SILICON GRAPHICS INC
Form 10-Q
November 08, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

ý	**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
	For the quarterly period ended September 24, 2004.
or	
o	**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
	For the transition period from to .

Commission File Number 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.)

1500 Crittenden Lane, Mountain View, California 94043-1351
(Address of principal executive offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No o

As of October 22, 2004 there were 262,429,677 shares of Common Stock outstanding.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ý No o

SILICON GRAPHICS, INC.

QUARTERLY REPORT ON FORM 10-Q

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

SILICON GRAPHICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(In thousands, except per share amounts)	Three Months Ended Sept. 24, 2004	Sept. 26, 2003
Product and other revenue	$ 97,986	$ 118,115
Service revenue	77,421	84,101
Total revenue	175,407	202,216
Costs and expenses:		
Cost of product and other revenue	65,785	70,316
Cost of service revenue	46,692	50,750
Research and development	23,306	31,959
Selling, general and administrative	62,717	69,351
Other operating expense, net (1)	3,166	24,236
Total costs and expenses	201,666	246,612
Operating loss	(26,259)	(44,396)
Interest and other income (expense), net	(5,402)	(7,358)
Loss from continuing operations before income taxes	(31,661)	(51,754)
Income tax benefit	(3,732)	(3,029)
Net loss from continuing operations	$ (27,929)	$ (48,725)
Discontinued operations:		
Net (loss) income from discontinued operations, net of tax	(276)	796
Net loss	$ (28,205)	$ (47,929)
Net loss per share basic and diluted:		
Continuing operations	$ (0.11)	$ (0.23)
Discontinued operations	(0.00)	0.00
Net loss per share basic and diluted:	$ (0.11)	$ (0.23)
Common shares outstanding basic and diluted	262,039	209,570

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(1) Represents charges for estimated restructuring costs, including related accretion expense, and asset impairments in each of the three-month periods ended September 24, 2004 and September 26, 2003.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SILICON GRAPHICS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	Sept. 24, 2004 (unaudited)	June 25, 2004 (1)
Assets:		
Current assets:		
Cash and cash equivalents	$ 122,933	$ 154,855
Short-term marketable investments	2,138	2,010
Short-term restricted investments	37,624	23,585
Accounts receivable, net	76,215	113,901
Inventories	67,328	66,938
Prepaid expenses and other current assets	39,044	34,916
Total current assets	345,282	396,205
Restricted investments	713	909
Property and equipment, net	68,529	74,595
Other assets	95,735	98,215
	$ 510,259	$ 569,924
Liabilities and Stockholders Deficit:		
Current liabilities:		
Accounts payable	$ 60,099	$ 65,119
Accrued compensation	30,594	37,053
Income taxes payable	5,373	6,082
Other current liabilities	66,872	70,591
Current portion of deferred revenue	90,130	96,058
Current portion of restructuring charges	24,821	27,876
Current portion of long-term debt	9,901	17,775
Total current liabilities	287,790	320,554
Long-term debt	263,973	264,212
Long-term deferred revenue	27,415	25,749
Other liabilities	81,910	82,087
Total liabilities	661,088	692,602
Stockholders deficit:		
Common stock and additional paid-in-capital	1,551,951	1,550,425
Accumulated deficit	(1,674,175)	(1,645,970)
Treasury stock	(6,774)	(6,774)
Accumulated other comprehensive loss	(21,831)	(20,359)
Total stockholders deficit	(150,829)	(122,678)
	$ 510,259	$ 569,924

(1) The balance sheet at June 25, 2004 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The accompanying notes are an integral part of these condensed consolidated financial statements.

SILICON GRAPHICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(In thousands)	**Three Months Ended Sept. 24, 2004**	**Sept. 26, 2003**
Cash Flows From Operating Activities of Continuing Operations:		
Net loss	$ (28,205)	$ (47,929)
Loss (income) from discontinued operations	276	(796)
Net loss from continuing operations	(27,929)	(48,725)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	15,238	21,196
Amortization of premium on 6.50% Senior Secured Convertible Notes	(1,175)	
Loss on sale of real estate		414
Non-cash impairment charges		1,714
Other	(1,500)	2,008
Changes in operating assets and liabilities:		
Accounts receivable	37,686	10,716
Inventories	(2,167)	(3,984)
Accounts payable	(5,020)	(8,295)
Accrued compensation	(6,459)	(7,261)
Deferred revenue	(4,262)	(9,084)
Other assets and liabilities	(12,144)	5,525
Total adjustments	20,197	12,949
Net cash used in operating activities of continuing operations	(7,732)	(35,776)
Cash Flows From Investing Activities of Continuing Operations:		
Purchase of marketable investments	(128)	(844)
Purchases of restricted investments	(33,760)	(29,107)
Proceeds from the maturities of restricted investments	19,968	37,187
Proceeds from sale of real estate and fixed assets		10,615
Capital expenditures, net	(3,032)	(4,860)
(Increase) decrease in other assets	(1,843)	230
Net cash (used in) provided by investing activities of continuing operations	(18,795)	13,221
Cash Flows From Financing Activities of Continuing Operations:		
Payments of debt principal	(8,491)	(4,223)
Proceeds from financing arrangement	1,601	
Issuance of SGI common stock	1,495	321
Net cash used in financing activities of continuing operations	(5,395)	(3,902)
Net decrease in cash and cash equivalents	(31,922)	(26,457)
Cash and cash equivalents at beginning of period continuing operations	154,855	136,028
Cash and cash equivalents at end of period continuing operations	$ 122,933	$ 109,571

The accompanying notes are an integral part of these condensed consolidated financial statements

SILICON GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation.

The condensed consolidated financial statements include the accounts of SGI and our wholly owned subsidiaries. The unaudited results of operations for the interim periods shown herein are not necessarily indicative of operating results for the entire fiscal year. In the opinion of management, all adjustments (consisting of normal adjustments) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made. The unaudited condensed consolidated financial statements included in this Form 10-Q should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 25, 2004 filed with the Securities and Exchange Commission. Certain reclassifications of prior year amounts, due to such changes as the sale of our Alias application software business, which is reflected as a discontinued operation, a segments structure change and certain changes to current liabilities presentation, have been made on the Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Cash Flows and Notes to Condensed Consolidated Financial Statements to conform to the current year presentation.

We have incurred net losses and negative cash flows from operations during each of the past several fiscal years and had working capital of $57 million at September 24, 2004, down from $76 million at June 25, 2004. Our unrestricted cash and marketable investments at September 24, 2004 were $125 million, down from $157 million at June 25, 2004. While a forecast of future events is inherently uncertain, we believe that the combination of our current resources and cash expected to be generated from operations will be sufficient to meet our financial obligations through fiscal 2005.

We are committed to our goal of re-establishing profitable operations and positive cash flow. If we experience a material shortfall versus our plan for fiscal 2005, we expect to take all appropriate actions to ensure the continued operation of our business and to mitigate any negative impact on our profitability and cash reserves. We believe that we have a range of actions we can take to achieve this outcome, including but not limited to expense-related actions such as further reductions in headcount-related expenses and re-evaluation of our global distribution model. We also believe that we can take actions to generate cash by licensing intellectual property, seeking funding from marketing partners and key government customers, and seeking further equity or debt financing from strategic partners or financial sources. Beyond fiscal 2005, the adequacy of our resources will depend largely on our success in re-establishing profitable operations and positive operating cash flows. See Risks That Affect Our Business.

2. Stock-Based Compensation.

At September 24, 2004, we have stock based employee compensation plans, which are more fully described in our 2004 Annual Report on Form 10-K. We have elected to use the intrinsic method under APB Opinion No. 25, Accounting for Stock Issued to Employees, as permitted by SFAS No. 123, Accounting for Stock Based Compensation (SFAS 123), subsequently amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure to account for stock-based awards issued to employees under these plans, which, with the exception of restricted stock awards, generally results in no compensation expense. In net loss from continuing operations during the periods presented in the table below, we recorded compensation expense from restricted stock awards and from options to purchase approximately 150,000 shares issued prior to 2000 at values below the fair market value of the underlying common stock on the date of grant.

The following table illustrates the pro forma effect on net loss from continuing operations and net loss per share from continuing operations as if we had applied SFAS 123 s fair value method of accounting for stock-based awards issued to our employees:

(In thousands, except per share amounts)	**Three Months Ended September 24, 2004**		**September 26, 2003**	
Net loss from continuing operations as reported	$	(27,929)	$	(48,725)
Additions:				
Stock based employee compensation expense, net of tax effect, included in net loss above		9		68
Deductions:				
Stock based employee compensation expense determined under fair value method for all awards, net of tax effect		(1,396)		(1,346)
Pro forma net loss from continuing operations	$	(29,316)	$	(50,003)
Net loss per share from continuing operations basic and diluted as reported	$	(0.11)	$	(0.23)
Net loss per share from continuing operations basic and diluted pro forma	$	(0.11)	$	(0.24)

As a result of recent guidance from the Internal Revenue Service regarding certain employer tax reporting obligations, we amended our 1993 Long-Term Incentive Stock Plan, 1996 Supplemental Non-Executive Equity Incentive Plan, 1985 Stock Incentive Plan and Amended and Restated 1989 Employee Benefit Stock Plan in November 2004 to allow, at the Compensation Committee s discretion, the transfer of nonqualified stock options to, among other persons, an employee s former spouse in connection with a divorce settlement.

3. Other Operating Expense.

As of September 24, 2004 we have substantially completed the execution of our fiscal 2000, fiscal 2001, fiscal 2002 and fiscal 2003 restructuring plans, with the exception of certain severance obligations of our international subsidiaries and vacated leased facilities that have lease terms expiring through the end of fiscal 2010. Our obligations associated with these plans as of September 24, 2004 were approximately $5 million under the fiscal 2000 restructuring plan, $4 million under the fiscal 2001 restructuring plan, $0.5 million under the fiscal 2002 restructuring plan and $1 million under the fiscal 2003 restructuring plan. Facilities obligations noted above are net of aggregated estimated sublease income of approximately $3 million between the fiscal 2000 and fiscal 2001 plans. Estimated sublease income associated with the fiscal 2002 and 2003 plans is negligible.

In an effort to reduce our operating expense and better align operating expenses with expected revenue levels, we announced and began to implement restructuring activities under the fiscal 2004 restructuring plan at the end of fiscal 2003 and continued these actions throughout fiscal 2004. Under the fiscal 2004 restructuring plan, we eliminated approximately 520 positions across all levels and functions and vacated approximately 100,000 square feet of sales and administrative facilities throughout the world, with lease terms expiring through fiscal 2007. As a result of the fiscal 2004 restructuring plan, we also agreed to sublease our Amphitheatre Technology Center campus in Mountain View, California and relocated our headquarters to our nearby Crittenden Technology Center campus by the end of fiscal 2004. Pursuant to SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities , we are required to determine the fair value of future contractual obligations using our credit-adjusted risk-free interest rate at the point we cease to use the respective buildings. As such, we have discounted the future remaining obligations for each building, which approximate $18 million. On a quarterly basis, we are also required to accrete the discounted future obligations for the buildings up to their undiscounted value of $71 million from the respective cease-use dates to the end of the lease terms ending in fiscal 2013 using the effective interest model. Beginning in fiscal 2004, we began to record accretion expense, which will approximate $0.2 million to $10 million annually through fiscal 2013.

In the first quarter of fiscal 2005, we recorded $3.6 million in Amphitheatre Technology Center-related expense. Our obligation associated with the fiscal 2004 restructuring plan as of September 24, 2004 included approximately $1 million in severance and related charges and approximately $45 million of vacated leased facility obligations, net of sublease income of $92 million. During the first quarter of fiscal 2005, we paid approximately $8 million in rent obligations and $0.1 million in severance and related charges for the restructuring plans of the prior years. We made an adjustment to decrease our estimate of severance and related charges associated with the fiscal 2002 and fiscal 2003 restructuring by approximately $0.4 million, which reflected lower estimated costs. We also increased our severance related accruals associated with our fiscal 2002 and fiscal 2003 restructuring plans by reclassifying approximately $0.3 million of a locally recorded liability related to restructuring actions that was previously included in other liabilities.

The remaining restructuring accrual balance of approximately $56 million at September 24, 2004 includes approximately $1 million in severance obligations and $55 million of facility-related liabilities, net of estimated sublease income of $95 million, the majority of which is contractual sublease income. Approximately $1 million in severance and related charges is expected to be paid by the third quarter of fiscal 2005 and approximately $55 million, net, of facility related liabilities will be paid through fiscal 2013.

The following table depicts the restructuring and impairment activity by plan during the first three months of fiscal 2005 (in thousands):

	Balance at June 25, 2004	Costs Incurred	Adjustments	Reclassification	Cash Payments	Balance at September 24, 2004
Fiscal 2000 plan:						
Vacated Facilities	5,898				(1,038)	4,860
Total	$ 5,898	$	$	$	$ (1,038)	$ 4,860
Fiscal 2001 plan:						
Vacated Facilities	4,225				(563)	3,662
Total	$ 4,225	$	$	$	$ (563)	$ 3,662
Fiscal 2002 plan:						
Severance & Related Charges	52		(140)	276		188
Vacated Facilities	450				(161)	289
Total	$ 502	$	$ (140)	$ 276	$ (161)	$ 477
Fiscal 2003 plan:						
Severance & Related Charges	288		(248)	52	(7)	85
Vacated Facilities	959				(291)	668
Total	$ 1,247	$	$ (248)	$ 52	$ (298)	$ 753
Fiscal 2004 plan:						
Severance & Related Charges	1,086	3			(126)	963
Vacated Facilities	46,966	3,551			(5,469)	45,048
Total	$ 48,052	$ 3,554	$	$	$ (5,595)	$ 46,011
All Restructuring Plans						
Severance & Related Charges	1,426	3	(388)	328	(133)	1,236
Vacated Facilities	58,498	3,551				