CRAY INC
Form 10-K
February 19, 2015

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

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FORM 10-K

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

For the Fiscal Year Ended December 31, 2014

¨ 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: 000-26820

CRAY INC.

(Exact Name of Registrant as Specified in Its Charter)

Washington	93-0962605
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
901 Fifth Avenue, Suite 1000 Seattle, Washington	98164
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code:
(206) 701-2000

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.01 par value	Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:
Yes þ No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act: Yes ¨ No þ

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 þ No ¨

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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. ¨

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

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

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of June 30, 2014, was approximately $1,041,002,837 based upon the closing price of $26.60 per share reported on June 30, 2014, on the Nasdaq Global Market.

As of February 13, 2015, there were 40,826,651 shares of Common Stock issued and outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement to be delivered to shareholders in connection with the registrant's Annual Meeting of Shareholders to be held on or around June 10, 2015, are incorporated by reference into Part III.

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Forward-Looking Statements

This annual report on Form 10-K contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or if they prove incorrect, could cause our actual results to differ materially from those expressed or implied by such forward-looking statements. Forward-looking statements are based on our management's beliefs and assumptions and on information currently available to them. In some cases you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expect," "plans," "anticipates," "beli "estimates," "projects," "predicts" and "potential" and similar expressions, but the absence of these words does not mean that a statement is not forward-looking. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, and examples of forward-looking statements include any projections of earnings, revenue or other results of operations or financial results; any statements of the plans, strategies, objectives and beliefs of management of the Company; any statements concerning proposed new products, technologies or services; any statements regarding future research and development or co-funding for such efforts; any statements regarding future economic conditions; and any statements of assumptions underlying any of the foregoing. These forward-looking statements are subject to the safe harbor created by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us and described in Item 1A. Risk Factors in Part I and other sections of this report and our other filings with the U.S. Securities and Exchange Commission, or SEC, or Commission. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this report. You should read this report completely and with the understanding that our actual future results may be materially different from what we expect. We assume no obligation to update these forward-looking statements, whether as a result of new information, future events, or otherwise.

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PART I

Item 1. Business

General

We design, develop, manufacture, market and service the high-end of the high-performance computing, or HPC, market, primarily categories of systems commonly known as supercomputers and provide storage and analytics solutions. We also provide software, system maintenance and support services and engineering services related to supercomputer systems. Our customers include domestic and foreign government and government-funded entities, academic institutions and commercial entities. Our key target markets are the supercomputing portion of the HPC market and the expanding storage and analytics market. We provide customer-focused solutions based on three models: (1) highly integrated supercomputing and storage solutions, complete with highly tuned software, that stress capability, scalability, sustained performance and reliability at scale; (2) flexible commodity-based "cluster" supercomputing and storage solutions based upon utilizing best-of-breed components and working with our customers to define solutions that meet specific needs; and (3) turn-key analytic solutions featuring industry standards and innovative graph technologies. All of our solutions also emphasize total cost of ownership, scalable price-performance and data center flexibility as key features. Our strategy is to gain market share in the supercomputer market segment, extend our technology leadership, maintain our focus on execution and profitability and grow by continuing to expand our addressable market in areas where we can leverage our experience and technology, such as in high performance storage systems and powerful analytic tools on large volumes of data, popularly referred to as "big data". We also meet diverse customer requirements by combining supercomputing, cluster, storage and analytics technology, into unique solutions offerings that work in a workflow-driven datacenter environment.

We were incorporated in the State of Washington in December 1987 under the name Tera Computer Company. We changed our corporate name to Cray Inc. in connection with our acquisition of the Cray Research, Inc., or Cray Research, operating assets from Silicon Graphics, Inc. in 2000. Our corporate headquarters are located at 901 Fifth Avenue, Suite 1000, Seattle, Washington 98164. Our telephone number is (206) 701-2000 and our website address is www.cray.com. The contents of our website are not incorporated by reference into this annual report on Form 10-K or our other SEC reports and filings.

Products, Services and Customer Support

We concentrate on building product solutions for our customers in two major markets – the supercomputing portion of HPC and big data, including storage and data analytics. We also provide a range of service offerings around these products that leverage our high quality support and intimate understanding of our customers.

Cray Supercomputing Systems

Our supercomputing products span a broad performance spectrum and address the critical computing resource challenges HPC users face today: achieving massive scaling to tens of thousands of processors; ease of use for high productivity; and very high levels of sustained performance on real applications. We achieve this by designing and integrating supercomputers that combine highly capable processors, high speed interconnect technology for maximum communication efficiency, innovative packaging to address increased density, upgradability, energy efficiency and reliability requirements and scalable system software that significantly enhances performance, productivity and manageability at scale. With our "Adaptive Supercomputing" vision, we have expanded the concept of heterogeneous computing to a fully integrated view of hardware and software supporting both multiple processing technologies and diverse workloads.

Our supercomputers are the result of our Adaptive Supercomputing vision that integrates diverse technologies into a unified architecture enabling customers to match the computational solution to the need. Our systems utilize components and technologies designed to support the requirements of the most demanding HPC users. Our XC40 supercomputers are designed to provide significantly higher sustained performance on many important applications that require the very highest levels of scaling, with substantial performance improvements over comparable commodity technologies. Our CS series of supercomputer cluster solutions (including CS400 and CS-Storm) emphasize flexibility, capacity and industry standard designs for compute-intensive customer needs. All of our supercomputers are designed to allow HPC users to focus on their primary objectives, including advancing scientific discovery, increasing industrial capabilities and improving national security.

Our supercomputer systems are designed to offer several additional benefits including:

- superior price-performance;
- production quality reliability and resiliency;
- open standards, including Linux-based operating systems, open file systems (e.g., Lustre™) and open programming models (e.g., MPI, OpenMP and OpenACC);
- upgrade paths that allow customers to leverage their investments over longer periods of time and thereby reduce total costs of ownership;
- integrated operating system software and Cray programming environment;

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- excellent energy efficiency optimized for minimum energy consumed to solution;
- flexibility of processor type, memory, network configuration, storage configuration and system software tools developed towards our Adaptive Supercomputing vision; and
- the Cray service experience, that brings with it a proven research and development team and a global sales and service organization dedicated to the needs of HPC users.

We expect the continued advancement of many-core and accelerator processors to be advantageous to us as the processors complement our technical strengths in networking, scaling, system software and cooling and power management technologies. The growing number of cores on each processor continues to amplify the scaling issues that customers face today, and accelerators or coprocessors will further stress the system's communications network. We believe our balanced approach to system design and support for innovative parallel programming methodologies will become increasingly critical in enabling customers to take advantage of the benefits of many-core processing.

Cray XC40 Supercomputer. The Cray XC40 supercomputer is our recent highly integrated supercomputing system, which delivers on our commitment to an Adaptive Supercomputing architecture providing extreme scale and sustained performance in both water- and air-cooled packaging options. The Cray XC40 system provides the HPC user community the advantage of the computational resources of our supercomputers powered by the Intel Xeon E5 family of processors combined with the Aries interconnect, providing a flexible and unique Dragonfly network topology, our robust and fully-integrated software environment and innovative power and cooling technologies. In addition, the Cray XC family of supercomputers has been expanded to include Intel Xeon Phi coprocessors and NVIDIA Tesla graphics processor units, or GPUs.

The Cray XC40 supercomputer utilizes the Cray Linux Environment, which has been enhanced and hardened over the past 10 years on Cray Supercomputing systems. Customers may buy a single Cray XC40 supercomputer to run both a highly scalable custom workload as well as an industry-standard, independent software vendor workload. The Cray XC40 system includes powerful compiler, runtime and related software that allows users to transparently leverage the underlying hardware components.

Cray CS400-AC Supercomputer. The Cray CS400-AC supercomputer cluster system offers an energy-efficient, air-cooled architecture featuring high performance, high availability computing. It includes flexible configuration options for a wide range of data center cooling architecture requirements through the use of air or chilled cooling rear door heat exchangers. The Cray CS400-AC system is integrated with the HPC Software Stack, software tools compatible with most open source and commercial compilers, tools, schedulers and libraries to run complex applications. This solution is also integrated with the Advanced Cluster Engine. This management software suite is designed to substantially reduce the complexity of managing HPC clusters by offering server, cluster, storage, and network management features combined with node provisioning, failover, load-balancing, job scheduling and revision control capabilities with multi-Linux OS support.

Cray CS400-LC Supercomputer. The new Cray CS400-LC cluster supercomputer system offers the features and benefits of the Cray CS400-AC system with superior energy savings, lower total cost of operation and faster return on investment by requiring fewer or no air conditioning units in the data center. Its unique design uses warm water liquid-cooling heat exchangers with no chillers, reducing typical energy consumption used to cool the data center by up to 50%. This system offers high performance and energy efficiency three times more per rack than traditional air-cooled designs. It also provides up to 80% heat capture for heat reuse. The Cray CS400-LC solution isolates the primary data center loop and uses a low-pressure isolated secondary data center liquid loop to cool the server's critical components such as processors and memory improving cooling system reliability as well as safety.

Cray CS-Storm Supercomputer. The CS-Storm supercomputer is a purpose-built solution employing GPUs in a very high density architecture to deliver superior performance, density and energy efficiency on highly data-parallel computations. The Cray CS-Storm combines innovative architecture design, supporting up to 8 GPUs per compute node, with the same production software environment available on the CS400 products. Market segments such as finance, energy, government and higher education utilize GPU-accelerated applications that can benefit significantly from the CS-Storm architecture. A CS-Storm supercomputer chassis may also be incorporated within a CS400 cluster supercomputer when appropriate. The software stack, programming environment and management infrastructure are shared, making such integration seamless.

Cray Analytics Products

Our analytics products apply supercomputing technologies to solve the most challenging data analytics use-cases, with performance at scale. The tremendous growth in data volumes and data complexity as well as the development of advanced analytic techniques and increased time-to-value expectations are driving the need for supercomputing class architectures. Our experience in high performance data-intensive, memory-centric architectures are being brought to bear in our Urika line of products.

Cray Urika-GD Graph Discovery Appliance. Our Urika-GD graph discovery appliance addresses one of the most complex problems in advanced analytics - interactive data discovery with graphs. This enterprise-ready appliance is designed to discover unknown and hidden relationships in big and diverse data, perform real-time analytics, and shorten customers' time to insight.

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Urika-GD is based on a very large shared memory and massively multithreaded platform, with a highly scalable RDF/SPARQL based graph database.

Cray Urika-XA Extreme Analytics Platform. Our Urika-XA extreme analytics platform is architected for production-class data analytics workloads. Urika-XA's turnkey architecture comes pre-integrated with Apache Hadoop® and Apache Spark™ frameworks yet is versatile and open to support additional emerging tools in the big data ecosystem. Urika-XA enables users to consolidate multiple computing workloads ranging from data integration, machine learning, interactive data exploration, visualization, iterative algorithms and more onto a single analytics platform. This allows customers to optimize their dataflows or analytic pipelines and also reduce the footprint of their analytics infrastructure. The Urika-XA platform delivers performance and reliability on a wide range of analytics applications, thereby lowering total cost of ownership on production data analytics.

Cray Storage and Data Management Products

Our storage and data management products include integrated data storage and data management solutions for HPC and big data by leveraging years of experience delivering high performance parallel storage and file systems to our customers. We are able to rapidly deploy highly scalable and extremely fast file systems that integrate effectively with computing solutions ranging from third-party and Cray Linux clusters to highly integrated Cray supercomputers.

Cray Sonexion Storage Systems. Our flagship storage product line, the Cray Sonexion, embeds the Lustre parallel file system and other software in an optimal configuration to reduce deployment time, increase reliability, capacity and scale performance. Cray Sonexion offers an optimal combination of modular scaling capacity from terabytes to petabytes and sustained IO performance from seven gigabytes to over one terabyte per second in a single file system. High density is achieved through reducing storage componentry and cabling. Sonexion systems are engineered to be installed and put into production more quickly than other HPC storage solutions and can be attached to Cray XC30, XC40, CS300 and CS400 systems as well as industry-standard Linux clusters.

Cray Tiered Adaptive Storage (TAS). Cray Tiered Adaptive Storage, critical for big data and HPC, is a flexible storage and archiving solution that allows customers to transparently move data among fast, primary and archival tiers. TAS is a complete and open archiving solution, offering all hardware and software in an appliance-like form factor. Tiers may be comprised of SSD, disk, or tape libraries from several vendors.

Engineering and Customer Support

Custom Engineering. To address those users whose needs cannot be met through our standard product offerings, we provide an alternative. Our custom engineering business leverages our amassed intellectual property and technology portfolio, deep domain expertise and know-how to design and build solutions and services designed to match a customer's specific needs. The need for a unique solution often stems from special processing needs that are often performance, application or capacity related; special environmental needs that might include special size dimension, weight, power and cooling limitations; or unique interface or system software and integration requirements.

Customer Support. Our worldwide customer support organization delivers our customers the "Cray experience" that provides us with a competitive advantage and a predictable flow of revenue and cash. We believe that the quality of our customer support personnel plays an important role in our ability to maintain long-term customer relationships. Support services are important to our customers, and in many cases we locate our support personnel at or near customer sites globally, supported by a central service organization. Our support services include hardware and software maintenance in support of our systems, applications support, installation project management, system installation and de-installation, site preparation and technical training for our systems. In addition, we offer ancillary services in application consulting, third-party software support, site engineering, on-site analysts for defined projects and specialized training. In 2014, maintenance and support revenue accounted for roughly fifteen percent of our total revenue. Our support arrangements generally provide for support services on an annual basis, although some cover multiple years. While most customers pay for support on an annual basis, others pay on a monthly, quarterly or multi-year basis. Typically, customers may select levels of support and response times, ranging from delivery of parts only to 24 x 7 coverage with two-hour response times.

Sales and Marketing

We focus our sales and marketing activities on both horizontal and vertical marketing activities ranging from government agencies or funded research laboratories, to academic institutions and commercial entities requiring HPC,

big data systems and storage. Our primary sales model is direct, and we offer solutions through a highly-trained direct sales force that operates throughout North America, South America, Asia, Europe, the Middle East, Australia and Africa. More than half of our sales force is located in the United States and Canada, with the remainder overseas.
A formal request-for-proposal process for HPC systems or technology drives a majority of our highest-end systems sales and engineering service engagements in the academic and government markets. We utilize pre-sales technical experts to develop technical proposals that meet customer requirements and benchmarking teams to demonstrate the advantages of our particular

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supercomputing products or service being proposed. For a majority of our larger government and academic sales opportunities, the proposal process, including establishing system size, options, pricing and other commitments, involves a number of resources outside of our sales organization. While we often tailor our supercomputer (including cluster) solutions for each customer, there is substantial commonality in the underlying components and systems, allowing us to leverage manufacturing and supply chain operations.

Government agencies and government-funded scientific research institutions around the world comprise a large portion of our customer base. Our government programs' efforts are an integral part of our overall strategy by actively managing our relationship with U.S. government agencies and Congress.

Our marketing staff is primarily responsible for product marketing, business development and marketing communications. Product marketing bridges our research and development organization and our sales staff to help ensure that our products meet the demands and requirements of our key customers and a broader market set of prospects for our HPC and big data business and our new business initiatives. Marketing communications focus on our overall brand messaging, advertising, public relations, social media, conferences, trade shows and direct as well as online marketing campaigns to create brand awareness and generate demand. Business development focuses on providing products and services to specific customer sets, such as earth sciences, energy, financial services, manufacturing and life sciences.

Our Technology

We are dependent on the successful early identification, development and timely introduction of new products and capabilities. Our research and development activities include identification of new trends, technologies and workload needs in the ever changing HPC and big data markets, and then leveraging this research in the design of system architectures, hardware and software necessary to implement our expanding product portfolio to address customer needs.

Product Architectures

Our product portfolio covers a breath of architectures including tightly integrated massively parallel supercomputers, highly flexible and configurable cluster supercomputers, world class storage and data management solutions and purpose-built big data analytics appliances.

Hardware

We have extensive experience in the definition, design and integration of the hardware components required of HPC system solutions. This includes processors, board design, memory, storage, network and interconnect technologies, I/O subsystems, power, cooling and packaging infrastructures. The majority of our hardware research and development investments are in the following areas:

- Compute and storage architectures, high-speed interconnect and board integration and design. Integration of a variety of processor, volatile and nonvolatile memory and network devices using a combination of custom and industry standard printed circuit boards, high-density connectors, carefully chosen transmission and storage media and optimized topologies.
- Power, packaging and cooling. We use a variety of dense packaging techniques in order to produce systems with superior performance, socket densities and energy efficiency. This packaging combines industry standard and custom-designed technologies in the areas of printed circuit board assemblies, power distribution and liquid and air cooling.

Software

We have extensive experience in designing, developing and adapting system software such as the operating system, system management, optimized data management, movement and analysis as well as programming environment software as an integral aspect of our product portfolio and distributing that software as part of system sales. Our software research and development experience includes operating systems, scalable hardware control, reliability, availability and serviceability, or RAS, infrastructure systems for managing hardware, including power control, monitoring of environmental data, hardware diagnostics and programming environments. The programming environments include our own and commercially available third party compilers, communication and scientific libraries as well as a rich suite of application development tools and software for managing and monitoring data storage, tiered data infrastructures and archiving data.

Additionally, we research innovative software for advanced analytics at scale, including industry leading graph analytics and associated algorithms for discovering previously unknown insight from large, disparate data sets, as well as optimizations to Hadoop for performance and manageability at scale. Our research includes techniques and optimizations to scale advanced analytics across distributed scalable systems, and in large, shared memory architectures.

We purchase or license software technologies from third parties when necessary to meet certain specific customer requirements, while focusing our own resources where we believe we add the highest value.

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For information relating to amounts spent on research and development, see Note 20 - Research and Development in the Notes to Consolidated Financial Statements in Item 15. Exhibits, Financial Statement Schedules in Part IV of this annual report.

Manufacturing and Supply Chain

We subcontract the manufacture of a majority of the hardware sub-assemblies and certain components for our high-end products and custom-engineered systems, including integrated circuits, printed circuit boards, connectors, cables, power supplies and memory parts, on a sole or limited source basis to third-party suppliers. We use contract manufacturers to assemble certain components. Our manufacturing strategy currently centers on build-to-order systems, focusing on obtaining competitive assembly and component costs while concentrating our resources on the final assembly, test and quality assurance stages to ensure a positive customer experience. This strategy allows us to avoid the large capital commitment and overhead associated with establishing full-scale manufacturing facilities, helps us to maintain the flexibility to adopt new technologies as they become available without the risk of equipment obsolescence, provides near real-time configuration changes to exploit faster and/or less expensive technologies and provides a higher level of large scale system quality. We perform final system integration, testing and quality check-out of our systems. Our manufacturing personnel currently are located primarily in Chippewa Falls, Wisconsin. We work closely with a supplier to provide integrated and tested Cray Sonexion storage products. In January of 2014, we completed transitioning manufacturing operations for our cluster related products from Milpitas, California to Chippewa Falls, Wisconsin.

Our systems designed for the supercomputer market segment and our custom-engineered solutions incorporate components that are available from single or limited sources, often containing our design input or proprietary designs. Such components include integrated circuits, interconnect systems and certain memory devices. Prior to development of a particular product, components are typically competitively bid to a short list of technology partners. The technology partner that provides the highest value solution for the component is often awarded the contract for the life of the component. Once we have engaged a technology partner, changing our product designs to utilize another supplier’s integrated circuits can be a costly and time-consuming process. We also have sole or limited sources for less critical components, such as peripherals, power supplies, cooling and chassis hardware. We currently obtain key processors from Intel Corporation, or Intel, and NVIDIA for our Cray XC and cluster systems, AMD and NVIDIA for our Cray XE and XK systems and the Aries interconnect chip licensed from Intel and purchased through Avago who contracts to have Taiwan Semiconductor Manufacturing Company, or TSMC, manufacture the integrated circuit. Our procurements from these vendors are primarily through purchase orders. We have chosen to deal with sole sources in specific cases due to the availability of specific technologies, economic advantages and other factors. Reliance on single or limited source vendors involves several risks, including the possibility of shortages of key components, long lead times, reduced control over delivery schedules and changes in direction by vendors. We have been adversely affected by delays in obtaining qualified competitive components in previous years.

Our Markets

Our key target markets are the supercomputing portion of the HPC market and the big data market, encompassing both storage and analytics. High performance, real-time analytics on large volumes of data is developing into an important success driver for business, government and academia, and successfully leveraging this market is important to us. Big data is a relatively new target market for us, but several of our core strengths and technologies, such as the abilities to process vast amounts of unique data at very high speeds and to make “discoveries,” are essential to addressing big data challenges, enabling us to bring highly differentiated analytics offerings to market. The market segments we are targeting with our supercomputing, storage and analytics products for HPC and big data are as follows:

Scientific Research. Scientific research includes government research laboratories and research universities around the world. In the U.S., the Department of Defense, through its High Performance Computing Modernization Program, funds a number of research organizations that are our target customers. The Office of Science in the Department of Energy and its laboratories are key customers, as are the National Science Foundation and the National Aeronautics and Space Administration and similar agencies around the world. These research centers also provide supercomputing and big data resources to their affiliated organizations (such as the Department of Defense contractors) and industrial

partners.

National Security/Cybersecurity. Classified work in various worldwide government agencies has represented an important market for us over many years. Certain U.S. government departments have on occasion provided funding support for our research and development efforts to meet their objectives. Current and potential customers include a number of Department of Defense-related classified organizations, the National Nuclear Security Administration of the Department of Energy and analogous foreign counterparts who have interest in our full range of products. Commercial entities have had interest in our cybersecurity solutions.

Defense. The defense segment has wide-ranging needs for HPC systems that in some ways are unique and in other ways are similar to our other market segments. HPC systems can assist in the development of defense technologies, equipment and secure communications infrastructure, as well as in the identification and analysis of military intelligence. Intelligence supports

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real-time development of defense strategy and decision making, while technology advancements are necessary to maintain military advantages, including deterrents, and to protect the warfighter.

Earth Sciences. Weather forecasting and climate modeling applications require increasing speed and larger volumes of data. Forecasting models and climate applications have grown increasingly complex with an ever-increasing number of interactive variables, making improved supercomputing, storage and analytics capabilities increasingly critical. We have a number of customers running weather and climate applications, including customers in Germany, the United Kingdom, Korea, Brazil, Switzerland, Singapore, Denmark, Finland, India, Spain and the United States.

Energy. Supercomputing in the energy sector is driven largely by oil and gas exploration and processing, from seismic analysis to reservoir simulations. The simulation methods used often require high performance networks and storage subsystems. We currently have commercial customers utilizing both Cray systems and storage solutions in production and we are targeting this segment for future products.

Financial Services. Big data analytics and supercomputing systems are providing competitive advantage in areas as disparate as trading, compliance, marketing optimization and risk analysis. Financial services applications are very time sensitive, so high performance data analytics solutions are highly sought after. Our customers are using a range of our solutions and systems to derive competitive advantage today in this segment.

Life Sciences. The life sciences industry has demanding data and simulation requirements that test the limits of HPC and big data systems. In the life sciences, HPC methods cover a vast area ranging across modeling systems from the molecular level to the whole cell, next-generation genomic sequencing and healthcare optimization. Big data analytics are key to making sense and creating insight in the enormous volumes of data being generated. Our big data solutions can help discover new relationships that can allow existing drugs to help address new medical issues. Our customers are utilizing our products and solutions across this range of use cases today.

Manufacturing. Supercomputers are used to design lighter, safer and more durable vehicles, study wind noise and airflow around vehicles, improve airplane flight characteristics and, in many other computer-aided engineering applications, to improve time-to-market and product quality. We currently have aerospace, automotive and manufacturing customers around the globe that are actively using our HPC and big data solutions.

Other Markets. The rise of attention on big data in industries, including telecommunications, digital media, retail and professional sports, has resulted in growing interest in supercomputers. Enterprises in these markets are evaluating where high performance computing should be used as a complement to existing analytics solutions to solve some of their most challenging big data problems, particularly in the area of analytics.

Sales to the U.S. government and system acquisitions primarily funded by the U.S. government, or U.S. Government, accounted for approximately 48% of our revenue in 2014, 51% of our revenue in 2013 and 68% of our revenue in 2012. Significant customers with over 10% of our annual revenue were the U.S. Government in 2014; the U.S. Government and Exxon Mobil in 2013; and the U.S. Government and Exxon Mobil in 2012. International customers accounted for 42% of our total revenue in 2014, 32% of our total revenue in 2013 and 18% of our total revenue in 2012.

We have four operating segments that are reportable for financial reporting purposes. Segment information and related disclosures are set forth in Note 19 — Segment Information in the Notes to Consolidated Financial Statements in Item 15. Exhibits, Financial Statement Schedules in Part IV of this annual report.

Competition

The broad HPC market is very competitive. Many of our competitors in the U.S. and internationally are established companies well known in the HPC supercomputing market, including IBM, Hewlett-Packard, Lenovo, Dell, NEC, Hitachi, Fujitsu, Silicon Graphics International and Atos SE. Most of these competitors have substantially greater total research, engineering, manufacturing, marketing and financial resources than we do.

We compete with systems builders and resellers of systems that are constructed from commodity components using processors manufactured by Intel, AMD and others. IBM, NEC and Fujitsu also build systems leveraging their own processors. These competitors include the previously named companies as well as smaller companies that assemble systems from commercially available commodity products. These companies have capitalized on developments in parallel processing and increased computer performance in commodity-based networking and cluster systems. While these companies' products are more limited in applicability and scalability, they have achieved growing market

acceptance as they can offer significant price/peak performance on problems lacking complexity or extreme scalability. Such companies, because they may offer high peak performance per dollar, can put pricing pressure on us when competing in procurements. The Cray CS400 (including CS-Storm) supercomputing cluster products are designed to help us better address this market by providing flexible HPC offering alternatives with competitive pricing.

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To the extent that IBM and other processor suppliers develop processors or networks with greater capabilities than the processors we use from Intel, AMD and NVIDIA, our systems may be at a competitive disadvantage to systems utilizing such other processors.

For our products designed for the high-end supercomputer market segment, we compete primarily on the basis of product performance, scalability, breadth of features, price/performance, total cost of ownership, quality, reliability, upgradability, service and support, corporate reputation, brand image and account relationships. Our market approach here is more focused than many of our competitors, with high-end supercomputing products (Cray XC40) designed with high levels of integration to meet the exacting needs of this performance and scalability driven market. We work to offer systems that provide greater performance on the largest, most difficult computational problems and superior price/performance on many important applications in the upper-end of the supercomputer market segment. Our highly-integrated systems often offer superior total cost of ownership advantages as they typically use less electric power and cooling and occupy less space than lower bandwidth cluster systems.

The market for our Cray CS400 product line is very competitive. The majority of competition is from IBM, HP, Dell, SGI, Atos and Fujitsu that offer open-standards cluster solutions to address the growth in the mid-range supercomputing market. We compete primarily on the basis of price/performance, open-standards architecture, flexible configurations, energy-efficiency, reliability, scalability, comprehensive cluster management, corporate reputation and account relationships. Our market approach is to offer cluster solutions that provide greater performance on the large and complex computational problems and superior price/performance on many important applications in this market segment.

The competitive landscape in the big data market is quite varied, with competition from vendors offering integrated solutions, such as Oracle, commodity cluster systems with either open source or proprietary data analytics software, and traditional business intelligence vendors such as Teradata, Oracle, IBM and SAP. The market for knowledge discovery through graph analytics (Cray Urika-GD) is still nascent and fragmented as no dominant applications have as yet emerged, with the result that custom and open/source software approaches such as Hadoop/MapReduce are often used. However, customers with large, mission-critical graph problems have discovered that commodity approaches do not scale or deliver results in an acceptable timeframe, and have recognized the advantages of specialized solutions. We recently introduced the Urika-XA offering, which competes primarily on the basis of performance, scalability and integration, as well as total cost of ownership in the traditional Hadoop and Spark analytics marketplace.

Our storage products compete with a number of manufacturers and integrators of parallel storage solutions, including IBM with its GPFS parallel file system, as well as solutions from Data Direct Networks (DDN), NetApp, Panasas and other storage companies. The parallel storage and file system market is currently fragmented with a number of competing providers in the HPC marketplace. We believe that our strong storage products along with our extensive experience and excellent reputation as an HPC systems vendor, our storage offerings compete effectively against our competition, especially when the prospective target market overlaps with our HPC systems target market.

Intellectual Property

We attempt to protect our trade secrets and other proprietary rights through formal agreements with our employees, customers, suppliers and consultants, and through patent protection. Although we intend to protect our rights vigorously, there can be no assurance that our contractual and other security arrangements will be successful.

Our general policy is to seek patent protection for those inventions and improvements that give us a competitive advantage and are likely to be incorporated into our products and services. We have a number of patents and pending patent applications relating to our hardware and software technologies. While we believe our patents and applications have value, no single patent or group of patents is in itself essential to us as a whole or to any of our key products. Any of our proprietary rights could be challenged, invalidated or circumvented and may not provide significant competitive advantage.

We have licensed certain patents and other intellectual property from others in our industry. These licenses often contain restrictions on our use of the underlying technology. We have also entered into cross-license arrangements with other companies involved in the HPC industry. On May 2, 2012, we sold certain intellectual property and other assets related to the research and development of hardware network interconnect technologies to Intel.

Backlog

We do not believe backlog is a meaningful indicator of our future business prospects due to the uncertainty of converting orders into recognized revenue in any given period. Factors impacting the amount of backlog and our ability to recognize revenue from backlog in any given period include the possibility of significant contract amendments, the timing of our product development, manufacturing and delivery schedules and changes in delivery schedules requested by our customers. Therefore, we believe that backlog information is not material to an understanding of our overall business.

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Employees

As of December 31, 2014, we had 1,138 employees. We have no collective bargaining agreement with our employees. We have not experienced a work stoppage and believe that our employee relations are very good.

Available Information

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge at our website at www.cray.com, as soon as reasonably practicable after we file such reports with the SEC electronically. The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov. In addition, we have set forth our Code of Business Conduct, Corporate Governance Guidelines, the charters of the Audit, Compensation, Corporate Governance and Strategic Technology Assessment Committees of our Board of Directors and other governance documents on our website, www.cray.com, under "Company Information - Investors - Corporate Governance." The contents of our website are not incorporated by reference into this annual report on Form 10-K or our other SEC reports and filings.

Item 1A. Risk Factors

In addition to the other information contained in this annual report, you should carefully read and consider the following risk factors. If any of these risks actually occur, our business, financial condition or operating results could be materially adversely affected and the trading price of our common stock could decline.

Our operating results fluctuate significantly and we may not achieve profitability in any given period. Our operating results are subject to significant fluctuations which make predicting revenue and operating results for any specific period very difficult, particularly because a material portion of product revenue recognized in any given quarter or year typically depends on a very limited number of system sales expected for that quarter or year and the product revenue generally depends on the timing of product acceptances by customers and contractual provisions affecting revenue recognition. Delays in achieving customer acceptances of installed systems and recognizing revenue from a product transaction or transactions due to development or product delivery delays, not receiving needed components timely or with anticipated quality and performance, inability of a system to meet performance requirements or targets or other contractual obligations, or for other reasons, could have a material adverse effect on our operating results in any specific quarter or year, and could shift associated revenue, gross profit and cash receipts from one quarter to another, or even from one year to another in the case of revenue expected to be realized in the fourth quarter of any year. In addition, because our revenue can be concentrated in particular quarters, often the fourth quarter, rather than evenly spread throughout a year, we generally do not expect to sustain profitability over successive quarters even if we are profitable for the year.

Although we have recorded positive annual net income since 2010, we experienced net losses in earlier periods. Net income may fluctuate significantly as a result of many factors, including as a result of significant investments we may make to grow our business even though the benefits of those investments often require many years to come to fruition and may not be realized when expected or at all.

Whether we will be able to increase our revenue and achieve and sustain profitability on a quarterly and annual basis depends on a number of factors, including:

- our ability to secure sufficient orders for our Cray XC and Cray CS systems as well as upgrades and successor systems;
- successfully delivering and obtaining sufficient customer acceptances of our Cray XC and Cray CS systems, including attached Sonexion storage systems;
- our ability to successfully generate revenue and profitability from sales of our analytics and storage and data management products, as well as upgrades and successor systems;
- revenue delays or losses due to customers postponing purchases to wait for future upgraded or new systems, including those containing new processors, delays in delivery of upgraded or new systems, longer than expected customer acceptance cycles or penalties resulting from system acceptance issues;

- our ability to efficiently scale our internal processes effectively to enable growth;
- the level of revenue recognized in any given period, which is affected by the very high average sales prices and limited number of significant system sales and resulting potential acceptances in any quarter, the timing of product acceptances by customers and contractual provisions affecting the timing and amount of revenue recognition;

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- our ability to continue to broaden our customer base beyond our traditional customers;
- our expense levels, including research and development expense net of government funding;
- our ability to successfully and timely design, integrate and secure competitive processors for our Cray XC and Cray CS systems and upgrades and successors systems;
- the level of product gross profit contribution in any given period due to volume, competition or product mix, particularly with the introduction of flexible commodity-based supercomputers, competitive factors, strategic transactions, product life cycle, currency fluctuations, acceptance penalties and component costs;
- the competitiveness of our products and prices;
- our ability to secure additional government funding for future development projects;
- maintaining and successfully completing our product development projects on schedule and within budgetary limitations;
- the level and timing of maintenance contract renewals with existing customers; and
- the terms and conditions of sale or lease for our products and services.

The receipt of orders and the timing of shipments and acceptances impact our quarterly and annual results, including cash flows, and are affected by events outside our control, such as:

- the timely availability of acceptable components, including, but not limited to, processors, in sufficient quantities to meet customer delivery schedules and other customer commitments at a competitive cost;
- the timing and level of government funding and resources available for product acquisitions and research and development contracts, which has been, and may continue to be, adversely affected by the current economic and fiscal uncertainties, increased governmental budgetary limitations and disruptions in the operations of the U.S. government;
- the introduction or announcement of competitive or key industry supplier products;
- competitor pricing strategies;
- price fluctuations in the processors and other commodity electronics and memory markets;
- the availability of adequate customer facilities to install and operate new Cray systems;
- currency fluctuations, international conflicts or economic crises, including the ongoing economic challenges in the United States, Japan and Europe and fluctuations in oil prices that can affect the resources available to potential customers to purchase products;
- general economic trends, including changes in levels of customer capital spending; and
- our customers' ability to make future payments in accordance with contractual terms of their purchase or sales-type lease agreements.

Because of the numerous factors affecting our revenue and results of operations, we may not achieve profitability on a quarterly or annual basis in the future. We anticipate that our quarterly results will fluctuate significantly, and include losses, even in years where we expect or achieve positive annual net income. Delays in third-party component availability, product development, receipt of orders, or product acceptances, the level and timing of approved government fiscal budgets, issues with third-party component performance, reductions in outside funding for our research and development efforts and achieving contractual development milestones have had a substantial adverse effect on our past results and could continue to have such an effect on our results in 2015 and in future years.

If we are unable to successfully develop, sell and deliver our Cray XC systems and successor systems, and recognize revenue for these systems, our operating results will be adversely affected. We expect that a substantial portion of our revenue in the foreseeable future will come from acceptances of delivered Cray XC systems and successor systems, including systems integrating future processors and accelerators. The development effort related to these systems are lengthy and technically challenging processes, and require a significant investment of capital, engineering and other resources often years ahead of the time when we can be assured that they will result in competitive products. We may invest significant resources in alternatives that prove ultimately unfruitful. Unanticipated performance and/or development issues may require more engineers, time or testing resources than are currently available. Given the breadth of our engineering challenges, changes in the market and technology and our limited engineering and technical personnel resources, we periodically review the anticipated contributions and expense of our product programs to determine their long-term viability, and we may substantially modify or terminate one or more

development programs. We may not be successful in meeting our development schedules for technical reasons and/or because of insufficient engineering resources, which could result in an uncompetitive product or cause a lack of confidence in our capabilities among our key customers. To the extent that we incur delays in completing the design, development and production of hardware components, delays in development of requisite system software, cancellation of programs due to technical or economic infeasibility or investment in unproductive development efforts, our revenue, results of operations and cash flows, and the reputation of such systems in the market, could be adversely affected.

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In addition, many factors affect our ability to successfully sell and recognize revenue for these systems, including the following:

- the level of product differentiation in our Cray XC systems and successor systems. We need to compete successfully against HPC systems from both large established companies and smaller companies and demonstrate the value of our balanced high bandwidth systems;
- whether potential customers delay purchases of our products because they decide to wait for successor systems or upgrades that we have announced or they believe will be available in the future;
- our ability to meet all customer requirements for acceptance. Even once a system has been delivered, we sometimes do not meet all of the contract requirements for customer acceptance and ongoing reliability of our systems within the provided-for acceptance period, which has resulted in contract penalties and delays in our ability to recognize revenue from system deliveries. Most often these penalties have adversely affected gross profit at the time of revenue recognition through the provision of additional equipment and services and/or service credits to satisfy delivery delays and performance shortfalls. The risk of contract penalties is increased when we bid for new business prior to completing development of new products when we must estimate future system performance, such as has been required with our Cray XC systems and will be frequently required for subsequent systems; and
- our ability to source competitive, key components in appropriate quantities (to have enough to sell without ending up with excess inventory that can lead to obsolescence charges), in a timely fashion and on acceptable terms and conditions and that meet the performance criteria required.

Failure to successfully develop and sell our Cray XC systems and successor systems into the supercomputing market and recognize revenue for such systems will adversely affect our operating results.

If our current and future products targeting markets outside of our traditional markets, primarily our big data analytics and storage and data management products, are not successful, our ability to grow our revenues and achieve and sustain profitability will be adversely affected. Our ability to materially grow our revenues and achieve and sustain profitability will be adversely affected if we are unable to generate sufficient revenue from products targeting markets outside of our traditional markets, particularly if those market segments do not grow significantly. We are currently focusing on big data analytics and storage and data management opportunities. To grow our revenue from opportunities outside our primary markets, we must successfully and in a cost-effective manner design and develop products utilizing technologies different from our traditional supercomputing products, compete successfully with many established companies and new entrants in these markets, continue to win awards for new contracts, timely perform on existing contracts, develop our capability for broader market sales and business development and successfully develop and introduce new solution-oriented offerings, notwithstanding that these are relatively new businesses for us and we do not have significant experience targeting these markets. Big data analytics and storage and data management opportunities require significant monetary investments ahead of revenue, including product development efforts, adding experienced personnel and initiating new marketing and sales efforts and therefore may reduce net income in the short term even if successful.

The continuing commoditization of HPC hardware and software has resulted in pricing pressure and may adversely affect our operating results. The continuing commoditization of HPC hardware, such as processors, interconnects, storage and other infrastructure, and the growing commoditization of software, including plentiful building blocks and more capable open source software, as well as the potential for integration of differentiated technology into already-commoditized components, has resulted in, and may result in pricing pressure that may cause us to reduce our pricing in order to remain competitive, which can negatively impact our gross margins and adversely affect our operating results.

If the U.S. government and other governments purchase, or fund the purchase of, fewer supercomputers or delay such purchases, our revenue would be reduced and our operating results would be adversely affected. Historically, sales to the U.S. Government have represented the largest single market segment for supercomputer sales worldwide, including our products and services. In 2012, 2013 and 2014, approximately 68%, 51% and 48%, respectively, of our revenue was derived from such sales. Our plans for the foreseeable future contemplate significant sales to the U.S. Government. Sales to the U.S. Government, including further sales pursuant to existing contracts, have been, and may continue to be, adversely affected by factors outside our control, such as by:

- Congressional decisions in addressing budget concerns and current economic uncertainty;
- disruptions in the operations of the U.S. government;
- "sequestration";
- the downgrading of U.S. government debt or the possibility of such action;
- the political climate in the U.S. focusing on cutting or limiting budgets and their effect on government budgets;
- the limits on federal borrowing capacity;

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- changes in procurement policies;
- budgetary considerations, including Congressional delays in completing appropriation bills as occurred in 2011, 2012, 2013 and 2014;
- domestic crises;
- political efforts to limit the activities of U.S. intelligence community agencies; including proposed state legislation that would limit or even criminalize doing business with the NSA for certain companies doing business with state governments; and
- international political developments, such as the downgrading of European debt.

If agencies and departments of the United States or other governments were to stop, reduce or delay their use and purchases of supercomputers, our revenue and operating results would be adversely affected.

Our reliance on third-party suppliers poses significant risks to our operating results, business and prospects. We rely upon third-party vendors to supply processors, including accelerators, for most of the products we sell and use service providers to co-develop key technologies. We subcontract the manufacture of a majority of the hardware components for our high-end products, including integrated circuits, printed circuit boards, memory parts, connectors, cables and power supplies, on a sole or limited source basis to third-party suppliers. We use contract manufacturers to assemble certain important components for all of our systems. We also rely on third parties to supply key software and hardware capabilities, such as file systems, solution-specific servers and storage subsystems, and in the case of our Sonexion products, we rely on third-party original equipment manufacturers to supply complete storage systems. Because specific components must be designed into our systems well in advance of initial deliveries of those systems, we are particularly reliant on our processor vendors to deliver on the capabilities and pricing expected at the time we design key elements of the system and make binding bids to customers. We are subject to substantial risks because of our reliance on these and other limited or sole source suppliers, including the following risks:

- if a supplier does not provide components or systems that meet our specifications in sufficient quantities and with acceptable quality on time or deliver when required, or delays future components or systems beyond anticipated delivery dates, then sales, production, delivery, acceptance and revenue from our systems could be delayed and/or reduced and we could be subject to costly penalties even once delivered and accepted, which has happened multiple times in the past and has at times significantly lowered our revenue for a particular quarter or year;
- if a supplier cannot provide a competitive key component (for example, due to inadequate performance or a prohibitive price) or eliminates key features from components, such as with the processors we design into our systems, our systems may be less competitive than systems using components with greater capabilities;
- if an interruption of supply of our components, services or capabilities occurs because a supplier changes its technology roadmap, decides to no longer provide those products or services, increases the price of those products or services significantly or imposes reduced delivery allocations on its customers, it could take us a considerable period of time to identify and qualify alternative suppliers, to redesign our products as necessary and to begin to manufacture the redesigned components or otherwise obtain those services or capabilities. In some cases, such as with key integrated circuits and memory parts or processors, we may not be able to redesign such components or find alternate sources that we could use in any realistic timeframe;
- if a supplier plans future processors that are made available in a way that encourages customers to delay purchases of our products because they decide to wait for successor systems or upgrades they believe will be available in the future or to purchase products with the future processors from our competitors who are willing to take greater risk on delivery;
- if a supplier of a component is subject to a claim that the component infringes a third-party's intellectual property rights, as has happened with multiple suppliers, our ability to obtain necessary components could be adversely affected or our cost to obtain such components could increase significantly;
- if a supplier providing us with key research and development and design services or core technology components with respect to integrated circuit design, network communication capabilities or software is late, fails to provide us with effective functionality or loses key internal talent, our development programs may be delayed or prove to be impossible to complete;

- if a supplier provides us with hardware or software that contains bugs or other errors or is different from what we expected, our development projects and production systems may be adversely affected through reduced performance or capabilities, additional design testing and verification efforts, re-spins of integrated circuits and/or development of replacement components, and the production and sales of our systems could be delayed and systems installed at customer sites could require significant, expensive field component replacements or result in penalties;

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- some of our key component and service suppliers are small companies with limited financial and other resources, and consequently may be more likely to experience financial and operational difficulties than larger, well-established companies, which increases the risk that they will be unable to deliver products as needed; and
- if a key supplier is acquired or has a significant business change, such as occurred with the acquisition of the third-party original equipment manufacturers that supplies complete storage systems for our Sonexion product, the production and sales of our systems and services may be delayed or adversely affected, or our development programs may be delayed or may be impossible to complete.

Certain delays in the availability of acceptable components, including processors and memory parts, and increases in order lead times for certain components, adversely affected our revenue and operating results in multiple prior periods, in some cases significantly, and could adversely affect future results.

If our cluster systems are not successful, our operating results will be adversely affected. Our cluster products were first introduced late in 2012. We have had relatively limited experience selling cluster-based solutions, including into the same markets we sell our core supercomputers, and if we cannot successfully and at acceptable margins sell these solutions, our operating results will be adversely affected.

We have in the past, and may make acquisitions in the future, which could require significant management attention, disrupt our business, result in dilution to our shareholders, deplete our cash reserves and adversely affect our financial results. Acquisitions involve numerous risks, including the following:

- difficulties in successfully integrating the operations, systems, technologies, products, offerings and personnel of the acquired company or companies;
- insufficient revenue to offset increased expenses associated with acquisitions;
- diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;
- potential difficulties in completing projects associated with in-process research and development intangibles;
- difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- initial dependence on unfamiliar supply chains or relatively small supply partners; and
- the potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

Acquisitions may also cause us to:

- use a substantial portion of our cash reserves or incur debt;
- issue equity securities or grant equity incentives to acquired employees that would dilute our current shareholders' percentage ownership;
- assume liabilities, including potentially unknown liabilities;
- record goodwill and non-amortizable intangible assets that are subject to impairment testing on a regular basis and potential periodic impairment charges;
- incur amortization expenses related to certain intangible assets;
- incur large and immediate write-offs and restructuring and other related expenses; or
- become subject to intellectual property or other litigation.

Acquisitions of high-technology companies and assets are inherently risky and subject to many factors outside of our control, and no assurance can be given that our recently completed or future acquisitions will be successful and will not materially adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could materially harm our business and operating results.

If we are unable to compete successfully in the highly competitive HPC market, our business will not be successful. The market for HPC systems is very competitive. An increase in competitive pressures in our market or our failure to compete effectively may result in pricing reductions, reduced gross margins and loss of market share and revenue. Many of our competitors are established companies well known in the HPC market, including IBM, Hewlett-Packard, Lenovo, Dell, NEC, Hitachi, Fujitsu, Silicon Graphics International and Atos SE. Most of these competitors have substantially greater research, engineering, manufacturing, marketing and financial resources than we do.

We also compete with systems builders and resellers of systems that are constructed from commodity components using processors manufactured and/or designed by Intel, ARM, AMD, NVIDIA and others. These competitors include the companies named above and Dell, with IBM using both third-party processors and its own proprietary processors, as well as smaller companies that benefit from the low research and development costs needed to assemble systems from commercially available

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commodity products. Such companies, because they can offer high peak performance per dollar, can put pricing pressure on us in certain competitive procurements. In addition, to the extent that Intel, IBM and other processor suppliers develop processors with greater capabilities or at a lower cost than the processors we currently use, our Cray XC systems may be at a competitive disadvantage to systems utilizing such other processors until we can design in, integrate and secure competitive processors, if at all.

Our growth initiatives in the big data analytics and storage and data management markets must also compete successfully with many established companies and new entrants, many of whom have significantly greater resources and brand recognition in these markets than we do.

Periodic announcements by our competitors of new HPC, storage or data analytics systems or plans for future systems and price adjustments may reduce customer demand for our products. Many of our potential customers already own or lease high performance computer, storage or data analytics systems. Some of our competitors may offer substantial discounts to potential customers. We have in the past and may again be required to provide substantial discounts to make strategic sales, which may reduce or eliminate any gross profit on such transactions, or require us to provide lease financing for our products, which could result in a multi-year deferral of our receipt of cash and revenue for these systems. These developments limit our revenue and financial resources and reduce our ability to be profitable and grow.

If we cannot retain, attract and motivate key personnel, we may be unable to effectively implement our business plan. Our success depends in large part upon our ability to retain, attract and motivate highly skilled management, development, marketing, sales and service personnel. The loss of and failure to replace key engineering management and personnel could adversely affect multiple development efforts. Recruitment and retention of senior management and skilled technical, sales and other personnel is very competitive, and we may not be successful in either attracting or retaining such personnel. From time to time, including recently, we have lost key personnel to other high technology companies, and many larger companies with significantly greater resources than we do have aggressively recruited, and continue to aggressively recruit, key personnel. As part of our strategy to attract and retain key personnel, we may offer equity compensation through stock options and restricted stock grants. Potential employees, however, may not perceive our equity incentives as attractive enough. In addition, due to the intense competition for qualified employees, we may be required to and have had to increase the level of compensation paid to existing and new employees, which could materially increases our operating expenses.

We may not be able to protect our proprietary information and rights adequately. We rely on a combination of patent, copyright and trade secret protection, nondisclosure agreements and licensing arrangements to establish, protect and enforce our proprietary information and rights. We have a number of patents and have additional applications pending. There can be no assurance, however, that patents will be issued from the pending applications or that any issued patents will adequately protect those aspects of our technology to which such patents will relate. Despite our efforts to safeguard and maintain our proprietary rights, we cannot be certain that we will succeed in doing so or that our competitors will not independently develop or patent technologies that are substantially equivalent or superior to our technologies. The laws of some countries do not protect intellectual property rights to the same extent or in the same manner as do the laws of the United States. Additionally, under certain conditions, the U.S. government might obtain non-exclusive rights to certain of our intellectual property. Although we continue to implement protective measures and intend to defend our proprietary rights vigorously, these efforts may not be successful.

We maintain confidential and proprietary information on our computer networks and employ security measures designed to protect this information from unauthorized access. If our security measures are breached, we could lose proprietary data and may suffer economic losses. We maintain confidential information on our computer networks, including information and data that are proprietary to our customers and third parties, as well as to us. Although we have designed and employed and continue to enhance a multitude of security measures to protect this information from unauthorized access, security breaches may occur as a result of third-party action, including computer hackers, employee error, malfeasance or otherwise, that could result in someone obtaining unauthorized access to our customers' data or our data, including our intellectual property and other confidential business information. Because the techniques employed by hackers to obtain unauthorized access or to sabotage systems change frequently, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any security breach could

result in disclosure of our trade secrets or disclosure of confidential customer, supplier or employee data. If this should happen, we could be exposed to potentially significant legal liability, remediation expense, harm to our reputation and other harm to our business.

Customers and other third parties may make statements speculating about or announcing an intention to complete purchases or acceptances of our products before such purchases or acceptances are substantially certain, and these proposed purchases or acceptances may not be completed when or as expected, if at all. From time to time, customers and other third parties may make statements speculating about or announcing a potential purchase of our products

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before we have obtained an order for such purchases or completed negotiations and signed a contract for the purchase of such products. In some instances, government and government-funded customers may announce possible purchases even before they have obtained the necessary budget to procure the products. As a result, these statements or announcements do not mean that we will ultimately be able to secure the sale when or as expected or at all as it is not certain that the contract or order negotiations will be completed successfully or as expected or that the customer will be able to obtain the budget they hope for or expect. In addition, from time to time, customers and other third parties may make statements speculating about or announcing the completion of an acceptance process of a delivery system before such acceptance is completed or certain. As a result, these statements or announcements do not mean that we will ultimately be able to obtain the acceptance when or as expected or recognize revenue.

We are subject to increasing government regulations and other requirements due to the nature of our business, which may adversely affect our business operations. In 2012, 2013 and 2014, approximately 68%, 51% and 48% respectively, of our revenue was derived from the U.S. Government. In addition to normal business risks, our contracts with the U.S. government are subject to unique risks, some of which are beyond our control. Our contracts with the U.S. government are subject to particular risks, including:

The funding of U.S. government programs is subject to congressional appropriations. Many of the U.S. government programs in which we participate may extend for several years; however, these programs are normally funded annually. Changes in U.S. strategy and priorities may affect our future procurement opportunities and existing programs. Long-term government contracts and related orders are subject to cancellation, or delay, if appropriations for subsequent performance periods are not made. The termination of funding for existing or new U.S. government programs could result in a material adverse effect on our results of operations and financial condition.

The U.S. government may modify, curtail or terminate its contracts with us. The U.S. government may modify, curtail or terminate its contracts and subcontracts with us, without prior notice at its convenience upon payment for work done and commitments made at the time of termination. Modification, curtailment or termination of our major programs or contracts could have a material adverse effect on our results of operations and financial condition.

Our U.S. government contract costs are subject to audits by U.S. government agencies. U.S. government representatives may audit the costs we incur on our U.S. government contracts, including allocated indirect costs. Such audits could result in adjustments to our contract costs. Any costs found to be improperly allocated to a specific contract will not be reimbursed, and such costs already reimbursed must be refunded. If any audit uncovers improper or illegal activities or non-compliance with the terms of a specific contract, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. government.

Our business is subject to potential U.S. government inquiries and investigations. We may be subject to U.S. government inquiries and investigations of our business practices due to our participation in government contracts. Any such inquiry or investigation could potentially result in a material adverse effect on our results of operations and financial condition.

Our U.S. government business is also subject to specific procurement regulations and other requirements. These requirements, although customary in U.S. government contracts, increase our performance and compliance costs. These costs might increase in the future, reducing our margins, which could have a negative effect on our financial condition. Failure to comply with these regulations and requirements could lead to suspension or debarment, for cause, from U.S. government contracting or subcontracting for a period of time and could have a negative effect on our reputation and ability to secure future U.S. government contracts.

U.S. export controls could hinder our ability to make sales to foreign customers and our future prospects. The U.S. government regulates the export of HPC systems such as our products. Occasionally we have experienced delays for up to several months in receiving appropriate approvals necessary for certain sales, which have delayed the shipment of our products. Delay or denial in the granting of any required licenses could make it more difficult to make sales to certain foreign customers, eliminating an important source of potential revenue. Our ability to have certain components manufactured in certain foreign countries for a lower cost has also been adversely affected by export restrictions covering information necessary to allow such foreign manufacturers to manufacture components for us.

We may infringe or be subject to claims that we infringe the intellectual property rights of others. Third parties have asserted, and may in the future assert, intellectual property infringement claims against us. As a result of such intellectual property infringement claims, we could be required or otherwise decide that it is appropriate to:

- pay third-party infringement claims;

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- discontinue manufacturing, using or selling particular products subject to infringement claims;
- discontinue using the technology or processes subject to infringement claims;
- develop other technology not subject to infringement claims, which could be time-consuming and costly or may not be possible; or
- license technology from the third party claiming infringement, which license may not be available on commercially reasonable terms.

Regardless of the merits, any intellectual property infringement claim would require management attention and could be expensive to defend.

Our stock price is volatile. The trading price of our common stock is subject to significant fluctuations in response to many factors, including stock market trends and shareholder profile, our quarterly operating results, changes in analysts' estimates or our outlook, our capital raising activities, announcements of technological innovations and customer contracts by us or our competitors, a significant aggressive seller or buyer, general economic conditions and conditions in our industry.

We incorporate software licensed from third parties into the operating systems for our products as well as in our tools to design products and any significant interruption in the availability of these third party software products or defects in these products could reduce the demand for our products or cause delay in development. The operating system as well as other software we develop for our supercomputers contains components that are licensed to us under open source software licenses. Our business could be disrupted if this software, or functional equivalents of this software, were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case we would be required to redesign our operating system software to function with alternative third-party software, or develop these components ourselves, which would result in increased costs and could result in delays in product shipments. Our supercomputer systems utilize software system variants that incorporate Linux technology. The open source licenses under which we have obtained certain components of our operating system software may not be enforceable. Any ruling by a court that these licenses are not enforceable, or that Linux-based operating systems, or significant portions of them, may not be copied, modified or distributed as provided in those licenses, would adversely affect our ability to sell our systems. In addition, as a result of concerns about the risks of litigation and open source software generally, we may be forced to protect our customers from potential claims of infringement. In any such event, our financial condition and results of operations may be adversely affected.

We also incorporate proprietary incidental software from third parties, such as for file systems, job scheduling and storage subsystems. We have experienced some functional issues in the past with implementing such software with our supercomputer systems. In addition, we may not be able to secure needed software systems on acceptable terms, which may make our systems less attractive to potential customers. These issues may result in lost revenue, additional expense by us and/or loss of customer confidence.

We may not realize the anticipated benefits, or minimize the possible risks, of the sale of certain interconnect hardware assets to Intel Corporation, which could alter the revenue, costs and nature of our business. In connection with our sale of certain interconnect hardware assets to Intel, we conducted business, legal and financial due diligence with the goal of identifying and evaluating material risks involved in the transaction. Despite our efforts, we may not have been successful in ascertaining or evaluating all such risks and, as a result, might not ultimately realize all of the intended advantages of the transaction. Additionally, the transfer of certain of our employees and technologies to Intel may result in unforeseen operating difficulties and expenditures and could involve a number of potential adverse risks to our business, including the following:

- harm to our ability to compete in relevant markets or in customer perception of our products;
- unanticipated costs or adverse tax consequences;
- exposure to potential liabilities to third parties or Intel, or claims for indemnification by Intel, including with respect to third-party litigation matters;
- delays and difficulties in receiving key components for our products from suppliers, including Intel;
- loss of customers, vendors or alliances; and
- failure to create long-term shareholder value with the additional cash resources.

If we fail to realize the expected benefits from the transaction, or to minimize the expected risks of the transaction, whether as a result of unidentified risks or other unforeseen events, our business, results of operations and financial condition could be adversely affected.

The “conflict minerals” rule of the Securities and Exchange Commission, or SEC, has caused us to incur additional expenses, could limit the supply and increase the cost of certain metals used in manufacturing our products, and could make us less competitive in our target markets. On August 22, 2012, the SEC adopted a rule requiring disclosure by public companies of the origin, source and chain of custody of specified minerals, known as conflict minerals, that are

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necessary to the functionality or production of products manufactured or contracted to be manufactured by us. The rule requires companies to obtain sourcing data from suppliers, engage in supply chain due diligence, and file annually with the SEC a specialized disclosure report on Form SD covering the prior calendar year. Implementation of our conflict minerals policy could limit our ability to source at competitive prices and to secure sufficient quantities of certain minerals used in the manufacture of our products, specifically tantalum, tin, gold and tungsten, as the number of suppliers that provide conflict-free minerals may be limited. In addition, we have incurred, and may continue to incur, material costs associated with complying with the conflict minerals rule, such as costs related to the determination of the origin, source and chain of custody of the minerals used in our products, the adoption of conflict minerals-related governance policies, processes and controls, and possible changes to products or sources of supply as a result of such activities. Within our supply chain, we may not be able to sufficiently verify the origins of the relevant minerals used in our products through the data collection and due diligence procedures that we implement, which may harm our reputation. Furthermore, we may encounter challenges in satisfying those customers that require that all of the components of our products be certified as conflict free, and if we cannot satisfy these customers, they may choose a competitor's products. We continue to investigate the presence of conflict materials within our supply chain.

We are required to evaluate our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002 at the end of each fiscal year, and any adverse results from such future evaluations could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price. Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to furnish a report by our management and a report by our independent registered public accounting firm on our internal control over financial reporting in our annual reports on Form 10-K as to whether we have any material weaknesses in our internal controls over financial reporting. Depending on their nature and severity, any future material weaknesses could result in our having to restate financial statements, could make it difficult or impossible for us to obtain an audit of our annual financial statements or could result in a qualification of any such audit. In such events, we could experience a number of adverse consequences, including our inability to comply with applicable reporting and listing requirements, a loss of market confidence in our publicly available information, delisting from the NASDAQ Global Market, an inability to complete a financing, loss of other financing sources such as our line of credit, and litigation based on the events themselves or their consequences.

Provisions of our Restated Articles of Incorporation and Amended and Restated Bylaws could make a proposed acquisition of our business that is not approved by our Board of Directors more difficult. Provisions of our Restated Articles of Incorporation and Amended and Restated Bylaws could make it more difficult for a third party to acquire us. These provisions could limit the price that investors might be willing to pay in the future for our common stock. For example, our Restated Articles of Incorporation and Amended and Restated Bylaws provide for:

- removal of a director only in limited circumstances and only upon the affirmative vote of not less than two-thirds of the shares entitled to vote to elect directors;
- the ability of our Board of Directors to issue up to 5,000,000 shares of preferred stock, without shareholder approval, with rights senior to those of the common stock;
- no cumulative voting of shares;
- the right of shareholders to call a special meeting of the shareholders only upon demand by the holders of not less than 30% of the shares entitled to vote at such a meeting;
- the affirmative vote of not less than two-thirds of the outstanding shares entitled to vote on an amendment, unless the amendment was approved by a majority of our continuing directors, who are defined as directors who have either served as a director since August 31, 1995, or were nominated to be a director by the continuing directors;
- special voting requirements for mergers and other business combinations, unless the proposed transaction was approved by a majority of continuing directors;
- special procedures to bring matters before our shareholders at our annual shareholders' meeting; and
- special procedures to nominate members for election to our Board of Directors.

These provisions could delay, defer or prevent a merger, consolidation, takeover or other business transaction between us and a third party that is not approved by our Board of Directors.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

Our principal properties are as follows:

Location of Property	Uses of Facility	Approximate Square Footage
Chippewa Falls, WI	Manufacturing, hardware development, central service and warehouse	213,600
Seattle, WA	Executive offices, hardware and software development, sales and marketing	54,000
St. Paul, MN	Software development, sales and marketing	65,688
San Jose, CA	Hardware and software development	21,733

We own 205,478 square feet of manufacturing, development, service and warehouse space in Chippewa Falls, Wisconsin, and lease the remaining space described above.

We lease a total of 8,600 square feet of office space, primarily for hardware development, in Austin, Texas. We lease a total of 5,200 square feet of office space, primarily for hardware and software engineering, in The Woodlands, Texas. We lease a total of 5,600 square feet of office space, primarily for software development, in Pleasanton, California. We also lease a total of approximately 6,200 square feet, primarily for sales and service offices, in other domestic locations. In addition, various foreign sales and service subsidiaries have leased an aggregate of approximately 25,000 square feet of office space. We believe our facilities are adequate to meet our needs at least through 2015.

Item 3. Legal Proceedings

We are currently not a party to any material legal proceedings.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for the Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Price Range of Common Stock and Dividend Policy

Our common stock is traded on the Nasdaq Global Market under the symbol CRAY. As of February 13, 2015, we had 40,826,651 shares of common stock outstanding that were held by 484 holders of record.

The quarterly high and low sales prices of our common stock for the periods indicated are as follows:

	High	Low
Year Ended December 31, 2014:		
First Quarter	$42.09	$26.64
Second Quarter	$38.69	$24.63
Third Quarter	$31.85	$24.94
Fourth Quarter	$35.81	$24.23
Year Ended December 31, 2013:		
First Quarter	$23.23	$15.41
Second Quarter	$23.59	$16.20
Third Quarter	$28.59	$19.51
Fourth Quarter	$28.20	$21.30

We have not paid cash dividends on our common stock and we do not anticipate paying any cash dividends on our common stock in the foreseeable future.

Equity Compensation Plan Information

The following table provides information as of December 31, 2014, with respect to compensation plans under which shares of our common stock are authorized for issuance, including plans previously approved by our shareholders and plans not previously approved by our shareholders.

Plan Category	Number of Shares of Common Stock to be Issued Upon Exercise of Outstanding Options	Weighted-Average Exercise Price of Outstanding Options	Number of Shares of Common Stock Available for Future Issuance Under Equity Compensation Plans (excluding shares reflected in 1st column)
Equity compensation plans approved by shareholders(1)	1,863,295	$12.61	3,079,888
Equity compensation plans not approved by shareholders(2)	67,695	$5.03	—
Total	1,930,990		3,079,888

(1) The shareholders approved our 1995, 1999 and 2003 stock option plans, our 2004, 2006 and 2009 long-term equity compensation plans, our 2013 equity incentive plan and our 2001 employee stock purchase plan, as amended; our 1995, 1999 and 2003 stock option plans and our 2004, 2006 and 2009 long-term equity compensation plans have terminated and no more options, restricted shares, restricted units or stock bonus awards may be granted under those plans. Pursuant to the 2013 equity incentive plan, incentive options may be granted to employees (including officers) and nonqualified options may be granted to employees, officers, directors, agents and consultants with exercise prices at least equal to the fair market value of the underlying common stock at the time of grant. While our Board of Directors may grant options with varying vesting periods under these plans, most options granted to employees vest over four years, with 25% of the options vesting after one year and the remaining options vesting monthly over the next three years, and most option grants to non-employee directors vesting immediately. Also

pursuant to the 2013 equity incentive plan, our Board of Directors may grant restricted stock awards, stock bonus awards, stock appreciation rights, restricted stock units, performance shares and performance units to employees, directors, consultants, independent contractors and advisors. As of December 31, 2014, under the 2013 equity incentive plan, an aggregate of 3,079,888 shares remained available for grant as stock options or stock appreciation

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rights and an aggregate of 1,987,025 shares were available for restricted stock awards, stock bonus awards, restricted stock units, performance shares or performance units to employees, directors, consultants, independent contractors and advisors.

(2) The shareholders did not approve the 2000 non-executive employee stock option plan. Under the 2000 non-executive employee stock option plan approved by our Board of Directors on March 30, 2000, an aggregate of 1,500,000 shares pursuant to non-qualified options could be issued to employees, agents and consultants but not to officers or directors. Otherwise, the 2000 non-executive employee stock option plan is similar to the stock option plans described in footnote (1) above. On March 30, 2010, the 2000 non-executive employee stock option plan was terminated, which ended future grants but did not affect then outstanding options. As of December 31, 2014, under the 2000 non-executive employee stock plan, we had options for 67,695 shares outstanding.

Unregistered Sales of Securities

We had no unregistered sales of our securities in 2014 not previously reported.

Issuer Repurchases

We did not repurchase any of our common stock in 2014, other than in connection with the forfeiture of common stock by holders of restricted stock awards in exchange for payments by the Company of statutory tax withholding amounts on behalf of the holders arising as a result of the vesting of restricted stock awards.

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STOCK PERFORMANCE GRAPHS

The graph below compares the cumulative total return to shareholders for our common stock with the comparable return of the NASDAQ OMX Global Indexes Nasdaq US Benchmark TR Index and the NASDAQ OMX Global Indexes ICB: 9572 Computer Hardware Index.

The graph assumes that a shareholder invested $100 in our common stock on December 31, 2009, and that all dividends were reinvested. We have never paid cash dividends on our common stock. All return information is historical and is not necessarily indicative of future performance.

COMPARISON OF CUMULATIVE TOTAL RETURN AMONG OUR COMMON STOCK,
THE NASDAQ US BENCHMARK TR INDEX AND THE ICB: 9572
COMPUTER HARDWARE INDEX THROUGH DECEMBER 31, 2014

	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014
Cray Inc.	100.0	111.7	100.8	248.4	427.7	537.1
Nasdaq US Benchmark TR Index	100.0	117.5	117.9	137.3	183.3	206.1
ICB: 9572 Computer Hardware Index	100.0	123.5	129.5	155.3	182.7	247.6

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Item 6. Selected Consolidated Financial Data

The following table presents selected historical consolidated financial data for Cray Inc. and its subsidiaries, which is derived from our audited consolidated financial statements:

	Years Ended December 31,				
	2014	2013	2012	2011	2010
	(In thousands, except for per share data)				
Operating Data:					
Product revenue	$460,748	$436,330	$353,767	$155,561	$239,085
Service revenue	100,858	89,419	67,291	80,485	80,303
Total revenue	561,606	525,749	421,058	236,046	319,388
Cost of product revenue	321,554	298,244	231,237	101,000	155,027
Cost of service revenue	55,638	43,179	38,643	40,680	54,404
Total cost of revenue	377,192	341,423	269,880	141,680	209,431
Gross profit	184,414	184,326	151,178	94,366	109,957
Research and development, net	94,048	87,728	64,303	49,452	43,618
Sales and marketing	57,785	51,345	37,180	26,134	31,085
General and administrative	23,381	23,603	20,707	15,840	17,767
Restructuring	—	—	—	1,783	—
Operating expenses	175,214	162,676	122,190	93,209	92,470
Net gain on sale of interconnect hardware development program	—	—	139,068	—	—
Income from operations	9,200	21,650	168,056	1,157	17,487
Other income (expense), net	(9)	(1,378)	472	(989)	(766)
Interest income (expense), net	506	757	204	(33)	219
Income before income taxes	9,697	21,029	168,732	135	16,940
Benefit (provision) for income taxes	52,626	11,194	(7,491)	14,194	(1,878)
Net income	$62,323	$32,223	$161,241	$14,329	$15,062
Net income per common share:					
Basic	$1.61	$0.85	$4.42	$0.41	$0.44
Diluted	$1.54	$0.81	$4.27	$0.40	$0.43
Weighted average outstanding shares:					
Basic	38,634	37,832	36,509	35,122	34,313
Diluted	40,435	39,776	37,789	36,072	35,278
Cash Flow Data:					
Cash provided by (used in):					
Operating activities	$(58,109)	$(87,350)	$156,892	$(3,823)	$(49,164)
Investing activities	(22,755)	27,211	37,694	(4,779)	500
Financing activities	(70)	(93)	7,827	1,462	933
Depreciation and amortization	16,324	14,242	8,652	8,601	9,431
Purchases of property and equipment	17,193	13,136	10,843	4,916	3,736
Balance Sheet Data:					
Cash, cash equivalents, restricted cash and investments	$145,796	$220,449	$323,205	$54,187	$61,295
Working capital	361,614	334,928	283,352	137,733	125,377
Total assets	651,434	603,366	510,314	283,099	260,628
Shareholders' equity	453,854	375,587	340,546	166,814	145,821

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

The information set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" below includes "forward-looking statements" as described in the section "Forward-Looking Statements" preceding Part I of this annual report on Form 10-K, and is subject to the safe harbor created by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us and described in Item 1A. Risk Factors in Part I and other sections of this report and our other filings with the Securities and Exchange Commission. The following discussion should also be read in conjunction with the Consolidated Financial Statements and accompanying Notes thereto.

Overview and Executive Summary

We design, develop, manufacture, market and service the high-end of the high-performance computing, or HPC, market, primarily categories of systems commonly known as supercomputers and provide storage and analytics solutions. We also provide software, system maintenance and support services and engineering services related to supercomputer systems and our storage and data analytics solutions. Our customers include domestic and foreign government and government-funded entities, academic institutions and commercial entities. Our key target markets are the supercomputing portion of the HPC market and the expanding storage and analytics market. We provide customer-focused solutions based on three models: (1) highly integrated supercomputing and storage solutions, complete with highly tuned software, that stress capability, scalability, sustained performance and reliability at scale; (2) flexible commodity-based "cluster" supercomputing and storage solutions based upon utilizing best-of-breed components and working with our customers to define solutions that meet specific needs; and (3) turn-key analytic solutions featuring industry standards and innovative graph technologies. All of our solutions also emphasize total cost of ownership, scalable price-performance and data center flexibility as key features. Our continuing strategy is to gain market share in the supercomputer market segment, extend our technology leadership, maintain our focus on execution and profitability and grow by continuing to expand our addressable market in areas where we can leverage our experience and technology, such as in high performance storage systems and powerful analytic tools for large volumes of data, popularly referred to as "big data". We also meet diverse customer requirements by combining supercomputing, cluster, storage and analytics technologies described above, into unique solutions offerings that work in a workflow-driven datacenter environment.

Summary of 2014 Results

Total revenue increased by $35.9 million in 2014 compared to 2013, from $525.7 million to $561.6 million. Product revenue increased by $24.4 million and service revenue increased by $11.4 million over the same period. The increase in product revenue was principally the result of a higher volume of Supercomputing acceptances, partially due to the release of our new Cray XC40 and CS400 systems, as well as increased revenues from our Storage and Data Management business. Service revenue increased due to higher maintenance revenue generated from our larger installed base of systems.

Product gross profit margin decreased from 32% in 2013 to 30% in 2014. Product gross profit margin decreased principally due to a higher portion of our revenue being generated by our Cray CS products, which typically carry lower margins. Gross profit margin from services decreased from 52% in 2013 to 45% in 2014 primarily due to increases in compensation cost due to a higher number of support personnel to support growth in systems installations, higher third party costs for our engineering services contracts, and severance costs due to a workforce rebalancing.

We recorded income from operations of $9.2 million in 2014 compared to income from operations of $21.7 million in 2013. The decrease in income from operations was primarily attributable to lower gross profit margin percentages and an increase in operating expenses of $12.5 million. Operating expenses increased principally due to additional investments in research and development activities and increased sales and marketing costs.

Net income increased from $32.2 million in 2013 to $62.3 million in 2014, primarily driven by the $55.7 million reduction of substantially all of the valuation allowance held against our U.S. deferred tax assets in 2014, partially offset by the decrease in operating income discussed above.

Net cash used in operations during 2014 was $58.1 million, as compared to net cash used in operations of $87.4 million in 2013. Net cash used in operations during 2014 was primarily driven by an increase in inventory of $54.1 million, due to several system builds that we expect to accept early in 2015. Working capital increased by $26.7 million from $334.9 million at December 31, 2013 to $361.6 million at December 31, 2014.

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Market Overview and Challenges

Significant trends in the HPC industry include:

- Supercomputing with many-core commodity processors driving increasing scalability requirements;
- Increased micro-architectural diversity, including increased usage of many-core processors and accelerators, as the rate of per-core performance increases slows;
- Data needs growing much faster than computational needs;
- Technology innovations in memory and storage allowing for faster data access such as NVRAM, SSDs and flash devices;
- The commoditization of HPC hardware, particularly processors and system interconnects;
- The growing commoditization of software, including plentiful building blocks and more capable open source software;
- Electrical power requirements becoming a design constraint and driver in total cost of ownership determinations;
- Increasing use of analytics technologies (Hadoop, Spark, NoSQL and Graph) in both the HPC and big data markets; and
- Cloud computing for cost-effective computing on loosely-coupled HPC applications.

Several of these trends have resulted in the expansion and acceptance of loosely-coupled cluster systems using processors manufactured by Intel, AMD and others combined with commercially available, commodity networking and other components, particularly in the middle and lower segments of the HPC market. These systems may offer higher theoretical peak performance for equivalent cost, and “price/peak performance” is sometimes the dominant factor in HPC procurements. Vendors of such systems often put pricing pressure on us in competitive procurements.

In the market for the largest, and most scalable systems, those often costing in excess of $3 million, the use of generally available network components can result in increasing data transfer bottlenecks as these components do not balance processor power with network communication capability. With the arrival of increasing processor core counts due to new many-core processors, these unbalanced systems will typically have even lower productivity, especially in larger systems running more complex applications. We augment standard microprocessors with other processor types, such as graphics processing units and many-core attached processors, in order to increase computational power, further complicating programming models. In addition, with increasing scale, bandwidth and processor core counts, large computer systems use progressively higher amounts of power to operate and require special cooling capabilities.

To position ourselves to meet the market’s demanding needs, we concentrate our research and development efforts on technologies that enable our supercomputers to perform at scale - that is, to continue to increase actual performance as systems grow ever larger in size - and in areas where we can leverage our core expertise in other markets whose applications demand these tightly-coupled architectures. We also have demonstrated expertise in several processor technologies. We expect to be in a comparatively advantageous position as larger many-core processors become available and as multiple processing technologies become integrated into single systems in heterogeneous environments. In addition, we have continued to expand our addressable market by leveraging our technologies, customer base, the Cray brand and industry trends by introducing complementary products and services to new and existing customers, as demonstrated by our emphasis on strategic initiatives, such as storage and data management and “big data” analytics.

In storage, we are developing and delivering high value products for the high performance storage and data archiving markets. Cray storage products are primarily positioned to enable tight integration of storage to computing solutions and/or utilize parallel file processing technologies and facilitate storage across multiple data tiers. We support open source parallel file systems and protocol such as Lustre and are a founding member of the OpenSFS (Open Scalable File System) consortia for Lustre.

In analytics, we are developing and delivering high performance data discovery and advanced analytics solutions. These solutions compete with open source software, running on commodity cluster systems. Although these competitive systems have low acquisition costs, the total cost of ownership, or TCO, is driven up by management, power and efficiency challenges. We concentrate our efforts on developing solutions that minimize the TCO, delivering faster time-to-solution and advanced capabilities that are key drivers for many of our data analytics customers.

We have also expanded our addressable market by providing cluster systems and solutions to the supercomputing market that allow us to offer flexible platforms to incorporate best of breed components to allow customers to optimize the system to fit their unique requirements.

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Key Performance Indicators

Our management monitors and analyzes several key performance indicators in order to manage our business and evaluate our financial and operating performance, including:

Revenue. Product revenue generally constitutes the major portion of our revenue in any reporting period and, for the reasons discussed in this annual report on Form 10-K, is subject to significant variability from period to period. In the short term, we closely review the status of product shipments, installations and acceptances in order to forecast revenue and cash receipts; longer-term, we monitor the status of the pipeline of product sales opportunities and product development cycles. We believe product revenue growth measured over several quarters is a better indicator of whether we are achieving our objective of increased market share in the supercomputing market. The introduction of the Cray XC and Cray CS products, along with our longer-term product roadmap are efforts to increase product revenue. We are also increasing our business and product development efforts in storage and data management along with big data analytics. Maintenance service revenue is more constant in the short term and assists, in part, to offset the impact that the variability in product revenue has on total revenue.

Gross profit margin. Product gross profit margin decreased from 32% in 2013 to 30% in 2014. Product gross profit margin decreased principally due to a higher portion of our revenue being generated by our Cray CS products which typically carry lower margins. Gross profit margin from services decreased from 52% in 2013 to 45% in 2014 primarily due to increases in compensation cost due to a higher number of support personnel to support growth in systems installations, higher third party costs for our engineering services contracts, and severance costs due to a workforce rebalancing. Total gross profit margin decreased from 35% in 2013 to 33% in 2014.

Operating expenses. Our operating expenses are driven largely by headcount, the level of recognized co-funding for research and development, contracted third-party research and development services, and incentive compensation expense. As part of our ongoing efforts to control operating expenses, we monitor headcount levels in specific geographic and operational areas. Operating costs increased as we made significant investments in research and development and sales and marketing to support the growth in 2014 and position us for growth in the future.

Liquidity and cash flows. Due to the variability in product revenue, new contracts, and payment terms, our cash position also varies significantly from quarter-to-quarter and within a quarter. We monitor our expected cash levels, particularly in light of increased inventory purchases for large system installations and the risk of delays in product shipments and acceptances and, longer-term, in product development. Cash receipts generally lag customer acceptances and, because we had a number of large customer acceptances in the fourth quarter of 2014, we anticipate significant cash receipts in the first quarter of 2015.

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Results of Operations

Revenue and Gross Profit

Our product and service revenue for the indicated years ended December 31 were (in thousands, except for percentages):

	Year Ended December 31,		
	2014	2013	2012
Product revenue	$460,748	$436,330	$353,767
Less: Cost of product revenue	321,554	298,244	231,237
Product gross profit	$139,194	$138,086	$122,530
Product gross profit percentage	30%	32%	35%
Service revenue	$100,858	$89,419	$67,291
Less: Cost of service revenue	55,638	43,179	38,643
Service gross profit	$45,220	$46,240	$28,648
Service gross profit percentage	45%	52%	43%
Total revenue	$561,606	$525,749	$421,058
Less: Total cost of revenue	377,192	341,423	269,880
Total gross profit	$184,414	$184,326	$151,178
Total gross profit percentage	33%	35%	36%

Product Revenue

Product revenue in 2014 increased by $24.4 million, or 6%, over 2013 in part due to the release of our new Cray XC40 and CS400 systems. CS based revenue increased substantially in 2014 and revenues from our Storage and Data Management business also increased year over year.

Product revenue in 2013 increased by $82.6 million, or 23%, over 2012 principally as the result of the strong acceptance in the market of our Cray XC30 and CS300 products as well as increased revenues from our Storage and Data Management business.

Service Revenue

Service revenue for 2014 increased by $11.4 million from 2013, or 13%. Approximately 75% of the $11.4 million increase in service revenue for 2014 resulted from growth in our maintenance and support services due to our larger installed system base. Engineering service revenue also increased in 2014.

Service revenue for 2013 increased by $22.1 million from 2012, or 33%. Approximately 70% of the $22.1 million increase in service revenue for 2013 resulted from growth in our maintenance and support services due to our larger installed system base. Engineering service revenue also increased in 2013.

Cost of Product Revenue and Product Gross Profit

Cost of product revenue for 2014 increased by $23.3 million compared to 2013 driven primarily by higher product revenue. Product gross profit percentage was 30% in 2014 and 32% in 2013. The 2014 product gross profit margin was impacted by a higher portion of our revenue being generated by our Cray CS products which typically carry lower margins.

Cost of product revenue for 2013 increased by $67.0 million compared to 2012 driven by significantly higher product revenue. Product gross profit percentage was 32% in 2013 and 35% in 2012. The 2013 product gross profit margin was impacted by higher than anticipated costs on the second phase of the upgrade at Oak Ridge National Laboratory, aggressive pricing, fluctuations in foreign currency rates and lower margins on our Cray CS products that were also impacted by $3 million in amortization and other acquisition adjustments.

Cost of Service Revenue and Service Gross Profit

Cost of service revenue increased by $12.5 million in 2014 driven primarily by higher service revenue. Service gross profit margin decreased by seven percentage points to 45% in 2014 compared to 2013. The service gross profit margin decreased primarily due to increases in compensation cost due to a higher number of support personnel to support

growth in systems installations, higher third party costs for our engineering services contracts and third party products, and severance costs due to a workforce rebalancing.

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Cost of service revenue increased by $4.5 million and service gross profit margin increased by nine percentage points to 52% in 2013 compared to 2012. The service gross profit margin increased due to higher maintenance revenue from our larger installed system base where expense growth was slower and benefited from economies in cost structure.

Operating Expenses

Research and Development

Research and development expenses for the indicated years ended December 31 were as follows (in thousands, except for percentages):

	Year Ended December 31,		
	2014	2013	2012
Gross research and development expenses	$104,797	$92,469	$86,305
Less: Amounts included in cost of revenue	(7,713)	(3,741)	(1,080)
Less: Reimbursed research and development (excludes amounts in revenue)	(3,036)	(1,000)	(20,922)
Net research and development expenses	$94,048	$87,728	$64,303
Percentage of total revenue	17%	17%	15%

Gross research and development expenses in the table above reflect all research and development expenditures. Research and development expenses include personnel expenses, depreciation, allocations for overhead expenses, software, prototype materials and outside contracted expenses.

In 2014, gross research and development expenses increased by $12.3 million from 2013 levels primarily due to increased investments in the development of new products. We increased our average headcount which resulted in higher compensation costs of $4.6 million. The increase in total compensation costs also included the impact of increased share based compensation costs, offset by a decrease in incentive compensation costs. We also incurred an additional $4.1 million in software and materials purchases, depreciation and benchmarking costs when compared to 2013 and an additional $2.8 million in outside services.

In 2013, gross research and development expenses increased by $6.2 million from 2012 levels primarily due to increased investments in the development of new products for our new initiatives, principally big data analytics. Reimbursed research and development decreased $19.9 million in 2013 compared to 2012 primarily due to the completion of the DARPA HPCS Phase III project in 2012.

Other Operating Expenses

Our sales and marketing and general and administrative expenses for the indicated years ended December 31 were (in thousands, except for percentages):

	Year Ended December 31,		
	2014	2013	2012
Sales and marketing	$57,785	$51,345	$37,180
Percentage of total revenue	10%	10%	9%
General and administrative	$23,381	$23,603	$20,707
Percentage of total revenue	4%	4%	5%

Sales and Marketing. The $6.4 million increase in sales and marketing expenses in 2014 compared to 2013 was primarily due to an increase in salaries and employee-related expenses in connection with the expansion of our sales force. Compensation costs increased by $3.3 million and included the impact of increased share based compensation costs, offset by a decrease in incentive compensation costs. We also incurred an additional $0.6 million in marketing program costs, $0.5 million in outside services and $1.3 million in benchmarking costs when compared to 2013.

The $14.2 million increase in sales and marketing expenses in 2013 compared to 2012 was primarily due to an increase in salaries and employee-related expenses in connection with the expansion of our sales force and as a result of our acquisition of Appro International, Inc., or Appro.

General and Administrative. The $0.2 million decrease in general and administrative expenses in 2014 compared to 2013 was primarily due to a $1.7 million decrease in outside services, partially offset by increased compensation expense of $1.2 million, when compared to 2013, due to a year over year increase in headcount to support the growth in the business. The increase in total compensation costs also included the impact of increased share based

compensation costs, offset by a decrease in incentive compensation costs.

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The $2.9 million increase in general and administrative expenses in 2013 compared to 2012 was partly due to increased employee-related expenses, including the addition of employees related to our acquisition of Appro. This was partially offset by lower incentive-based compensation.

Sale of Interconnect Hardware Development Program

On May 2, 2012, we sold our interconnect hardware development program to Intel for cash consideration of $140 million. As part of the transaction, 73 of our employees joined Intel, and certain intellectual property and fixed assets were transferred to Intel. We retained certain rights to use the transferred assets and intellectual property. As a result of the sale, we recorded a gain of $139.1 million for the year ended December 31, 2012.

Other Income (Expense), Net

We recorded $9,000 and $1.4 million of net other expense and $0.5 million of net other income for the years ended December 31, 2014, 2013 and 2012, respectively. Net other income and expense includes gains and losses from foreign currency transactions, investments and disposals of assets.

Interest Income, Net

Our interest income and interest expense for the years ended December 31 were (in thousands):

	Year Ended December 31,		
	2014	2013	2012
Interest income	$643	$894	$397
Interest expense	(137)	(137)	(193)
Net interest income	$506	$757	$204

Interest income in 2014 decreased as compared to 2013 due to lower average investment balances and a higher proportion of investments held in short-term money market funds which typically carry a lower interest rate. Interest income in 2013 increased as compared to 2012 due to higher average invested balances. Interest expense decreased in 2013 as a result of changes in our credit arrangements. Interest expense in 2014 was in line with the prior year comparative period.

Taxes

We recorded income tax benefit (expense) for the years ended December 31 as follows (in thousands):

	Year Ended December 31,		
	2014	2013	2012
Net income before income taxes	$9,697	$21,029	$168,732
Tax benefit (expense)	52,626	11,194	(7,491)
Net income	$62,323	$32,223	$161,241
Effective tax rate	543%	53%	(4)%

The difference between the income tax provision at the federal statutory rate of 35% and our income tax benefit at the effective income tax rate of 543% for the year ended December 31, 2014 was attributable to our decision to reduce substantially all of the remaining valuation allowance that was held against our U.S. deferred tax assets. The difference between the income tax provision at the federal statutory rate of 35% and our income tax benefit at the effective rate of 53% for the year ended December 31, 2013 was primarily attributable to a partial reduction, in the amount of $13.5 million, of the valuation allowance held against our U.S. deferred tax assets. The primary reason for the difference between the federal statutory rate and our effective income tax rate for the year ended December 31, 2012 was that the gain from the sale of our interconnect hardware development program did not result in significant income tax expense. We had existing deferred tax assets that were subject to valuation allowances and deductible temporary differences that were previously unrecognized. The sale of the interconnect hardware development program was never anticipated in previous evaluations of the realizability of our deferred tax assets and consequently the sale, together with a tax benefit that was recognized as a result of restructuring a subsidiary, resulted in our ability to experience a relatively small tax consequence from the sale.

Our decision to reduce substantially all of the remaining valuation allowance held against our U.S. deferred tax assets during the year ended December 31, 2014 was based upon an evaluation of all available positive and negative evidence, known business risks and industry trends. During the year ended December 31, 2014, we reduced the valuation allowance held against our U.S. deferred tax assets by $55.7 million based upon an assessment of all

positive and negative evidence relating to future years. We consider our actual results over several years to have stronger weight than other more subjective indicators, including forecasts,

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when considering whether or not to establish or reduce a valuation allowance on deferred tax assets and believe that our ability to forecast results significantly into the future is severely limited due to the rapid rate of technological and competitive change in the industry in which we operate. As of December 31, 2014 we had generated U.S. pre-tax income in each of the last three years and cumulative U.S. pre-tax income of $184.8 million ($51.1 million excluding the impact of the sale of our interconnect hardware development program) over the last three years. In addition to our cumulative income position, the assessment of our ability to utilize our U.S. deferred tax assets included an assessment of forecasted domestic and international earnings over a number of years, which included the impact of several major contracts that were finalized during the fourth quarter of 2014.

During the year ended December 31, 2013, we reduced the valuation allowance held against our deferred tax assets by $13.5 million due to actual income from operations during the year ended December 31, 2013 exceeding amounts previously used in the evaluation of the realizability of our deferred tax assets at the beginning of the year and based upon an assessment of all positive and negative evidence relating to future years.

During the year ended December 31, 2012 we reduced the valuation allowance held against our deferred tax assets by $18.4 million as a result of the sale of our interconnect hardware development program. We further reduced the valuation allowance held against our U.S. deferred tax assets by $10.7 million during the year ended December 31, 2012 due to actual income from operations during the year ended December 31, 2012 exceeding amounts previously used in the evaluation of the realizability of our deferred tax assets at the beginning of the year and based upon an assessment of all positive and negative evidence relating to future years.

Our conclusion about the realizability of our deferred tax assets, and therefore the appropriateness of the valuation allowance, is reviewed quarterly and could change in future periods depending on our future assessment of all available evidence in support of the likelihood of realization of our deferred tax assets. If our conclusion about the realizability of our deferred tax assets and therefore the appropriateness of our valuation allowance changes in a future period we could record a substantial tax provision or benefit in our Consolidated Statement of Operations when that occurs.

As of December 31, 2014, we had U.S. federal net operating loss carryforwards of approximately $115.4 million, of which approximately $37.9 million was related to stock-based income tax deductions in excess of amounts that have been recognized for financial reporting purposes, and federal research and development tax credit carryforwards of approximately $21.3 million. The federal net operating loss carryforwards will expire between 2019 through 2031, and the research and development tax credits will expire from 2021 through 2034 if not utilized.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under generally accepted accounting principles in the United States of America, or GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for the fiscal and interim reporting periods beginning after December 15, 2016 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our consolidated financial statements.

Liquidity and Capital Resources

We generate cash from operations predominantly from the sale of supercomputing systems and related services. We typically have a small number of significant contracts that make up the majority of total revenue. We also recently entered into a sales-type lease agreement with a customer, under which we will receive quarterly payments over the next four years. The material changes in certain of our balance sheet accounts were due to the timing of product

deliveries, customer acceptances, contractually determined billings and cash collections. Working capital requirements, including inventory purchases and normal capital expenditures, are generally funded with cash from operations.

Total cash and investments decreased from $220.4 million at December 31, 2013 to $145.8 million at December 31, 2014, principally due to increased inventory at December 31, 2014 related to several systems that we expect customer acceptance to occur early in 2015. At the end of both 2014 and 2013 we had significant accounts receivable balances of $165.1 million and $182.5 million due to the large amount of revenue we recorded in the fourth quarter of each respective year. We anticipate that

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cash will increase in the first half of 2015 as we collect on outstanding accounts receivable for systems accepted at the end of the fourth quarter of 2014.

As of December 31, 2014, we had $16.9 million in restricted cash associated with certain letters of credit outstanding to secure customer prepayments.

As of December 31, 2014, we had working capital of $361.6 million compared to $334.9 million as of December 31, 2013.

Cash flow information for the years ended December 31 included the following (in thousands):

	2014	2013	2012
Cash (used in) provided by:			
Operating Activities	$(58,109)	$(87,350)	$156,892
Investing Activities	(22,755)	27,211	37,694
Financing Activities	(70)	(93)	7,827

Operating Activities. For the year ended December 31, 2014, cash used in operating activities was primarily driven by an increase in inventory of $54.1 million, due to several system builds that we expect to accept early in 2015. For the year ended December 31, 2013, cash used in operating activities was principally the result of significant increases in accounts receivables. For the year ended December 31, 2012, cash provided by operating activities was principally the result of significant decreases in accounts receivable and increases in deferred revenue.

Investing Activities. For the year ended December 31, 2014, cash used in investing activities was principally due to purchases of investments and property and equipment of $56.1 million and $17.2 million, respectively, partially offset by sales and maturities of investments of $53.6 million. For the year ended December 31, 2013, net cash provided by investing activities was due principally to sales and maturities of investments of $139.3 million, partially offset by purchases of investments of $85.2 million. For the year ended December 31, 2012, net cash provided by investing activities was due principally to the sale of our interconnect hardware development program to Intel for $139.2 million, net of direct transaction costs, partially offset by purchases of investments of $70.2 million and the acquisition of Appro of $24.2 million, net of cash acquired.

Financing Activities. Net cash used in or provided by financing activities in 2014, 2013 and 2012 resulted primarily from cash received from the issuance of common stock from exercises of options and from the issuance of stock through our employee stock purchase plan, offset by payments of statutory tax withholding amounts made in exchange for the forfeiture of common stock by holders of vesting restricted stock awards.

Over the next twelve months, we expect our significant cash requirements will relate to operational expenses, consisting primarily of personnel costs, costs of inventory associated with certain large-scale product deliveries, spare parts, outside engineering expenses, and the acquisition of property and equipment. In addition, we lease certain equipment and facilities used in our operations under operating leases in the normal course of business.

The following table summarizes our contractual cash obligations as of December 31, 2014 (in thousands):

	Amounts Committed by Year				
Contractual Obligations	Total	1 Year	Years 2-3	Years 4-5	Thereafter
Development agreements	$6,956	$6,856	$50	$50	$—
Operating leases	37,624	5,097	9,325	8,639	14,563
Total contractual cash obligations	$44,580	$11,953	$9,375	$8,689	$14,563

As of December 31, 2014, we had a $10.0 million unsecured line of credit with Wells Fargo Bank, National Association and an $11.0 million letter of credit facility with Silicon Valley Bank. Both facilities are designed to support the issuance of letters of credit and foreign exchange hedging transactions. The Wells Fargo Bank, National Association credit facility matures in October 2015 and the Silicon Valley Bank credit facility matures in December 2015. We made no draws and had no outstanding cash borrowings on any lines of credit as of December 31, 2014.

As of December 31, 2014, we had $13.5 million in outstanding letters of credit and $16.9 million in restricted cash associated with certain letters of credit to secure customer prepayments and other customer related obligations.

In our normal course of operations, we have development arrangements under which we engage outside engineering resources to work on our research and development projects. For the year ended December 31, 2014, we incurred

$12.2 million for such arrangements.

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At any particular time, our cash position is affected by the timing of cash receipts for product sales, maintenance contracts, other service contracts, and our payments for inventory, resulting in significant fluctuations in our cash balance from quarter-to-quarter and within a quarter. Our principal sources of liquidity are our cash and cash equivalents, short-term investments and cash from operations. We expect our cash resources to be adequate for at least the next twelve months.

Beyond the next twelve months, the adequacy of our cash resources will largely depend on our success in achieving profitable operations and positive operating cash flows on a sustained basis.

Critical Accounting Policies and Estimates

This discussion as well as disclosures included elsewhere in this annual report on Form 10-K are based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingencies. In preparing our financial statements in accordance with GAAP, there are certain accounting policies that are particularly important. These include revenue recognition, inventory valuation, income taxes, research and development expenses and share-based compensation. We believe these accounting policies and others set forth in Note 2 — Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements in Item 15. Exhibits and Financial Statement Schedules in Part IV of this annual report should be reviewed as they are integral to understanding our results of operations and financial condition. In some cases, these policies represent required accounting. In other cases, they may represent a choice between acceptable accounting methods or may require substantial judgment or estimation.

Additionally, we consider certain judgments and estimates to be significant, including those relating to the estimated selling price determination used in revenue recognition, percentage of completion accounting, estimates of proportional performance on co-funded engineering contracts, collectibility of receivables and prepaid engineering services, determination of inventory at the lower of cost or market, useful lives for depreciation and amortization, determination of future cash flows associated with impairment testing of long-lived assets, including goodwill and other intangibles, determination of the implicit interest rate used in the sales-type lease calculation, estimated warranty liability, determination of the fair value of stock options and other assessments of fair value, calculation of deferred income tax assets, including estimates of future financial performance in the determination of the likely recovery of deferred income tax assets, our ability to utilize such assets, potential income tax assessments and other contingencies. We base our estimates on historical experience, current conditions and on other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates and assumptions.

Our management has discussed the selection of significant accounting policies and the effect of judgments and estimates with the Audit Committee of our Board of Directors.

Revenue Recognition

We recognize revenue, including transactions under sales-type leases, when it is realized or realizable and earned. We consider revenue realized or realizable and earned when we have persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Delivery does not occur until the products have been shipped or services provided to the customer, risk of loss has transferred to the customer, and, where applicable, a customer acceptance has been obtained. The sales price is not considered to be fixed or determinable until all material contingencies related to the sales have been resolved. We record revenue in the Consolidated Statements of Operations net of any sales, use, value added or certain excise taxes imposed by governmental authorities on specific sales transactions. In addition to the aforementioned general policy, the following are our statements of policy with regard to multiple-element arrangements and specific revenue recognition policies for each major category of revenue.

Multiple-Element Arrangements. We commonly enter into revenue arrangements that include multiple deliverables of our product and service offerings due to the needs of our customers. Product may be delivered in phases over time periods which can be as long as five years. Maintenance services generally begin upon acceptance of the first equipment delivery and future deliveries of equipment generally have an associated maintenance period. We consider the maintenance period to commence upon acceptance of the product or installation in situations where a formal acceptance is not required, which may include a warranty period and accordingly allocate a portion of the arrangement

consideration as a separate deliverable which is recognized as service revenue over the entire service period. Other services such as training and engineering services can be delivered as a discrete delivery or over the term of the contract. A multiple-element arrangement is separated into more than one unit of accounting if the following criteria are met:

- The delivered item(s) has value to the customer on a standalone basis; and
- If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in our control.

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If these criteria are met for each element, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative selling price. If these criteria are not met, the arrangement is accounted for as one unit of accounting which would result in revenue being recognized ratably over the contract term or being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered.

We follow a selling price hierarchy in determining the best estimate of the selling price of each deliverable. Certain products and services are sold separately in standalone arrangements for which we are sometimes able to determine vendor specific objective evidence, or VSOE. We determine VSOE based on normal pricing and discounting practices for the product or service when sold separately.

When we are not able to establish VSOE for all deliverables in an arrangement with multiple elements, we attempt to establish the selling price of each remaining element based on third-party evidence, or TPE. Our inability to establish VSOE is often due to a relatively small sample of customer contracts that differ in system size and contract terms which can be due to infrequently selling each element separately, not pricing products within a narrow range, or only having a limited sales history, such as in the case of certain advanced and emerging technologies. TPE is determined based on our prices or competitor prices for similar deliverables when sold separately. However, we are often unable to determine TPE, as our offerings usually contain a significant level of customization and differentiation from those of competitors and we are often unable to reliably determine what similar competitor products' selling prices are on a standalone basis.

When we are unable to establish selling price using VSOE or TPE, we use estimated selling price, or ESP, in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact a sale if the product or service were sold on a standalone basis. In determining ESP, we use the cost to provide the product or service plus a margin, or consider other factors. When using cost plus a margin, we consider the total cost of the product or service, including customer-specific and geographic factors. We also consider the historical margins of the product or service on previous contracts and several factors including any changes to pricing methodologies, competitiveness of products and services and cost drivers that would cause future margins to differ from historical margins.

Products. We most often recognize revenue from sales of products upon delivery or customer acceptance of the system. Where formal acceptance is not required, we recognize revenue upon delivery or installation. When the product is part of a multiple element arrangement, we allocate a portion of the arrangement consideration to product revenue based on estimates of selling price.

Services. Maintenance services are provided under separate maintenance contracts with customers. These contracts generally provide for maintenance services for one year, although some are for multi-year periods, often with prepayments for the term of the contract. We consider the maintenance period to commence upon acceptance of the product or installation in situations where a formal acceptance is not required, which may include a warranty period. When service is part of a multiple element arrangement, we allocate a portion of the arrangement consideration to maintenance service revenue based on estimates of selling price. Maintenance contracts that are billed in advance of revenue recognition are recorded as deferred revenue. Maintenance revenue is recognized ratably over the term of the maintenance contract.

Revenue from engineering services is recognized as services are performed.

Project Revenue. Revenue from design and build contracts is recognized under the percentage-of-completion (or POC method). Under the POC method, revenue is recognized based on the costs incurred to date as a percentage of the total estimated costs to fulfill the contract. If circumstances arise that change the original estimates of revenues, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are recorded in income in the period in which the circumstances that gave rise to the revision become known by management. We perform ongoing profitability analyses of our contracts accounted for under the POC method in order to determine whether the latest estimates of revenue, costs and extent of progress require updating. If at any time these estimates indicate that the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately.

We record revenue from certain research and development contracts which include milestones using the milestone method if the milestones are determined to be substantive. A milestone is considered to be substantive if management

believes there is substantive uncertainty that it will be achieved and the milestone consideration meets all of the following criteria:

- It is commensurate with either of the following:
  - Our performance to achieve the milestone; or

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- The enhancement of value of the delivered item or items as a result of a specific outcome resulting from our performance to achieve the milestone.
- It relates solely to past performance.
- It is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

The individual milestones are determined to be substantive or non-substantive in their entirety and milestone consideration is not bifurcated.

Revenue from projects is classified as Product Revenue or Service Revenue, based on the nature of the work performed.

Nonmonetary Transactions. We value and record nonmonetary transactions at the fair value of the asset surrendered unless the fair value of the asset received is more clearly evident, in which case the fair value of the asset received is used.

Sales-type leases

When we lease a system to a customer, the accounting involves specific determinations, which often involve complex provisions and significant judgments. The four criteria of the accounting standard that we use in the determination of whether a lease is a sales-type lease or an operating lease are: (a) a review of the lease term to determine if it is equal to or greater than 75% of the economic life of the system; (b) a review of the minimum lease payments to determine if they are equal to or greater than 90% of the fair value of the system; (c) a determination of whether or not the lease transfers ownership to the lessee at the end of the lease term; and (d) a determination of whether or not the lease contains a bargain purchase option. If the lease transaction meets one of the four criteria, then it is recorded as a sales-type lease; otherwise it is an operating lease. Additionally, we assess whether collectibility of the lease payments is reasonably assured and whether there are any significant uncertainties related to costs that it has yet to incur with respect to the lease.

We consider the economic lives of most of our products to range from three to four years. There is no significant after-market for our used products and we believe that the economic lives are representative of the periods during which our products are expected to be economically usable, with normal service, for the purposes for which they were intended. Residual values are not significant.

The discount rate implicit in the sales-type lease is used to calculate the present value of minimum lease payments, which we record as a lease receivable. The minimum lease payment consists of the gross lease payments net of executory costs and contingencies, if any. While revenue is recognized at the inception of the lease, the cash flow from the sales-type lease occurs over the course of the lease, which results in interest income. Unearned interest income is recorded at the inception of the lease and amortized over the lease term using the effective interest method.

Inventory Valuation

We record our inventory at the lower of cost or market. We regularly evaluate the technological usefulness and anticipated future demand for our inventory components. Due to rapid changes in technology and the increasing demands of our customers, we are continually developing new products. Additionally, during periods of product or inventory component upgrades or transitions, we may acquire significant quantities of inventory to support estimated current and future production and service requirements. As a result, it is possible that older inventory items we have purchased may become obsolete, be sold below cost or be deemed in excess of quantities required for production or service requirements. When we determine it is not likely we will recover the cost of inventory items through future sales, we write-down the related inventory to our estimate of its market value.

Because the products we sell have high average sales prices and because a high number of our prospective customers receive funding from U.S. or foreign governments, it is difficult to estimate future sales of our products and the timing of such sales. It also is difficult to determine whether the cost of our inventories will ultimately be recovered through future sales. While we believe our inventory is stated at the lower of cost or market and that our estimates and assumptions to determine any adjustments to the cost of our inventories are reasonable, our estimates may prove to be inaccurate. We have sold inventory previously reduced in part or in whole to zero, and we may have future sales of previously written-down inventory. We also may have additional expense to write-down inventory to its estimated market value. Adjustments to these estimates in the future may materially impact our operating results.

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Accounting for Income Taxes

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and operating loss and tax credit carryforwards and are measured using the enacted tax rates and laws that will be in effect when the differences and carryforwards are expected to be recovered or settled. A valuation allowance for deferred tax assets is provided when we estimate that it is more likely than not that all or a portion of the deferred tax assets will not be realized through future operations. This assessment is based upon consideration of available positive and negative evidence, which includes, among other things, our recent results of operations and expected future profitability. We consider our actual historical results over several years to have stronger weight than other more subjective indicators, including forecasts, when considering whether to establish or reduce a valuation allowance on deferred tax assets. We have significant difficulty projecting future results due to the nature of the business and the industry in which we operate.

We recognize the income tax benefit from a tax position only if it is more likely than not that the tax position will be sustained on examination by the applicable taxing authorities, based on the technical merits of our position. The tax benefit recognized in the financial statements from such a position is measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement.

Estimated interest and penalties are recorded as a component of interest expense and other expense, respectively.

As of December 31, 2014, we had approximately $87.6 million of net deferred tax assets, against which we provided a $10.1 million valuation allowance, resulting in a net deferred tax asset of $77.5 million. During the year ended December 31, 2014 we reduced substantially all of the remaining valuation allowance held against our U.S. deferred tax assets. The assessment of our ability to utilize our deferred tax assets included an assessment of all known business risks and industry trends as well as forecasted domestic and international earnings over a number of years. Our ability to forecast results significantly into the future is severely limited due to the rapid rate of technological and competitive change in the industry in which we operate.

We continue to provide a valuation allowance against specific U.S. deferred tax assets and a full valuation allowance against deferred tax assets arising in a limited number of foreign jurisdictions as the realization of such assets is not considered to be more likely than not at this time. In a future period our assessment of the realizability of our deferred tax assets and therefore the appropriateness of the valuation allowance could change based on an assessment of all available evidence, both positive and negative in that future period. If our conclusion about the realizability of our deferred tax assets and therefore the appropriateness of the valuation allowance changes in a future period we could record a substantial tax provision or benefit in our Consolidated Statement of Operations when that occurs.

Research and Development Expenses

Research and development expenses include costs incurred in the development and production of our hardware and software, costs incurred to enhance and support existing product features, costs incurred to support and improve our development processes, and costs related to future product development. Research and development costs are expensed as incurred, and may be offset by co-funding from third parties. We may also enter into arrangements whereby we make advance, non-refundable payments to a vendor to perform certain research and development services. These payments are deferred and recognized over the vendor’s estimated performance period.

Amounts to be received under co-funding arrangements with the U.S. government or other customers are based on either contractual milestones or costs incurred. These co-funding milestone payments are recognized in operations as performance is estimated to be completed and are measured as milestone achievements occur or as costs are incurred. These estimates are reviewed on a periodic basis and are subject to change, including in the near term. If an estimate is changed, net research and development expense could be impacted significantly.

We do not record a receivable from the U.S. government prior to completing the requirements necessary to bill for a milestone or cost reimbursement. Funding from the U.S. government is subject to certain budget restrictions and milestones may be subject to completion risk, and as a result, there may be periods in which research and development costs are expensed as incurred for which no reimbursement is recorded, as milestones have not been completed or the U.S. government has not funded an agreement. Accordingly, there can be substantial variability in the amount of net research and development expenses from quarter to quarter and year to year.

We classify amounts to be received from funded research and development projects as either revenue or a reduction to research and development expense based on the specific facts and circumstances of the contractual arrangement, considering total costs expected to be incurred compared to total expected funding and the nature of the research and development contractual arrangement. In the event that a particular arrangement is determined to represent revenue, the corresponding costs are classified as cost of revenue.

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Share-based Compensation

We measure compensation cost for share-based payment awards at fair value and recognize it as compensation expense over the service period for awards expected to vest. We recognize share-based compensation expense for all share-based payment awards, net of an estimated forfeiture rate. We recognize compensation cost for only those shares expected to vest on a straight-line basis over the requisite service period of the award.

Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. We utilize the Black-Scholes options pricing model to value the stock options granted under our options plans. In this model, we utilize assumptions related to stock price volatility, stock option term and forfeiture rates that are based upon both historical factors as well as management’s judgment.

The fair value of restricted stock is determined based on the number of shares granted and the quoted price of our common stock at the date of grant.

We grant performance vesting restricted shares to executives as one of the ways to align compensation with shareholder interests. Vesting of these awards is contingent upon achievement of certain performance conditions. Compensation expense for these awards is only recognized when vesting is deemed to be probable.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in interest rates and equity price fluctuations.

Interest Rate Risk: We invest our available cash in money market mutual funds whose underlying investments include investment-grade debt instruments of corporate issuers and in debt instruments of the U.S. government and its agencies. We do not have any derivative instruments or auction rate securities in our investment portfolio. We protect and preserve invested funds by limiting default, market and reinvestment risk. Investments in both fixed-rate and floating-rate interest earning instruments carry a degree of interest rate risk. Fixed-rate securities may have their fair market value adversely affected due to a rise in interest rates, while floating-rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates. Although we have the above noted risks, a 0.5% change in interest rates would not be material.

Foreign Currency Risk: We sell our products primarily in North America, Asia and Europe. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Our products are generally priced based on U.S. dollars, and a strengthening of the dollar could make our products less competitive in foreign markets. While we often sell products with payments in U.S. dollars, our product sales contracts may call for payment in foreign currencies and to the extent we do so, or engage with our foreign subsidiaries in transactions deemed to be either short-term or long-term in nature, we are subject to foreign currency exchange risks.

As of December 31, 2014, we had entered into forward exchange contracts that were designated as cash flow hedges that hedge approximately $192.5 million of anticipated cash receipts on specific foreign currency denominated sales contracts. These forward contracts hedge the risk of foreign exchange rate changes between the time that the related contracts were signed and when the cash receipts are expected to be received. As of December 31, 2014, we had also entered into forward exchange contracts that were not designated as cash flow hedges totaling $43.4 million in order to minimize the impact of foreign exchange rate changes on a $45.8 million intercompany balance that resulted from a sales-type lease agreement that was entered into by one of our subsidiaries and a customer. Our foreign maintenance contracts are typically paid in local currencies and provide a partial natural hedge against foreign exchange exposure. To the extent that we wish to repatriate any of these funds to the United States, however, we are subject to foreign exchange risks. We do not hold or purchase any currency forward exchange contracts for trading purposes. As of December 31, 2014, a hypothetical 10% unfavorable change in foreign currency exchange rates would impact our annual operating results and cash flows by approximately $1.1 million.

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Item 8. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS*

* The Financial Statements are located following page F-1.

The selected quarterly financial data required by this item is set forth in Note 22 of the Notes to Consolidated Financial Statements.

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, as appropriate, to allow timely decisions regarding required disclosure. Our management, with the participation and under the supervision of our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer/Corporate Controller, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, and based on that evaluation, our Chief Executive Officer and Chief Financial Officer determined that our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting during the fourth quarter of 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined by Rule 13a-15(f) under the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

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

Our management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "Internal Control — Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2014.

Peterson Sullivan LLP, an independent registered public accounting firm, has expressed an unqualified opinion on the effectiveness of our internal control over financial reporting as of December 31, 2014.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
To the Board of Directors and Shareholders
Cray Inc.

We have audited Cray Inc. and Subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014, and our report dated February 19, 2015, expressed an unqualified opinion.

/S/ PETERSON SULLIVAN LLP

Seattle, Washington
February 19, 2015

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Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item is contained in the proxy statement for our annual meeting of shareholders scheduled to be held on or around June 10, 2015, and such information is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this Item is contained in the proxy statement for our annual meeting of shareholders scheduled to be held on or around June 10, 2015, and such information is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The information required by this Item is contained in the proxy statement for our annual meeting of shareholders scheduled to be held on or around June 10, 2015, and such information is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is contained in the proxy statement for our annual meeting of shareholders scheduled to be held on or around June 10, 2015, and such information is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this Item is contained in the proxy statement for our annual meeting of shareholders scheduled to be held on or around June 10, 2015, and such information is incorporated herein by reference.

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PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Financial Statements

Consolidated Balance Sheets at December 31, 2014 and December 31, 2013

Consolidated Statements of Operations for the years ended December 31, 2014, 2013 and 2012

Consolidated Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2014, 2013 and 2012

Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

(a)(2) Financial Statement Schedules

Schedule II — Valuation and Qualifying Accounts — The financial statement schedule for the years ended December 31, 2014, 2013 and 2012 should be read in conjunction with the consolidated financial statements of Cray Inc. filed as part of this annual report on Form 10-K.

Schedules other than that listed above have been omitted since they are either not required, not applicable, or because the information required is included in the consolidated financial statements or the notes thereto.

(a)(3) Exhibits

The Exhibits listed in the Exhibit Index, which appear immediately following the signature page and are incorporated herein by reference, are filed as part of this annual report on Form 10-K. Each management contract or compensatory plan or agreement listed on the Exhibit Index is identified by an asterisk.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Seattle, State of Washington, on February 19, 2015.

CRAY INC.

By /s/ PETER J. UNGARO
Peter J. Ungaro
Chief Executive Officer and President

Each of the undersigned hereby constitutes and appoints Peter J. Ungaro, Brian C. Henry and Michael C. Piraino and each of them, the undersigned's true and lawful attorney-in-fact and agent, with full power of substitution, for the undersigned and in his or her name, place and stead, in any and all capacities, to sign any or all amendments to this Annual Report on Form 10-K and any other instruments or documents that said attorneys-in-fact and agents may deem necessary or advisable, to enable Cray Inc. to comply with the Securities Exchange Act of 1934 and any requirements of the Securities and Exchange Commission in respect thereof, and to file the same, with all exhibits thereto, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents and each of them full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that each such attorney-in-fact and agent, or his substitute, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities indicated on February 19, 2015.

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Signature	Title
By /s/ PETER J. UNGARO Peter J. Ungaro	Chief Executive Officer, President and Director (Principal Executive Officer)
By /s/ BRIAN C. HENRY Brian C. Henry	Chief Financial Officer and Executive Vice President (Principal Financial Officer)
By /s/ CHARLES D. FAIRCHILD Charles D. Fairchild	Chief Accounting Officer, Controller and Vice President (Principal Accounting Officer)
By /s/ PRITHVIRAJ BANJEREE Prithviraj Banjeree	Director
By /s/ STEPHEN C. KIELY Stephen C. Kiely	Director
By /s/ FRANK L. LEDERMAN Frank L. Lederman	Director
By /s/ SALLY G. NARODICK Sally G. Narodick	Director
By /s/ DANIEL C. REGIS Daniel C. Regis	Director
By /s/ STEPHEN C. RICHARDS Stephen C. Richards	Director
By /s/ MAX SCHIRESON Max Schireson	Director

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EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Filing Date	Exhibit/ Annex	
2.1	Asset Purchase Agreement between Intel Corporation and the Company, dated April 24, 2012	8-K	000-26820	04/25/12	2.1	
2.2	Agreement and Plan of Merger by and among Astro Acquisition Corp., Appro International, Inc., the Shareholders' Agent and the Company, dated November 8, 2012	8-K	000-26820	11/09/12	2.1	
3.1	Restated Articles of Incorporation	8-K	000-26820	06/08/06	3.3	
3.2	Amended and Restated Bylaws	8-K	000-26820	02/12/07	3.1	
3.3	First Amendment to Amended and Restated Bylaws	8-K	000-26820	04/19/12	3.1	
10.0*	1999 Stock Option Plan	S-8	333-57970	03/30/01	4.1	
10.1*	2000 Non-Executive Employee Stock Option Plan	S-8	333-57970	03/30/01	4.2	
10.2*	Amended and Restated 2001 Employee Stock Purchase Plan	10-K	000-26820	03/04/11	10.28	
10.3*	2003 Stock Option Plan	DEF 14A	000-26820	03/31/03	A	
10.4*	2004 Long-Term Equity Compensation Plan	DEF 14A	000-26820	03/24/04	B	
10.5*	2006 Long-Term Equity Compensation Plan	DEF 14A	000-26820	04/28/06	B	
10.6*	2009 Long-Term Equity Compensation Plan	DEF 14A	000-26820	03/31/09	A	
10.7*	2013 Equity Incentive Plan	DEF 14A	000-26820	04/24/13	A	
10.8*	Form of Officer Non-Qualified Stock Option Agreement	10-K	000-26820	04/01/05	10.32	
10.9*	Form of Officer Incentive Stock Option Agreement	10-K	000-26820	04/01/05	10.33	
10.10*	Form of Employee Restricted Stock Agreement	10-K	000-26820	03/09/07	10.11	
10.11*	Form of Director Restricted Stock Agreement	8-K	000-26820	06/08/06	10.1	
10.12*	Form of 2013 Equity Incentive Plan Notice of Stock Option Grant and Stock Option Award Agreement	8-K	000-26820	07/03/13	99.1	
10.13*	Form of 2013 Equity Incentive Plan Notice of Restricted Stock Award and Restricted Stock Purchase Agreement	8-K	000-26820	07/03/13	99.2	
10.14*	Form of 2013 Equity Incentive Plan Notice of Restricted Stock Award and Restricted Stock Purchase Agreement	8-K	000-26820	12/17/14	10.1	
10.15*	Form of 2013 Equity Incentive Plan Notice of Stock Option Grant and Stock Option Award	8-K	000-26820	12/17/14	10.2	

	Agreement				
10.16*	Form of 2013 Equity Incentive Plan Notice of Restricted Stock Unit Award and Restricted Stock Unit Award Agreement	8-K	000-26820	12/17/14	10.3
10.17*	Form of 2013 Equity Incentive Plan Notice of Stock Appreciation Right Award Grant and Stock Appreciation Right Award Agreement	8-K	000-26820	12/17/14	10.4

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Exhibit Number	Exhibit Description	Incorporated by Reference				
		Form	File No.	Filing Date	Exhibit/ Annex	Filed Herewith
10.18*	Letter Agreement between the Company and Peter J. Ungaro, dated March 4, 2005	8-K	000-26820	03/08/05	10.1	
10.19*	Offer Letter between the Company and Brian C. Henry, dated May 16, 2005	10-Q	000-26820	11/09/05	10.1	
10.20*	Offer Letter between the Company and Steve Scott, dated August 30, 2014	10-Q	000-26820	10/28/14	10.1	
10.21*	Form of Management Retention Agreement entered into with executive officers prior to September 27, 2011 (including Annex A-1 and Annex A-2 applicable only to Peter J. Ungaro and Brian C. Henry)	8-K	000-26820	12/22/08	10.1	
10.22*	Form of Management Retention Agreement entered into with executive officers from September 27, 2011 forward	10-K	000-26820	02/13/14	10.20	
10.23*	Executive Severance Policy, as adopted on December 13, 2010	8-K	000-26820	12/17/10	10.1	
10.24*	Amended and Restated Non-Employee Director Compensation Policy	10-Q	000-26820	04/29/14	10.3	
10.25*	2014 Executive Bonus Plan	10-Q	000-26820	04/29/14	10.1	
10.26*	Form of Indemnification Agreement	8-K	000-26820	02/08/11	10.1	
10.27	Lease Agreement between NEA Galtier, LLC and the Company, dated as of July 2, 2009	8-K	000-26820	07/16/09	10.1	
10.28	First Amendment to Lease between NEA Galtier, LLC and the Company, dated as of October 1, 2009					X
10.29	Second Amendment to Lease between NEA Galtier, LLC and the Company, dated as of April 21, 2011					X
10.30	Third Amendment to Lease between NEA Galtier, LLC and the Company, dated as of August 31, 2011					X
10.31	Fourth Amendment to Lease between NEA Galtier, LLC and the Company, dated as of April 1, 2012					X
10.32	Fifth Amendment to Lease between NEA Galtier, LLC and the Company, dated as of March 31, 2014					X
10.33	Intellectual Property Agreement between Intel Corporation and the Company, dated May 2, 2012	8-K	000-26820	05/03/12	10.1	

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Exhibit Number	Exhibit Description	Incorporated by Reference				
		Form	File No.	Filing Date	Exhibit/ Annex	Filed Herewith
21.1	Subsidiaries of the Company					X
23.1	Consent of Peterson Sullivan LLP, Independent Registered Public Accounting Firm					X
24.1	Power of Attorney for directors and officers (included on the signature page of this report)					X
31.1	Rule 13a-14(a)/15d-14(a) Certification of Mr. Ungaro, Chief Executive Officer					X
31.2	Rule 13a-14(a)/15d-14(a) Certification of Mr. Henry, Chief Financial Officer					X
32.1	Certification pursuant to 18 U.S.C. Section 1350 by the Chief Executive Officer and the Chief Financial Officer					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X

* Management contract or compensatory plan or arrangement.

Excluded from this list of exhibits, pursuant to Paragraph (b)(4)(iii)(a) of Item 601 of Regulation S-K, may be one or more instruments defining the rights of holders of long-term debt of the Company. The Company hereby agrees that it will, upon request of the Securities and Exchange Commission, furnish to the Commission a copy of any such instrument.

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CRAY INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$112,633	$192,633
Restricted cash	16,874	—
Short-term investments	16,289	14,048
Accounts and other receivables, net	165,113	182,527
Inventory	143,632	95,129
Deferred tax asset	36,073	9,195
Prepaid expenses and other current assets	17,948	11,804
Total current assets	508,562	505,336
Long-term restricted cash	—	13,768
Long-term investment in sales-type lease, net	31,089	—
Property and equipment, net	34,793	30,278
Service spares, net	1,868	1,828
Goodwill	14,182	14,182
Intangible assets other than goodwill, net	3,895	6,362
Long-term deferred tax asset	41,414	19,206
Other non-current assets	15,631	12,406
TOTAL ASSETS	$651,434	$603,366
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$48,699	$34,225
Accrued payroll and related expenses	16,054	22,470
Other accrued liabilities	16,285	22,225
Deferred revenue	65,910	91,488
Total current liabilities	146,948	170,408
Long-term deferred revenue	47,588	50,477
Other non-current liabilities	3,044	6,894
TOTAL LIABILITIES	197,580	227,779
Commitments and contingencies (Note 14)		
Shareholders' equity:		
Preferred stock — Authorized and undesignated, 5,000,000 shares; no shares issued or outstanding	—	—
Common stock and additional paid-in capital, par value $.01 per share — Authorized, 75,000,000 shares; issued and outstanding 40,822,377 and 40,469,854 shares, respectively	598,390	586,243
Accumulated other comprehensive income	6,503	853
Accumulated deficit	(151,039)	(211,509)
TOTAL SHAREHOLDERS' EQUITY	453,854	375,587
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$651,434	$603,366

See accompanying notes

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CRAY INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Years Ended December 31,		
	2014	2013	2012
Revenue:			
Product	$460,748	$436,330	$353,767
Service	100,858	89,419	67,291
Total revenue	561,606	525,749	421,058
Cost of revenue:			
Cost of product revenue	321,554	298,244	231,237
Cost of service revenue	55,638	43,179	38,643
Total cost of revenue	377,192	341,423	269,880
Gross profit	184,414	184,326	151,178
Operating expenses:			
Research and development, net	94,048	87,728	64,303
Sales and marketing	57,785	51,345	37,180
General and administrative	23,381	23,603	20,707
Total operating expenses	175,214	162,676	122,190
Net gain on sale of interconnect hardware development program	—	—	139,068
Income from operations	9,200	21,650	168,056
Other income (expense), net	(9)	(1,378)	472
Interest income, net	506	757	204
Income before income taxes	9,697	21,029	168,732
Income tax benefit (expense)	52,626	11,194	(7,491)
Net income	$62,323	$32,223	$161,241
Basic net income per common share	$1.61	$0.85	$4.42
Diluted net income per common share	$1.54	$0.81	$4.27
Basic weighted average shares outstanding	38,634	37,832	36,509
Diluted weighted average shares outstanding	40,435	39,776	37,789

See accompanying notes

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CRAY INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Years Ended December 31,		
	2014	2013	2012
Net income	$62,323	$32,223	$161,241
Other comprehensive income (loss), net of tax:			
Unrealized gain (loss) on available-for-sale investments	12	46	(46)
Foreign currency translation adjustments	(1,188)	(1,044)	(43)
Unrealized gain (loss) on cash flow hedges	8,475	(4,292)	(824)
Reclassification adjustments on cash flow hedges included in net income	(1,649)	962	(386)
Other comprehensive income (loss)	5,650	(4,328)	(1,299)
Comprehensive income	$67,973	$27,895	$159,942

See accompanying notes

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CRAY INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in thousands)

	Common Stock and Additional Paid In Capital		Accumulated Other Comprehensive Income	Accumulated Deficit	Total
	Number of Shares	Amount			
BALANCE, December 31, 2011	36,763	$564,148	$6,480	$(403,814)	$166,814
Issuance of shares under employee stock purchase plan	38	397			397
Exercise of stock options	1,346	7,430			7,430
Restricted shares issued for compensation, net of forfeitures and taxes	1,288	—			—
Share-based compensation	—	5,963			5,963
Other comprehensive loss			(1,299)		(1,299)
Net income				161,241	161,241
BALANCE, December 31, 2012	39,435	$577,938	$5,181	$(242,573)	$340,546
Issuance of shares under employee stock purchase plan	25	517			517
Exercise of stock options	495	3,161			3,161
Restricted shares issued for compensation, net of forfeitures and taxes	515	(2,612)		(1,159)	(3,771)
Share-based compensation	—	7,239			7,239
Other comprehensive loss			(4,328)		(4,328)
Net income				32,223	32,223
BALANCE, December 31, 2013	40,470	$586,243	$853	$(211,509)	$375,587
Issuance of shares under employee stock purchase plan	21	611			611
Exercise of stock options	411	3,086			3,086
Restricted shares issued for compensation, net of forfeitures and taxes	(80)	(1,914)		(1,853)	(3,767)
Share-based compensation	—	10,364			10,364
Other comprehensive income			5,650		5,650
Net income				62,323	62,323
BALANCE, December 31, 2014	40,822	$598,390	$6,503	$(151,039)	$453,854

See accompanying notes

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CRAY INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years Ended December 31,		
	2014	2013	2012
Operating activities:			
Net income	$62,323	$32,223	$161,241
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Depreciation and amortization	16,324	14,242	8,652
Accretion and amortization on available for sale investments	235	1,977	—
Loss on disposal of property and equipment	1,594	42	128
Net gain on sale of interconnect hardware development program	—	—	(139,068)
Share-based compensation expense	10,364	7,239	5,963
Inventory write-down	2,330	917	2,329
Deferred income taxes	(53,204)	(13,175)	3,020
Cash (used in) provided by operations due to changes in operating assets and liabilities:			
Accounts and other receivables	17,450	(169,753)	60,744
Long-term investment in sales-type lease, net	(32,889)	—	—
Inventory	(54,147)	(10,780)	7,004
Prepaid expenses and other assets	(9,349)	(2,670)	1,763
Accounts payable	14,504	(509)	(6,489)
Accrued payroll and related expenses and other accrued liabilities	(1,395)	4,721	15,202
Other non-current liabilities	(3,842)	3,701	492
Deferred revenue	(28,407)	44,475	35,911
Net cash (used in) provided by operating activities	(58,109)	(87,350)	156,892
Investing activities:			
Sales and maturities of available-for-sale investments	53,608	139,277	—
Purchases of available-for-sale investments	(56,064)	(85,162)	(70,218)
Change in restricted cash	(3,106)	(13,768)	3,776
Proceeds from the sale of interconnect hardware development program, net	—	—	139,225
Cash used in acquisition, net of cash acquired	—	—	(24,246)
Purchases of property and equipment	(17,193)	(13,136)	(10,843)
Net cash (used in) provided by investing activities	(22,755)	27,211	37,694
Financing activities:			
Proceeds from issuance of common stock through employee stock purchase plan	611	517	397
Purchase of employee restricted shares to fund related statutory withholding	(3,767)	(3,771)	—
Proceeds from exercise of options	3,086	3,161	7,430
Net cash (used in) provided by financing activities	(70)	(93)	7,827
Effect of foreign exchange rate changes on cash and cash equivalents	934	(200)	241
Net (decrease) increase in cash and cash equivalents	(80,000)	(60,432)	202,654
Cash and cash equivalents:			
Beginning of period	192,633	253,065	50,411
End of period	$112,633	$192,633	$253,065
Supplemental disclosure of cash flow information:			
Cash paid for interest	$5	$3	$90
Cash paid for income taxes	2,935	2,611	2,804

Non-cash investing and financing activities:			
Inventory transfers to property and equipment and service spares	$3,313	$4,530	$6,278

See accompanying notes

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NOTE 1 DESCRIPTION OF BUSINESS

Cray Inc., or Cray, or the Company, designs, develops, manufactures, markets and services the high-end of the high-performance computing, or HPC, market, primarily categories of systems commonly known as supercomputers, and provides storage and analytics solutions. The Company also provides software, system maintenance and support services and engineering services related to supercomputer systems. Cray's supercomputer systems address challenging scientific, engineering, commercial and national security computing problems. The Company's customers include foreign and domestic government agencies, government-funded entities, academic institutions and commercial entities.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles

The consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation. There has been no impact on previously reported net income or shareholders' equity from such reclassifications.

Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Company's consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

Cash, Cash Equivalents and Restricted Cash

Cash and cash equivalents consist of highly liquid financial instruments that are readily convertible to cash and have maturities of three months or less at the time of acquisition. The Company maintains cash and cash equivalent balances with financial institutions that exceed federally insured limits. As of December 31, 2014, the Company had $16.9 million in short-term restricted cash and as of December 31, 2013, $13.8 million in long-term restricted cash, associated with certain letters of credit outstanding to secure customer prepayments.

Investments

The Company's investments consist primarily of commercial paper, corporate debt, and other debt securities. Debt securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses, net of applicable taxes, recorded in accumulated other comprehensive income, a component of shareholders' equity. The realized gains and losses for available-for-sale securities are included in other income and expense in the Consolidated Statements of Operations. Realized gains and losses are calculated based on the specific identification method.

The Company monitors its investment portfolio for impairment on a periodic basis. When the carrying value of an investment in debt securities exceeds its fair value and the decline in value is determined to be an other-than-temporary decline, and when the Company does not intend to sell the debt security and it is not more likely than not that the Company will be required to sell the debt securities prior to recovery of its amortized cost basis, the Company records an impairment charge in the amount of the credit loss and the balance, if any, to other comprehensive income (loss).

Investments that mature between three months and one year from the purchase date are initially classified as short-term investments in the Consolidated Balance Sheet. Investments that mature beyond one year from the purchase date are initially classified as long-term investments in the Consolidated Balance Sheet.

Foreign Currency Derivatives

The Company uses forward foreign currency exchange contracts to hedge certain foreign currency exposures. Forward contracts are cash flow hedges of the Company's foreign currency exposures on certain revenue contracts and are recorded at the contract's fair value. Any gains or losses on the effective portion of the forward contract is initially reported in "Accumulated other

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comprehensive income," a component of shareholders' equity, with a corresponding asset or liability recorded based on the fair value of the forward contract. When the hedged transaction is recognized, any unrecognized gains or losses on the hedged transaction are reclassified into results of operations in the same period. Any hedge ineffectiveness is recorded to operations in the current period. The Company measures hedge effectiveness by comparing changes in fair values of the forward contract and expected cash flows based on changes in the spot prices of the underlying currencies. Cash flows from forward contracts accounted for as cash flow hedges are classified in the same category as the cash flows from the items being hedged. The Company does not use derivative financial instruments for speculative purposes.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents, available-for-sale investments, accounts receivable, short-term and long-term restricted cash and forward foreign currency exchange contracts.

The Company maintains cash and cash equivalents, available-for-sale securities and forward contracts with various financial institutions. As part of its risk management process, the Company performs periodic evaluations of the relative credit standing of the financial institutions. The Company has not sustained any credit losses from instruments held at financial institutions. The Company utilizes forward contracts to protect against the effects of foreign currency fluctuations. Such contracts involve the risk of non-performance by the counterparty, which could result in a material loss.

The Company currently derives a significant portion of its revenue from sales of products and services to different agencies of the U.S. government or commercial customers primarily serving various agencies of the U.S. government. See Note 19 — Segment Information for additional information. Given the type of customers, the Company does not believe its accounts receivable represent significant credit risk.

The Company currently has a long-term investment in a sales-type lease it entered into with one of its customers. See Note 9 — Sales-type Lease for additional information. Given the credit standing of the customer, the Company does not believe that this investment represents a significant credit risk.

Other Concentration

The Company obtains certain components from single source suppliers due to technology, availability, price, quality or other considerations. The loss of a single source supplier, the single source supplier's inability to deliver the required components or intellectual property due to natural disaster or other reasons, the deterioration of the relationship with a single source supplier, or any unilateral modification of contract terms under which the Company is supplied components by a single source supplier could have a significant adverse effect on the Company's revenue and gross margins.

Accounts Receivable

Accounts receivable are stated at principal amounts and are primarily comprised of amounts contractually due from customers for products and services and amounts due from government research and development contracts. The Company provides an allowance for doubtful accounts based on an evaluation of customer past due account balances. In determining whether to record an allowance for a specific customer, the Company considers a number of factors, including prior payment history and financial information for the customer.

Fair Values of Financial Instruments

The Company measures certain financial assets and liabilities at fair value based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. The Company's financial instruments primarily consist of debt securities, time deposits, money market funds, and foreign currency derivatives. See Note 5 — Fair Value Measurement for a further discussion on fair value of financial instruments.

Inventories

Inventories are valued at the lower of cost or market, with cost computed on a first-in, first-out basis. The Company regularly evaluates the technological usefulness and anticipated future demand for various inventory components and the expected use of the inventory. When the Company determines it is not likely the cost of inventory items will be recovered through future sales, the Company writes-down the related inventory to its estimated market value.

In connection with certain of its sales agreements, the Company may receive used equipment from a customer. This inventory generally will be recorded at no value based on the expectation that the Company will not be able to resell or otherwise use the equipment. In the event that the Company has a specific contractual plan for resale at the date the inventory is acquired, the inventory is recorded at its estimated fair value.

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Property and Equipment and Intangible Assets, net

Property and equipment are recorded at cost less accumulated depreciation and amortization. Additions and improvements are capitalized and maintenance and repairs are expensed as incurred. Depreciation is calculated on a straight-line basis over the estimated useful lives of the related assets, ranging from eighteen months to seven years for furniture and fixtures, three years for computer equipment, and eight to twenty-five years for buildings and land improvements. Leasehold improvements are depreciated over the life of the lease or asset, whichever is shorter.

The Company amortizes purchased intangible assets with finite lives using the straight-line method over the estimated economic lives of the assets, ranging from two to ten years.

Service Spares

Service spares are valued at the lower of cost or market and represent inventory used to support service and maintenance agreements with customers. As inventory is utilized, replaced items are returned to the Company and are either repaired or scrapped. Costs incurred to repair inventory to a usable state are charged to expense as incurred. Service spares are recorded at cost and amortized over the estimated service life of the related product platform (generally four years).

Impairment of Long-Lived Assets and Intangibles

The Company evaluates property, plant and equipment and intangible assets with finite lives for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. The Company assesses the recoverability of the assets based on the undiscounted future cash flow the assets are expected to generate and recognizes an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When the Company identifies an impairment, the carrying value of the asset is reduced to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, to comparable market values.

Goodwill

Goodwill is not amortized but is tested for impairment at least annually. The Company reviews goodwill for impairment annually at the beginning of its fourth fiscal quarter and whenever events or changes in circumstances indicate the carrying value of the asset may not be recoverable. The goodwill impairment test consists of a two-step process, if necessary. However, the Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC Topic 350. The more likely than not threshold is defined as having a likelihood of more than 50 percent. If, after assessing the totality of events or circumstances, the Company determines that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary and goodwill is considered to be unimpaired. However, if based on the qualitative assessment the Company concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the Company will proceed with performing the two-step process.

In step one, the Company determines the fair value of each reporting unit and compares it to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then the Company must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit’s goodwill. If the carrying value of a reporting unit’s goodwill exceeds its implied fair value, the Company records an impairment loss equal to the difference.

The Company performed its qualitative assessment during the fourth fiscal quarter of 2014 and concluded that it was more likely than not that the fair values of its reporting units were greater than their carrying amounts. After reaching this conclusion, the two-step impairment test was unnecessary and no further testing was performed. The qualitative factors that were considered included, but were not limited to, general economic conditions, outlook for the HPC and big data markets, recent and forecasted financial performance and the price of the Company’s common stock.

Business Combinations

The Company accounts for business combinations using the acquisition method of accounting and allocates the purchase price to the tangible and intangible assets acquired and the liabilities assumed based upon their estimated fair values at the acquisition date. The difference between the purchase price and the fair value of the net assets acquired is recorded as goodwill. The Company uses estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date. During the

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measurement period, which may be up to one year from the acquisition date, any refinements made to the fair value of the assets and liabilities assumed are recorded with retrospective effect.

The fair values of intangible assets acquired are estimated using a discounted cash flow approach with Level 3 inputs. Under this method, an intangible asset's fair value is equal to the present value of the incremental after-tax cash flows (excess earnings) attributable solely to the intangible asset over its remaining useful life. To calculate fair value, the Company uses risk-adjusted cash flows discounted at rates considered appropriate given the inherent risks associated with each type of asset. The Company believes the level and timing of cash flows appropriately reflects market participant assumptions.

Revenue Recognition

The Company recognizes revenue, including transactions under sales-type leases, when it is realized or realizable and earned. The Company considers revenue realized or realizable and earned when it has persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Delivery does not occur until the products have been shipped or services provided to the customer, risk of loss has transferred to the customer, and, where applicable, a customer acceptance has been obtained. The sales price is not considered to be fixed or determinable until all material contingencies related to the sales have been resolved. The Company records revenue in the Consolidated Statements of Operations net of any sales, use, value added or certain excise taxes imposed by governmental authorities on specific sales transactions. In addition to the aforementioned general policy, the following are the Company's statements of policy with regard to multiple-element arrangements and specific revenue recognition policies for each major category of revenue.

Multiple-Element Arrangements. The Company commonly enters into revenue arrangements that include multiple deliverables of its product and service offerings due to the needs of its customers. Products may be delivered in phases over time periods which can be as long as five years. Maintenance services generally begin upon acceptance of the first equipment delivery and future deliveries of equipment generally have an associated maintenance period. The Company considers the maintenance period to commence upon acceptance of the product or installation in situations where a formal acceptance is not required, which may include a warranty period and accordingly allocates a portion of the arrangement consideration as a separate deliverable which is recognized as service revenue over the entire service period. Other services such as training and engineering services can be delivered as a discrete delivery or over the term of the contract. A multiple-element arrangement is separated into more than one unit of accounting if the following criteria are met:

- The delivered item(s) has value to the customer on a standalone basis; and
- If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company.

If these criteria are met for each element, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative selling price. If these criteria are not met, the arrangement is accounted for as one unit of accounting which would result in revenue being recognized ratably over the contract term or being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered.

The Company follows a selling price hierarchy in determining the best estimate of the selling price of each deliverable. Certain products and services are sold separately in standalone arrangements for which the Company is sometimes able to determine vendor specific objective evidence, or VSOE. The Company determines VSOE based on normal pricing and discounting practices for the product or service when sold separately.

When the Company is not able to establish VSOE for all deliverables in an arrangement with multiple elements, the Company attempts to establish the selling price of each remaining element based on third-party evidence, or TPE. The Company's inability to establish VSOE is often due to a relatively small sample of customer contracts that differ in system size and contract terms which can be due to infrequently selling each element separately, not pricing products within a narrow range, or only having a limited sales history, such as in the case of certain advanced and emerging technologies. TPE is determined based on the Company's prices or competitor prices for similar deliverables when sold separately. However, the Company is often unable to determine TPE, as the Company's offerings usually contain

a significant level of customization and differentiation from those of competitors and the Company is often unable to reliably determine what similar competitor products' selling prices are on a standalone basis.

When the Company is unable to establish selling price using VSOE or TPE, the Company uses estimated selling price, or ESP, in its allocation of arrangement consideration. The objective of ESP is to determine the price at which the Company would transact a sale if the product or service were sold on a standalone basis. In determining ESP, the Company uses the cost to provide the product or service plus a margin, or considers other factors. When using cost plus a margin, the Company considers the total cost of the product or service, including customer-specific and geographic factors. The Company also considers the historical margins of the product or service on previous contracts and several factors including any changes to pricing methodologies, competitiveness of products and services and cost drivers that would cause future margins to differ from historical margins.

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Products. The Company most often recognizes revenue from sales of products upon customer acceptance of the system. Where formal acceptance is not required, the Company recognizes revenue upon delivery or installation. When the product is part of a multiple element arrangement, the Company allocates a portion of the arrangement consideration to product revenue based on estimates of selling price.

Services. Maintenance services are provided under separate maintenance contracts with customers. These contracts generally provide for maintenance services for one year, although some are for multi-year periods, often with prepayments for the term of the contract. The Company considers the maintenance period to commence upon acceptance of the product or installation in situations where a formal acceptance is not required, which may include a warranty period. When service is part of a multiple element arrangement, the Company allocates a portion of the arrangement consideration to maintenance service revenue based on estimates of selling price. Maintenance contracts that are billed in advance of revenue recognition are recorded as deferred revenue. Maintenance revenue is recognized ratably over the term of the maintenance contract.

Revenue from engineering services is recognized as services are performed.

Project Revenue. Revenue from design and build contracts is recognized under the percentage-of-completion (or POC method). Under the POC method, revenue is recognized based on the costs incurred to date as a percentage of the total estimated costs to fulfill the contract. If circumstances arise that change the original estimates of revenues, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are recorded in income in the period in which the circumstances that gave rise to the revision become known by management. The Company performs ongoing profitability analyses of its contracts accounted for under the POC method in order to determine whether the latest estimates of revenue, costs and extent of progress require updating. If at any time these estimates indicate that the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately.

The Company records revenue from certain research and development contracts which include milestones using the milestone method if the milestones are determined to be substantive. A milestone is considered to be substantive if management believes there is substantive uncertainty that it will be achieved and the milestone consideration meets all of the following criteria:

- It is commensurate with either of the following:
  - The Company’s performance to achieve the milestone; or
  - The enhancement of value of the delivered item or items as a result of a specific outcome resulting from the Company’s performance to achieve the milestone.
- It relates solely to past performance.
- It is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

The individual milestones are determined to be substantive or non-substantive in their entirety and milestone consideration is not bifurcated.

Revenue from projects is classified as Product Revenue or Service Revenue, based on the nature of the work performed.

Nonmonetary Transactions. The Company values and records nonmonetary transactions at the fair value of the asset surrendered unless the fair value of the asset received is more clearly evident, in which case the fair value of the asset received is used.

Sales-type leases

When the Company leases a system to a customer, the accounting involves specific determinations, which often involve complex provisions and significant judgments. The four criteria of the accounting standard that the Company uses in the determination of whether a lease is a sales-type lease or an operating lease are: (a) a review of the lease term to determine if it is equal to or greater than 75% of the economic life of the system; (b) a review of the minimum lease payments to determine if they are equal to or greater than 90% of the fair value of the system; (c) a

determination of whether or not the lease transfers ownership to the lessee at the end of the lease term; and (d) a determination of whether or not the lease contains a bargain purchase option. If the lease transaction meets one of the four criteria, then it is recorded as a sales-type lease; otherwise it is an operating lease. Additionally, the Company assesses whether collectibility of the lease payments is reasonably assured and whether there are any significant uncertainties related to costs that it has yet to incur with respect to the lease.

The Company considers the economic lives of most of its products to range from three to four years. There is no significant after-market for the Company's used products and the Company believes that the economic lives are representative

of the periods during which its products are expected to be economically usable, with normal service, for the purposes for which they were intended. Residual values are not significant.

The discount rate implicit in the sales-type lease is used to calculate the present value of minimum lease payments, which the Company records as a lease receivable. The minimum lease payment consists of the gross lease payments net of executory costs and contingencies, if any. While revenue is recognized at the inception of the lease, the cash flow from the sales-type lease occurs over the course of the lease, which results in interest income. Unearned interest income is recorded at the inception of the lease and amortized over the lease term using the effective interest method.

Foreign Currency Translation

The Company uses the U.S. dollar predominantly as its functional currency. Assets and liabilities of foreign subsidiaries that have a functional currency denominated in non-U.S. dollars are translated into U.S. dollars at year-end exchange rates, and revenue and expenses of these foreign subsidiaries are translated at average rates prevailing during the year. Translation adjustments are included in “Accumulated other comprehensive income,” a separate component of shareholders’ equity. Transaction gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved are included in “Other (income) expense, net” in the accompanying Consolidated Statements of Operations. Net transaction gains were $2.1 million for 2014 and net transactions losses were $1.3 million, and $0.1 million for 2013, and 2012, respectively.

Research and Development

Research and development expenses include costs incurred in the development and production of hardware and software, costs incurred to enhance and support existing product features, costs incurred to support and improve development processes, and costs related to future product development. Research and development costs are expensed as incurred, and may be offset by co-funding from third parties. The Company may also enter into arrangements whereby it makes advance, non-refundable payments to a vendor to perform certain research and development services. These payments are deferred and recognized over the vendor’s estimated performance period. During the third quarter of 2009, the Company amended a vendor agreement to settle outstanding performance issues. The Company had made advance payments of $16.2 million to the vendor. Due to the amendment, the Company received a refund of $10.0 million of amounts previously paid to the vendor and the right to receive rebates on future purchases. The Company estimated the fair value of this rebate right to be $6.2 million. The Company believes the rebate right is recoverable and it has been classified in “Other non-current assets” in the Consolidated Balance Sheets. No gain or loss was recorded as a result of this amendment. As of December 31, 2014, $0.1 million in rebates remain available for use.

Amounts to be received under co-funding arrangements with the U.S. government or other customers are based on either contractual milestones or costs incurred. These co-funding milestone payments are recognized in operations as performance is estimated to be completed and are measured as milestone achievements occur or as costs are incurred. These estimates are reviewed on a periodic basis and are subject to change, including in the near term. If an estimate is changed, net research and development expense could be impacted significantly.

The Company does not record a receivable from the U.S. government prior to completing the requirements necessary to bill for a milestone or cost reimbursement. Funding from the U.S. government is subject to certain budget restrictions and milestones may be subject to completion risk, and as a result, there may be periods in which research and development costs are expensed as incurred for which no reimbursement is recorded, as milestones have not been completed or the U.S. government has not funded an agreement. Accordingly, there can be substantial variability in the amount of net research and development expenses from quarter to quarter and year to year.

The Company classifies amounts to be received from funded research and development projects as either revenue or a reduction to research and development expense based on the specific facts and circumstances of the contractual arrangement, considering total costs expected to be incurred compared to total expected funding and the nature of the research and development contractual arrangement. In the event that a particular arrangement is determined to represent revenue, the corresponding research and development costs are classified as cost of revenue.

Income Taxes

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and operating loss and tax credit carryforwards and are measured using the enacted tax rates and laws that will be in effect when the differences and carryforwards are expected to be recovered or settled. A valuation allowance for deferred tax assets is provided when the Company estimates that it is more likely than not that all or a portion of the deferred tax assets may not be realized through future operations. This assessment is based upon consideration of available positive and negative evidence, which includes, among other things, recent results of operations and expected future profitability. The Company considers its

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actual historical results over several years to have stronger weight than other more subjective indicators, including forecasts, when considering whether to establish or reduce a valuation allowance on deferred tax assets.

The Company recognizes the income tax benefit from a tax position only if it is more likely than not that the tax position will be sustained on examination by the applicable taxing authorities, based on the technical merits of the Company's position. The tax benefit recognized in the financial statements from such a position is measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement.

Estimated interest and penalties are recorded as a component of interest expense and other expense, respectively.

As of December 31, 2014, the Company had approximately $87.6 million of net deferred tax assets, against which the Company provided a $10.1 million valuation allowance, resulting in a net deferred tax asset of $77.5 million. During the year ended December 31, 2014 the Company reduced substantially all of the remaining valuation allowance held against the Company's U.S. deferred tax assets. The Company continues to provide a valuation allowance against specific U.S. deferred tax assets and a full valuation allowance against deferred tax assets arising in a limited number of foreign jurisdictions as the realization of such assets is not considered to be more likely than not at this time. In a future period the Company's assessment of the realizability of its deferred tax assets and therefore the appropriateness of the valuation allowance could change based on an assessment of all available evidence, both positive and negative in that future period. If the Company's conclusion about the realizability of its deferred tax assets and therefore the appropriateness of the valuation allowance changes in a future period, the Company could record a substantial tax provision or benefit in its Consolidated Statement of Operations when that occurs.

Share-Based Compensation

The Company measures compensation cost for share-based payment awards at fair value and recognizes it as compensation expense over the service period for awards expected to vest. Share-based compensation expense is recognized for all share-based payment awards, net of an estimated forfeiture rate. Compensation cost is only recognized for those shares expected to vest on a straight-line basis over the requisite service period of the award. Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. The Company utilizes the Black-Scholes options pricing model to value the stock options granted under its options plans. In this model, the assumptions utilized relate to stock price volatility, stock option term and forfeiture rates that are based upon both historical factors as well as management's judgment.

The fair value of restricted stock and restricted stock units is determined based on the number of shares or units granted and the quoted price of the Company's common stock at the date of grant.

The Company grants performance vesting restricted shares to executives as one of the ways to align compensation with shareholder interests. Vesting of these awards is contingent upon achievement of certain performance conditions. Compensation expense for these awards is only recorded when vesting is deemed to be probable.

Shipping and Handling Costs

Costs related to shipping and handling are included in "Cost of product revenue" and "Cost of service revenue" in the accompanying Consolidated Statements of Operations.

Advertising Costs

Sales and marketing expenses in the accompanying Consolidated Statements of Operations include advertising expenses of $2.9 million, $2.2 million, and $1.2 million in 2014, 2013, and 2012, respectively. The Company incurs advertising costs for representation at certain trade shows, promotional events and sales lead generation, as well as design and printing costs for promotional materials. The Company expenses all advertising costs as incurred.

Earnings Per Share, or EPS

Basic EPS is computed by dividing net income available to common shareholders by the weighted average number of common shares, excluding unvested restricted stock outstanding during the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average number of common and potential common shares outstanding during the period, which includes the additional dilution related to conversion of stock options, unvested restricted stock and restricted stock units as computed under the treasury stock method. For the

years ended December 31, 2014, 2013 and 2012, the added shares from these items included in the calculation of diluted shares and EPS totaled approximately 1.8 million, 1.9 million, and 1.3 million, respectively. Potentially dilutive shares of 0.6 million, 0.5 million, and 0.4 million, respectively, have been excluded from the denominator in the computation of diluted EPS for the years ended December 31, 2014, 2013 and 2012, respectively, because they are antidilutive. Performance vesting restricted stock totaling 0.8 million, 1.1 million and 0.7 million were excluded

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from the computation of diluted EPS for the years ended December 31, 2014, 2013 and 2012, respectively, because the conditions for vesting had not been met as of the balance sheet date.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income, a component of Shareholders' equity, consisted of the following at December 31 (in thousands):

	2014	2013	2012
Accumulated unrealized net gain (loss) on available-for-sale investments	$12	$—	$(46)
Accumulated currency translation adjustments	2,069	3,257	4,301
Accumulated unrealized net gain (loss) on cash flow hedges	4,422	(2,404)	926
Accumulated other comprehensive income	$6,503	$853	$5,181

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for the fiscal and interim reporting periods beginning after December 15, 2016 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09. The Company is currently evaluating the potential impact of the pending adoption of ASU 2014-09 on its consolidated financial statements.

NOTE 3 ACQUISITION

On November 21, 2012, the Closing Date, the Company acquired all the outstanding shares of Appro International, Inc., or Appro, for cash consideration of $24.9 million. Appro is a provider of cluster solutions in the high performance computing market. The acquisition of Appro allowed the Company to expand its product offering in the high performance computing market. The Company reports the financial results of the Appro business in the supercomputing segment.

The Company utilized a third-party appraisal in its determination of the fair value of the various assets acquired and liabilities assumed. The fair value of the acquired assets, net of assumed liabilities, equals the $24.9 million cash consideration paid by the Company. No measurement period adjustments were required.

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The following are the estimated fair values of the assets acquired and liabilities assumed (in thousands):

Cash	$635
Inventories	7,526
Other tangible assets	5,702
Deferred revenue	(2,400)
Accounts payable	(2,918)
Deferred tax liabilities	(3,685)
Other liabilities assumed	(2,061)
Net tangible assets	2,799
Trademarks	300
Developed technology	5,400
Customer relationships	1,800
Non-compete agreements	400
Goodwill	14,182
Total net assets acquired	$24,881

The fair values of the major components of the intangible assets acquired and their estimated useful lives are as follows (in thousands):

Intangible Asset Class	Fair Value	Useful Life (in Years)
Trademarks	$300	5
Developed technology	$5,400	3
Customer relationships	$1,800	10
Non-compete agreements	$400	2

The revenue and net loss of Appro from the Closing Date to December 31, 2012 included in the accompanying consolidated statements of operations were $0.6 million and $1.3 million, respectively.

The Company incurred acquisition-related costs (i.e., legal, accounting, valuation, and other costs) of $0.9 million during the year ended December 31, 2012. The acquisition-related costs were expensed in the accompanying Consolidated Statements of Operations for the year ended December 31, 2012.

The following unaudited pro forma condensed financial information presents the combined results of operations of the Company and Appro for the year ended December 31, 2012 as if the acquisition had occurred on January 1, 2012 (in thousands):

	Year Ended December 31, 2012
Revenue	$494,369
Net income	$161,985

The unaudited pro forma condensed financial information is not intended to represent or be indicative of the results of operations of the Company that would have been reported had the acquisition been completed as of the beginning of the period presented, and should not be taken as representative of the future consolidated results of operations of the Company.

The goodwill recorded in connection with the acquisition of Appro is primarily related to the synergies expected to be achieved and the value of the assembled workforce. The goodwill balance is not deductible for tax purposes.

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The carrying amount of purchased intangibles at December 31, 2014 was as follows (in thousands):

	December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademarks	$300	$127	$173
Developed technology	5,400	3,800	1,600
Customer relationships	1,800	380	1,420
Non-compete agreements	400	400	—
Total	$7,900	$4,707	$3,193

The carrying amount of purchased intangibles at December 31, 2013 was as follows (in thousands):

	December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademarks	$300	$67	$233
Developed technology	5,400	2,000	3,400
Customer relationships	1,800	200	1,600
Non-compete agreements	400	222	178
Total	$7,900	$2,489	$5,411

Aggregate estimated amortization expense for the years ending December 31 are as follows (in thousands):

2015	$1,840
2016	240
2017	233
2018	180
2019	180
	$2,673

For the years ended December 31, 2014, 2013 and 2012, amortization expense related to purchased intangibles was $2.2 million, $2.2 million and $0.2 million, respectively.

NOTE 4 - SALE OF INTERCONNECT HARDWARE DEVELOPMENT PROGRAM

On May 2, 2012, the Company sold its interconnect hardware development program to Intel Corporation (“Intel”) for cash consideration of $140 million. As part of the transaction, 73 of the Company’s employees joined Intel, and certain intellectual property and fixed assets were transferred to Intel. The Company retained certain rights to use the transferred assets and intellectual property. As a result of the sale, the Company recorded a gain of $139.1 million in “Net gain on sale of interconnect hardware development program” on the Consolidated Statements of Operations for the year ended December 31, 2012.

NOTE 5 FAIR VALUE MEASUREMENTS

Under FASB Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures, based on the observability of the inputs used in the valuation techniques used to determine the fair value of certain financial assets and liabilities, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values.

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities. Fair values determined by Level 3 inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. The following table presents information

about the Company’s financial assets and liabilities that have been

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measured at fair value on a recurring basis as of December 31, 2014 and 2013, and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value (in thousands):

Description	Fair Value as of December 31, 2014	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets:			
Cash and cash equivalents and restricted cash	$129,507		