipment and a $9 million increase in other assets, including $4 million in debenture issuance costs. Additionally, we had net cash provided by discontinued operations investing and operating activities of $58 million in 2004 as a result of the sale of our Alias application software business, including proceeds from the sale.

Financing activities over the past three years have included the repayment of debt and the issuance of common stock in a private placement transaction and under employee stock purchase and option plans. Financing activities provided $103 million and $28 million during fiscal 2006 and fiscal 2004, respectively, and used $10 million during fiscal 2005. During fiscal 2006, we repaid debt principal of $78 million and received proceeds of $178 million from DIP funding issued while under Chapter 11. We also received proceeds of $3 million from stock issued under our employee stock plans. During fiscal 2005, we repaid debt principal of $18 million and received proceeds of $4 million from stock issued under our employee stock plans and $4 million from lease financing of customer support contracts and other financing. Our principal financing activity during fiscal 2004 was the sale of 18 million shares of our common stock to certain institutional investors in a private placement transaction. This transaction had an aggregate sale price of $50 million and provided us with net

proceeds of $47 million. During fiscal 2004, we also completed an exchange offer under which we issued $226 million principal amount of 6.50% Senior Secured Convertible Notes and 11.75% Senior Secured Notes, both due 2009, in exchange for notes that would otherwise have matured in September 2004. In connection with this transaction, we repaid $18 million of our debt and paid approximately $4 million in debt issuance costs.

We have incurred net losses and negative cash flows from operations during each of the past several fiscal years. At June 30, 2006, our principal sources of liquidity included unrestricted cash and marketable investments of $55 million, down from $64 million at June 24, 2005. Currently, we expect to continue consuming cash from operations through at least the first half of fiscal 2007. 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 to the beginning of the following quarter. We also continue to focus on expense controls, margin improvement initiatives and working capital efficiencies. However, it is essential to our operating plan for fiscal 2007 that we complete the execution of the definitive agreements associated with our exit financing. See Restructuring Activities and Additional Capital .

Credit Arrangements. On October 25, 2005, we announced the completion of a new two-year asset-backed credit facility with Wells Fargo Foothill, Inc. and Ableco Finance LLC. The new facility provided for credit of up to $100 million, consisting of a $50 million revolving line of credit and a $50 million term loan. The borrowing base under our credit facility was determined weekly based on the value of working capital items, real estate and intellectual property. Our facility was secured by substantially all of the assets of SGI and our domestic subsidiaries (the Borrowers) and, together with the indentures governing our Senior Secured Notes, included covenants for minimum levels of EBITDA, minimum levels of cash and cash equivalents, and limits on capital expenditures. Subject to certain specified exceptions, the facility and the indentures governing our Senior Secured Notes also limited our ability to incur additional indebtedness, create liens on our assets, enter into certain transactions (including mergers, consolidations and reorganizations), dispose of certain assets, pay dividends or other distributions on capital stock, repurchase capital stock, or prepay or repurchase debt obligations. Our credit facility was subject to acceleration upon various events of default and failure to comply with these covenants could entitle the lender to accelerate the underlying obligations. On several occasions during the past three fiscal years, we were in violation of financial and administrative covenants in the predecessor credit facility. In each case, we received a waiver of compliance from the lender.

At June 27, 2006, we had an outstanding balance of $30 million against the term loan. Through June 27, 2006 we were using our revolving line of credit under this facility to support letters of credit, including letters of credit required under our lease obligations for the Crittenden and Amphitheatre Technology Center campuses in Mountain View, California and to support our current operations. This facility was paid in full on June 28, 2006 with funds from our $130 million DIP Financing described below.

On May 26, 2006, we reached a settlement with our landlord to restructure our 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 our lease obligations at ATC and terminated our lease obligations for two buildings at CTC as of June 30, 2006. It also amended our lease obligations for a third building at CTC. Pursuant to the agreement, we vacated the two buildings at CTC by June 30, 2006 and plan to vacate our third building by December 31, 2006.

At June 24, 2005, we had outstanding $191 million, in aggregate principal amount of senior secured convertible notes and senior secured notes, both due in 2009, and $57 million in aggregate principal amount of convertible subordinated debentures, due in 2011. As a result of filing for bankruptcy under Chapter 11 and in accordance with SOP 90-7, the Senior Secured Convertible Notes, the Senior Secured Notes and the 6.125% Convertible Subordinated Debentures were considered subject to compromise at June 30, 2006. Our Senior Secured Notes contain a covenant that limits our ability to incur indebtedness to banks and other institutional lenders in excess of $100 million, including any indebtedness under our credit facility unless such condition is waived.

During the fourth quarter of fiscal 2005, we received a notice of default from an investor claiming to own more than 25% of our outstanding 2011 convertible subordinated debentures. We assumed these debentures when we acquired Cray Research in 1996. The notice alleges that in 2000 we violated the indenture for the 2011 Debentures when we sold certain assets relating to the former Cray Research vector computing business to Tera Computer (now known as Cray, Inc.) without having them assume the indenture. We strongly disagree with the claims made in the notice and intend to vigorously challenge any claim of an event of default. There is currently $57 million outstanding principal amount of 2011 Debentures. The 2011 Debentures are unsecured and subordinated. Upon the effective date of the Plan, all of the claims of the 2011 Debentures will have been addressed in accordance with the terms of the Plan and all claims relating to defaults will be discharged.

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DIP Financing. On May 10, 2006, we entered into an 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 for which we borrowed $28 million through June 27, 2006. In June 2006, the Debtors entered into the DIP Agreement with the DIP Lenders providing up to $130 million of debtor-in-possession financing. This DIP Agreement was approved by the Court on June 26, 2006 and we borrowed $100 million against this facility, of which a portion of the funds were used to repay our outstanding borrowings against the $70 million Interim DIP Financing and our pre-petition asset-backed credit facility.

Restructuring Activities and Additional Capital. In the fourth quarter of fiscal 2005 we retained the turnaround firm AlixPartners LLC to advise us regarding further expense reductions, increasing revenue, improving liquidity and our intentions to initiate restructuring actions in the first quarter of fiscal 2006. During fiscal 2006, we implemented restructuring activities under three fiscal 2006 restructuring plans. These actions included headcount reductions, initiatives to reduce costs in other areas, including procurement costs for goods and services, consolidation and reorganization of operations in several locations, focusing marketing spending on the highest priority activities, and benefits and other spending controls. The original goal of our fiscal 2006 restructuring actions was to achieve $80 to $100 million in annualized cost savings when fully realized. In the third quarter of fiscal 2006, we increased our goal of $100 million in annualized savings to $150 million in annualized savings. We have taken actions during fiscal 2006 that we believe achieve the anticipated $150 million in annualized savings. We have seen considerable cost savings benefit during fiscal 2006 from these initiatives and expect to realize the remaining saving during fiscal 2007.

Forecasts of future events are inherently uncertain, and there are significant risks associated with the achievement of our goals for fiscal 2007. While we are implementing initiatives aimed at improving revenue and margins for our core systems products, we expect to continue consuming cash from operations through at least the first half of fiscal 2007. We expect the $130 million DIP Financing to provide adequate liquidity to meet our operating needs through our expected emergence from bankruptcy. On August, 30 2006, SGI signed a commitment letter with Morgan Stanley Senior Funding, Inc. and General Electric Capital Corporation to provide exit financing as part of our plan to emerge from bankruptcy in fiscal 2007. The exit f