MGP INGREDIENTS INC
Form 10-K
March 12, 2013
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from _______ to _______

Commission file number 0-17196

MGP Ingredients, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Kansas (State or Other Jurisdiction of Incorporation or Organization)	48-0531200 (I.R.S. Employer Identification No.)
100 Commercial Street, Box 130, Atchison, Kansas (Address of Principal Executive Offices)	66002 (Zip Code)

(913) 367-1480
Registrant's telephone number, including area code

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, no par value	NASDAQ Global Select Market

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 __ No X

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

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

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

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

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 definition of "accelerated filer, "large accelerated filer" and smaller company: in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ___ Accelerated filer ___ Non-accelerated filer ___ Smaller reporting company X

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ___ No X

The aggregate market value of common equity held by non-affiliates, computed by reference to the last sales price as reported by NASDAQ on June 29, 2012, was $38,041,322.

The number of shares of the registrant's common stock outstanding as of March 1, 2013 was 17,934,233.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents are incorporated herein by reference:

(1) Portions of the MGP Ingredients, Inc. Proxy Statement for the Annual Meeting of Stockholders to be held on May 23, 2013 are incorporated by reference into Part III of this report to the extent set forth herein.

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The calculation of the aggregate market value of the Common Stock held by non-affiliates is based on the assumption that affiliates include directors and executive officers. Such assumption does not constitute an admission by the Company or any director or executive officer that any director or executive officer is an affiliate of the Company.

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements as well as historical information. All statements, other than statements of historical facts, included in this Annual Report on Form 10-K regarding the prospects of our industry and our prospects, plans, financial position and business strategy may constitute forward-looking statements. In addition, forward-looking statements are usually identified by or are associated with such words as “intend,” “plan”, “believe,” “estimate,” “expect,” “anticipate,” “hopeful,” “should,” “may,” “will”, “could”, “encouraged”, “opportunities”, “pot negatives of these terms or variations of them or similar terminology. They reflect management’s current beliefs and estimates of future economic circumstances, industry conditions, Company performance and financial results and are not guarantees of future performance. All such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those contemplated by the relevant forward-looking statement. Important factors that could cause actual results to differ materially from our expectations include, among others: (i) disruptions in operations at our Atchison facility or Indiana Distillery, (ii) the availability and cost of grain and fluctuations in energy costs, (iii) the effectiveness of our hedging strategy, (iv) the competitive environment and related market conditions, (v) the ability to effectively pass raw material price increases on to customers, (vi) the viability of the Illinois Corn Processing, LLC (“ICP”) joint venture and its ability to obtain financing, (vii) our ability to maintain compliance with all applicable loan agreement covenants, (viii) our ability to realize operating efficiencies, (ix) actions of governments, (x) and consumer tastes and preferences. For further information on these and other risks and uncertainties that may affect our business, see Item 1A. Risk Factors.

METHOD OF PRESENTATION

All amounts in this report, except for share, bushels, gallons, pounds, mmbtu, per share, per bushel, per gallon and percentage amounts, are shown in thousands.

AVAILABLE INFORMATION

We make available through our website (www.mgpingredients.com) under “Investors – Investor Relations,” free of charge, our annual and transition reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, special reports and other information, and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such material with the Securities and Exchange Commission.

PART I

ITEM 1. BUSINESS

Throughout this Report, when we refer to "the Company", "we", “us”, “our” and words of similar import in reference to activities that occurred prior to the "Reorganization", as defined below, on January 3, 2012, we are referring to the combined business of MGPI Processing, Inc. (formerly MGP Ingredients, Inc.) and its consolidated subsidiaries, and when we refer to "the Company", "we", “us”, “our” and words of similar import in reference to activities occurring after the Reorganization, we are referring to the combined business of MGP Ingredients, Inc. (formerly named MGPI Holdings, Inc.) and its consolidated subsidiaries, except to the extent that the context otherwise indicates.

MGP Ingredients, Inc. (“Registrant” or “Company”) is a Kansas corporation headquartered in Atchison, Kansas. It was incorporated in 2011 and is a holding company with no operations of its own. Its principal directly-owned operating subsidiaries are MGPI Processing, Inc. (“Processing”) and MGPI of Indiana, LLC (“MGPI-I”). Processing was incorporated in Kansas in 1957 and is the successor to a business founded in 1941 by Cloud L. Cray, Sr. Prior to the Reorganization (discussed below), Processing was named MGP Ingredients, Inc. MGPI-I (previously named Firebird Acquisitions, Inc.) acquired substantially all the beverage alcohol distillery assets of Lawrenceburg Distillers Indiana, LLC (“LDI”) at its Lawrenceburg and Greendale, Indiana distillery (“Indiana Distillery”) on December 27, 2011.

On January 3, 2012, MGP Ingredients, Inc. reorganized into a holding company structure (the “Reorganization”) through a series of steps involving various legal entities as further described below. By engaging in the Reorganization, we sought to better isolate risks that might reside in one facility or operating unit from our other facilities or operating units. We also believe that a holding company structure will facilitate ramp-up of new businesses that might be developed, accommodate future growth through acquisitions and joint ventures, create tighter focus within operating units, and enhance commercial activities and financing possibilities.

The Reorganization was effected through a merger (the “Merger”) of Processing with MGPI Merger Sub, Inc., which was an indirect wholly-owned subsidiary of Processing and a direct, wholly-owned subsidiary of MGPI Holdings, Inc (“Holdings”). Holdings was formerly a direct, wholly-owned subsidiary of Processing. Each of Holdings and MGPI Merger Sub, Inc. were organized in connection with the Merger. Processing survived the Merger, and as a result, became a direct wholly-owned subsidiary of Holdings. Upon completion of the Reorganization, Holdings changed its name to MGP Ingredients, Inc., former holders of Processing’s common stock owned the same number of shares and same ownership percentage of Holdings as they did of Processing immediately prior to the Reorganization, and Holdings replaced Processing as the public corporation. The consolidated assets and liabilities of Holdings and its subsidiaries immediately after the Reorganization were the same as the consolidated assets and liabilities of Processing and its subsidiaries immediately before the effective time of the Merger. Immediately following the Reorganization: Holdings’ articles of incorporation and bylaws were the same in all material respects as those of Processing before the Merger, each director of Processing was a director of Holdings, and management of Holdings was the same (in all material respects) as the management of Processing prior to the Merger. Following the Reorganization, “Holdings” and “Company” refer to the same entity. To further the holding company structure, Processing distributed three of its formerly directly owned subsidiaries, MGPI-I, D.M. Ingredients, GmbH and Midwest Grain Pipeline, Inc., to Holdings. Processing’s other subsidiary, Illinois Corn Processing, LLC (“ICP”), remained a directly owned subsidiary of Processing, now 30% owned.

Effective December 31, 2011, we changed our fiscal year end from June 30 to December 31. We believe that this change in fiscal year better aligns the reporting of our financial results with those of our joint venture partners and strengthens our ability to gauge growing and harvesting conditions for seasonal grain crops. This change also enables our strategic planning process to better synchronize with our key customers’ product development initiatives. The consolidated financial statements presented herein include the results for the year ended December 31, 2012 (our first full fiscal year since the year end change), the six month transition period of July 1, 2011 to December 31, 2011, and the fiscal year ended June 30, 2011. The unaudited comparative information for the year ended December 31, 2011 and the six months ended December 31, 2010 is included in Note 17. Transition Period Comparative Data.

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GENERAL INFORMATION

We produce certain distillery and ingredient products which are derived from corn, rye and barley, and wheat flour, respectively, primarily to serve the packaged goods industry. As of December 31, 2012, we had three reportable segments: distillery products, ingredient solutions and other. Effective February 8, 2013, we sold substantially all assets included in our other segment as further described in Note 20. Subsequent Events. Our distillery products segment consists primarily of food grade alcohol, and to a much lesser extent, fuel grade alcohol and distillers feed, which are co-products of our distillery operations. The ingredient solutions segment products primarily consist of specialty starches, specialty proteins, commodity starches and commodity vital wheat gluten. Included in the other segment products were plant-based biopolymers and wood-based composite resins manufactured through the further processing of certain of our starches and proteins and wood particles.

We purchase corn, rye and barley, which we use in our distillery operations, primarily from or through grain elevators. Currently we purchase most of our corn requirements from a single supplier, Bunge. We purchase wheat flour, the principal raw material used in the manufacture of our protein and starch products at our Atchison facility, from ConAgra Mills. We process flour with water to extract vital wheat gluten, the basic protein component of flour, which we use primarily to process into specialty wheat proteins with increased protein levels and/or enhanced functional characteristics. Most wheat protein products are dried into powder and sold in packaged or bulk form. We further process the starch slurry resulting after the extraction of the protein component to extract premium wheat starch. A portion of wheat starch is processed into specialty starches, a portion is sold as commodity starch, and all of such is dried into powder and sold in packaged or bulk form. We mix the remaining starch slurry with corn and water and then cook, ferment and distill it into alcohol. We dry the residue of the distilling operations and sell it as a high protein additive for animal feed. At our Indiana Distillery, we produce customized and premium grade corn and rye whiskeys, bourbon, gin, grain neutral spirits and distillers feed.

The principal location at which we made our products as of December 31, 2012 was our plant located in Atchison, Kansas. We operate an Indiana Distillery, which we acquired on December 27, 2011, when we acquired substantially all the assets used by LDI in its beverage alcohol distillery business ("Distillery Business"). We also operated a facility in Onaga, Kansas for the production of plant-based biopolymers and wood composite resin until February 8, 2013, when we sold this facility. Our line of textured wheat proteins are currently produced through a toll manufacturing arrangement at a facility in the Netherlands. In November 2009, we entered into a joint venture with SEACOR Energy Inc.'s affiliate, Illinois Corn Processing Holdings LLC ("ICP Holdings"), to reactivate distillery operations at the facility in Pekin, Illinois. This facility is now owned and operated by a non-consolidated joint venture entity named ICP, which reactivated the plant in the quarter ended March 31, 2010. We own 30% of the equity interests of ICP. ICP produces food grade alcohol for beverage and industrial applications, which we purchase, and fuel grade alcohol, which SEACOR Energy Inc. purchases.

2012 AND RECENT DEVELOPMENTS

Acquisition of the Indiana Distillery

On December 27, 2011, we acquired substantially all the assets used by LDI in its beverage alcohol business, and we now produce premium bourbon, corn and rye whiskeys, gin, grain neutral spirits and distillers feed at our Indiana Distillery. The purchase price of the acquisition was equal to the current assets minus current liabilities as of December 27, 2011, which was estimated at closing to be $11,041. During April 2012, management and the seller completed working capital true-ups. The result of the true-ups was not material to our financial position or operating results.

During the quarter ended March 31, 2012, MGPI-I and the union that covers certain employees at the Indiana Distillery ratified a new multi-year collective bargaining unit agreement, that terminates December 31, 2017.

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In conjunction with the acquisition of the distillery operations of LDI, we acquired a grain elevator that was not expected to be used, which was reported as Assets held for sale at December 31, 2011. On March 21, 2012, we sold this facility and its related assets for $2,252, resulting in a loss of $48. Net proceeds received, after fees and prorated taxes, totaled $2,232.

Since acquiring the distillery operations of LDI, we have taken several steps to improve its profitability. On July 1, 2012 we went live on SAP, an information technology system used for accounting, sales, supply chain and manufacturing at this facility.

Agreement to Develop New Technologies and Products

On January 5, 2012 we commenced a relationship with the Kansas Alliance for Biorefining and Bioenergy (“KABB”) and four Kansas universities to develop new technologies and products that use bio-based raw materials. The three-year research and development efforts will seek to find innovative ways to produce cost-competitive bio-based foams, plastics, fuels and other materials from distillers dried grains and soluables. In conjunction with the sale of our bioplastics manufacturing business on February 8, 2013, we entered into a service agreement with the purchaser that allows us to use the purchaser’s labor and equipment so that we may continue to fulfill the obligations under this contract.

Ownership change of ICP

On February 1, 2012, ICP Holdings, an affiliate of SEACOR Energy Inc., exercised its option to purchase from us an additional 20 percent of the membership interest in ICP. The proceeds for this sale approximated $9,103. Following its exercise, ICP Holdings owns 70 percent of ICP, is entitled to name 4 of ICP’s 6 advisory board members, and generally has control of ICP’s day-to-day operations. We own 30 percent of ICP and are entitled to name 2 of ICP’s 6 advisory board members. The transaction resulted in a pre-tax gain of $4,055 during the quarter ended March 31, 2012.

ICP’s revolving credit facility with an affiliate of SEACOR Energy Inc. has expired and has not been renewed.

Under the Marketing Agreement, ICP manufactured and supplied food grade and industrial-use alcohol products for us and we purchased, marketed and sold such products for a marketing fee. Effective January 1, 2013, the Marketing Agreement expired. We do not plan to source products from ICP after March 2013.

Grain Supply Agreements

During the quarter ended March 31, 2012, we entered a grain supply contract for the Indiana Distillery, and during the quarter ended June 30, 2012 we extended this agreement for use at our Atchison facility. The grain supply contracts permit us to purchase corn for delivery up to 12 months in the future, at negotiated prices. The pricing for these contracts is based on a formula using several factors. If we don’t purchase a minimum amount of grain, the supplier may terminate the contract. We have determined that the firm commitments to purchase corn under the terms of these new contracts meet the normal purchases and sales exception as defined under ASC 815, Derivatives and Hedging, and we have excluded the fair value of these commitments from recognition within our consolidated financial statements until the actual contracts are physically settled.

Supply for commodities has been tight during much of the year ended December 31, 2012 due, in part, to the drought in the Midwestern United States. Market prices for commodities, including corn, have been near historic highs in summer of 2012, reaching a high in August 2012. This impacts the pricing we pay under our grain supply agreements.

Sale of Other Segment

As discussed in Note 20. Subsequent Events, on February 8, 2013, we sold substantially all of the assets of our other segment or bioplastics manufacturing business, including all of our assets at our bioplastics manufacturing facility in Onaga, Kansas and certain assets of the Company's extruder bio-resin laboratory located in Atchison, Kansas. The sales price totaled $2,800 and resulted in a pre-tax gain of approximately $1,400 that will be recognized in the first quarter of 2013.

FINANCIAL INFORMATION ABOUT SEGMENTS

Note 12. Operating Segments of our Notes to Consolidated Financial Statements set forth in Item 8 of this report, which is incorporated herein by reference, includes information about sales, depreciation and amortization, income (loss) before income taxes for the year ended December 31, 2012, the six month transition period ended December 31, 2011 and for the year ended June 30, 2011, by reportable segment. Information about sales to external customers and assets located in foreign countries is included. Information about identifiable assets is included as of December 31, 2012 and 2011.

BUSINESS STRATEGY

We seek to deliver strong profit margins and high returns on capital over time. To achieve our objectives, over the years we have restructured our business and modified our product portfolio to emphasize a greater mix of higher margin, value-added products, principally specialty food ingredients and high quality food grade alcohol. At the same time, we have taken measures to significantly reduce our production and marketing of lower and negative margin, commodity type products. Our strategy is focused on the development and marketing of wheat-based specialty protein and starch products and high quality food grade alcohol. We seek to add value to our customers' major branded packaged goods products by providing product solutions across a range of food and beverage applications, as well as certain non-food product applications, that can ultimately benefit the consumer.

As a component of our strategy, we have prioritized strengthening our overall operational capabilities and effectiveness through ongoing continuous improvement projects. Simultaneously, we are boosting our efforts to place greater focus on research, development and innovation initiatives, supply chain management, and customer service practices.

In the ingredients segment, we hope to benefit from the health and wellness lifestyle trends in the food area. We also continue to concentrate on specific, highly functional ingredient solutions for our customers. We are concentrating our production and marketing efforts on supplying a core base of loyal customers with an array of high quality, premium ingredients that address nutritional, functional, sensory and convenience issues and that can help build value while making more efficient use of our existing capacities.

In the distillery segment, we have positioned MGP to serve not only the major players in our industry, but also the growing base of independent craft distillers. Meanwhile, aged brown goods remain in short supply and we will continue to pursue opportunistic purchases to add to our aged barrel inventory.

We assess the competitive landscape to identify opportunities to bolster our customer and supplier relationships, while at the same time building scale to further improve our cost position. Our goal is to invest in growth opportunities that increase long-term shareholder value by advancing our strategic position and increasing our long-term cash flows.

We continue to be a leading company in the food grade alcohol industry and pursue efforts to maintain highly efficient alcohol production operations. We have been in the food grade alcohol business since the Company's founding in 1941. The majority of our Atchison distillery's capacity has been dedicated to the production of high quality, high purity food grade alcohol for beverage and industrial applications, and we provide our customers with what we believe is among the highest quality, high purity alcohol in the world. We produce only a minimal amount of fuel grade alcohol as a co-product of our food grade production activities. The Indiana Distillery's capacity is dedicated to the production of high quality, high purity food grade alcohol. The majority of our former Pekin plant's capacity for several years had been dedicated to the production of fuel grade alcohol. The Pekin plant is now owned and operated by a joint venture, ICP, which produces food grade alcohol, which we purchased, and fuel grade alcohol, which SEACOR Energy Inc. purchased as of December 31, 2012, as elsewhere described. We do not plan to source products from ICP after March 2013.

PRODUCT SALES

The following table shows our sales from continuing operations by each class of similar products during the year ended December 31, 2012, the six month transition period ended December 31, 2011 and the year ended June 30, 2011, as well as such sales as a percent of total sales.

PRODUCT GROUP SALES

	Year Ended December 31, 2012			Six Months Ended December 31, 2011			Year Ended June 30, 2011		
	Amount	%		Amount	%		Amount	%	
Distillery Products:									
Food grade Alcohol	$224,323	67.1	%	$98,358	67.2	%	$157,486	63.5	%
Distillers Grain and related Co-products	40,739	12.2	%	14,170	9.7	%	20,642	8.3	%
Fuel grade Alcohol	2,555	0.8	%	5,909	4.0	%	10,865	4.4	%
Warehouse revenue	9,073	2.7	%	-	-		-	-	
Total Distillery Products	$276,690	82.8	%	$118,437	80.9	%	$188,993	76.2	%
Ingredient Solutions:									
Specialty Starches	$26,393	7.9	%	$15,557	10.6	%	$29,459	11.9	%
Specialty Proteins	19,947	6.0	%	9,853	6.7	%	20,918	8.4	%
Commodity Wheat Starch	9,027	2.7	%	2,065	1.4	%	7,228	2.9	%
Vital Wheat Gluten	1,121	0.3	%	121	0.1	%	160	0.1	%
Total Ingredients	$56,488	16.9	%	$27,596	18.8	%	$57,765	23.3	%
Other Products:	$1,157	0.3	%	$444	0.3	%	$1,157	0.5	%
Net Sales	$334,335	100.0	%	$146,477	100.0	%	$247,915	100.0	%

Substantially all of our sales are made directly or through distributors to manufacturers and processors of finished packaged goods or bakeries. Sales to our customers purchasing food grade alcohol are made primarily on a spot, monthly, or quarterly basis with some annual contracts, depending on the customer’s needs and market conditions. Customers who purchase unaged whiskey or bourbon may also enter into separate warehouse service agreements with us, allowing the product to age. As part of our acquisition of LDI’s Distillery Business, we assumed certain multi-year contracts to supply distilled products and certain contracts to provide barreling and warehousing services, which typically are also multi-year contracts. Sales of fuel grade alcohol are made on the spot market. Contracts with distributors may be for multi-year terms with periodic review of pricing. Contracts with ingredients customers are generally price and term agreements which are fixed for three or six month periods, with very few agreements of twelve months duration or more. During the year ended December 31, 2012, our five largest distillery products customers combined accounted for 25.1% of our consolidated revenues, and our five largest ingredients solutions customers combined accounted for 11.1% of our consolidated revenues.

DISTILLERY PRODUCTS SEGMENT

Our Atchison plant processes corn, mixed with starch slurry from the wheat starch and protein processing operations, into food grade alcohol and distillery co-products such as fuel grade alcohol and distillers feed. Our Indiana Distillery processes corn, rye and barley into food grade alcohol, primarily beverage alcohol, and distillers feed.

Food grade alcohol consists of beverage alcohol and industrial food grade alcohol that are distilled to remove impurities. Fuel grade alcohol is grain alcohol that has been distilled to remove all water to yield 200 proof alcohols suitable for blending with gasoline. We presently generate and sell only minimal amounts as a co-product of the food grade alcohol production process at our Atchison distillery in order to reduce our exposure to the fuel grade alcohol market.

Historically, the Pekin plant had been principally dedicated to the production of fuel grade alcohol. On November 20, 2009, we completed a series of transactions whereby we contributed our former Pekin plant to a newly-formed company, ICP, and then sold 50% of the membership interest in this company to ICP Holdings, an affiliate of SEACOR Energy Inc. ICP reactivated distillery operations at the Pekin facility during the quarter ended March 31, 2010. We purchase food grade alcohol products manufactured by ICP, and SEACOR Energy Inc. purchases fuel grade alcohol products manufactured by ICP. On February 1, 2012, ICP Holdings exercised an option to acquire an additional 20% interest in ICP from us for $9,103.

In December 2011, we acquired substantially all the assets used by LDI in its beverage alcohol distillery business at the Indiana Distillery, where we now produce premium bourbon, corn and rye whiskeys, gin, grain neutral spirits and distillers feed. LDI owned an associated bottling business, which we did not purchase.

Both bourbon and whiskey are typically aged in wooden barrels from two to four years. As a part of our strategy, we produce certain volumes of bourbon and whiskey that are in addition to current customer demand. This product is barreled and included in our inventory. Our goal is to maintain inventory levels for whiskey and bourbon sufficient to satisfy anticipated future purchase orders in the wholesale market. Production schedules are adjusted from time to time to bring inventories into balance with estimated future demand.

Food Grade Alcohol. The majority of the Atchison distillery's and the Indiana Distillery's capacities are dedicated to the production of high quality, high purity food grade alcohol for beverage and industrial applications. New state-of-the-art equipment that was installed in 2004 has resulted in improved alcohol production efficiencies at the Atchison plant.

Food grade alcohol sold for beverage applications consists primarily of grain neutral spirits and gin, premium bourbon, and corn and rye whiskey. Grain neutral spirits are sold in bulk quantities at various proof concentrations to bottlers and rectifiers, which further process the alcohol for sale to consumers under numerous labels. Our gin is created by redistilling grain neutral spirits together with proprietary customer formulations of botanicals or botanical oils. Our bourbon is created by distilling primarily corn and may be blended with customer formulas. Our whiskey is made from fermented grain mash, including primarily corn and rye.

We believe that in terms of net sales, we are one of the four largest merchant market sellers of food grade alcohol in the United States. Our principal competitors in the beverage alcohol market are Grain Processing Corporation of Muscatine, Iowa, Archer-Daniels-Midland Company of Decatur, Illinois, and Beam, Inc. of Deerfield, Illinois.

Significant customer consolidation has occurred in the beverage alcohol industry at the customer level over the past two decades. As these consolidations have come about, we have maintained a strong and steady presence in the market due to longstanding relationships with customers and our reputation for producing very high quality, high purity alcohol products. We believe our presence in the market and strong reputation has improved with our acquisition of LDI's Distillery Business.

We sell food-grade industrial alcohol for use as an ingredient in foods (e.g., vinegar and food flavorings), personal care products (e.g., hair sprays and hand sanitizers), cleaning solutions, biocides, insecticides, fungicides, pharmaceuticals, and a variety of other products. Although grain alcohol is chemically the same as petroleum-based or synthetic alcohol, certain customers prefer a natural grain-based alcohol. We sell food-grade industrial alcohol in tank truck or rail car quantities direct to a number of industrial processors.

Historically, synthetic alcohol was a highly significant component of the food grade industrial alcohol market. In recent years, however, the use of grain-based alcohol has exceeded synthetic alcohol in this market. Our principal competitors in the grain-based food grade industrial alcohol market are Grain Processing Corporation of Muscatine, Iowa, and Archer-Daniels-Midland Company of Decatur, Illinois. Competition is based primarily upon price, service and quality factors.

Distillery Co-Products. The bulk of sales of alcohol co-products in the year ended December 31, 2012 consisted of distillers feed and fuel grade alcohol.

Distillers Feed. Distillers feed is principally derived from the residue of corn from alcohol processing operations. The residue is dried and sold primarily to processors of animal feeds as a high protein additive. We compete with other distillers of alcohol as well as a number of other producers of animal food additives in the sale of distillers feed. During the year ended December 31, 2012 distillers feed prices were higher on average compared to the six month transition period ended December 31, 2011 due to increased prices for corn, the basic raw material from which distillers feed is derived.

Fuel Grade Alcohol. We produce fuel grade alcohol as a co-product of our food grade alcohol business at our distillery in Atchison. For the year ended December 31, 2012, fuel grade alcohol sales represented approximately 3.3 percent of total sales for the distillery products segment. Although we historically retained some additional exposure to the volatility of the fuel alcohol market through our investment in ICP in Pekin, Illinois, we had an opportunity to participate when the economics of that market were good, while limiting the exposure to bad markets had we operated the Pekin facility ourselves.

Fuel grade alcohol is sold primarily for blending with gasoline to increase the octane and oxygen levels of the gasoline. As an octane enhancer, fuel grade alcohol can serve as a substitute for lead and petroleum-based octane enhancers. As an oxygenate, fuel grade alcohol has been used in gasoline to meet certain environmental regulations and laws relating to air quality by reducing carbon monoxide, hydrocarbon particulates and other toxic emissions generated from the burning of gasoline ("toxics"). Because fuel grade alcohol is produced from grain, a renewable resource, it also provides a fuel alternative that tends to reduce domestic dependence on foreign oil.

To encourage the production of fuel grade alcohol for use in gasoline, the Federal government and various states have enacted tax and other incentives designed to make fuel grade alcohol competitive with gasoline and gasoline additives. Under the Internal Revenue Code, and until the end of the 2011 calendar year, gasoline that was blended with fuel grade alcohol provided sellers of the blend with certain credits or payments which amounted to $0.45 per gallon for calendar year 2011. Although these benefits have not been directly available to us, they were intended to permit us to sell our fuel grade alcohol at prices which generally are competitive with less expensive additives and gasoline. The expiration of these credits, along with the $0.54 per gallon of fuel alcohol import tariff which expired on December 31, 2011, caused margins during 2012 to dampen. Fuel grade alcohol sales volumes were supported by favorable gasoline blending economics in the U.S. However, excess industry production of fuel grade alcohol, together with reduced U.S. fuel grade alcohol demand, have negatively impacted ethanol margins. Similar to the rest of the industry, ICP margins have been negatively impacted. ICP has adjusted production rates to support the anticipated demand.

Major market participants in the fuel grade alcohol market include Poet Biorefining, Archer-Daniels-Midland Company and Valero Energy Corporation, which together account for approximately a third of the total production capacity. We and our joint venture, ICP, compete with other producers of fuel grade alcohol on the basis of price and delivery service.

INGREDIENT SOLUTIONS SEGMENT

Our ingredient solutions segment consists primarily of specialty wheat starches, specialty wheat proteins, commodity wheat starch and vital wheat gluten. We have substantially exited the commodity wheat gluten market and have curtailed the production of commodity wheat starches.

In recent years, our specialty wheat starches and proteins have accounted for a sizeable share of our total sales in this segment, which has been a component of our business strategy as we focus on higher margin products. The results were based, in part, on the following factors: partnerships with customers on product development, capacity to produce these products, and increased marketing efforts that have resulted in greater customer recognition. We use an on-line Customer Relationship Management ("CRM") solution system to improve our ability to develop new sales of our product lines. Our commercialization functions are focused on increasing sales growth of our specialty products to the largest and most innovative producers of consumer packaged goods in the U.S. These factors will also be required for future growth of our higher margin products.

Specialty Wheat Starches. Wheat starch constitutes the carbohydrate-bearing portion of wheat flour. We produce a premium wheat starch powder by extracting the starch from the starch slurry, substantially free of all impurities and fibers, and then drying the starch by spray, flash or drum. Premium wheat starch differs from low grade or B wheat starches, which are extracted along with impurities and fibers and are used primarily as a binding agent for industrial applications, such as the manufacture of charcoal briquettes. We do not sell low grade or B starches. Premium wheat starch differs from corn starch in its granular structure, color, granular size and name identification.

A substantial portion of our premium wheat starch is altered during processing to produce certain unique specialty wheat starches designed for special applications. Our strategy is to market our specialty wheat starches in special market niches where the unique characteristics of these starches are better suited to a customer's requirements for a specific use. We have developed a number of specialty wheat starches, and continue to explore the development of additional starch products with the view to increasing sales of value-added specialty starches. We produce our Fibersym® resistant starch, which has become one of our more popular specialty starches, using a patented technology referred to below under Patents. We sell our specialty starches on a nationwide basis, primarily to food processors and distributors.

Our specialty wheat starches are used primarily for food applications as an additive in a variety of food products to affect their nutritional profile, appearance, texture, tenderness, taste, palatability, cooking temperature, stability, viscosity, binding and freeze-thaw characteristics. Important physical properties contributed by wheat starch include whiteness, clean flavor, viscosity and texture. For example, our starches are used to improve the taste and texture of cream puffs, éclairs, puddings, pie fillings, breading and batters; to improve the size, symmetry and taste of angel food cakes; to alter the viscosity of soups, sauces and gravies; to improve the freeze-thaw stability and shelf life of fruit pies and other frozen foods; to improve moisture retention in microwavable foods; and to add stability and to improve spreadability in frostings, mixes, glazes and sugar coatings. We also sell our specialty starches for a number of non-food applications, which include biopolymer products, and for use in the manufacturing of adhesives, paper coatings, carbonless paper, and wall board.

Our wheat starches as a whole generally compete primarily with corn starch, which dominates the United States starch market. However, the unique characteristics of our specialty wheat starches provide them with a number of advantages over corn and other starches for certain baking and other end uses. Our principal competitors in the starch market are Cargill Incorporated (primarily corn and tapioca starch), Ingredion Incorporated (corn starch), Manildra Milling Corporation (wheat starch), Penford Corporation (potato starch), Archer-Daniels-Midland Company (wheat and other grain starches) and various European companies. Competition is based upon price, name, color and differing granular characteristics which affect the food product in which the starch is used. Specialty wheat starches usually enjoy a price premium over corn starches and low grade wheat starches. Commodity wheat starch price fluctuations generally track the fluctuations in the corn starch market. The specialty wheat starch market usually permits pricing consistent with costs which affect the industry in general, including increased grain costs. However, this is not always the case; during the six month transition period ended December 31, 2011 and the year ending June 30, 2011, for example, increases in grain prices outpaced market price increases in the specialty wheat starch market.

Specialty Wheat Starches

- Fibersym® Resistant Starch series. These starches serve as a convenient and rich source of dietary fiber. Unlike traditional fiber sources like bran, our resistant starches possess a clean, white color and neutral flavor that allow food formulators to create a wide range of both traditional and non-traditional fiber enhanced products that are savory in both appearance and taste. Applications include pan breads, pizza crust, flour tortillas, cookies, muffins, pastries and cakes.

- FiberRite® RW Resistant Starch. FiberRite® RW is a product that boosts dietary fiber levels while also reducing fat and caloric content in such foods as breads, sweet goods, ice cream, yogurt, salad dressings, sandwich spreads and emulsified meats.

- Pregel™ Instant Starch series. Our Pregel ™ starches perform as an instant thickener in bakery mixes, allowing fruit, nuts and other particles such as chocolate pieces to be uniformly suspended in the finished product. In coating systems, batter pick-up can be controlled for improved yield and consistent product appearance. Additionally, shelf-life can be enhanced due to improved moisture retention, allowing products to remain tender and soft over an extended storage period.

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- Midsol™ Cook-up Starch series. As a whole, these starches deliver increased thickening, clarity, adhesion and tolerance to high shear, temperature and acidity during food processing. Certain varieties in this line of starches can also be used to reduce sodium content in some food formulations. Such properties are important in products such as soups, sauces, gravies, salad dressings, fillings and batter systems. Processing benefits of these starches also include the ability to control expansion in extruded breakfast cereals. In addition, they provide textural enhancement and moisture management in processed foods, especially during storage under frozen and refrigerated conditions.

Commodity Wheat Starch. As is the case with value-added wheat starches, our commodity wheat starch has both food and non-food applications, but such applications are more limited than those of value-added wheat starches and typically sell for a lower price in the marketplace. As noted above, commodity wheat starch competes primarily with corn starches, which dominate the marketplace and prices generally track the fluctuations in the corn starch market.

Specialty Wheat Proteins. We have developed a number of specialty wheat proteins for food and non-food applications. Specialty wheat proteins are derived from vital wheat gluten through a variety of proprietary processes which change its molecular structure. Wheat proteins for food applications include products in the Arise®, Wheatex®, HWG 2009™ and FP™ series. Our specialty wheat proteins generally compete with other ingredients and modified proteins having similar characteristics, primarily soy proteins and other wheat proteins, with competition being based on factors such as functionality, price and, in the case of food applications, flavor. Our principal competitors in the specialty proteins market are Archer-Daniels-Midland Company (wheat and other grain proteins), The Solae Company (soy), Manildra Milling (gluten and wheat proteins), and various European companies. Although we are producing a number of our specialty wheat proteins on a commercial basis, some products are in the test marketing or development stage.

Specialty Wheat Proteins

- Arise® series. Our Arise® series of products consists of specialty wheat proteins that increase the freshness and shelf life of frozen, refrigerated and fresh dough products after they are baked. Certain ingredients in this series are also sold for use in the manufacturing of high protein, lower net carbohydrate products.

    - Wheatex® series. This series consists of texturized wheat proteins made from vital wheat gluten by changing it into a pliable substance through special processing. The resulting solid food product can be further enhanced with flavoring and coloring and reconstituted with water. Texturized wheat proteins are used for meat, poultry and fish product enhancements and/or substitutes. Wheatex® mimics the textural characteristics and appearance of meat, fish and poultry products. It is available in a variety of sizes and colors and can be easily formed into patties, links or virtually any other shape the customer requires.

- FP™ series. The FP™ series of products consists of specialty wheat proteins, each tailored for use in a variety of food applications. These include proteins that can be used to form barriers to fat and moisture penetration to enhance the crispness and improve batter adhesion in fried products, effectively bond other ingredients in vegetarian patties and extended meat products, increase the softness and pliability of flour tortillas, and fortify nutritional drinks.

- HWG 2009™. This is a lightly hydrolyzed wheat protein that is rich in peptide-bonded glutamine, an amino acid that counters muscle fatigue brought on by exercise and other physical activities. Applications include nutritional beverages and snack products.

Vital Wheat Gluten. Vital wheat gluten is a free-flowing light tan powder which contains approximately 75 to 80 percent protein. When we process flour to derive starch, we also derive vital wheat gluten. Vital wheat gluten is added by bakeries and food processors to baked goods, such as breads, and to pet foods, cereals, processed meats, fish and poultry to improve the nutritional content, texture, strength, shape and volume of the product. The neutral flavor and color of wheat gluten also enhances, but does not change, the flavor and color of food. The cohesiveness and elasticity of the gluten enables the dough in wheat and other high protein breads to rise and to support added ingredients, such as whole cracked grains, raisins and fibers. This allows the baker to make an array of different breads by varying the gluten content of the dough. Vital wheat gluten is also added to white breads, hot dog buns and hamburger buns to improve the strength and cohesiveness of the product.

Vital wheat gluten in recent years has been considered a commodity, and therefore, competition primarily has been based upon price.

In prior years, vital wheat gluten has sometimes been a principal ingredients product. However, we generally have been unable to compete with subsidized imports and now use it as a base for further processing into our specialty wheat proteins.

OTHER SEGMENT

As discussed in Note 20. Subsequent Events, on February 8, 2013, we sold substantially all of the assets included in our other segment.

Our plant-based biopolymers and composite resins, which were produced from the further processing of certain of our wheat proteins and wheat starches (and other plant sources), can be used to produce a variety of eco-friendly products. We formerly manufactured plant-based resins for use primarily in pet treat applications. Our principal products in our other segment consisted of our MGPI Terratek® biopolymers and composite resins. The MGPI Terratek® SC starch-based biopolymers were our environmentally-friendly biopolymers that can be molded to produce a variety of formed objects. Applications include disposable eating utensils, golf tees, food and feed containers and similar type vessels, as well as non-degradable hard plastic-like products. We also produced MGPI Terratek® WC wood-based composite resins, which can be used in the manufacture of eco-friendly decking materials, furniture parts, toys and a number of other wood-like products.

PATENTS

We are involved in a number of patent-related activities. We have filed patent applications to protect a range of inventions made in our expanding research and development efforts, including inventions relating to applications for our products. Our most significant patents or patent licenses are described below.

In 2003, we licensed, on an exclusive basis, certain patented technology from The Kansas State University Research Foundation relating to U. S. Patent No. 5,855,946, which describes and claims processes for making food-grade starches resistant to alpha-amylase digestion, as well as products and uses for the resistant starches. The license relates to products derived from plant-based starches and is a royalty-bearing, worldwide license whose term, subject to termination for material, uncured breaches or bankruptcy, extends until the patent rights expire in 2017. Royalties generally are based on net sales. The patent rights relate to the referenced U.S. patent and any corresponding foreign patent application, which has been filed in Australia. Under the license, we can make, have made, use, import, offer for sale, and sell licensed products within the scope of a claim of the patent rights or which are sold for a use within the scope of the patent rights and may, with approval of the licensor, grant similar rights to sublicensees. We produce and sell our resistant wheat starch under this patent. We have granted sublicenses from time to time under this patent. Under one such arrangement, we granted Cargill Incorporated a royalty bearing sublicense to use the patented process in the production of tapioca-based starches for use in food products. We also have agreements with Cargill Incorporated that would apply if we determined to use the patented process to make starches derived from other plant sources (other than wheat or potato).

We hold U.S. Patent No. 5,610,277 expiring in 2015 relating to the alcohol-free wet extraction of gluten dough into gliadin and glutenin.

RESEARCH AND DEVELOPMENT

During the year ended December 31, 2012 we spent $2,344, and during the six month transition period ended December 31, 2011, and the year ended June 30, 2011, we spent $954 and $1,431, respectively, on research and development activities, principally in the ingredient solutions and other segments.

SEASONALITY

Our sales are not seasonal. Production of our barreled products is seasonal during the spring and the fall. There is a degree of seasonality with respect to our natural gas as further described under "Energy."

TRANSPORTATION

Historically, our output has been transported to customers by truck and rail transportation equipment, most of which is provided by common carriers.

We currently lease 304 rail cars, which may be dispatched on short notice. ICP, our joint venture operation in Pekin, Illinois, also has the ability to transport by barge from its site, with barge loading facilities on the Illinois River.

We use third party transportation companies to help us manage truck and rail carriers who deliver inbound materials to us and our products to our North American customers.

RAW MATERIALS

Our principal raw materials are wheat flour, which is processed into our starches and proteins, and corn, which are processed into food grade alcohol and distillery co-products consisting of fuel grade alcohol and animal feed. We purchase corn throughout the year primarily from or through grain elevators. Currently we purchase most of our corn requirements from a single supplier, Bunge. Our historical practice has been to order corn for a month at a time. During the quarter ended March 31, 2012, we entered into a grain supply contract for our Indiana Distillery that permits us to purchase corn for delivery up to 12 months in the future, at negotiated prices. During the quarter ended June 30, 2012, we extended this grain supply agreement used for its Indiana Distillery to its Atchison facility. The pricing is based on a formula using several factors. We now expect to order corn anywhere from a month to 12 months in the future. We provide for our flour requirements through a supply contract with ConAgra Mills whose initial term, as amended, expires in October 2015. The supply contract is automatically renewable for an additional term of 5 years unless either party gives at least 180 days written notice of termination. Pricing is based on a formula that contains several factors.

Other less significant raw materials include rye and barley used in the production of bourbons and whiskeys, and oak barrels, which are required for bourbon and whiskey aging. We purchase rye and barley throughout the year, each from a single supplier.

The cost of grain has historically been subject to substantial fluctuations, depending upon factors such as crop conditions, weather, disease, plantings, government programs and policies, competition for acquisition of inputs such as agricultural commodities, purchases by foreign governments and changes in demand resulting from population growth and customer preference. Variations in grain prices have had from time to time significant adverse effects on the results of our operations in cases where we cannot recoup the cost increase in our selling prices. Fuel grade alcohol prices, which historically have tracked the cost of gasoline, do not usually adjust to rising grain costs. It generally has been difficult for us to compensate for increases in grain costs through adjustments in prices charged for our vital wheat gluten due to subsidized European Union wheat gluten, whose traditionally lower prices are not affected by such costs. We have taken steps to reduce the impact of cost fluctuations on our business, primarily by ceasing and/or significantly reducing our production and marketing of lower and negative margin commodity type products such as gluten and fuel grade alcohol, but we will continue to be affected by cost fluctuations to some degree, particularly when they are volatile.

Historically, we have engaged in the forward purchase of grain and in the purchase of commodity futures and options to hedge economic risks associated with fluctuating grain and grain products prices. Prior to entering into our new grain supply agreements, our hedging program generally consisted of purchasing commodity futures and options and contract for the future delivery of grain only to protect margins on contracted, and a portion of spot market, alcohol sales. However, during the six month transition period ended December 31, 2011, we began to buy and sell derivative instruments to manage market risk associated with alcohol purchases, including ethanol futures and options contracts, in order to mitigate risks associated with our investment in ICP. As we are now able to purchase corn for delivery up to 12 months in the future under new grain supply agreements, we have reduced the volume of our corn futures and options contracts. We intend to contract for the future delivery of flour only to protect margins on expected ingredients sales. See Item 1A – Risk Factors and Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Derivative and Hedging Activities. Also see Item 7A - Quantitative and Qualitative Disclosures about Market Risk.

ENERGY

Because energy comprises a major cost of operations, we seek to assure the availability of fuels at competitive prices.

We use natural gas to operate boilers that we use to make steam heat. We procure natural gas for the Atchison plant and the Indiana Distillery in the open market from various suppliers. We can purchase contracts for the delivery of natural gas in the future or can purchase future contracts on the exchange. Depending on existing market conditions, at Atchison we have the ability to transport the gas through a gas pipeline owned by a wholly-owned subsidiary. Historically, prices of natural gas have been higher in the late fall and winter months than during other periods.

We have a risk management program whereby, at pre-determined prices, we may purchase a portion of our natural gas requirements for future delivery. However, we intend to enter contracts for future delivery only to protect margins on contracted alcohol sales and expected ingredients sales.

EMPLOYEES

As of December 31, 2012, we had a total of 267 employees. A collective bargaining agreement covering 98 employees at the Atchison plant expires on August 31, 2014. Another collective bargaining agreement covering 44 employees at the Indiana Distillery expires on December 31, 2017. As of December 31, 2011 we had 256 employees. We consider our relations with our personnel generally to be good.

REGULATION

We are subject to a broad range of federal, state, local and foreign laws and regulations intended to protect public health and the environment. Our operations are also subject to regulation by various federal agencies, including the Alcohol and Tobacco Tax Trade Bureau, the Occupational Safety and Health Administration, the Food and Drug Administration and the U.S. Environmental Protection Agency ("USEPA"), and by various state and local authorities. Such regulations cover virtually every aspect of our operations, including production facilities, marketing, pricing, labeling, packaging, advertising, water usage, waste water discharge, disposal of hazardous wastes and emissions and other matters.

Our alcohol business is subject to regulation by the Alcohol and Tobacco Tax and Trade Bureau ("TTB") and the alcoholic beverage agencies in the States of Kansas, Illinois and Indiana. Food products are also subject to regulation by the Food and Drug Administration. TTB regulation includes periodic TTB audits of all production reports, shipping documents, and licenses to assure that proper records are maintained. We are also required to file and maintain monthly reports with the TTB of alcohol inventories and shipments. Under federal regulations, bourbons and whiskeys must be aged for at least two years in charred oak barrels.

We are subject to extensive environmental regulations at the federal, state and local levels. All of our principal plants are regulated at the federal level by the USEPA. The USEPA has adopted regulations requiring the owners of certain facilities to measure and report their greenhouse gas emissions, and has also begun a process to regulate these emissions under the Clean Air Act. At the state level, we are regulated in Kansas by the Division of Environment of the Kansas Department of Health and Environment (the “KDHE”) and in Indiana by the Indiana Department of Environmental Management. In Illinois, our joint venture entity, ICP, is regulated by the Illinois Environmental Protection Agency. We are required to obtain operating permits and to submit periodic reports to regulating agencies.

Our current National Pollutant Discharge Elimination System ("NPDES") permit is valid through September 30, 2015. The KDHE required us to install a distillery water cooling system at the Atchison plant referred to below at a cost of approximately $10,000, which was completed in 2011. The new system is designed to meet KDHE Volatile Organic Compounds ("VOC") emission standards, while also enhancing alcohol production efficiencies. We are required to submit a draft study to the KDHE by August 1, 2014 regarding the improvements needed to reduce phosphorus concentrations in the wastewater discharges at the Atchison plant. Within 180 days after KDHE comments on the draft study, we are required to submit a final study.

In January 2006, we entered a consent agreement with the KDHE resolving past allegations relating to permits, emissions levels and compliance with pollution regulations. During the second half of fiscal 2010, due to increased production activity, we anticipated that we would exceed the emissions cap imposed by the KDHE in the 2006 consent agreement and began negotiating an amendment to the consent agreement with the KDHE. This amendment, which was approved by the KDHE in May 2010, required us to complete the closed-loop, process water cooling system project described above, resulting in significant VOC reduction, in accordance with a scheduled timeline extending over an approximate seventeen month period ending on September 30, 2011. The process water cooling system was completed during July of 2011 as described elsewhere. We agreed to pay a $5 per month penalty for any month that we might exceed the rolling 12-month emissions cap imposed in the consent agreement, as well as a $1 per day penalty for each day we might fail to file monthly progress reports or exceed established completion dates for various stages of the project. During the year ended December 31, 2012, we did not exceed the emissions cap and therefore we were not subject to related penalties.

INVESTMENT IN EQUITY METHOD INVESTMENTS

Illinois Corn Processing, LLC. On November 20, 2009, through our subsidiary MGPI Processing, Inc., we completed a series of related transactions pursuant to which we contributed our Pekin plant and certain maintenance and repair materials to a newly-formed company, Illinois Corn Processing, LLC (“ICP”), and then sold 50% of the membership interest in ICP to Illinois Corn Processing Holdings LLC (“ICP Holdings”), an affiliate of SEACOR Energy Inc. ICP reactivated distillery operations at the Pekin facility during the quarter ended March 31, 2010. At of December 31, 2012, we purchased food grade alcohol products manufactured by ICP, and SEACOR Energy Inc. purchased fuel grade alcohol products manufactured by ICP.

On February 1, 2012, ICP Holdings exercised its option and purchased an additional 20 percent from us for $9,103, reducing our ownership from 50% to 30%.

In connection with these transactions, we entered into various agreements with ICP and ICP Holdings, including a Contribution Agreement, an LLC Interest Purchase Agreement, a Limited Liability Company Agreement and a Marketing Agreement.

- Under the LLC Interest Purchase Agreement, we sold ICP Holdings 50% of the membership interest in ICP. This agreement gave ICP Holdings the option to purchase up to an additional 20% of the membership interest in ICP at any time between the second and fifth anniversary based on an agreed to criteria. As described above, this option was exercised on February 1, 2012.

- Pursuant to the Limited Liability Company Agreement, control of day to day operations generally is retained by the members, acting by a majority in interest. Following ICP Holdings' exercise of its option referred to above, ICP Holdings owns 70% of ICP and generally is entitled to control its day to day operations. However, if SEACOR Energy Inc. were to default under its marketing agreement, referred to below, we could assume sole control of ICP's daily operations until the default is cured.

The Limited Liability Company Agreement also provides for the creation of an advisory board. As a result of ICP Holdings’ option exercise on February 1, 2012, this board consists of two advisors appointed by us and four advisors appointed by ICP Holdings. All actions of the advisory board require majority approval of the entire board, except that any transaction between ICP and ICP Holdings or its affiliates must be approved by the advisors appointed by us.

The Limited Liability Company Agreement gives either member certain rights to shut down the plant if it operates at a loss. Such rights are conditional in certain instances but absolute if EBITDA losses aggregate $1,500 over any three consecutive quarters or if ICP's net working capital is less than $2,500. ICP Holdings also has the right to shut down the plant if ICP is in default under its loan agreement for failure to pay principal or interest for two months.

The Limited Liability Company Agreement contains various buy/sell provisions and restrictions on transfer of membership interests. These include buy/sell provisions relating to a member's entire interest that may be exercised by any member at any time.

- Under the Marketing Agreement, ICP manufactured and supplied food grade and industrial-use alcohol products for us and we purchased, marketed and sold such products for a marketing fee. The Marketing Agreement provided that we would share margin realized from the sale of the products under the agreement with ICP.

The Marketing Agreement had an initial term of one year but automatically renewed for one year terms thereafter, subject to specified exceptions, including the following: (i) there was an uncured breach by one of the parties, (ii) we gave timely notice of termination, (iii) we (or our affiliates) cease to be a member of the joint venture, or (iv) the parties were unable to mutually agree to modifications to the Marketing Agreement that are proposed in good faith by one of the parties as necessary or desirable to further the purposes of the parties' respective expectations of economic benefits to be derived under the Marketing Agreement and their interests in ICP. Effective January 1, 2013, the Marketing Agreement expired. For six months following expiration or termination of the Marketing Agreement, ICP will provide us with reasonable assistance to transition production of the products it makes for us to another producer that we designate. SEACOR Energy Inc. has entered into a similar agreement with ICP with respect to the marketing of fuel grade alcohol.

An affiliate of SEACOR Energy Inc. has provided funding to ICP through two loans secured by all of the assets of ICP, including the Pekin Plant. The revolving credit facility expired at December 31, 2012 and was not renewed.

D.M. Ingredients GmbH. In 2007 we acquired a 50% interest in D.M. Ingredients, GmbH, a German joint venture company which produces certain of our specialty ingredients products through a toller for distribution in the European Union ("E.U.") and elsewhere. As of December 31, 2012 our total capital commitment to the joint venture was $750, of which we had contributed $571.

OFFICERS OF THE REGISTRANT

The Company's officers are listed below.

Name	Age	Position
Timothy W. Newkirk	44	President and Chief Executive Officer
Donald P. Tracy	55	Vice President, Finance and Chief Financial Officer
Donald G. Coffey, Ph.D.	58	Executive Vice President, Research, Development and Innovation
David E. Dykstra	49	Vice President, Alcohol Sales and Marketing
Michael J. Lasater	44	National Director of Sales
Scott B. Phillips	47	Vice President, Supply Chain Operations
David E. Rindom	57	Vice President, Human Resources
Ody Maningat, Ph.D.	58	Vice President, Applications Technology and Technical Services
Randy M. Schrick	62	Vice President, Engineering
Lori D. Norlen	51	Corporate Secretary

Mr. Newkirk has served as President and Chief Executive Officer since March, 2008. He previously had been President and Chief Operating Officer since October, 2006 and Vice President of Operations and Chief Operating Officer since April, 2006. He first joined the Company in 1991, serving initially as a distillery shift manager and later as a process engineer, project engineer and quality control manager at the Atchison, Kansas plant. He became manager of the Company's Pekin, Illinois plant in 1997. From 2000 to 2002, he was Vice President of Operations for the former High Plains Corporation, a fuel grade alcohol production company located in Wichita, Kansas. He became Vice President of Global Operations for Abengoa Bioenergy S.L. following that company's acquisition of High Plains in January, 2002. He then served as Chief Operating Officer of Abengoa Bioenergy Corporation from August, 2003 until his return to the Company as Director of Operations in 2005.

Mr. Tracy has served as Vice President of Finance and Chief Financial Officer of MGP Ingredients, Inc. since November 2009. From 2007 until joining the Company, he served as Chief Financial Officer at Emery Oleochemicals, a global chemical manufacturer, and was based in Cincinnati. Prior to his position at Emery Oleochemicals, Mr. Tracy served as Chief Financial Officer at Briggs Industries, a worldwide manufacturer and distributor of kitchen and bath fixtures, at the company's U.S. headquarters in Charleston, South Carolina, from 2005 to 2007. Before that, he spent four years with the Tenaris Corp., a global producer of steel tubes, where he began as Director of Financial Projects and subsequently was promoted to Chief Financial Officer of Tenaris, North America. His previous experience included 10 years with the Procter & Gamble Company.

Dr. Coffey has served as Executive Vice President of Research, Development and Innovation since August 2010. Prior to that, he had jointly served as Executive Vice President of Research, Development and Innovation and of Sales and Marketing since June 2009. Prior to that, he had been Executive Vice President of the Company's Ingredient Solutions segment since November 2008. He joined the Company as Vice President of Innovation in July 2007. He previously spent 22 years in commercialization and research positions with the Dow Chemical Co. For 12 years beginning in 1985, he worked in the commercial and research operations of the METHOCEL business, a global business unit within Dow's Special Chemical Group that manufactures cellulose derivatives for a variety of food and non-food applications. He was later promoted to General Manager of Dow Food Stabilizers with responsibilities for global sales, marketing and research.

Mr. Dykstra has served as Vice President of Alcohol Sales and Marketing since 2009. He previously has been industrial alcohol sales manager since 2006. He first joined the Company in 1988 eventually serving as director of sales for both beverage and fuel grade alcohol. In 1999, he left the company to assume the role of vice president of sales and marketing for Abengoa Bio Energy, Wichita, Kansas. He remained in that position until 2003, when he joined United Bio Energy Fuels, L.L.C., in Wichita as vice president of that company's alcohol marketing division. He returned to the Company in 2006.

Mr. Lasater re-joined the Company in 2010 and serves as our National Sales Director. He has nearly 20 years of experience in food ingredient sales, including eight years with the Company, where he began his career as a territorial sales manager in the Company's former wheat starch business unit in 1992. Following his initial years of employment with the Company, Mr. Lasater joined National Starch and Chemical Co. as corporate accounts manager in 2000 and was responsible for select customer accounts located mainly in major Midwestern metropolitan areas. In 2005, he left National, now a part of Corn Products International, to become a partner and sales associate with Gregg and Associates, a food ingredients brokerage business based in Excelsior, Minnesota. He remained there until his return to the Company in 2010.

Mr. Phillips has served as Vice President of Supply Chain Operations since June 2009. For a year prior to that, he served as Corporate Director of Manufacturing for the Company's Ingredient Solutions segment. He joined the Company as General Manager of Extrusion Technology in July 2007. He previously spent 17 years in plant supervisory and management positions with General Mills, Inc., including four years as plant manager of that company's operations in Kansas City, Missouri, and a year as Plant Manager of the General Mills facility in Methuen, Massachusetts. From 1988 to 1990, he was employed as a production supervisor for the Quaker Oats Company.

Mr. Rindom joined the Company in 1980. He has served as Vice President, Human Resources since June 2000. He was Corporate Director of Human Relations from 1992 to June 2000, Personnel Director from 1988 to 1992, and Assistant Personnel Director from 1984 to 1988.

Dr. Maningat joined the Company in 1986 as R&D Chemist. He has served as Vice President of Application Technology and Technical Services since June 2002. Previously, he was Corporate Director of Research and Development and Technical Marketing from 1997 to 2002. He served as Corporate Director of Research and Development and Quality Control for the Company from 1993 to 1997.

Mr. Schrick served as President of Illinois Corn Processing, LLC, from November 2009 to December 2011. He also has been Vice President of Engineering for the Company since June 2009. He previously had served as Corporate Director of Distillery Products Manufacturing from June 2008 to June 2009 and as Vice President, Manufacturing and Engineering from July 2002 to June 2008. He served as Vice President - Operations from 1992 until July 2002. From 1984 to 1992, he served as Vice President and General Manager of the Pekin plant. From 1982 to 1984, he was the Plant Manager of the Pekin plant subsequent to joining the Company in 1973. Prior to 1982, he was Production Manager at the Atchison plant. He was a Director of the Company from 1987 to 2008.

Ms. Norlen joined the Company in October 2010 as Assistant Controller and was named Corporate Secretary in late 2012. She previously spent 5 years in consulting and management accounting positions at Hostess Brands in Kansas City, Missouri. From 1982 to 2005, Ms. Norlen was employed by Kansas City area companies in the insurance, insurance premium finance and animal health industries, including officer and management-level responsibilities beginning in 1986.

ITEM 1A. RISK FACTORS

Our business is subject to certain risks and uncertainties. The following identifies those which we consider to be most important:

RISKS THAT AFFECT OUR BUSINESS AS A WHOLE

An interruption of operations at either our Atchison facility or our Indiana Distillery, a disruption in supply of oak barrels, or a disruption of transportation services, could negatively affect our business.

The bulk of our ingredient solutions business takes place at our facility in Atchison, while food grade alcohol is produced both at our Atchison plant and our Indiana Distillery. An interruption in or loss of operations at either of our facilities could reduce or postpone production of our products, which could have a material adverse effect on our business, results of operations and/or financial condition. To the extent that our value-added products rely on unique or proprietary processes or techniques, replacing lost production by purchasing from outside suppliers becomes more difficult.

We hold a substantial amount of inventory of aged products of whiskeys and bourbons at our Indiana Distillery. If there were a catastrophic event at our Indiana Distillery, our business could be adversely affected. The loss of a significant amount of aged inventory – through fire, natural disaster, or otherwise - could result in a significant reduction in supply of the affected product or products and could result in customer claims against us. A disruption in transportation services could result in difficulties supplying materials to our facilities and impact our ability to deliver products to our customers in a timely manner. Similarly, if we experienced a disruption in the supply of new oak barrels in which to age our whiskeys, our business could suffer.

Our profitability is affected by the energy costs, ethanol and grain and flour that we use in our business, the availability and cost of which are subject to weather and other factors beyond our control. Our hedging strategy may not protect us completely from changes in prices of commodities and natural gas or may not translate to a competitive advantage in the marketplace. We may not be able to recoup cost increases in our selling prices due to the competitive environment.

Grain and flour costs are a significant portion of our costs of goods sold. Historically, the cost of such raw materials has been subject to substantial fluctuations, depending upon a number of factors which affect commodity prices in general and over which we have no control. These include crop conditions, weather, disease, plantings, government programs and policies, competition for acquisition of inputs such as agricultural commodities, purchases by foreign governments, and changes in demand resulting from population growth and customer preferences. The price of natural gas, also fluctuates, based on anticipated changes in supply and demand, weather and the prices of alternative fuels. Fluctuations in the price of commodities and natural gas can be sudden and volatile at times and have had, from time to time, significant adverse effects on the results of our operations. Higher energy costs could result in higher transportation costs and other operating costs.

Historically, we have engaged in the forward purchase of grain and in the purchase of commodity futures and options to hedge economic risks associated with fluctuating grain and grain products prices. Prior to entering into our new grain supply agreements, our hedging program generally consisted of purchasing commodity futures and options and contract for the future delivery of grain only to protect margins on contracted, and a portion of spot market, alcohol sales. During the six month transition period ended December 31, 2011, we began to buy and sell derivative instruments to manage market risk associated with ethanol purchases, including ethanol futures and options contracts, in order to mitigate risks associated with our investment in ICP. With our new grain supply agreements, we may purchase corn for delivery up to 12 months in the future, and because of this we have reduced the volume of futures and options contracts. We intend to contract for the future delivery of flour only to protect margins on expected ingredients sales. On the portion of volume not hedged, management will attempt to recover higher commodity costs through higher sales prices, but market considerations may not always permit this. Even where prices can be adjusted, there would likely be a lag between when we experience higher commodity or natural gas costs and when we might be able to increase prices. To the extent we do not enter such derivative contracts or engage in forward purchases and are also unable to timely pass increases in the cost of raw materials to our customers under sales contracts, we may be adversely impacted by market fluctuations in the cost of grain, natural gas and ethanol. Further, our hedging strategy may not be effective in mitigating our exposure to commodity price fluctuations and can result in losses, some of which may be material.

We have moved to single-source supplies for our wheat flour and corn.

We have signed long-term supply agreements with ConAgra and Bunge for our wheat flour and corn supply, respectively. If either of these companies encounters an operational or financial issue, it could lead to an interruption in supply to us and/or higher prices than those we have negotiated or than are available in the market at the time.

We may not succeed in our strategies for acquisitions and dispositions.

From time to time, we may acquire additional assets or businesses. Our goal is to invest in growth opportunities that increase long-term shareholder value by advancing our strategic position and increase our long-term cash flows; however, we cannot assure that we will be able to find and purchase assets or businesses at acceptable prices and terms.

There is no assurance that we will be able to generate sufficient cash flow from acquisitions to service the debt that we may incur to finance such acquisitions and subsequent capital expenditures. Acquisitions may involve operating risks such as:

- the difficulty of assimilating and integrating the acquired operations into ourcurrent business;
- the difficulty of incorporating the acquired employees into our corporate culture and the possible loss of key employees;
- the diversion or dilution of management resources or focus;
- the possibility that effective internal controls are not established and maintained at the acquired company;
- the risks of entering new product markets with which we have limited experience;
- the possibility that the debt and liabilities that we incurred and assumed will prove to be more burdensome that we anticipated; and
- the possibility that the acquired operations do not perform as expected or do not increase our profits.

We also evaluate from time-to-time the potential disposition of assets or businesses that may no longer meet our growth, return and/or strategic objectives. In selling assets or businesses, we may not get a price or terms as favorable as we anticipated. We could also encounter difficulty in finding buyers on acceptable terms in a timely manner, which could delay our accomplishment of strategic objectives. Expected costs savings from reduced overhead related to the sold assets may not materialize, and the overhead reductions could temporarily disrupt our other business operations. Any of these outcomes could hurt our performance.

If ICP incurs losses, it could result in closure of its Pekin plant. ICP's access to capital may be reduced. This could result in reduced sales and impairment losses in the future for us.

ICP's Limited Liability Company Agreement gives us and our joint venture partner, ICP Holdings, a subsidiary of SEACOR Energy Inc., certain rights to shut down the Pekin plant if ICP operates at an EBITDA loss of $500 in any quarter. Such rights are conditional in certain instances but are absolute if losses aggregate $1,500 over any three consecutive quarters or if ICP's net working capital is less than $2,500. For the three consecutive quarters ending both September 30, 2011 and June 30, 2011, ICP experienced an EBITDA loss in excess of the $1,500 aggregate loss threshold amount permitted over any three consecutive quarters; however, both partners have agreed to waive rights related to EBITDA losses through September 30, 2011. Losses of such nature are also events of default under ICP's term loan and revolving credit agreements with its lender, an affiliate of SEACOR Energy Inc., which, upon any requisite notice and/or lapse of time, would entitle the lender to impose a default rate of interest, foreclose on ICP's assets and, in the case of the working capital deficiency or successive losses, enforce the closure provisions referred to above. During fiscal 2011 and the six month transition period ended December 31, 2011, ICP experienced EBITDA losses in the quarters ending December 31, 2010, June 30, 2011 and September 30, 2011. A lender affiliated with SEACOR Energy Inc. has permanently waived rights related to these EBITDA losses through September 30, 2011. However, if future losses of the requisite magnitudes occur in any quarter or over three consecutive quarters, we, ICP Holdings or ICP's lender may elect to exercise its rights under the applicable agreement.

Based on the facts and circumstances that existed at December 31, 2012, including recurring losses experienced, forecasted losses expected for 2013, the expiration of ICP's revolving credit facility resulting in no assured liquidity source and the Company's plan to substantially reduce the sourcing of product from ICP, we decided to assess our investment in ICP for impairment. If new funding is secured, but carries more onerous terms and conditions than the previous agreement, then operating flexibility or profitability may be negatively affected.

The Company now has a minority ownership position in ICP, and that could reduce our ability to influence its operations and profitability.

Since February 1, 2012 when ICP Holdings increased its ownership through the exercise of an option to purchase from us an additional 20% ownership interest, we have a minority ownership interest of 30%, and have only two representatives on the Advisory Board of ICP. The reduced ownership and advisory role mean that our ability to influence operating decisions and affect profitability of the joint venture is more limited. As a consequence, we are more dependent on the management of ICP and the other members of the Advisory Board to operate the joint venture profitably and take our interests into account.

Our high quality marketing agreement with ICP has expired.

Under the Marketing Agreement, ICP manufactured and supplied high quality products for us and we purchased, marketed and sold such products for a marketing fee. Effective January 1, 2013, the Marketing Agreement expired. We do not plan to source products from ICP after March 2013. Our sales in 2013 could be reduced from previous levels, and the value of our investment in ICP could be impaired.

We have incurred impairment and restructuring losses in the past and may suffer such losses in the future.

We review long-lived assets for impairment at year end or if events or circumstances indicate that usage may be limited and carrying values may not be recoverable. Should events indicate the assets cannot be used as planned, the realization from alternative uses or disposal is compared to their carrying value. If an impairment loss is measured, this estimate is recognized. Considerable judgment is used in these measurements, and a change in the assumptions could result in a different determination of impairment loss and/or the amount of any impairment. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies

– Impairment of Long-Lived Assets.

The markets for our products are very competitive, and our results could be adversely affected if we do not compete effectively.

The markets for products in which we participate are very competitive. Our principal competitors in these markets have substantial financial, marketing, and other resources, and several are much larger enterprises than us.

We are dependent on being able to generate net sales and other operating income in excess of cost of products sold in order to obtain margins, profits, and cash flows to meet or exceed its targeted financial performance measures. Competition is based on such factors as product innovation, product characteristics, product quality, pricing, color and name. Pricing of our products is partly dependent upon industry processing capacity, which is impacted by competitor actions to bring on-line idled capacity or to build new production capacity. If market conditions make our specialty ingredients too expensive for use in consumer goods, our revenues could be affected. If our large competitors were to decrease their pricing, we could choose to do the same, which could adversely affect our margins and profitability. If we did not do the same, our revenues could be adversely affected due to the potential loss of sales or market share. Our revenue growth could also be adversely impacted if we are not successful in developing new ingredients products for our customers or through new product introductions by our competitors. In addition, more stringent new customer demands may require us to make internal investments to achieve or sustain competitive advantage and meet customer expectations.

Our unionized workforce could cause interruptions in the Company's provision of services.

As of December 31, 2012, approximately 142 of our 267 employees were members of a union. Although our relations with our two relevant unions are stable and our labor contracts do not expire until August 2014 and December 2017, there is no assurance that we will not experience work disruptions or stoppages in the future, which could have a material adverse effect on our business and results of operations and adversely affect our relationships with our customers.

If we lose certain key personnel, we may not be successful.

We rely on the continued services of key personnel involved in management, finance, product development, sales, manufacturing and distribution, and, in particular, upon the efforts and abilities of our executive management team. The loss of service of any of the members of our executive management team could have a material adverse effect on our business, financial condition and results of operations. We do have key personnel life insurance covering two key executives, but this may not ensure complete avoidance of loss in that circumstance.

Covenants and other provisions in our credit facility could hinder our ability to operate. Our failure to comply with covenants in our credit facility could result in the acceleration of the debt extended under such facility, limit our liquidity and trigger other rights.

Our credit agreement with Wells Fargo Bank, National Association contains a number of financial and other covenants, including provisions that require us in certain circumstances to meet certain financial tests. These covenants may limit or restrict our ability to:

- incur additional indebtedness;
- pay cash dividends or make distributions;
- dispose of assets;
- create liens on our assets;
- pledge the fixed and real property assets of LDI's Distillery Business; or
- merge or consolidate.

These covenants could hinder our ability to operate and could reduce our profitability. Other covenants require excess availability of at least $4,000 at all times prior to the later of (a) November 2, 2013 and (b) the last day of the first twelve month period for which Borrowers have maintained a Fixed Charge Coverage Ratio of at least 1.10:1.00. For all periods in which the excess availability is less than $9,625, we are required to have a Fixed Charge Coverage Ratio, measured on a month end trailing basis, of at least 1.10:1.00 (a) for each month-end until October 31, 2013, the trailing months from November 1, 2012 through such date, and (b) as of each month-end commencing November 30, 2013 using a trailing twelve-month measure. A breach of any of these covenants or requirements could result in a default under our credit agreement. See Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Financial Covenants.

In addition, our credit agreement permits the lender to modify borrowing base and advance rates, the effect of which may limit the amount of loans that we may have outstanding at any given time. The lender may also terminate or accelerate our obligations under the credit agreement upon the occurrence of various events in addition to payment defaults and other breaches, including such matters as a change of control of the Company, defaults under other material contracts with third parties, and ERISA violations. Any modification to reduce our borrowing base or termination of our credit agreement would negatively impact our overall liquidity and may require us to take other actions to preserve any remaining liquidity. Although we anticipate that we will be able to meet the covenants in our credit agreement, there can be no assurance that we will do so, as there are a number of external factors that affect our operations, such as commodity prices, over which we have little or no control. If we default on any of our covenants, and if such default is not cured or waived, Wells Fargo could, among other remedies, terminate its commitment to lend and/or accelerate any outstanding debt and declare that such debt is immediately due and payable. If Wells Fargo were to terminate our credit, or materially change our borrowing base, we may not have sufficient funds available for us to operate. If it were to accelerate our debt, we might be unable to repay such debt immediately and might not be able to borrow sufficient funds to refinance. Even if new financing were available, it may not be on terms that are acceptable to us. Acceleration could result in foreclosure on assets that we have pledged to Wells Fargo. Further, certain of our other secured debt instruments contain cross default provisions, such that an event of default under our credit agreement with Wells Fargo may result in an event of default under these other debt instruments. If our lenders were to terminate our credit or accelerate our debt, or if Wells Fargo were to materially change our borrowing base, we might not have sufficient funds to operate.

As a result of the acquisition of LDI's Distillery Business, and significant capital expenditures, our debt has increased substantially.

Since June 30, 2010, our borrowings under our credit facility increased substantially from $0 to $25,893 at December 31, 2012, primarily due to our acquisition of the LDI Distillery Business, higher costs of inventory (including aging bourbon and whiskey stock) and capital expenditures. Our debt service requirements are greater than in recent history and the amount of debt we have incurred may have important consequences, including the following:

- We would have to use a greater portion of our cash flows from operations to pay principal and interest on our debt, which will reduce the funds that would otherwise be available to us for our operations, capital expenditures, future business opportunities and dividends; and
- We would be adversely affected by any increases in prevailing interest rates.

We may require significant cash flow to make needed capital expenditures, and our ability to make such expenditures could be limited.

Over the course of the next few years we may need to make substantial capital expenditures. See – Item 1. Business - Regulation and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Cash Flow Information – Investing Cash Flows. For example, we expect to make significant capital expenditures related to our recent acquisition of the Indiana Distillery. While our credit facility does not limit the amount of our capital expenditures, we are still limited by the size of the line and must continue to meet our other covenants. We may require additional long-term financing to meet certain of our capital expenditure requirements, but have not determined the amount, type or source of such financing. Our credit facility restricts new debt from other lenders and requires the consent of our lender, Wells Fargo Bank, to incur many kinds of new debt. We cannot provide assurances that we will be able to obtain such consent or arrange such financing on favorable terms, if at all.

We are subject to extensive regulation and taxation, and compliance with existing or future laws and regulations, including those relating to greenhouse gases and climate change, may require us to incur substantial expenditures or require us to make product recalls.

We are subject to a broad range of federal, state, local and foreign laws and regulations relating to protect public health and the environment. Our operations are also subject to regulation by various federal agencies, including TTB, the Occupational Safety and Health Administration, the Food and Drug Administration, and the USEPA, and by various state and local authorities. Such regulations cover virtually every aspect of our operations, including production facilities, marketing, pricing, labeling, packaging, advertising, water usage, waste water discharge, disposal of hazardous wastes and emissions and other matters. Violations of any of these laws and regulations may result in administrative, civil or criminal penalties being levied against us, revocation or modification of permits, performance of environmental investigatory or remedial activities, voluntary or involuntary product recalls, or a cease and desist order against operations that are not in compliance. These laws and regulations may change in the future and we may incur material costs in our efforts to comply with current or future laws and regulations or to effect any product recalls. These matters may have a material adverse effect on our business. See Item 1. Business – Regulation, where we discuss certain environmental proceedings in which governmental agencies sought fines from us and required significant capital expenditures.

Our Atchison facility and our joint venture's facility currently produce fuel grade alcohol as a by-product and emit carbon dioxide into the atmosphere as a by-product of the fermentation process. In 2007, the U.S. Supreme Court classified carbon dioxide as an air pollutant under the Clean Air Act in a case seeking to require the USEPA to regulate carbon dioxide in vehicle emissions. On February 3, 2010, the USEPA released its final regulations on the Renewable Fuel Standard program (RFS2). We believe these final regulations grandfather both facilities at their current operating capacity for fuel grade alcohol, but plant expansion would need to meet a 20% threshold reduction in greenhouse gas emissions from a 2005 baseline measurement to produce fuel grade alcohol eligible for the RFS2 mandate. Additionally, legislation is pending in Congress on a comprehensive carbon dioxide regulatory scheme, such as a carbon tax or cap-and-trade system. We may be required to install carbon dioxide mitigation equipment or take other steps unknown to us at this time in order to comply with other future laws or regulations. Compliance with future laws or regulations relating to emission of carbon dioxide could be costly and may require additional capital, which may not be available, preventing us and our joint venture from operating our plants as originally designed, which may have a material adverse impact on our respective operations, cash flows and financial position.

Also, the distribution of beverage alcohol products is subject to extensive taxation in the United States and internationally (and, in the United States, at both at the federal and state government levels), and beverage alcohol products themselves are the subject of national import and excise duties in most countries around the world. This taxation has a minor effect on us; however, it has larger effects on our beverage alcohol customers, and accordingly, an increase in taxation or in import or excise duties could significantly harm our sales revenues and margins, both through the reduction of overall consumption and by encouraging consumers to switch to lower-taxed categories of beverage alcohol.

We face risk related to changes in the global economic environment.

Our business may be impacted by the weak U.S. and global economic conditions, which are increasingly volatile. General business and economic conditions that could affect us include short-term and long-term interest rates, unemployment, inflation, fluctuations in debt markets and the strength of the U.S. economy and the local economies in which we operate. While currently these conditions have not impaired our ability to access credit markets and finance our operations and acquisitions, there can be no assurance that there will not be a further deterioration in the financial markets.

There could be a number of other effects from these economic developments on our business, including reduced consumer demand for products; insolvency of our customers, resulting in increased provisions for credit losses; decreased customer demand, including order delays or cancellations and counterparty failures negatively impacting our operations.

A failure of our information systems could impact our ability to operate.

Although the Company has an offsite back-up system and disaster recovery plans, any failure of our information systems could adversely impact the Company's ability to operate. Routine maintenance or development of new information systems may result in systems failures, which may adversely affect business operations. Information systems could be penetrated by outside parties to extract information, corrupt information or disrupt business processes. This can lead to outside parties having access to privileged data or strategic information of the Company, its employees or customers. Any breach of our data security systems or failure of our information systems may have a material adverse impact on our business operations and financial results.

Unsuccessful research and product launches could affect our profitability.

Research activities and products launch activities are inherently uncertain. The failure to launch a new product successfully can give rise to inventory write-offs and other costs and can affect consumer perception of an existing brand. Any significant changes in consumer preferences and failure to anticipate and react to such changes could result in reduced demand for our products. Unsuccessful research and product launches could affect our profitability.

RISKS SPECIFIC TO OUR DISTILLERY PRODUCTS SEGMENT

Volatile grain prices affect our profitability.

A portion of our operating income is dependent on the spreads between alcohol and corn prices. We intend to protect the margins on our alcohol contracts, but may not always be able to do so. If we are not successful in protecting our margins through hedging activities, volatility in corn prices could affect our profitability. These fluctuating prices create challenges since our customers are interested in stable prices for the distillery products they purchase from us.

The relationship between the price we pay for corn and the sales prices of our distillery co-products can fluctuate significantly and affect our results of operations.

Dried grain, or distillers feed, and fuel grade alcohol are the principal co-products of our alcohol production process and can contribute in varying degrees to the profitability of our distillery products segment. We sell fuel grade alcohol, the prices for which typically, but not always, have tracked price fluctuations in gasoline prices. Distillers feed is sold for prices which historically have tracked the price of corn. In regard to distillers feed, we believe that, in part, this resulted from decreased demand in the E.U. due to the E.U.'s non-approval of several varieties of genetically modified corn commonly grown in the U.S. Further, certain of our co-products compete with similar products made from other plant feedstocks whose cost may not have risen in unison with corn prices. As a result, the profitability of these products to us could be affected.

A forecasting error in determining quantity of maturing stock could affect our profitability.

There is an inherent risk of a forecasting error in determining the quantity of maturing stock to lay down in a given year for future consumption. This could lead to an inability to supply future demand or lead to a future surplus of inventory and consequent write down in value of maturing stocks. As a result, profitability of the distillery products segment can be affected.

Water scarcity or poor quality could negatively impact our production costs and capacity.

Water is the main ingredient in substantially all of our distillery products. It is also a limited resource, facing unprecedented challenges from climate change, increasing pollution, and poor management. As demand for water continues, becomes more scarce and the quality of available water deteriorates, we may be affected by increasing production costs or capacity constraints, which could adversely affect our results of operations and profitability.

Although we have reduced our production and sales of fuel grade alcohol and have entered into ethanol derivative contracts to mitigate market risk, we continue to have some exposure to fuel grade alcohol market price fluctuations.

Because of the continued erosion of the fuel alcohol markets, in the fiscal year 2009 we determined to substantially reduce our production of fuel alcohol and temporarily ceased production at our former Pekin facility. Subsequently, after exploring our strategic options with respect to this facility, we contributed the facility to ICP and sold a 50 percent interest in ICP to ICP Holdings. On February 1, 2012, ICP Holdings exercised its option to purchase an additional 20 percent of ICP, reducing our share of future ICP earnings to 30 percent. We purchase food grade alcohol products from ICP and market and sell such products, and SEACOR Energy Inc. has a similar arrangement with respect to the fuel grade alcohol produced by ICP. Although we have reduced our exposure to the volatility of the fuel grade alcohol business through this arrangement, because we share in the profits and losses of ICP and continue to produce some fuel alcohol as a by-product at our Atchison plant, we retain some exposure to such volatility.

We are subject to litigation directed at the beverage alcohol industry and other litigation.

Companies in the beverage alcohol industry are, from time to time, exposed to class action or other litigation relating to alcohol advertising, product liability, alcohol abuse problems or health consequences from the misuse of alcohol. Such litigation may result in damages, penalties or fines as well as reputational damage, which could adversely affect us.

Adverse public opinion about alcohol could reduce demand for our products.

In recent years, there has been increased social and political attention directed at the beverage alcohol industry. The recent attention has focused largely on public health concerns related to alcohol abuse, including drunk driving, underage drinking, and the negative health impacts of the abuse and misuse of beverage alcohol.

Anti-alcohol groups have, in the past, advocated successfully for more stringent labeling requirements, higher taxes and other regulations designed to discourage alcohol consumption. More restrictive regulations, negative publicity regarding alcohol consumption and/or changes in consumer perceptions of the relative healthfulness or safety of beverage alcohol could decrease sales and consumption of alcohol and thus the demand for our products. This could, in turn, significantly decrease both our revenues and our revenue growth, causing a decline in our results of operations.

RISKS SPECIFIC TO OUR INGREDIENT SOLUTIONS SEGMENT

Our focus on higher margin specialty ingredients may make us more reliant on fewer, more profitable customer relationships.

Our business strategy for our ingredient solutions segment includes focusing our efforts on the sale of specialty proteins and starches to targeted domestic consumer packaged goods customers. Our major focus is directed at food ingredients, which are primarily used in foods that are developed to address consumers' desire for healthier and more convenient products; these consist of dietary fiber, wheat protein isolates and concentrates, and textured wheat proteins The bulk of our applications technology and research and development efforts are dedicated to providing customers with specialty ingredient solutions that deliver nutritional benefits, as well as desired functional and sensory qualities to their products. Our business could be adversely affected if our customers were to determine to reduce their new product development ("NPD") activities or cease using our unique dietary fibers, starches and proteins in their NPD efforts. In addition, our sales growth opportunities could be at risk in these areas if consumers abandon or significantly limit their interest in healthier foods, limit their interest in convenience foods, and/or adopt a widespread aversion to foods containing wheat gluten.

OTHER RISKS

Common stockholders have limited rights under our Articles of Incorporation.

Under our Articles of Incorporation, holders of our Preferred Stock are entitled to elect five of our nine directors and only holders of our Preferred Stock are entitled to vote with respect to a merger, dissolution, lease, exchange or sale of substantially all of the Company's assets, or on an amendment to the Articles of Incorporation, unless such action would increase or decrease the authorized shares or par value of the Common or Preferred Stock, or change the powers, preferences or special rights of the Common or Preferred Stock so as to affect the holders of Common Stock adversely. Generally, the Common Stock and Preferred Stock vote as separate classes on all other matters requiring stockholder approval. A majority of the outstanding shares of our Preferred Stock is held by the MGP Ingredients Voting Trust, whose trustees are Karen Seaberg, Richard B. Cray and Laidacker M. Seaberg.

The trading volume in our common stock fluctuates, and depending on market conditions, the sale of a substantial number of shares in the public market could depress the price of our stock and make it difficult for stockholders to sell their shares.

Our common stock is listed on the NASDAQ Stock Market. Our public float at December 31, 2012 (including non-vested restricted stock awards held by non-affiliates) was approximately 11,850,879 shares, as approximately 6,083,354 shares are held by affiliates. Over the year ended December 31, 2012, our daily trading volume as reported to us by NASDAQ has fluctuated from788 to 718,072 shares (excluding block trades). When trading volumes are relatively light, significant price changes can occur even when a relatively small number of shares are being traded and an investor's ability to quickly sell quantities of stock may be affected.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We own or lease the following principal plants, warehouses and office facilities:

Location	Purpose	Owned or Leased	Plant Area (in sq. ft.)	Tract Area (in acres)
Atchison, Kansas	Grain processing, distillery, warehousing, and research and quality control laboratories (Distillery Products and Ingredient Solutions)	Owned	494,640	26
	Principal executive office building (Corporate)	Leased	18,000	1
	Technical Innovation Center (Ingredient Solutions, Distillery Products and Other)	Leased	19,600	1
Lawrenceburg and Greendale, Indiana	Distillery, warehousing, tank farm and quality control facilities	Owned	1,458,143	43
Onaga, Kansas (1)	Production of plant-based polymers and wood composites (Other)	Owned	23,040	3
Lenexa, Kansas	Administrative Office Space	Leased	3,222	1

(1) Subsequent to December 31, 2012, the production facility for plant-based polymers and wood composites was sold as further described in Note 20. Subsequent Events.

Our 30% owned joint venture subsidiary, ICP, owns the following facility:

Pekin, Illinois	Distillery, warehousing and quality control laboratories (Distillery Products)	Owned	462,926	49

The foregoing facilities are generally in good operating condition, and are generally suitable for the business activity conducted therein. We operated our Atchison distillery operations at full capacity during much of 2012. We have existing manufacturing capacity to grow our ingredients business at our Atchison plant if the market for our ingredients business improves.   Our Indiana Distillery was operating below its rated capacity when it was acquired. We grew this business during 2012 and operated near full capacity as we closed out the year ended December 31, 2012. The Pekin distillery operation, which is owned by ICP, was operating below full capacity during the year 2012 due to general market conditions.

Except for our process water cooling system project, which is leased under a capital lease, all of the other production facilities that we or ICP utilize are owned, and all of our owned properties are subject to mortgages in favor of one or more of our lenders. ICP's facility is subject to a mortgage in favor of its lender. The executive offices and technical innovation center in Atchison are leased from the City of Atchison pursuant to an industrial revenue bond financing.

Our leasehold interest in these properties is subject to a leasehold mortgage. We also own or lease transportation equipment and facilities and a gas pipeline described under Item 1. Business – Transportation and Item 1. Business – Energy. Our loan agreements contain covenants that limit our ability to pledge our facilities to others.

ITEM 3. LEGAL PROCEEDINGS

There are various legal proceedings involving the Company and its subsidiaries. Except for the following matter, management considers that the aggregate liabilities, if any, arising from such actions would not have a material adverse effect on the consolidated financial position or overall trends in results of operations of the Company.

In 2006, we entered a Consent Agreement with the Kansas Department of Health and Environment (KDHE) which, among other matters, imposed a source-wide, rolling 12-month volatile organic compounds (VOC) emissions cap on our Atchison facility. Pursuant to a second amendment that we entered in 2010, we agreed to complete a closed-loop, process water cooling system project, resulting in significant VOC reduction, in accordance with a scheduled timeline extending over an approximate 17-month period ending on September 30, 2011. We completed this in July 2011 at a cost of approximately $10,000. We also agreed to a $5 per month penalty for any month that we might exceed the rolling 12-month cap and a $1 per day penalty for each day that we fail to submit certain monthly reports. During the year ended December 31, 2012, we were not subjected to any penalties related to the above criteria.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

TRADING MARKET

Our Common Stock is traded on the NASDAQ Global Select Market. Our trading symbol is MGPI.

In connection with the Reorganization, our Common Stock was deemed to commence trading on the NASDAQ Global Select Market under the symbol "MGPI" on January 4, 2012. As a result of the Reorganization, common shares of MGPI Processing, Inc. (formerly MGP Ingredients, Inc.), which previously traded on the NASDAQ Global Select Market under the symbol "MGPI", were deemed to no longer be publicly traded. The Reorganization did not require shareholders to exchange their stock certificates.

HISTORICAL STOCK PRICES AND DIVIDENDS

The table below reflects the high and low closing prices of our Common Stock and dividends per share for each quarter of the year ended December 31, 2012, the six month transition period ended December 31, 2011 and the year ended June 30, 2011:

	Sales Price		Dividend
	High	Low	Per Share
For the Year Ended December 31, 2012			
For the Quarter Ended March 31, 2012	$6.37	$5.28	$0.05
For the Quarter Ended June 30, 2012	4.90	3.43	-
For the Quarter Ended September 30, 2012	3.68	3.30	-
For the Quarter Ended December 31, 2012	3.71	3.40	-
			$0.05
For the Transition Period from July 1, 2011 to December 31, 2011			
For the Quarter Ended September 30, 2011	$8.75	$5.07	$0.05
For the Quarter Ended December 31, 2011	6.82	4.27	-
			$0.05
For the Year Ended June 30, 2011			
For the Quarter Ended September 30, 2010	$8.15	$6.46	$0.05
For the Quarter Ended December 31, 2010	11.90	8.14	-
For the Quarter Ended March 31, 2011	11.06	7.90	-
For the Quarter Ended June 30, 2011	9.00	7.75	-
			$0.05

Our Credit Agreement with Wells Fargo Bank, limits the amount of cash dividends that we may pay if we don't maintain excess availability of $9,625 and a fixed charge coverage ratio for the most recently completed twelve months of at least 1.20:1.00.

On February 28, 2013, the Board of Directors declared a five (5) cent dividend per share of common stock. The dividend will be paid on April 10, 2013 to holders of record on March 18, 2013.

We expect to continue our policy of paying periodic cash dividends, although there is no assurance as to future dividends because they are dependent on future earnings, capital requirements, and debt service obligations.

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RECORD HOLDERS

At March 1, 2013, there were approximately 677 holders of record of our Common Stock. We believe that the Common Stock is held by approximately 4,110 beneficial owners.

TRADING VOLUMES

According to reports received from NASDAQ, the average daily trading volume of our Common Stock (excluding block trades) ranged from 788 to 718,072 shares during the year ended December 31, 2012.

PURCHASES OF EQUITY SECURITIES BY ISSUER

We did not sell or purchase our equity securities during the quarter ended December 31, 2012.

ITEM 6. SELECTED FINANCIAL DATA

As a smaller reporting company, we are not required to provide Item 6 disclosure in this Form 10-K.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Dollars in thousands except per-share amounts)

GENERAL

We produce certain distillery products and ingredients and as of December 31, 2012, we had three reportable segments: a distillery products segment, an ingredient solutions segment, and an other segment. As previously discussed, substantially all assets used in the other segment were sold effective February 8, 2013. Substantially all of our sales are made directly or through distributors to manufacturers and processors of finished goods. Sales to our customers purchasing food grade alcohol are made primarily on a spot, monthly or quarterly basis, with some annual contracts, depending on the customer's needs and market conditions. Customers who purchase whiskey or bourbon may also enter into separate warehouse service agreements with us, allowing the product to age. As part of our acquisition of LDI's Distillery Business, we assumed certain multi-year contracts to supply distilled products as well as certain contracts to provide barreling warehousing services, which typically are multi-year contracts. Sales of fuel grade alcohol are made on the spot market. Contracts with distributors may be for multi-year terms with periodic review of pricing. Contracts with ingredients customers are generally price and term agreements which are fixed for three or six month periods, with very few agreements of twelve months duration or more.

Since fiscal 2009, when we incurred significant impairment and restructuring costs, our business focus has been on the production of value-added ingredients and distillery products. As a part of our strategy, given the available capacity at our Indiana Distillery, we produce certain volumes of bourbon and whiskey that is in addition to current customer demand. This product is barreled and included in our inventory. Our goal is to maintain inventory levels for whiskey and bourbon sufficient to satisfy anticipated future purchase orders in the wholesale market. Production schedules are adjusted from time to time to bring inventories into balance with established future demand. The majority of our former Pekin plant's capacity for several years had been dedicated to the production of fuel grade alcohol, of which the market economics has been volatile in recent years. The Pekin plant is now owned and operated by a joint venture, ICP, which produces food grade alcohol, which we have historically purchased, and fuel grade alcohol, which SEACOR Energy Inc. purchases. We retain some exposure to the volatility to fuel grade alcohol through our remaining interest in ICP as well as from the fuel that we make as a co-product at our Atchison facility. Through our investment in ICP, we have an opportunity to participate when the economics of that market are good, and we believe that the extent of our exposure to bad markets is significantly less than when we operated Pekin ourselves. Further, we have the ability, through the termination provisions in the ICP Limited Liability Company Agreement, to limit our operating losses by causing ICP to shut down the plant if losses reach specified amounts. ICP’s revolving credit facility has expired and has not been renewed. If ICP should be unable to secure financing from its lender or another source, this creates a risk to ICP’s future working capital needs.

Our principal raw materials are corn and flour. Corn is processed into alcohol and animal feed and flour is processed into all of our products, except whiskey and bourbon. The cost of raw materials is subject to substantial fluctuations depending upon a number of factors which affect commodity prices in general, including crop conditions, weather, disease, plantings, government programs and policies, competition for acquisition of inputs such as agricultural commodities, purchases by foreign governments and changes in demand resulting from population growth and customer preferences. While corn prices have fluctuated significantly over the past several years and the overall trend in recent prices has been up, there has been a lot of variability in corn pricing during this period. We expect corn pricing to remain volatile in the near term due to a number of factors impacting global demand and supply of this commodity. These fluctuating prices create challenges since our customers are interested in stable prices for the distillery products they purchase from us.

We have a supply agreement with ConAgra Mills, who supplies wheat flour for use in the production of protein and starch ingredients. The price we pay ConAgra for flour is a function of the per-bushel cost of wheat and, accordingly, wheat prices continue to directly impact the cost of raw materials. We believe our focus on value-added products can reduce our risk to such price variations as larger profit margins related to such products can absorb higher levels of raw material volatility and as we may more readily seek adjustable price terms in contracts for such products. However, we will continue to be affected by commodity price fluctuations to some degree, which may be significant at times, and may not be able to recoup cost increases in our selling prices, particularly when price fluctuations are volatile.

Historically, we have engaged in the forward purchase of grain and in the purchase of commodity futures and options to hedge economic risks associated with fluctuating grain and grain products prices. These contracts help fix corn prices over short periods of time, generally three to six months, which is consistent with most of the sales orders we typically enter into with our distillery customers. During fiscal 2011, we changed our risk management program related to the volatility of raw material costs, and began purchasing a larger amount of contracts for future delivery, which we typically held until maturity, in order to protect margins on contracted, and a portion of spot market, alcohol sales and expected ingredients sales. During the six month transition period ended December 31, 2011, we began to buy and sell derivative instruments to manage market risk associated with alcohol purchases, including ethanol futures and options contracts, in order to mitigate risks associated with our investment in ICP. During the quarter ended March 31, 2012, we entered into a grain supply contract for our Indiana Distillery that permits us to purchase corn for delivery up to 12 months in the future, at negotiated prices. During the quarter ended June 30, 2012, we extended this grain supply agreement used for its Indiana Distillery to its Atchison facility. The pricing is based on a formula with several factors. We now order corn anywhere from a month to 12 months in the future. As we are now able to purchase corn for delivery up to 12 months in the future under these grain supply agreements, we have reduced the volume of our corn futures and options contracts.

From April 1, 2008 until June 30, 2011, we did not use hedge accounting for our open commodity derivative positions. This was primarily due to the increased record keeping and documentation requirements needed to meet these accounting standards. This accounting policy led to significant volatility in earnings as a result of unrealized losses (or gains) on our open contracts. Effective July 1, 2011 we elected to restart the use of hedge accounting for qualifying derivative contracts entered into on and after July 1, 2011and we continued to use hedge accounting until February 29, 2012. During this period of hedge accounting, we typically entered into cash flow hedges to cover between 70 and 80 percent of our monthly anticipated grind. To the extent we did not enter such cash flow hedges and were unable to timely adjust the prices we charged under sales contracts, we could be adversely impacted by market fluctuations in the cost of grain and natural gas. During the quarter ended September 30, 2011, we began to buy and sell derivative instruments to manage market risks associated with ethanol purchases, including ethanol futures and options contracts. These contracts were entered into to mitigate risks associated with our investment in ICP. On February 29, 2012, we de-designated our cash flow hedges. See Note 14. Derivative Instruments and Fair Value Measurements and “Critical Accounting Policies and Estimates”.

Energy represents a major cost of operations, and seasonal increases in natural gas and other utility costs can affect our profitability. Energy costs have typically increased year to year. We sometimes try to protect ourselves from increased energy costs by entering into natural gas contracts for future delivery.

Historically, we recorded the collection of excise taxes on distilled products sold to customers as accrued expenses and no revenue or expense was recognized in the Consolidated Statements of Operations. With the Company's acquisition of the distillery operations of LDI on December 27, 2011, the Company is now subject to more excise taxes. In the quarter ended March 31, 2012, because excise taxes exceeded 1 percent of net sales, the Company began to present excise taxes as a caption on the Consolidated Statements of Operations, which is a reduction to gross sales. The prior years and quarters within those years have been conformed to the current presentation. This reclassification had no impact on net loss or reported loss per share.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing consolidated financial statements, management must make estimates and judgments that affect the carrying values of our assets and liabilities as well as recognition of revenue and expenses. Management's estimates and judgments are based on our historical experience and management's knowledge and understanding of current facts and circumstances. The policies discussed below are considered by management to be critical to an understanding of our consolidated financial statements. The application of certain of these policies places significant demands on management's judgment, with financial reporting results relying on estimations about the effects of matters that are inherently uncertain. For all of these policies, management cautions that future events rarely develop as forecast, and estimates routinely require adjustment and may require material adjustment.

Derivative and Hedging Activities. From April 1, 2008 until June 30, 2011 and from February 29, 2012 to December 31, 2012, we did not use hedge accounting for our open commodity derivative positions. Accordingly, during these periods changes in the value of derivatives have been recorded in cost of sales in our Consolidated Statements of Operations. Additionally, derivative instruments entered into during these periods have not been designated as hedges. Derivative instruments related to our hedging program have been recorded as either assets or liabilities and measured at fair value. The change in the fair value of these instruments has been recorded in cost of sales in our Consolidated Statements of Operations.

From July 1, 2011, until February 28, 2012, we used hedge accounting for qualifying derivative contracts entered into on or after July 1, 2011. On February 29, 2012, we discontinued hedge accounting and de-designated our cash flow hedges, which resulted in a reclassification of a $27 loss from accumulated other comprehensive income ("AOCI") into current period earnings. The application of hedge accounting requires significant resources, record-keeping and analytical systems. Under hedge accounting, the changes in fair value of such contracts historically were highly effective at offsetting changes in price movements of the hedged items. Consistent with application of hedge accounting under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 815, Derivatives and Hedging, gains and losses arising from open and closed hedging transactions were recorded as part of other comprehensive income (loss) and are recognized in costs of sales as part of product costs when the related products are sold. Any ineffective portion of a hedged transaction was immediately recognized in current earnings.

We may discontinue cash-flow hedge accounting for a particular derivative instrument prospectively when we (i) determine that the derivative is no longer considered to be highly effective in offsetting changes in the expected cash flows of the hedged item; (ii) the derivative is sold, terminated or exercised; (iii) we de-designate the derivative as a hedging instrument because it is unlikely that a forecasted transaction will occur; or (iv) it determines that designation of the derivative as a hedging instrument is no longer appropriate. When cash flow hedge accounting is discontinued, we continue to carry the derivative on the Consolidated Balance Sheet at its fair value, and gains and losses that were included in AOCI are deferred until the original hedged item affects earnings. However, if the original hedged transaction is no longer probable of occurring, the related gains and losses incurred as of discontinuation are recognized in current period earnings.

Regardless of accounting treatment, we believe all of our commodity hedges are economic hedges.

Business Combination.   We account for acquired businesses using the acquisition method of accounting, which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. The difference between the total cost of the acquisition and the sum of the fair values of the acquired tangible and identifiable intangible assets less liabilities is recorded as either goodwill or bargain purchase gain, depending on whether total cost exceeds, or is less than, such net fair values. A bargain purchase gain must be recognized in earnings as of the acquisition date. Any adjustments to the fair values assigned to the assets acquired and the liabilities assumed during the measurement period, which may be up to one year from the acquisition date, has a corresponding increase or decrease to bargain purchase gain or goodwill. Transaction costs are expensed as incurred.

We completed a significant business acquisition during the six month transition period ended December 31, 2011 with our acquisition of LDI's Distillery Business. In connection with this acquisition, we recognized a bargain purchase gain of $13,048 (net of taxes of $8,336) based on the difference between the purchase price ($11,041) and fair values of the assets acquired. We acquired these assets from a distressed seller.

Some of the more significant estimates and assumptions used by management in valuing our acquisition of LDI's Distillery Business and allocating purchase price include: (a) the business enterprise value, which is based on estimated future cash flows (including timing) which are estimated using the income approach and discount rates reflecting the risk inherent in the future cash flows, and (b) the values of land, buildings and equipment, which are estimated using the cost and market approaches. The determination of fair value is based on internal assumptions as well as assistance from third party valuation specialists. The estimated fair values recorded were based on unobservable inputs, which are material and represent Level 3 measures in the fair value hierarchy discussed in Note 14. Derivative Instruments and Fair Value Measurements. There are also judgments made to determine the expected useful life assigned to each class of assets acquired and the duration of liabilities assumed. The judgments made in this determination of the estimated fair value assigned to the assets acquired and liabilities assumed, as well as the estimated useful life of each asset and the duration of each liability, can materially impact the financial statements in periods after acquisition, such as through depreciation and amortization expense.

We believe the resulting bargain purchase gain of $13,048 (net of taxes of $8,336) is reasonable based on the following circumstances: (a) the seller was financially distressed, (b) LDI's Distillery Business was not widely marketed for sales – an investment bank was hired, however efforts were initially unsuccessful, (c) the machinery and equipment are highly specialized for the industry, resulting in limited alternative uses for the property, and (d) independent property appraisals and business valuations indicated that its fair value was in excess of the purchase price. See Note 18. Business Combination.

Impairment of Assets.

Impairment of Investments

We review our investments in non-consolidated subsidiaries for impairment whenever events or changes in business circumstances indicate that the carrying amount of the investments may not be fully recoverable. Evidence of a loss in value that is other than temporary include, but are not limited to, the absence of an ability to recover the carrying amount of the investment, the inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment, or, where applicable, estimated sales proceeds which are insufficient to recover the carrying amount of the investment. If the fair value of the investment is determined to be less than the carrying value and the decline in value is considered to be other than temporary, an appropriate write-down is recorded based on the excess of the carrying value over the best estimate of fair value of the investment. Considerable judgment is used in these measurements, and a change in the assumptions could result in a different determination of impairment loss and/or the amount of any impairment.

The Company's evaluation of ICP includes a specific assessment of the fair value of ICP's net assets, after considering ICP capitalization, sales proceeds of other similar plants and expected net sales proceeds that management would expect to be realized if ICP were sold to a third party. Given this specific situation, the Company's management has concluded the fair value of the Company's 30% interest in ICP is greater than the $6,898 carrying value of the ICP investment at December 31, 2012.

No events or conditions occurred during the year ended December 31, 2012, during the six month transition period ended December 31, 2011 or the year ended June 30, 2011 that required us to record an impairment. Given significant contingencies related to ICP (see Note 3. Equity Method Investments), we anticipate that impairment testing will be required at each quarterly reporting period for the foreseeable future given the volatility of the business in which ICP operates and the since fair values can change over time. If there was an other than temporary decline in the fair value of the ICP investment below ICP's carrying value management would record an impairment charge to write down the invested value at that time.

Impairment of Long-Lived Assets

We review long-lived assets, mainly buildings and equipment assets, for impairment when events or circumstances indicate that usage may be limited and carrying values may not be fully recoverable.

In making such assessments, management must make estimates and judgments relating to anticipated revenues and expenses and values of our assets and liabilities. Management's estimates and judgments are based on our historical experience and management's knowledge and understanding of current facts and circumstances. Management derives data for its estimates from both outside appraisals and internal sources, and considers such matters as product mix, unit sales, unit prices, input costs, expected target volume levels in supply contracts and expectations about new customers as well as overall market trends. Should events indicate the assets cannot be used as planned, the realization from alternative uses or disposal is compared to the carrying value. Considerable judgment is used in these measurements, and a change in the assumptions could result in a different determination of impairment loss and/or the amount of any impairment.

No events or conditions occurred during the year ended December 31, 2012 or the year ended June 30, 2011 that required us to record an impairment.

We recognized non-cash impairment losses of $706 and $595 during the six month transition period ended December 31, 2011. In measuring the $706 impairment loss, management estimated the undiscounted future cash flows generated by the equipment that manufacture Wheatex® and determined that the estimated cash flows were less than their carrying values. Given the short duration of future cash flow stream, the undiscounted future cash flows were determined to be fair value. In conjunction with the impairment described above, management performed an impairment review of certain other equipment used to produce Wheatex®. In this review, management reviewed the timing of the anticipated business development and recent decisions to not renew leases where Wheatex® is currently produced. The carrying values of the equipment were reduced to fair value, which resulted in a charge of $595. Because of the uncertainty in estimated cash flow estimates, management estimated fair value using a third party appraisal. During the year ended December 31, 2012, we were able to identify a buyer for certain equipment previously used to produce Wheatex® that we had previously impaired. We sold this equipment, resulting in a gain on sale of $889 during the year ended December 31, 2012.

Defined Benefit Retirement Plans. We sponsor two funded, noncontributory qualified Defined Benefit Retirement Plans that cover substantially all our union employees at Atchison and former union employees at Pekin, who did not begin work at ICP, and thus remain our obligation. The benefits under these plans are based upon years of qualified credited service. However, benefit accruals under both plans were frozen in the second quarter of 2010. Our funding policy is to contribute annually not less than the regulatory minimum and not more than the regulatory maximum amount deductible for income tax purposes. Historically, the measurement and valuation date of the plans was June 30 of each year; however in conjunction with our change in fiscal year end, the measurement date was changed to December 31, beginning December 31, 2011. We make various assumptions in valuing the liabilities and benefits under the plan each year. We consider the rates of return on long-term, high-quality fixed income investments using the Citigroup Pension Liability Index as of December 31, 2012. Assumptions regarding employee and retiree life expectancy are based upon the RP 2000 Combined Mortality Table.

Other Post-Retirement Benefits. We also provide certain other post retirement health care and life insurance benefits to certain retired employees. Currently, the plan covers 277 participants, both active and retired. The number of participants was reduced during fiscal 2010, in part due to the transfer of employees to our joint venture, ICP, as described elsewhere. These actions caused a partial settlement and curtailment of our obligation for accrued retirement benefits. The number of participants was further reduced during the year ended December 31, 2012, when we made a change to the plan to terminate health care and life insurance benefits at retirement age for non-union employees who were not at least 60 years old on September 1, 2012, which was treated as a negative plan amendment and a curtailment.

We fund the post retirement benefit plans on a pay-as-you-go basis, and there are no assets that have been segregated and restricted to provide for post retirement benefits. We pay claims as they are submitted for the medical plan. We provide varied levels of benefits to participants depending upon the date of retirement and the location in which the employee worked. The retiree medical and life plans are available to union employees who have attained the age of 62 and rendered the required five years of service. All health benefit plans provide company-paid continuation of the active medical plan until the retiree reaches age 65. At age 65, we pay a lump sum advance premium on behalf of the retiree to the MediGap carrier of the retiree's choice. The employee retirement date determines which level of benefits is provided.

Consistent with the discussion above, our plan measurement date is now December 31. We make various assumptions in valuing the liabilities and benefits under the plan each year. We consider the rates of return on currently available, high-quality fixed income investments, using the Citigroup Pension Liability Index as of December 31 (long term rates of return are not considered because the plan has no assets). For the year ended December 31, 2012, the accumulated post retirement benefit obligation ("APBO") decreased to \$5,700 from \$6,309 at December 31, 2011. A portion of the other post-retirement benefits obligation reduction was due to the previously mentioned negative plan amendment and curtailment during the year ended December 31, 2012. The effect of this plan change was a negative plan amendment of \$1,165 and a \$79 curtailment. The negative plan amendment includes \$1,021 for health care benefits and \$144 for life insurance benefits. These amounts will be recognized into income over the average remaining years of service to retirement and the average expected lifetime remaining for health care benefits and life insurance benefits, respectively. The accounting impact for the curtailment resulted in immediate recognition of a benefit related to unamortized prior service cost of \$79. Assumptions regarding employee and retiree life expectancy are based upon the RP 2000 Combined Mortality Table. We also consider the effects of expected long term trends in health care costs, which are based upon actual claims experience and other environmental and market factors impacting the cost of health care in the short and long-term.

Income Taxes. We account for deferred income tax assets and liabilities resulting from the effects of transactions reported in different periods for financial reporting and income tax under the liability method of accounting for income taxes. This method gives consideration to the future tax consequences of the deferred income tax items and immediately recognizes changes in income tax laws upon enactment as well as applied income tax rates when facts and circumstances warrant such changes. We establish a valuation allowance to reduce deferred tax assets when it is more likely than not that a deferred tax asset may not be realized. Additionally, we follow the provisions of FASB ASC 740, Income Taxes, related to the accounting for uncertainty in income tax positions, which requires management judgment and use of estimates in determining whether the impact of a tax position is "more likely than not" of being sustained on audit by the relevant taxing authority. We consider many factors when evaluating and estimating our tax positions, which may require periodic adjustment and which may not accurately anticipate actual outcomes.

2012 AND RECENT INITIATIVES

Acquisition of the Indiana Distillery

On December 27, 2011, we acquired substantially all the assets used by LDI in its beverage alcohol business, and we now produce premium bourbon, corn and rye whiskeys, gin, grain neutral spirits and distillers feed at our Indiana Distillery. The purchase price of the acquisition was equal to the current assets minus current liabilities as of December 27, 2011, which was estimated at closing to be \$11,041. During April 2012, management and the seller completed working capital true-ups. The result of the true-ups was not material to our financial position or operating results.

During the quarter ended March 31, 2012, MGPI-I and the union that covers certain employees at the Indiana Distillery ratified a new multi-year collective bargaining unit agreement that terminates December 31, 2017.

In conjunction with the acquisition of the distillery operations of LDI, we acquired a grain elevator that was not expected to be used, which was reported as Assets held for sale at December 31, 2011. On March 21, 2012, we sold this facility and its related assets for $2,252, resulting in a loss of $48. Net proceeds received, after fees and prorated taxes, totaled $2,232.

Since acquiring the distillery operations of LDI, we have taken several steps to improve its profitability. On July 1, 2012 we went live on SAP, an information technology system used for accounting, sales, supply chain and manufacturing at this facility.

Agreement to Develop New Technologies and Products

On January 5, 2012 we commenced a relationship with the Kansas Alliance for Biorefining and Bioenergy ("KABB") and four Kansas universities to develop new technologies and products that use bio-based raw materials. The three-year research and development efforts will seek to find innovative ways to produce cost-competitive bio-based foams, plastics, fuels and other materials from distillers dried grains and solubles. In conjunction with the sale of our Other segment on February 8, 2013, we entered into a service agreement with the purchaser that allows us to use the purchaser's labor and equipment so that we may continue to fulfill the obligations under this contract.

Ownership change of ICP

On February 1, 2012, ICP Holdings, an affiliate of SEACOR Energy Inc., exercised its option to purchase from us an additional 20 percent of the membership interest in ICP, reducing our ownership from 50% to 30%. The proceeds for this sale approximated $9,103. Following its exercise, ICP Holdings owns 70 percent of ICP, is entitled to name 4 of ICP's 6 advisory board members, and generally has control of ICP's day-to-day operations. We own are entitled to name 2 of ICP's 6 advisory board members. The transaction resulted in a pre-tax gain of $4,055 during the quarter ended March 31, 2012.

ICP's revolving credit facility with an affiliate of SEACOR Energy Inc. has expired and has not been renewed.

Under the Marketing Agreement, ICP manufactured and supplied food grade and industrial-use alcohol products for us and we purchased, marketed and sold such products for a marketing fee. Effective January 1, 2013, the Marketing Agreement expired. We do not plan to source products from ICP after March 2013.

Grain Supply Agreements

During the quarter ended March 31, 2012, we entered a grain supply contract for the Indiana Distillery and during the quarter ended June 30, 2012 we extended this agreement for use at our Atchison facility. The grain supply contracts permit us to purchase corn for delivery up to 12 months in the future, at negotiated prices. The pricing for these contracts is based on a formula using several factors. If we don't purchase a minimum amount of grain, the supplier may terminate the contract.

Supply for commodities has been tight during much of the year ended December 31, 2012 due, in part, to the drought in the Midwestern United States. Market prices for commodities, including corn, have been near historic highs in summer of 2012, reaching a high in August 2012. This impacts the pricing we pay under our grain supply agreements.

Sale of Other Segment

On February 8, 2013, we sold substantially all of the assets of our other segment or bioplastics manufacturing business, including all of our assets at our bioplastics manufacturing facility in Onaga, Kansas and certain assets of our extruder bio-resin laboratory located in Atchison, Kansas. The sales price totaled $2,800 and resulted in a pre-tax gain of approximately $1,400 that will be recognized in the first quarter of 2013.

Use of Hedge Accounting

Reducing earnings volatility from commodity price swings has long been at the forefront of our risk management strategy, and in early calendar 2011, the Company's Board of Directors made the decision to adopt hedge accounting. Effective July 1, 2011, we elected to restart the use of hedge accounting for qualifying derivative contracts entered into on and after July 1, 2011. For further discussion related to the accounting policy and accounting requirements for our derivative instruments, see Note 1. Nature of Operations and Summary of Significant Accounting Policies – Derivative Instruments and Note 14. Derivative Instruments and Fair Value Measurements set forth in Item 8.

Our utilization of hedge accounting proved to mitigate a portion of our earnings volatility that had been experienced over the few years leading up to the restart of hedge accounting.

In connection with our new grain supply agreements previously discussed, we now order corn anywhere from a month to 12 months in the future. We have determined that the firm commitments to purchase corn under the terms of these new agreements meet the normal purchases and sales exception as defined under ASC 815, Derivative and Hedging, and exclude the fair value of these commitments from recognition in our financial statements until the actual contracts are physically settled. Accordingly, on February 29, 2012, we discontinued hedge accounting and de-designated our cash flow hedges, which resulted in a reclassification of a $27 loss from accumulated other comprehensive income into earnings for the quarter ended March 31, 2012. The volume of corn futures and options and the use of hedge accounting has been reduced under our current strategy. In support of this strategy, as of December 31, 2012, we had no exchange traded corn futures contracts designated as cash flow hedges.

SEGMENT RESULTS

The following is a summary of revenues and pre-tax income (loss) allocated to each reportable operating segment for the year ended December 31, 2012, the year ended December 31, 2011 (unaudited), the six month transition period ended December 31, 2011, the six months ended December 31, 2010 (unaudited) and the year ended June 30, 2011. See Note 12. Operating Segments set forth in Item 8 for additional information regarding our operating segments.

	Years Ended		Six Months Ended		Year Ended
	December 31, 2012	5,137	4,446	3,720	3,029
Total revenue	48,462	48,159	45,147	42,953	
Cost of revenue:					
Product	15,331	15,698	14,551	14,021	
Support	1,614	1,388	1,157	1,006	
Total cost of revenue	16,945	17,086	15,708	15,027	
Gross profit	31,517	31,073	29,439	27,926	
Gross margin	65%	65%	65%	65%	
Operating expenses:					
Research and development	12,644	11,510	12,034	10,157	
Sales and marketing	15,744	15,191	15,078	14,301	
General and administrative	4,333	3,865	3,747	3,373	
Total operating expenses	32,721	30,566	30,859	27,831	
Income (loss) from operations	(1,204)	507	(1,420)	95	
Other income, net	355	47	125	753	
Income (loss) before provision for income taxes	(849)	554	(1,295)	848	
Provision for income taxes	(58)	(93)	104	(170)	
Net income (loss)	$ (907)	$ 461	$ (1,191)	$ 678	
Net income (loss) per common share, basic and diluted (1)	$ (0.01)	$ 0.01	$ (0.02)	$ 0.01	

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Fiscal 2008:

	Three Months Ended			
	March 31, 2008	December 31, 2007	September 30, 2007	June 30, 2007
	(in thousands, except per share amounts)			
Revenue:				
Product	$ 32,824	$ 28,961	$ 26,775	$ 23,123
Support	2,643	1,801	1,206	685
Total revenue	35,467	30,762	27,981	23,808
Cost of revenue:				
Product	11,802	10,401	9,126	8,110
Support	746	344	239	216
Total cost of revenue	12,548	10,745	9,365	8,326
Gross profit	22,919	20,017	18,616	15,482
Gross margin	65%	65%	67%	65%
Operating expenses:				
Research and development	9,035	8,320	8,909	7,807
Sales and marketing	13,128	11,762	9,936	10,457
General and administrative	3,126	2,284	2,212	2,054
Total operating expenses	25,289	22,366	21,057	20,318
Loss from operations	(2,370)	(2,349)	(2,441)	(4,836)
Other income (expense), net	1,250	510	116	182
Loss before provision for income taxes	(1,120)	(1,839)	(2,325)	(4,654)
Provision for income taxes	(52)	(38)	(38)	(30)
Net loss	$ (1,172)	$ (1,877)	$ (2,363)	$ (4,684)
Net loss per common share, basic and diluted (1)	$ (0.02)	$ (0.05)	$ (0.13)	$ (0.26)

(1) Basic and diluted net income (loss) per share are computed independently for each of the quarters presented. Therefore the sum of quarterly basic and diluted per share information may not equal annual basic and diluted net income (loss) per share.

Liquidity and Capital Resources

The following table summarizes our cash, cash equivalents and short-term investments for the periods presented (in thousands):

	As of March 31, 2009	As of March 31, 2008	Increase/ (Decrease)
Cash and cash equivalents	$ 47,621	$ 97,585	$ (49,964)
Short-term investments	56,186	18,058	38,128
Total	$ 103,807	$ 115,643	$ (11,836)

Our cash equivalents and short-term investments are invested primarily in money market funds, short-term United States Government and agency obligations, municipal bonds, corporate debt securities and commercial paper.

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Since our inception in 1999 through our IPO in November 2007, we funded our operations primarily with proceeds from the issuance of convertible preferred stock, customer payments for our products and services, proceeds from the issuance of notes payable and borrowings under our revolving line of credit facility. In November 2007, we completed our IPO which provided us with approximately $97.4 million in net proceeds after deducting underwriting discounts and commissions of approximately $7.5 million and other offering costs of $2.9 million.

We have a loan and security agreement with a commercial bank with a revolving line of credit, under which the aggregate amount available for borrowing is $15.0 million. The borrowings are collateralized by all of our assets with the exception of intellectual property. Our amended revolving line of credit agreement expires on May 28, 2010 and it contains a financial covenant that requires us to maintain a quick ratio of no less than 1.25 to 1.00 In addition, we are required to maintain a quarterly tangible net worth of not less than $85.0 million, which is increased by 50% of any new net equity proceeds and/or 50% of quarterly profits since March 31, 2009. The interest rate on the line of credit equals, at the election of the borrower, either the lender s variable prime rate or LIBOR plus 200 basis points for the applicable period, subject to a LIBOR rate floor of 1.50%, in effect at the time of the borrowing. There have been no borrowings under the current revolving line of credit.

The following table summarizes our cash flows from operating, investing and financing activities for the periods presented (in thousands):

	Years Ended March 31,		
	2009	**2008**	**2007**
Net cash provided by (used in) operating activities	$ 5,553	$ (2,965)	$ (2,380)
Net cash used in investing activities	(52,778)	(10,440)	(15,312)
Net cash provided by (used in) financing activities	(2,739)	94,268	4,765

Cash Flows from Operating Activities

Our cash flows from operating activities are significantly influenced by our cash investments to support the growth of our business in areas such as research and development, sales and marketing and corporate administration. Our operating cash flows are also influenced by our working capital needs to support growth and fluctuations in inventory, accounts receivable, accounts payable and other current assets and liabilities. Certain metrics such as inventory and accounts receivable turns historically have been impacted by our product mix and the timing of orders from our customer base. Our largest source of operating cash flows is cash collections from our customers. Our primary uses of cash from operating activities are personnel related expenditures and purchases of inventory.

During fiscal 2009, operating activities provided $5.5 million of cash compared to $3.0 million of cash used in operating activities during fiscal 2008. The $8.5 increase in our cash flow from operating activities in fiscal 2009 was primarily attributable to a $9.1 million lower net loss, $7.8 million higher non-cash expenses such as stock-based compensation and depreciation and $2.4 million higher accrued expenses due to higher headcount offset by a $10.0 million increase in our inventory primarily due to projected growth in our business and expansion of our product line.

The $585,000 increase in net cash used in operating activities in fiscal 2008 from fiscal 2007 was primarily attributable to an $8.7 million increase in our accounts receivable balance due to higher sales along with $566,000 used in other operating assets and liabilities offset by a reduction in our net loss of $5.4 million and a $3.3 million increase in our non-cash expenses relating to depreciation and amortization, bad debt expense and stock-based compensation expense in fiscal 2008 compared to fiscal 2007. The decrease in our net loss reflects our increased customer penetration and the expansion of our customer base resulting in higher revenue, which grew at a faster rate than expenses.

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Cash Flows from Investing Activities

Cash flows from investing activities primarily relate to capital expenditures to support our growth and investments of our available cash and cash equivalent balances. Net cash used in investing activities was $52.8 million, $10.4 million and $15.3 million in fiscal 2009, 2008 and 2007, respectively.

The $42.3 million increase in cash used in investing activities in fiscal 2009 from fiscal 2008 was primarily attributable to a $40.8 million increase in our short-term investments and investment in capital equipment. The increase in capital expenditure during fiscal 2009 was due to purchases of new test equipment to support our next generation of products and the continual build out of our infrastructure and expansion of premises as a result of our increased headcount.

The $4.9 million decrease in net cash used in investing activities in fiscal 2008 from fiscal 2007 was primarily attributable to an increase in the sale and maturity of short-term investments of $22.0 million offset by an $11.5 million increase in purchases of short-term investments and a $5.9 million increase in capital expenditures to support our head-count growth and product development.

We expect that in fiscal 2010 we will continue to invest in our infrastructure and in test equipment to support our research and development efforts.

Cash Flows from Financing Activities

Net cash used in financing activities was $2.7 million for the fiscal 2009 compared to net cash provided by financing activities of $94.3 million and $4.8 million in fiscal 2008 and fiscal 2007, respectively. In fiscal 2009, we paid $4.0 million and $883,000 in principal payments on our line of credit and notes payable, respectively. Additionally we used $1.5 million to repurchase shares of our common stock under our stock repurchase agreement. These payments were partially offset by proceeds from stock option exercises and purchases of shares under our employee stock purchase program. Net cash provided by financing activities in fiscal 2008 consisted principally of the net proceeds of our IPO of approximately $97.4 million, offset in part by $5.8 million higher repayments on the line of credit and notes payable.

We believe that our existing cash balances will be sufficient to meet our anticipated capital requirements for the next 12 months. However, we may need to raise additional capital or incur additional indebtedness to continue to fund our operations in the future. Our future capital requirements will depend on many factors, including our rate of revenue growth, if any, the expansion of our sales and marketing and research and development activities, the timing and extent of our expansion into new geographic territories, the timing of introductions of new products and enhancements to existing products and the continuing market acceptance of our products. Although we currently are not a party to any agreement or letter of intent with respect to potential material investments in, or acquisitions of, complementary businesses, services or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

Contractual Obligations

The following table summarizes our contractual obligations as of March 31, 2009 (in thousands):

		Payments due by period			
	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
Operating lease obligations	$ 10,521	$ 2,329	$ 4,576	$ 3,616	$
Non-cancellable inventory purchase commitments	6,170	6,170			
Total	$ 16,691	$ 8,499	$ 4,576	$ 3,616	$

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As of March 31, 2009, our unrecognized tax benefits amounted to $2.8 million of which the timing of the resolution is uncertain; therefore, there are no amounts presented in the above table.

We lease office space under non-cancelable operating leases with various expiration dates through May 2014. In April 2005, our primary facilities lease was renegotiated with a new lease expiration date in May 2014 with an option to cancel in May 2010 and two consecutive options to extend the lease, each for an additional five-year period. To the extent we elect to terminate the lease in 2010, we will be required to pay an early termination fee of approximately $1.0 million. We currently have no plans to exercise the early termination option.

We outsource the production of our hardware to third-party contract manufacturers. In addition, we enter into various inventory related purchase commitments with these contract manufacturers and suppliers. Generally these inventory purchase commitments are non-cancelable.

Guarantees

In the ordinary course of business, we have entered into agreements with, among others, customers, resellers, system integrators and distributors that include guarantees or indemnity provisions. Based on our historical experience and information known to us as of March 31, 2009, we believe that our exposure related to these guarantees and indemnities as of March 31, 2009 was not material. In the ordinary course of business, we also enter into indemnification agreements with our officers and directors and our certificate of incorporation and bylaws include similar indemnification obligations to our officers and directors. It is not possible to determine the amount of our liability related to these indemnification agreements and obligations to our officers and directors due to the lack of prior indemnification claims and the unique facts and circumstances involved in each particular agreement.

Off-Balance Sheet Arrangements

During the periods presented, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purpose.

Recent Accounting Pronouncements

See Note 1 of Notes to Consolidated Financial Statements for recent accounting pronouncements that could have an effect on us.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Foreign Currency Risk

Most of our sales contracts are denominated in the United States Dollar. As we expand our international sales, we expect that an increasing amount of our revenue could be denominated in foreign currencies. As a result, our cash and cash equivalents and operating results could be increasingly affected by changes in foreign currency exchange rates. Additionally, our international sales and marketing operations incur expenses that are denominated in foreign currencies. These expenses could be materially affected by foreign currency fluctuations. Our exposures are to fluctuations in exchange rates in the United States Dollar versus the British Pound, the Euro and, to a lesser extent, the Swiss Franc, the Japanese Yen, the Korean Won and the Chinese Yuan.

In order to decrease the inherent risk associated with translation of foreign currency cash balances into our reporting currency, we have not maintained excess cash balances in foreign currencies. Additionally, during the three months ended December 31, 2008 we began hedging British Pound denominated receivables held by us to reduce the risk that our earnings would be adversely affected by the fluctuations in the exchange rate of the British Pound against the United States Dollar. We account for these derivative instruments as either assets or liabilities on the balance sheet and measure them at fair value. Gains and losses from foreign exchange forward contracts are recorded each period as a component of other income (expense), net in the consolidated statements of operations.

We do not enter into foreign exchange forward contracts for speculative or trading purposes. Foreign currency transaction loss, including the impact of hedging, was $876,000 during fiscal year 2009. During fiscal 2008, we recorded a foreign currency transaction gain of $138,000. Based on our assets and liabilities denominated in the British Pound and the Euro at March 31, 2009 a hypothetical 10% strengthening or weakening in the United States Dollar against the British Pound and the Euro, would not have a material impact on the Company s statement of operations.

Interest Rate Sensitivity

We had cash and cash equivalents totaling $47.6 million at March 31, 2009. These amounts were invested primarily in money market funds and commercial paper. We believe that our cash and cash equivalents do not have a material exposure to changes in the fair value as a result of changes in interest rates due to the short term nature of our cash and cash equivalents. Declines in interest rates, however, would reduce future interest income. Based on our cash and cash equivalents at March 31, 2009, a hypothetical 100 basis points decline in interest rates would reduce our interest income by approximately $0.5 million.

Short-term investments consist of United States Government and agency obligations, municipal bonds, corporate debt securities and commercial paper. We do not enter into investments for trading or speculative purposes. If we sell our investments prior to their maturity, we may incur a charge to operations in the period the sale takes place.

The following tables present the hypothetical changes in fair values in the securities, excluding cash and cash equivalents, held at March 31, 2009 that are sensitive to changes in interest rates. The modeling technique used measures the change in fair values arising from hypothetical parallel shifts in the yield curve of plus or minus 50 basis points, or BPS and 100 BPS over six and twelve-month time horizons.

The following table estimates the fair value of the portfolio at a twelve-month time horizon (in thousands):

12-Month Period	Valuation of Securities Given an Interest Rate Decrease of X Basis Points		Current Fair Market Value	Valuation of Securities Given an Interest Rate Increase of X Basis Points	
	100 BPS	50 BPS		100 BPS	50 BPS
United States Government and agency securities	$ 42,479	$ 42,301	$ 42,122	$ 41,765	$ 41,944
Municipal bonds	2,558	2,556	2,556	2,552	2,553
Commercial paper	2,002	2,000	1,998	1,995	1,997
Corporate debt securities	9,561	9,535	9,510	9,456	9,482
Total short-term investments	$ 56,600	$ 56,392	$ 56,186	$ 55,768	$ 55,976

The following table estimates the fair value of the portfolio at a six-month time horizon (in thousands):

6-Month Period	Valuation of Securities Given an Interest Rate Decrease of X Basis Points		Current Fair Market Value	Valuation of Securities Given an Interest Rate Increase of X Basis Points	
	100 BPS	50 BPS		100 BPS	50 BPS
United States Government and agency securities	$ 42,836	$ 42,479	$ 42,122	$ 41,408	$ 41,765
Municipal bonds	2,562	2,558	2,556	2,549	2,552
Commercial paper	2,006	2,002	1,998	1,991	1,995
Corporate debt securities	9,614	9,561	9,510	9,403	9,456
Total short-term investments	$ 57,018	$ 56,600	$ 56,186	$ 55,351	$ 55,768

At March 31, 2009, we had no outstanding debt obligations and therefore no rising interest rate exposure. However, we could be exposed to increased interest rate risk if we make any borrowings under our amended revolving line of credit, which we entered into on May 29, 2009. The amended revolving line of credit bears interest, at the election of the borrower, at either the lender s variable prime rate or LIBOR plus 200 basis points for the applicable period, subject to a LIBOR rate floor of 1.50%, in effect at the time of the borrowing.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

The following financial statements are filed as part of this Annual Report

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

3PAR Inc.:

In our opinion, the consolidated balance sheets and the related consolidated statements of operations, redeemable convertible preferred stock and stockholders equity (deficit), and cash flows present fairly, in all material respects, the financial position of 3PAR Inc. and its subsidiaries at March 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2009 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and the financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company s internal control over financial reporting based on our audits (which was an integrated audit in 2009). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. 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 audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertain tax positions in fiscal 2008.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) 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.

/s/ PricewaterhouseCoopers LLP

San Jose, California

June 11, 2009

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3PAR Inc.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	March 31, 2009	March 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 47,621	$ 97,585
Short-term investments	56,186	18,058
Accounts receivable, net	34,706	34,596
Inventory	26,650	18,057
Deferred cost	2,887	4,273
Prepaid and other current assets	2,500	2,077
Total current assets	170,550	174,646
Property and equipment, net	22,079	14,781
Deferred cost, non-current		251
Other non-current assets	190	156
Total assets	$ 192,819	$ 189,834
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Line of credit	$	$ 4,000
Accounts payable	9,303	12,527
Accrued compensation and benefits	14,643	11,651
Other accrued liabilities	4,080	5,020
Deferred revenue	25,707	26,051
Accrued warranty	3,999	3,371
Current portion of notes payable		883
Total current liabilities	57,732	63,503
Accrued warranty, non-current	3,031	2,813
Deferred revenue, non-current	6,303	5,945
Other long-term liabilities	1,224	1,173
Total liabilities	68,290	73,434
Commitments and contingencies (Note 11)		
Stockholders equity:		
Preferred stock, $0.001 par value; 20,000,000 shares authorized at March 31, 2009 and 2008; No shares issued and outstanding at March 31, 2009 and 2008		
Common stock, $0.001 par value; 300,000,000 shares authorized at March 31, 2009 and 2008; 61,044,243 and 60,539,612 shares issued and outstanding at March 31, 2009 and 2008, respectively	61	61
Additional paid-in capital	299,445	290,558
Stockholders notes receivable		(36)
Deferred stock-based compensation	(15)	(186)
Accumulated other comprehensive loss	(21)	(15)
Accumulated deficit	(174,941)	(173,982)
Total stockholders equity	124,529	116,400

Total liabilities and stockholders equity	$ 192,819	$ 189,834

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

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3PAR Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Years Ended March 31, 2009	2008	2007
Revenue:			
Product	$ 168,389	$ 111,683	$ 64,977
Support	16,332	6,335	1,191
Total revenue	184,721	118,018	66,168
Cost of revenue:			
Product	59,601	39,439	23,644
Support	5,165	1,545	228
Total cost of revenue (1)	64,766	40,984	23,872
Gross profit	119,955	77,034	42,296
Operating expenses:			
Research and development (1)	46,345	34,071	24,519
Sales and marketing (1)	60,314	45,283	28,096
General and administrative (1)	15,318	9,676	6,104
Total operating expenses	121,977	89,030	58,719
Loss from operations	(2,022)	(11,996)	(16,423)
Other income (expense), net:			
Interest income	2,341	2,878	1,767
Interest expense	(185)	(958)	(769)
Other, net	(876)	138	12
Total other income, net	1,280	2,058	1,010
Loss before income tax provision	(742)	(9,938)	(15,413)
Income tax provision	(217)	(158)	(72)
Net loss	$ (959)	$ (10,096)	$ (15,485)
Net loss per common share, basic and diluted	($0.02)	($0.30)	($0.87)
Shares used to compute net loss per common share, basic and diluted	60,627	34,141	17,746

(1) Includes stock-based compensation as follows:

Cost of revenue	$ 267	$ 188	$ 160
Research and development	2,173	1,262	591
Sales and marketing	2,850	1,397	439
General and administrative	1,384	777	577

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

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3PAR Inc.

CONSOLIDATED STATEMENT OF REDEEMABLE CONVERTIBLE PREFERRED STOCK

AND STOCKHOLDERS EQUITY (DEFICIT)

(in thousands)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Stockholders Notes Receivable	Deferred Stock-based Compensation	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount						
Balance at March 31, 2006	33,257	94,343	18,913	19	94,885	(12)	(48)	(2,130)	(148,401)	(55,687)
Exercise of stock options			319		118					118
Repurchase of common stock related to unvested share-based awards			(20)		(5)					(5)
Stock-based compensation expense					476					476
Amortization of deferred stock-based compensation								1,291		1,291
Comprehensive loss:										
Unrealized gain on available-for-sale investments						22				22
Net loss									(15,485)	(15,485)
Total comprehensive loss										(15,463)
Balance at March 31, 2007	33,257	94,343	19,212	19	95,474	10	(48)	(839)	(163,886)	(69,270)
Exercise of stock options			171	1	419					420
Exercise of warrants, net			214							
Repurchase of common stock related to unvested share-based awards			(17)		(11)					(11)
Stock-based compensation expense					3,055					3,055
Amortization of deferred stock-based compensation								557		557
					(96)			96		

Reversal of deferred stock-based compensation related to cancellations										
Forgiveness of shareholder note receivable							12			12
Proceeds from initial public offering of common stock, net of issuance costs of $2,871			7,702	8	97,407					97,415
Conversion of redeemable convertible preferred stock into common stock upon completion of initial public offering	(33,257)	(94,343)	33,257	33	94,310					94,343
Comprehensive loss:										
Unrealized loss on available-for-sale investments						(25)				(25)
Net loss									(10,096)	(10,096)
Total comprehensive loss										(10,121)
Balance at March 31, 2008			60,539	61	290,558	(15)	(36)	(186)	(173,982)	116,400

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3PAR Inc.

CONSOLIDATED STATEMENT OF REDEEMABLE CONVERTIBLE PREFERRED STOCK

AND STOCKHOLDERS EQUITY (DEFICIT) (Continued)

(in thousands)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Stockholders Notes Receivable	Deferred Stock-based Compensation	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount						
Balance at March 31, 2008			60,539	61	290,558	(15)	(36)	(186)	(173,982)	116,400
Exercise of stock options			328		940					940
Exercise of warrants, net			20							
Issuance of common stock under employee stock purchase plan			420		3,124					3,124
Repurchase of common stock related to unvested share-based awards			(36)		(131)					(131)
Repurchase of common stock under stock repurchase program			(227)		(1,549)					(1,549)
Stock-based compensation expense					6,503					6,503
Amortization of deferred stock-based compensation								171		171
Payment of notes receivable from stockholder							36			36
Comprehensive loss:										
Unrealized loss on available-for-sale investments						(6)				(6)
Net loss									(959)	(959)
Total comprehensive loss										$ (965)
Balance at March 31, 2009		$	61,044	$ 61	$ 299,445	$ (21)	$	$ (15)	$ (174,941)	$ 124,529

The accompanying notes are integral part of these consolidated financial statements

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3PAR Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended March 31, 2009	2008	2007
Cash flows from operating activities:			
Net loss	$ (959)	$ (10,096)	$ (15,485)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	6,036	3,332	2,177
Stock-based compensation expense	6,674	3,624	1,767
Non-cash interest expense		59	76
Amortization of premium (accretion of purchase discounts) on short-term investments, net	28	(529)	(329)
Provision for doubtful accounts	1,328	313	128
Writedown for excess and obsolete inventory	1,399	877	528
Changes in assets and liabilities:			
Accounts receivable	(1,438)	(15,872)	(7,135)
Inventory	(10,044)	(5,132)	(7,232)
Deferred cost	1,637	(765)	(2,754)
Prepaid expenses and other current assets	(423)	(874)	(786)
Other non-current assets	(34)	(132)	(3)
Accounts payable	(1,943)	3,651	4,541
Accrued liabilities	2,381	4,971	5,586
Deferred revenue	14	12,794	14,623
Accrued warranty	846	636	1,516
Other long-term liabilities	51	178	402
Net cash provided by (used in) operating activities	5,553	(2,965)	(2,380)
Cash flows from investing activities:			
Proceeds from maturities of short-term investments	28,990	44,133	23,862
Proceeds from sales of short-term investments	15,596	1,688	
Purchases of short-term investments	(82,749)	(45,387)	(33,875)
Purchase of property and equipment	(14,615)	(11,207)	(5,305)
Restricted cash		333	6
Net cash used in investing activities	(52,778)	(10,440)	(15,312)
Cash flows from financing activities:			
Proceeds from issuance of common stock, net of issuance costs		97,415	
Proceeds from issuance of common stock under employee stock plans	3,824	332	433
Repurchase of shares of common stock	(1,680)	(11)	(5)
Proceeds from line of credit		6,500	8,500
Repayments on line of credit	(4,000)	(8,330)	(2,670)
Repayment of notes payable	(883)	(1,638)	(1,493)
Net cash provided by (used in) financing activities	(2,739)	94,268	4,765
Net change in cash and cash equivalents	(49,964)	80,863	(12,927)
Cash and cash equivalents, beginning of period	97,585	16,722	29,649
Cash and cash equivalents, end of period	$ 47,621	$ 97,585	$ 16,722

Supplemental disclosures of cash flow information						
Cash paid for income taxes	$	320	$	65	$	14
Cash paid for interest	$	214	$	906	$	648
Supplemental disclosure of non-cash activities:						
Conversion of redeemable convertible preferred stock to common stock	$		$	94,343	$	

The accompanying notes are integral part of these consolidated financial statements

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3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and its Significant Accounting Policies

The Company

3PAR Inc. (the Company) began operations in May 1999 and is a provider of utility storage solutions for mid-sized to large enterprises, financial services firms, cloud computing service providers, consumer-oriented Internet/Web 2.0 companies and government entities. Its utility storage products offer simple, efficient and scalable tiered storage arrays designed to enhance the economics and performance of storage. The Company s utility storage solution is designed to provision storage services rapidly and simply, reduce administrative cost, improve server and storage utilization, lower power requirements and scale efficiently to support the continuous growth of data.

Fiscal Year

The fiscal year ends on March 31. References to fiscal 2009, for example, refer to the fiscal year ended March 31, 2009.

Summary of Significant Accounting Policies

Principles of Consolidation

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

Use of Estimates

The preparation of these financial statements requires that the Company make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to revenue recognition, provisions for doubtful accounts and product warranties, valuation of inventory, useful lives of property and equipment, obligation for income taxes, the measurement of stock-based compensation and contingencies, among others. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ significantly from the estimates made by management with respect to these and other items.

Foreign Currency Accounting

The functional currency of the Company s foreign subsidiaries is the United States (U.S.) Dollar. Monetary assets and liabilities maintained in currencies other than the U.S. dollar are remeasured using the current exchange rate at the balance sheet date. Nonmonetary assets and liabilities and capital accounts maintained in currencies other than the U.S. dollar are remeasured using historical exchange rates. Revenues and expenses are remeasured using the average exchange rates in effect during the period. Foreign currency remeasurement gains and losses and gains and losses on non U.S. dollar denominated transactions, which amounted to a loss of $876,000 in fiscal 2009 and a gain of $138,000 and $12,000 in fiscal 2008 and 2007, respectively, are included in the consolidated statements of operations.

While the majority of the Company s contracts are denominated in U.S. dollars, in countries outside the U.S., the Company transacts business in various currencies besides the U.S. Dollar. In addition, the Company has

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

certain cash accounts, receivables and payables balances denominated in currencies other than the U.S. Dollar. During the third quarter of fiscal 2009, the Company began hedging certain British Pound denominated receivables held by the Company to reduce the risk that its earnings would be adversely affected by changes in the British Pound exchange rate. These derivatives are not designated as hedging instruments under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

The Company accounts for the derivative instruments in accordance with SFAS No. 52, *Foreign Currency Translation*, as either assets or liabilities on the balance sheet and measures them at fair value. Gains and losses on these contracts as well as the related costs are included in other income (expense), net along with the foreign currency gains and losses of the related hedged items. At March 31, 2009, the notional principal of the foreign exchange contract to sell British Pounds for U.S Dollars was £1.9 million (or approximately $2.6 million) with an original maturity of 30 days and a fair value of approximately $7,100 reported in other accrued liabilities.

Risks and Uncertainties

The Company is subject to all of the risks inherent in an early stage business operating in the information storage industry. These risks include, but are not limited to, a limited operating history, new and rapidly evolving markets, a lengthy sales cycle, dependence on the development of new products and services, unfavorable economic and market conditions, competition from larger and more established companies, limited management resources, dependence on a limited number of contract manufacturers and suppliers and the changing nature of the information storage industry. Failure by the Company to anticipate or to respond adequately to technological developments in its industry, changes in customer or supplier requirements, or changes in regulatory requirements or industry standards, or any significant delays in the development or introduction of products and services, would have a material adverse effect on the Company s business and operating results.

Fair Value of Financial Instruments

The reported amounts of the Company s financial instruments including cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short maturities. The reported amount of notes payable approximate fair value as the interest rates on these instruments approximate borrowing rates available to the Company for loans with similar terms.

Cash and Cash Equivalents

The Company considers all highly liquid marketable securities purchased with an original maturity of 90 days or less at the time of purchase to be cash equivalents. Cash and cash equivalents comprise demand deposits, money market funds and commercial paper and are stated at cost, which approximates fair value. The Company deposits cash and cash equivalents with high credit quality financial institutions.

Short-Term Investments

Investments comprise marketable securities that consist primarily of United States government and agency securities, municipal bonds, commercial paper, and corporate bonds, with original maturities beyond three months. All marketable securities are held in the Company s name with major financial institutions. All of the Company s marketable securities are classified as available-for-sale securities in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting For Certain Investments in Debt and Equity Securities*, and are carried at fair value with unrealized gains and losses, net of taxes, reported as a separate component of stockholders equity (deficit).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist principally of cash, cash equivalents, short-term investments and accounts receivable. The Company deposits cash and cash equivalents with high credit quality financial institutions. The Company has not experienced any losses on its deposits of its cash and cash equivalents.

The Company performs ongoing credit evaluations of its customers financial condition and generally requires no collateral from its customers. The Company reviews the expected collectibility of accounts receivable and records an allowance for doubtful accounts receivable. To date such losses have been within management s expectations.

Provision for Doubtful Accounts

The Company records a provision for doubtful accounts based on historical experience and a detailed assessment of the collectibility of its accounts receivable. In estimating the allowance for doubtful accounts, management considers, among other factors, (i) the aging of the accounts receivable, including trends within and ratios involving the age of the accounts receivable, (ii) the Company s historical write-offs, (iii) the credit- worthiness of each customer, (iv) the economic conditions of the customer s industry and (v) general economic conditions. In cases where the Company is aware of circumstances that may impair a specific customer s ability to meet its financial obligations, the Company records a specific allowance against amounts due from that customer, and thereby reduces the net recognized receivable to the amount the Company reasonably believes will be collected.

Inventory

Inventory is stated at the lower of cost or market. Cost is computed using the standard cost method, which approximates actual cost, on a first in, first out basis. The Company records inventory write-downs for excess and obsolete inventory based primarily on future demand forecasts. At the point of loss recognition, a new lower-cost basis for that inventory is established and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. In addition, the Company records a liability for firm, noncancelable purchase commitments with contract manufacturers and suppliers for quantities in excess of the Company s future demand forecasts.

Deferred Cost

When the Company s products have been delivered, but the product revenue associated with the arrangement has been deferred as a result of not meeting the revenue recognition criteria in SOP 97-2 (see Revenue Recognition below), the Company also defers the related inventory costs for the delivered items.

Property, Plant and Equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation. Repairs and maintenance cost are expensed as incurred. Depreciation is computed using the straight line method over the estimated useful lives of the assets. The estimated useful life of each asset category is as follows:

Computer equipment	3 years
Computer software	5 years
Machinery and equipment	3-5 years
Furniture and fixtures	7 years
Leasehold improvements	Shorter of the lease term or 5 years

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Upon retirement or sale, the cost of assets disposed of and related accumulated depreciation are removed from the accounts and any resulting gain or loss is credited or charged to operations.

The Company accounts for impairment of property and equipment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future net cash flows, an impairment charge is recognized based on the amount by which the carrying value of the asset exceeds the fair value of the asset. The Company did not incur any impairment charges in any of the periods presented.

Revenue Recognition

The Company derives its revenue from sales of storage solutions that include hardware, software and related support. Because the embedded software of its storage solution is deemed to be more than incidental to the product as a whole, the Company accounts for revenue for the entire sale in accordance with the guidance provided by the American Institute of Certified Public Accountants (AICPA) Statement of Position 97-2 (SOP 97-2), *Software Revenue Recognition*, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions*.

The Company recognizes revenue when persuasive evidence of an arrangement exists, the product has been delivered, the fee is fixed or determinable, collection of the resulting receivable is reasonably assured and, if applicable, upon satisfaction of evaluation criteria or expiration of the evaluation period, as the case may be. The Company s fees are considered fixed or determinable at the execution of an agreement, which comprises the final terms of sale including the description, quantity and price of each product purchased. The Company s sales arrangements with direct customers, resellers and channel partners do not include rights of return or rebates and to date, product returns have been negligible. The Company assesses its ability to collect from its customers based on a number of factors, including creditworthiness of the customer and past transaction history.

Prior to March 2007, the Company provided only basic and premium hardware warranty and software warranty, which was limited to bug fixes for any non-conforming software products. The Company also offered an extended hardware and software warranty after the initial contract term. The Company recognized as product revenue all revenue associated with sales of its products at the time of shipment or installation, depending on the terms of the arrangement, provided that all other revenue recognition criteria were met. In accordance with Financial Accounting Standard Board s (FASB) Technical Bulletin 90-1, (FTB 90-1), *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*, the Company recognized revenue relating to its premium hardware warranty and extended hardware and software warranties ratably as support revenue over the warranty period, which was typically three years for premium warranty and one year from termination of the basic warranty for extended warranty.

In March 2007, in anticipation of evolving customer requirements for software support, the Company changed its product offering from a software warranty model to a software support model. Under the software support model, the customer receives, in addition to bug fixes, unspecified software upgrades and enhancements, on a when-and-if available basis, over the term of the support period. Commencing in March 2007, all systems are sold together with software support. This new software support is considered post-contract customer support (PCS) under SOP 97-2.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s sales are comprised of multiple elements, which include hardware, software and PCS. The Company allocates revenue to each delivered element of the sale using the residual method. Under the residual method, when PCS is the only undelivered element, the Company defers revenue from the sale equivalent to the vendor specific objective evidence (VSOE) of fair value of PCS, or the undelivered element, and applies any discounts to the hardware and software elements in accordance with the provisions of SOP 97-2, as amended by SOP 98-9. VSOE of fair value of PCS within a sale is based upon stated renewal rates included within the evidence of arrangement with the customer. In circumstances where the arrangement does not include stated renewal rates, VSOE of fair value of PCS is based on actual renewal rates for separate sales of PCS to other customers.

During the first quarter of fiscal 2008, the Company established VSOE of the fair value for software support based on stated renewal rates offered to customers within the arrangement. As a result, beginning in the first quarter of fiscal 2008, the Company applied the residual method, as allowed by SOP 98-9, to revenue recognition of the software support. The Company defers revenue recognition of the software support and recognizes it on a straight-line basis over the support period, which is primarily one year. The Company allocates the remainder of the revenue associated with the sale to product revenue using the residual method. Premium and extended hardware warranties continue to be recognized in accordance with FTB 90-1 and are classified as support revenue.

During the month of March 2007, the Company did not have VSOE of fair value for its new software support model. Accordingly, through March 31, 2008, the Company was recognizing all of the hardware and support revenue from transactions that included software support during the month of March 2007 as product revenue ratably over the support period of one to three years. During the first quarter of fiscal 2009, the Company established VSOE of fair value of PCS for these March 2007 transactions based on actual renewal rates for separate sales of PCS to other customers. Accordingly, in the first quarter of fiscal 2009 the Company applied the residual method to the remaining deferred revenue associated with the March 2007 transactions.

The Company typically recognizes product revenue upon installation for transactions sold directly to end users and through certain resellers which require the Company s installation services, provided that the remaining revenue recognition criteria discussed above are satisfied. In cases where the arrangement includes customer-specific acceptance criteria, the Company recognizes revenue upon the earlier of receipt of customer acceptance or the lapse of the acceptance period. For sales through its channel partners, the Company generally recognizes product revenue upon shipment, based on freight terms of FOB Shipping Point or FOB Destination, assuming all other criteria for revenue recognition discussed above have been satisfied.

Capitalized Software Development Costs

The Company accounts for software development costs intended for sale in accordance with SFAS No. 86, *Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed* (SFAS 86). SFAS 86 requires product development costs to be charged to expense as incurred until technological feasibility is attained and all other research and development activities for the hardware components of the product have been completed. Technological feasibility is attained when the Company s software has completed the planning, design and testing phase of development and has been determined viable for its intended use, which typically occurs when beta testing commences. The time between the attainment of technological feasibility and the completion of software development has historically been relatively short with immaterial amounts of development costs incurred during this period. Accordingly, the Company has not capitalized any software development costs during the periods presented.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Advertising

All advertising costs are expensed as incurred. Advertising expenses were $208,000, $368,000 and $197,000 for the years ended March 31, 2009, 2008 and 2007, respectively.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109). Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets are recognized for deductible temporary differences, along with net operating loss carry- forwards, if it is more likely than not that the tax benefits will be realized. To the extent a deferred tax asset cannot be recognized under the preceding criteria, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

Effective April 1, 2007, the Company adopted FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, *an interpretation of FASB Statement No. 109*. FIN 48 provides a comprehensive model for the recognition, measurement and disclosure in financial statements of uncertain income tax positions that a company has taken or expects to take on a tax return.

Stock-Based Compensation

Prior to the adoption of SFAS 123 (revised 2004), *Share-Based Payment* (SFAS 123R), the Company accounted for share-based payment awards using the intrinsic value method in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees* (APB 25). Under the intrinsic value method, compensation expense is based on the difference, if any, on the date of the grant, between the estimated fair value of the Company s common stock and the exercise price of options to purchase that stock. The Company amortizes stock-based compensation expense resulting from the application of APB 25 over the vesting period of the options, using an accelerated basis, in accordance with FIN No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.*

Effective April 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R, using the prospective transition method, which requires the application of the provisions of SFAS 123R only to share-based payment awards granted, modified, repurchased, or cancelled on or after the adoption date. Under this method, the Company recognizes stock-based compensation expense for all share-based payment awards granted after March 31, 2006 in accordance with SFAS 123R. The stock-based compensation expense is then amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. SFAS 123R supersedes the previous accounting requirements under APB 25, and also amends SFAS No. 95, *Statement of Cash Flows*. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 107 providing supplemental implementation guidance for SFAS 123R. The Company has applied the provisions of SAB No. 107 in its adoption of SFAS 123R.

Upon adoption of SFAS 123R, the Company selected the Black-Scholes option pricing model for determining the estimated fair value for share-based awards. The Black-Scholes model requires the use of highly subjective and complex assumptions to determine the fair value of share-based awards, including the option s expected term and the expected volatility of the underlying stock over the expected term of the related grants. The value of the portion of the post adoption award that is ultimately expected to vest is recognized as expense

3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

over the requisite service (vesting) periods on a straight-line basis in the Consolidated Statements of Operations and the expense is reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from non-employees in accordance with the consensus reached by the Emerging Issues Task Force (EITF) in Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. Costs are measured at the fair market value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration other than employee services is determined on the earlier of (i) the date on which there first exists a firm commitment for performance by the provider of goods or services or (ii) on the date performance is complete, using the Black Scholes option pricing model.

Comprehensive Income (Loss)

The provisions of SFAS No. 130, *Reporting Comprehensive Income*, require companies to classify items of other comprehensive income (loss) by their nature in the financial statements and display the accumulated balance of other comprehensive income (loss) separately from accumulated deficit and additional paid in capital in the equity section of the balance sheet. Comprehensive income (loss) for each period presented is set forth in the Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders Equity (Deficit).

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which provides additional guidance for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements* (SFAS 157). FSP No. 157-4 states that a significant decrease in the volume and level of activity for the asset or liability when compared with normal market activity is an indication that transactions or quoted prices may not be determinative of fair value because there may be increased instances of transactions that are not orderly in such market conditions. Accordingly, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value. FSP No. 157-4 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the impact that the adoption of FSP No. 157-4 may have on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which requires disclosures about the fair value of the Company s financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the balance sheets, in interim reporting periods as well as in annual reporting periods. In addition, this FSP requires disclosures of the methods and significant assumptions used to estimate the fair value of those financial instruments. FSP No. 107-1 and APB 28-1 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the impact that the adoption of FSP No. FAS 107-1 and APB 28-1 may have on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments,* which establishes a new method of recognizing and reporting other-than-temporary impairments of debt securities and requires additional disclosures related to debt and equity securities. FSP No. 115-2 and 124-2 does not change existing recognition and measurement guidance related to other-than-

3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

temporary impairments of equity securities. FSP No. 115-2 and 124-2 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the impact that the adoption of FSP No. 115-2 and 124-2 may have on its consolidated results of operations and financial condition.

In June 2008, the FASB issued FSP on EITF Issue 03-6, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1) to clarify whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (EPS) under the two-class method described in paragraphs 60 and 61 of FASB Statement No. 128, *Earnings per Share*. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years.

In December 2007, FASB issued SFAS No. 141 (R), *Business Combinations* (SFAS No.141(R)), which becomes effective for fiscal periods beginning after December 15, 2008. SFAS No. 141 (R) requires all business combinations completed after the effective date to be accounted for by applying the acquisition method (previously referred to as the purchase method). Companies applying this method will have to identify the acquirer, determine the acquisition date and purchase price and recognize at the acquisition-date the fair values of the identifiable assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree. In the case of a bargain purchase, the acquirer is required to reevaluate the measurements of the recognized assets and liabilities at the acquisition date and recognize a gain on that date if an excess remains. The Company is required to adopt SFAS No 141(R) effective April 1, 2009. The Company does not expect the adoption of SFAS No. 141(R) to have a material effect on its financial position, results of operations, or cash flows.

In April 2009, FASB issued FASB Staff Position (FSP) No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*, which amends and clarifies the initial recognition and measurement, subsequent measurement and accounting, and related disclosures of assets and liabilities arising from contingencies in a business combination under Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), Business Combinations (SFAS 141R). This FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after December 15, 2008. The Company does not expect the adoption of SFAS 14(R)-1 to have a material effect on its financial position, results of operations, or cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB 51* (SFAS 160), which becomes effective for fiscal periods beginning after December 15, 2008. This statement amends Accounting Research Bulletin No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. In addition this statement establishes a single method of accounting for changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation and requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. The Company is required to adopt SFAS 160 effective April 1, 2009. The Company does not expect the adoption of SFAS 160 to have a material effect on its financial position, results of operations, or cash flows.

In February 2008, the FASB issued Financial Staff Position (FSP) SFAS 157-2, *Effective Date of FASB Statement No. 157 (FSP 157-2), which delays the effective date of SFAS No. 157, Fair Value Measurement* (SFAS 157), for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed

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at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. FSP 157-2 partially defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. The adoption of SFAS 157 for all nonfinancial assets and nonfinancial liabilities is effective for the Company beginning April 1, 2009. The Company does not expect the adoption of SFAS 157-2 to have a material effect on its financial position, results of operations, or cash flows

2. Balance Sheet Components

The following tables provide details of selected balance sheet accounts:

	March 31,	
	2009	2008
	(in thousands)	
Accounts Receivable, Net		
Trade accounts receivable	$ 35,832	$ 34,823
Less: Allowance for doubtful accounts	(1,126)	(227)
Total	$ 34,706	$ 34,596

	March 31,	
	2009	2008
	(in thousands)	
Inventory		
Raw materials	$ 21,914	$ 8,725
Work in process	2,985	5,696
Finished goods	1,751	3,636
Total	$ 26,650	$ 18,057

	March 31,	
	2009	2008
	(in thousands)	
Property and Equipment, Net		
Computer equipment	$ 30,378	$ 21,344
Computer software	3,107	2,211
Machinery and equipment	3,823	1,715
Furniture and fixtures	2,323	1,913
Leasehold improvements	8,517	7,804
	48,148	34,987
Less: accumulated amortization and depreciation	(26,069)	(20,206)
Total	$ 22,079	$ 14,781

3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Short-term Investments

The following tables summarize the available-for-sale securities presented as short-term investments:

	March 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Short-term Investments				
United States Government and agency securities	$ 42,110	$ 24	$ (12)	$ 42,122
Corporate debt securities	9,546	8	(44)	9,510
Municipal bonds	2,553	3		2,556
Commercial paper	1,998			1,998
Total short-term investments	$ 56,207	$ 35	$ (56)	$ 56,186

	March 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Short-term Investments				
United States Government and agency securities	$ 7,506	$ 7	$	$ 7,513
Municipal bonds	5,194		(23)	5,171
Commercial paper	4,567			4,567
Corporate debt securities	806	1		807
Total short-term investments	$ 18,073	$ 8	$ (23)	$ 18,058

The cost basis and fair value of available-for-sale securities as of March 31, 2009, by contractual maturity, are presented below:

	March 31, 2009	
Due in	Amortized Cost	Fair Value
	(in thousands)	
Less than 1 year	$ 46,057	$ 46,030
1 to 2 years		
2 to 5 years	10,150	10,156
Total short-term investments	$ 56,207	$ 56,186

As of March 31, 2009, all of the Company s short-term investments were classified as available-for-sale and certain investments had contractual maturities of greater than one year. However, management has the ability and intent, if necessary, to liquidate any of these investments in order to meet the Company s liquidity needs within the next twelve months. Accordingly, all investments are classified as current assets on the consolidated balance sheets.

The Company invests in securities that are rated investment grade or better. The unrealized losses at March 31, 2009 relate primarily to the Company s investment in four corporate debt securities and are due to the

3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

current volatility in the credit markets. At March 31, 2009, none of these securities have been in a continuous unrealized loss position for more than twelve months. The Company has determined that these unrealized losses are temporary as the duration of the decline in value of investments has been short, the extent of the decline, in both dollars and as a percentage of costs, is not significant, and the Company has the ability to hold the investments until recovery, if necessary.

Unrealized gains and losses are recorded as a component of cumulative other comprehensive income (loss) in stockholders equity. If these investments are sold at a loss or are considered to have other than temporarily declined in value, a charge to operations is recorded. The specific identification method is used to determine the cost of securities disposed of, with realized gains and losses reflected in other income (expense), net. The realized gains during fiscal 2009 and 2008 were approximately $1,200 in each fiscal year. There were no realized losses during fiscal 2008 and no realized gains or losses in fiscal 2007.

4. Fair Value Measurements

SFAS No. 157 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

Fair Value Hierarchy

SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities. As of March 31, 2009, the Company s Level 1 assets consist of money market fund deposits and United States government and agency securities that are traded in active markets with sufficient volume and frequency of transactions.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities. As of March 31, 2009, the Company s Level 2 assets consist of corporate debt securities, municipal bonds and commercial paper.

Level 3 Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities. As of December 31, 2008, the Company had no financial assets or liabilities for which fair value was determined using Level 3 inputs.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes our financial assets measured at fair value on a recurring basis as of March 31, 2009 (in thousands):

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total Balance
Description			
Cash equivalents:			
Money market funds	$ 27,354	$	$ 27,354
Commercial paper		11,991	11,991
Short-term investments:			
United States Government and agency securities	42,122		42,122
Corporate debt securities		9,510	9,510
Municipal bonds		2,556	2,556
Commercial paper		1,998	1,998
	$ 69,476	$ 26,055	$ 95,531

5. Deferred Revenue

Deferred revenue consists of the following:

	March 31,	
	2009	2008
	(in thousands)	
Deferred Revenue		
Product	$ 12,010	$ 15,810
Support	13,697	8,132
Ratable product and related support		2,109
Total deferred revenue, current	25,707	26,051
Support, non-current	6,303	4,894
Ratable product and related support, non-current		1,051
Total deferred revenue, non-current	6,303	5,945
Total deferred revenue	$ 32,010	$ 31,996

Deferred product revenue relates to arrangements where all revenue recognition criteria have not been met. Deferred support revenue primarily represents customer billings in excess of revenue recognized for PCS contracts, which the Company is legally entitled to invoice and collect. Support contracts are typically billed on an annual basis in advance and revenue is recognized into earnings ratably over the support period. Deferred ratable product and related support revenue consisted of revenue on March 2007 transactions where VSOE of fair value of PCS had not been established and the entire arrangement fee was being recognized ratably over the support period, which typically ranged from one year to three years. During the first quarter of fiscal 2009, the Company established VSOE of fair value of PCS for these March 2007 transactions based on renewal rates for separate sales of PCS to other customers. Accordingly, in the first quarter of fiscal 2009 the Company applied the residual method to the remaining deferred revenue associated with the March 2007 transactions and recognized $2.8 million of revenue associated with the March 2007 transactions. The remaining deferred revenue balance associated with these transactions is included in support deferred revenue. During fiscal 2009 and 2008, none of the Company s revenue arrangements resulted in ratable product and related support revenue.

At March 31, 2009, the Company had $6.3 million in long-term deferred revenue, of which $4.1 million, $1.6 million, $413,000 and $157,000 is expected to be amortized to revenue in fiscal 2011, 2012, 2013 and 2014, respectively.

6. Debt Obligations and Line of Credit

Notes Payable

In June 2005 and under amendments through March 2008, the Company entered into a loan and security agreement with a financial institution for borrowings of up to $6.0 million (the Notes Payable). The borrowings were available through March 31, 2006. Borrowings under this agreement bore interest at the 3-year Treasury Note rate plus 5.97%, fixed at the time of each advance. The Company borrowed an aggregate of $4.0 million on three notes through March 31, 2006, an aggregate of $883,000 of which was outstanding at March 31, 2008. Each note was repayable ratably over a 30-month-period from the date of the borrowing with final payment made in September 2008. The interest payable on these notes ranged from 9.66% to 10.28% per annum.

In connection with these notes payable, the Company issued the lender warrants to purchase 170,201 shares of the company s common stock at $1.88 per share in June, August and October of 2005. The aggregate fair value of the warrants of $190,000 was recorded as a discount to the notes payable and was amortized as interest expense over the period of the borrowings.

Line of Credit

In connection with the Notes Payable, the Company was granted an additional $6.0 million revolving line of credit which provided for borrowings of up to 80% of eligible domestic accounts receivable. In fiscal 2007, the Company was extended an additional $6.0 million under its revolving line of credit and the total borrowing capacity was increased to $12.0 million. The line of credit bore interest at a variable rate which was linked to the prime lending rate. Under the terms of the revolving line of credit the Company was required to maintain a minimum tangible net worth level of $1.5 million plus 50% of all issuances of new equity or subordinated debt after September 30, 2007. In fiscal 2007 and 2008, the Company borrowed $8.5 million and $6.5 million under the revolving line of credit. The revolving line of credit was repaid in full in April 2008.

On May 30, 2008, the Company entered into an amended and restated loan and security agreement, which provides for borrowings up to $15.0 million. This agreement was amended and extended through May 28, 2010 on May 29, 2009. The revolving line of credit agreement contains a financial covenant that requires the Company to maintain a minimum tangible net worth of $85.0 million, which is increased by 50% of any new net equity proceeds and/or 50% of quarterly profits since March 31, 2009. Tangible net worth is defined as the consolidated total assets minus any amounts attributable to goodwill and intangible assets, reserves not already deducted from assets and total liabilities including all subordinated debt. In addition, the Company is required to maintain a quick ratio of at least 1.25 to 1.0. The revolving line of credit provides the Company two options for interest rate: (i) the lender s variable prime rate of at least 4.00% or (ii) LIBOR plus 200 basis points for the applicable period, subject to a LIBOR rate floor of 1.50%, in effect at the time of the borrowing. To date there have been no borrowings under the revolving line of credit.

The Notes Payable and the revolving line of credit are collateralized by an interest in all of the Company s assets, excluding intellectual property. The Company is not permitted to sell its intellectual property other than to issue a nonexclusive license in the ordinary course of business.

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7. Income Taxes

The Company s tax provision relates primarily to alternative minimum tax (AMT) in the U.S., state income taxes and provisions for income tax related to the Company s international subsidiaries. Income (loss) before taxes and provision for income taxes for the years ended March 31, 2009, 2008 and 2007 consist of the following:

	Years Ended March 31,		
	2009	2008 (in thousands)	2007
Income (loss) before taxes:			
Domestic	$ (1,151)	$ (10,401)	$ (15,677)
International	409	463	264
Total loss before taxes	(742)	(9,938)	(15,413)
Provision for taxes:			
Current			
Federal	$ (92)	$	$
State	268		
International	41	158	72
Total provision for income taxes	$ 217	$ 158	$ 72

The income tax provision for fiscal 2009 was impacted by recognition of a $388,000 tax benefit during the fiscal year 2009 for a U.S. federal refundable tax credit as provided by the Housing and Economic Recovery Act of 2008 and the American Recovery and Reinvestment Act of 2009. These acts, that were signed into law in July 2008 and February 2009, respectively, allow taxpayers to claim refundable AMT or research and development credit carryovers if they forego bonus depreciation on certain qualified fixed assets placed in service from April 2008 through December 31, 2009. The Company estimated and recognized the credit based on fixed assets placed into service through the twelve months ended March, 31, 2009.

On September 30, 2008, California enacted Assembly Bill 1452 which among other provisions, suspends net operating loss deductions for 2008 and 2009 and extends the carryforward period of any net operating losses not utilized due to such suspension; adopts the federal 20-year net operating loss carryforward period; phases-in the federal two-year net operating loss carryback periods beginning in 2011 and limits the utilization of tax credits to 50% of a taxpayer s taxable income. The Company incorporated the impact of this new law on the income tax provision during the second quarter of fiscal 2009. As a result, only 50% of California tax liability was off-set by the available state research and development tax credit carryover, yielding $220,000 of tax liability for the fiscal year ended March 31, 2009.

On October 3, 2008, the United States enacted a law, Emergency Economic Stabilization Act of 2008, which contains the Tax Extenders and Alternative Minimum Tax Relief Act of 2008. Under this act, the research credit was retroactively extended for amounts paid or incurred after December 31, 2007 and before January 1, 2010. The research credit change had no impact on the Company s effective tax rate or tax provision in the third quarter of fiscal 2009 and it expects no impact during the fourth quarter of fiscal 2009 due to the Company s valuation allowance.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The differences between the income tax provision computed at the federal statutory rate of 34% and the Company s actual provision for income taxes for the years ended March 31, 2009, 2008 and 2007 are as follows:

	Years Ended March 31, 2009	2008 (in percentages)	2007
Income tax at federal statutory rate	(34.0)%	(34.0)%	(34.0)%
State tax net of federal benefit	25.8		
Losses not benefited	51.4	33.0	36.9
Tax credits	(164.3)	(7.7)	(5.3)
Non-deductible stock compensation	205.4	8.9	2.2
Foreign taxes	(14.4)	(0.1)	0.5
Refundable research and development credits	(52.3)		
Non-deductible meals and entertainment	16.1	1.3	0.4
Other	(4.5)	0.2	(0.2)
Income tax rate	29.2%	1.6%	0.5%

The tax effects of temporary differences that give rise to significant portions of deferred tax assets as of March 31, 2009 and 2008 are as follows:

	March 31, 2009	2008 (in thousands)
Net operating loss carryforwards	$ 49,256	$ 53,657
Tax credits	10,123	8,370
Accruals and reserves	8,997	7,148
Amortization of capitalized research and development	437	1,161
Fixed assets	1,469	585
Other	1,296	1,000
Total deferred tax assets	71,578	71,921
Valuation allowance	(71,578)	(71,921)
Net deferred tax assets	$	$

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that all or some portion of the deferred tax assets will be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income in the period in which those temporary differences and the net operating loss carryforwards are deductible. Based on the available objective evidence, including the fact that the Company has generated annual losses since inception, management believes it is more likely than not that the deferred tax assets will not be realized. Accordingly, the Company has provided a full valuation allowance against its deferred tax assets as of March 31, 2009 and 2008.

As of March 31, 2009, the Company had approximately $131 million and $82 million, respectively, of federal and state net operating loss carryforwards available to reduce future taxable income. These carryforwards expire between 2019 and 2028 for federal purposes and between 2011 and 2020 for state purposes. The Company is tracking the portion of its deferred tax assets attributable to stock option benefits in a separate memo account pursuant to SFAS No. 123(R). Therefore, these amounts are no longer included in the Company s gross or net deferred tax assets. Pursuant to SFAS No. 123(R), footnote 82, the stock option benefits of approximately $1.7

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million for federal taxes and $107,000 for state taxes will only be recorded to equity when they reduce cash taxes payable.

Under Section 382 of the Internal Revenue Code, the amounts of and benefits from net operating loss carryforwards may be impaired or limited in certain circumstances. Events which cause limitations in the amount of net operating losses that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50%, as defined, over a three year period. The use of the Company s net operating losses is subject to certain limitations and may be subject to further limitations as a result of changes in ownership as defined by federal and state tax law.

The Company also has approximately $5.6 million and $6.3 million, respectively, of federal and state research and development tax credit carryovers at March 31, 2009. The federal research and development tax credit carryovers will begin to expire in 2020. The state research and development tax credit carryovers can be carried forward indefinitely.

Effective April 1, 2007, the Company adopted FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, *an interpretation of FASB Statement No. 109*. FIN 48 provides a comprehensive model for the recognition, measurement and disclosure in financial statements of uncertain income tax positions that a company has taken or expects to take on a tax return. Under FIN 48, a company can recognize the benefit of an income tax position only if it is more likely than not (greater than 50%) that the tax position will be sustained upon tax examination, based solely on the technical merits of the tax position. Otherwise, no benefit can be recognized. The tax benefits recognized are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures for which reserves have been established consistent with jurisdictional tax laws. The cumulative effect of adopting FIN 48 is recorded as an adjustment to the opening balance of the Company s accumulated deficit on the adoption date. As a result of the implementation of FIN 48, the Company recognized no change in the liability for unrecognized tax benefits related to tax positions taken in prior periods, and no corresponding change in the accumulated deficit. Additionally, the Company made no reclassifications between current taxes payable and long-term taxes payable upon adoption of FIN 48.

At the adoption date of April 1, 2007, the Company had $2.0 million of unrecognized tax benefits, none of which would affect its income tax expense if recognized to the extent that the Company continues to maintain a full valuation allowance against its deferred tax assets. As of March 31, 2009, the Company had $2.8 million of unrecognized tax benefits, none of which would affect its income tax expense if recognized to the extent that the Company continues to maintain a full valuation allowance against its deferred tax assets.

The following table summarizes the activity related to the unrecognized tax benefits:

	Years Ended March 31,	
	2009	**2008**
	(in thousands)	
Balance at the beginning of the year	$ 2,892	$ 2,030
Gross increases (decreases) related to prior years tax positions	(580)	604
Gross increases related to current year tax positions	523	258
Settlements		
Expiration of the statute of limitations for the assessment of taxes		
Balance at the end of the year	$ 2,835	$ 2,892

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company estimates that there will be no material changes in its uncertain tax positions in the next 12 months. The Company recognizes interest and penalties related to income tax matters as part of the provision for income taxes. To date, the Company has incurred no such charges.

The Company files annual income tax returns in the United States (U.S.) federal jurisdiction, various U.S. state and local jurisdictions, and in various foreign jurisdictions. The Company remains subject to tax authority review for all jurisdictions for all years.

8. Capital Stock and Warrants

Initial Public Offering

In November 2007, the Company completed an initial public offering (IPO) of its common stock in which it sold and issued 7,702,479 shares of common stock, including 202,479 shares issued in December 2007 in connection with the partial exercise of the underwriters over-allotment option, at an issue price of $14.00 per share. A total of $107.8 million in gross proceeds was raised from the IPO, or approximately $97.4 million in net proceeds after deducting underwriting discounts and commissions of $7.5 million and other offering costs of $2.9 million. Upon the closing of the offering, all shares of the Company s then-outstanding convertible preferred stock automatically converted into 33,256,720 shares of common stock.

Common Stock and Preferred Stock

The Company s Amended and Restated Certificate of Incorporation, as amended and restated in November 2007, authorizes the issuance of 300,000,000 shares of common stock with $0.001 par value per share and 20,000,000 shares of preferred stock with $0.001 par value per share.

Certain stock options granted by the Company are exercisable at the date of grant, with unvested shares subject to repurchase by the Company in the event of voluntary or involuntary termination of employment of the shareholder. Such exercises are recorded as a liability on the balance sheet and reclassified into equity as the options vest. As of March 31, 2009 and 2008, a total of 18,482 and 410,275 shares of common stock, respectively, were subject to repurchase by the Company at the original exercise price of the related stock option. The corresponding exercise value of approximately $51,000 and $329,000 as of March 31, 2009 and 2008, respectively, is recorded in accrued liabilities.

The activity of non-vested shares for fiscal 2009 and 2008 as a result of early exercise of options granted to employees, is as follows:

	Year Ended March 31,	
	2009	**2008**
Beginning Balance	410,275	972,676
Early exercise of options		43,846
Vested	(356,331)	(589,445)
Repurchased	(35,462)	(16,802)
Ending Balance	18,482	410,275

3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Warrants

During September 2000, in connection with a capital lease agreement, the Company issued to the lessor a fully vested warrant to purchase 20,000 shares of Series B preferred stock at $5.00 per share. This warrant may be exercised at any time prior to September 4, 2010. The estimated fair value of this warrant measured on the date of grant, using the Black-Scholes option pricing model, was $78,000 and was recorded as a discount to the capital lease obligations and amortized to interest expense over the term of the capital lease agreement. In February 2004, the warrant was converted into a warrant to purchase 20,000 shares of common stock at a price of $0.02 per share. The fair value of the warrant was fully amortized by March 31, 2004. In May 2008, the Company issued 19,948 shares of its common stock upon net issuance exercise of the outstanding warrant by the lender.

During March 2002, in connection with a loan agreement, the Company issued to the lender a fully vested warrant to purchase 80,000 shares of common stock of the Company at $4.00 per share. This warrant may be exercised at any time prior to December 31, 2009. The estimated fair value of this warrant measured on the date of grant, using the Black-Scholes option pricing model, was $225,000. The estimated fair value was recorded as a discount to the loan and was amortized as interest expense over the period of the loan.

During September 2004, in connection with a loan agreement, the Company issued to the lender a fully vested warrant to purchase 66,485 shares of common stock at $0.02 per share, with a maximum term of ten years. The estimated fair value of this warrant measured on the date of grant, using the Black-Scholes option pricing model, was $30,000. The estimated fair value was recorded as a discount to the loan and was amortized as interest expense over the period of the loan. In December 2007, the Company issued 66,381 shares of its common stock upon net issuance exercise of the outstanding warrant by the lender.

During June 2005 through October 2005, in connection with two loan and security agreements and specific borrowings thereunder, the Company issued to two lenders eight fully vested warrants to purchase a total of 170,201 shares of common stock of the Company at $1.88 per share, with a maximum term of ten years. The aggregate estimated fair value of the warrants, measured on the dates of grant using the Black-Scholes option pricing model, was $190,000 and was recorded as a discount to the loans. The estimated fair value was amortized as interest expense over the period of the loans. In December 2007, the Company issued 147,460 shares of its common stock upon net issuance exercise of all the outstanding warrants by the two lenders.

9. Share Based Payments

Stock-Based Benefit Plans:

2007 Equity Incentive Plan: The Company adopted the Amended and Restated 2007 Equity Incentive Plan (2007 Plan) subsequent to stockholder approval at the Company s annual stockholder meeting in September 2008. This plan was implemented to amend the Company s 2007 Equity Incentive Plan, which was adopted in October 2007, to include limitations to the number of shares that may be granted on an annual basis through individual awards. Additionally, the 2007 Plan allows the inclusion in awards of specific performance objectives upon achievement of which certain awards will vest or be issued, which in turn will allow the Company to be eligible to receive income tax deductions under Section 162(m) of the Internal Revenue Code.

The maximum aggregate number of shares that may be issued under the 2007 Plan is 10,375,000 shares, plus an automatic increase on the first day of each fiscal year beginning with the 2009 fiscal year, in an amount equal to the lesser of (A) five million shares of the Company s common stock, (B) five percent of the Company s outstanding common stock on the last day of the immediately preceding fiscal year or (C) such number of shares

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of the Company s common stock determined by the Company s board of directors. In accordance with these provisions, on April 1, 2009 and 2008 the number of shares available for issuance under the plan was increased by 3.1 million shares and 3.0 million shares, respectively.

The 2007 Plan provides for the grant of incentive stock options, nonstatutory stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, performance stock awards, and other forms of equity compensation, which may be granted to employees (including officers), directors, and service providers. The 2007 Plan provides that a participant may not receive options for more than 1,000,000 shares in any fiscal year, except in connection with his or her initial service with the Company, in which case he or she may be granted an option covering up to an additional 4,000,000 shares. Under the 2007 Plan, incentive options granted to an employee who owns more than 10% of the voting power of all classes of the Company s stock shall have an exercise price no less than 110% of the fair market value per share on the date of the grant. Options generally vest over four years at the rate of 25% on each anniversary of the date of service contingent upon employment with the Company and expire no later than ten years after the date of grant. As of March 31, 2009, there were 10.2 million shares available for future issuance under the 2007 Plan.

2007 Employee Stock Purchase Plan: In October 2007, the Company s stockholders approved the 2007 Employee Stock Purchase Plan (the ESPP Plan) and the Company reserved 1,550,000 shares for future issuance plus an annual increase to be added on the first day of each fiscal year beginning with the 2009 fiscal year, equal to the lesser of (i) 1.5 million shares of common stock, (ii) two percent of the outstanding shares of common stock on such date or (iii) an amount determined by the administrator. In accordance with these provisions, on each of April 1, 2008 and 2009 shares available for issuance under the plan was increased by 1.2 million shares.

Under the ESPP Plan, the Company grants stock purchase rights to all eligible employees during one-year overlapping offering periods with purchase dates at the end of each 6-month purchase period except for the first offering period, which commenced in November 2007 and had its first purchase date on August 1, 2008. Shares are purchased through employees payroll deductions, up to a maximum of 10% of an employee s compensation for each purchase period at a purchase price equal to 85% of the lesser of the fair market value of the Company s common stock on the first trading day of the applicable offering period or the purchase date. If the fair market value of the common stock on any purchase date in an offering period is lower than the fair market value of the common stock on the first trading day of the offering period, then all participants in the offering period will be automatically withdrawn from the offering period immediately after the stock has been purchased on the purchase date and automatically re-enrolled in the immediately following offering period. The number of shares that may be purchased by a participant during any purchase period is limited to 1,250 shares. The ESPP Plan is compensatory and results in compensation expense. Through March 31, 2009, the Company has issued 419,590 shares under the ESPP Plan. As of March 31, 2009, there were 2.3 million shares available for future issuance under the ESPP Plan.

During the second and fourth quarters of fiscal 2009, the Company modified the terms of certain existing awards under its ESPP pursuant to the reset provisions of the plan. Consequently, the Company recognized $183,000 incremental stock-based compensation in fiscal 2009 and will recognize $11,000 of additional stock-based compensation in fiscal 2010.

1999 Stock Plan and 2000 Management Stock Option Plan: The Company s 1999 Stock Plan (the 1999 Plan) and the 2000 Management Stock Option Plan (the 2000 Plan) authorize the board of directors to grant incentive and nonstatutory stock options and stock purchase rights to employees, directors and consultants of the Company. Under the 1999 Plan and the 2000 Plan, incentive and nonstatutory stock options may be granted at

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

prices not less than 100% of the estimated fair value of the stock at the date of grant, as determined by the board of directors. For options granted to an employee who owns more than 10% of the voting power of all classes of stock of the Company, the exercise price shall be no less than 110% of the fair market value of the stock at the date of grant. Options generally vest over a four year period and expire no later than ten years after the date of grant. The Company s board of directors concluded not to grant any additional options or other awards under the 1999 Plan and 2000 Plan following the IPO. However, the 1999 Plan and 2000 Plan will continue to govern the terms and conditions of the outstanding awards previously granted under these plans.

Stock Option Activity:

The following table summarizes information about stock options outstanding:

	Options Outstanding			
	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (4) (in Thousands)
Balance at March 31, 2006	2,811,967	0.44		
Options granted at less than fair value (1)	1,900,113	4.82		
Options exercised, including early exercises	(319,319)	1.36		
Options cancelled	(234,416)	1.60		
Balance at March 31, 2007	4,158,345	2.32		
Options grated at fair value (2)	2,597,676	10.38		
Options granted in excess of fair value (3)	121,000	14.00		
Options exercised	(170,782)	1.94		
Options cancelled	(288,315)	4.89		
Balance at March 31, 2008	6,417,924	5.69		
Options granted at fair value (2)	2,591,210	8.41		
Options exercised	(327,755)	2.02		
Options cancelled	(511,417)	8.28		
Balance at March 31, 2009	8,169,962	$ 6.54	7.98	$ 14,594
Options vested as of March 31, 2009	3,619,000	$ 4.01	6.95	$ 12,897
Options exercisable as of March 31, 2009	5,898,084	$ 5.72	7.34	$ 14,532
Options vested as of March 31, 2009 and expected to vest thereafter (5)	8,024,429	$ 6.49	7.96	$ 14,574

(1) Options granted at less than fair value represent options whose exercise price is less than the estimated fair value of the common stock on the date of the grant.

(2) Options granted at fair value prior to the Company s IPO represent options whose exercise price equals the estimated fair value of the common stock on the date of the grant. Options granted at fair value subsequent to the Company s IPO represent options whose exercise price equals the closing sales price of the Company s common stock on the date of the grant.

(3) Options granted in excess of fair value represent options whose exercise price is greater than the closing sales price of the Company s common stock on the date of the grant.

(4) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $6.57 of the Company s common stock on March 31, 2009.

(5) Options expected to vest are the result of applying the pre-vesting forfeiture rate assumption to total outstanding options

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The total fair value of options and share awards vested in the years ended March 31, 2009, 2008 and 2007 were $4.0 million, $2.1 million and $92,000, respectively. As of March 31, 2009, there was $14.8 million of total unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of approximately 2.9 years. The total intrinsic value of options exercised in fiscal 2009, 2008 and 2007 was $2.2 million, $1.3 million and $1.4 million, respectively, determined on the date of the option exercise as the difference between the exercise price of the underlying awards and the fair value of the Company s common stock. The weighted average fair value per share of options granted in fiscal 2009, 2008 and fiscal 2007 was $3.71, $4.18 and $2.08, respectively.

Restricted Stock Unit Award Activity

Restricted stock unit awards may be granted under the 2007 Plan on terms approved by the Board of Directors. Stock awards generally provide for the issuance of restricted stock which vests over a fixed period. Activity with respect to outstanding restricted stock units for fiscal 2009 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Balance at March 31, 2008		$
Granted	355,000	7.48
Balance at December 31, 2009	355,000	$ 7.48

During fiscal 2009, the Company awarded non-vested restricted stock units to its officers and certain senior-level employees under the 2007 Plan. The shares will be released to the recipients on the day the restricted stock units vest, which is four years after the grant date. If a participant terminates employment prior to the vesting date, the unvested restricted stock will be canceled and returned to the 2007 Plan.

Fair Value Disclosures:

The fair value of each option and employee stock purchase right was estimated on the date of grant using the Black-Scholes model with the following weighted average assumptions:

	Years Ended March 31,		
	2009	2008	2007
Employee Stock Options			
Risk-free interest rate	2.55%	4.18%	4.81%
Expected life (years)	4.12	4.30	4.18
Dividend yield	0.00%	0.00%	0.00%
Expected volatility	53.2%	44.5%	47.0%

	Years Ended March 31,	
	2009	2008
Employee Stock Purchase Plan		
Risk-free interest rate	0.84%	3.50%
Expected life (years)	0.68	1.00
Dividend yield	0.00%	0.00%
Expected volatility	55.8%	53.9%

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The risk-free interest rate for the expected term of the option is based on the yield available on United States Treasury Zero Coupon issues with an equivalent expected term. The expected term represents the period of time that share-based awards are expected to be outstanding, giving consideration to the contractual terms of the awards, vesting schedules and expectations of future employee behavior. Given the Company s limited operating history, comparable companies from a representative peer group selected on industry data were used to determine the expected term. The computation of expected volatility was based on the Company s historical stock price volatility along with the volatility of comparable companies from a representative peer group selected based on industry data. As required by SFAS No. 123 (revised 2004), *Share-Based Payment*, management made an estimate of expected forfeitures and is recognizing stock-based compensation costs only for those equity awards that the Company expects to vest.

10. Net Loss per Common Share

The Company applies the provisions of the Emerging Issues Task Force EITF Issue No. 03-6, *Participating Securities and the Two Class Method under FASB Statement 128* (EITF No. 03-6), which established standards regarding the computation of earnings per share by companies with participating securities or multiple classes of common stock. Prior to its conversion to common stock upon the closing of the IPO, the Company s redeemable convertible preferred stock were participating securities due to their participation rights related to cash dividends declared by the Company.

EITF No. 03-6 requires net loss attributable to common stockholders for the period to be allocated to common stock and participating securities to the extent that the securities are required to share in the losses. The Company s redeemable convertible preferred stock did not have a contractual obligation to share in losses of the Company. Since the Company incurred a net loss in all periods presented, basic net loss per share is calculated by dividing net loss by the weighted average shares of common stock outstanding during the period that are not subject to vesting provisions.

The following table sets forth the computation of net loss per common share:

	Year Ended March 31,		
	2009	2008	2007
	(in thousands, except per share amounts)		
Numerator:			
Net income (loss)	$ (959)	$ (10,096)	$ (15,485)
Denominator:			
Weighted average number of shares outstanding basic and diluted	60,627	34,141	17,746
Net loss per share basic and diluted	$ (0.02)	$ (0.30)	$ (0.87)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following potential shares of common stock (prior to application of treasury method) outstanding at March 31, 2009, 2008 and 2007 were excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an antidilutive effect:

	Year Ended March 31,		
	2009	2008	2007
		(in thousands)	
Employee share based awards	9,066	6,418	4,159
Common stock subject to repurchase	18	410	973
Warrants to purchase common stock	80	100	337
Redeemable convertible preferred stock (as converted method)			33,257
	9,164	6,928	38,726

11. Commitments and Contingencies

Legal Matters

From time to time, third parties assert claims against the Company arising from the normal course of business activities. There are no claims as of March 31, 2009 that, in the opinion of management, might have a material adverse effect on the Company s financial position, results of operations or cash flows.

Lease Obligations

The Company leases equipment and office space under non-cancelable operating leases with various expiration dates through May 2014. In April 2005, the Company s primary facilities lease was renegotiated with a new lease expiration date in May 2014 with an option to cancel in May 2010 and two consecutive options to extend the lease, each for an additional five-year period. To the extent the Company elects to terminate the lease in 2010, it will be required to pay an early termination fee of approximately $1.0 million. The Company currently has no plans to exercise the early termination option. Rent expense for the years ended March 31, 2009, 2008 and 2007 was $3.2 million $2.0 million, $1.2 million, respectively. The terms of certain of the facility leases provide for rental payments on a graduated scale. The Company recognizes rent expense on a straight line basis over the lease period and has accrued for rent expense incurred but not paid. The Company subleased a portion of its facility under an operating lease which ran from January 2006 to August 2006. The sublease rental income related to this operating sublease was $40,000 for fiscal 2007. There was no sublease rental income during fiscal 2009 or 2008.

Future minimum lease payments under non-cancelable operating leases, assuming no early termination, are as follows (in thousands):

For the years ending March 31,	Rent Commitment
2010	2,329
2011	2,378
2012	2,198
2013	2,013
2014	1,603

Thereafter		
Total minimum lease payments	$	10,521

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3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Warranties

The Company provides for future warranty costs upon revenue recognition. The specific terms and conditions of those warranties vary depending upon the product sold and country in which the Company does business. The warranties are generally for three years from the date of installation of equipment.

Factors that affect the Company s warranty liability include the number of installed units, historical experience and management s judgment regarding anticipated rates of warranty claims and cost per claim. The Company assesses the adequacy of its recorded warranty liabilities each period and makes adjustments to the liability as necessary.

Changes in the warranty liability are as follows:

	Year Ended March 31, 2009	2008
	(in thousands)	
Beginning balance	$ 6,184	$ 5,548
Provision	5,019	4,151
Settlements made	(4,173)	(3,515)
Ending balance	$ 7,030	$ 6,184

Warranty liabilities are classified based on the assumption that the claims will be made ratably over the three year term, which to date has been consistent with the Company s actual warranty experience, as follows:

	March 31, 2009	2008
	(in thousands)	
Current	$ 3,999	$ 3,371
Non-current	3,031	2,813
Total	$ 7,030	$ 6,184

Noncancelable Purchase Commitments

The Company outsources the production of its hardware to third-party contract manufacturers. In addition, the Company enters into various inventory related purchase commitments with these contract manufacturers and suppliers. The Company had $6.2 million and $13.6 million in noncancelable purchase commitments with these providers as of March 31, 2009 and 2008, respectively. The Company records a liability for firm, noncancelable purchase commitments with contract manufacturers and suppliers for quantities in excess of its future demand forecasts. As of March 31, 2009 and 2008, the liability for these purchase commitments was $243,000 and $295,000, respectively. These liabilities were included in other accrued liabilities.

Guarantees and Indemnifications

The Company indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company s request in such capacity. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and enables it to recover a portion of any future amounts paid. The Company is unable to reasonably estimate the maximum amount that could be payable under these arrangements

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3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

since these obligations are not capped but are conditional to the unique facts and circumstances involved. Accordingly, the Company has no liabilities recorded for these agreements as of March 31, 2009 and 2008.

In its sales agreements, the Company may agree to indemnify its indirect sales channels and end-user customers for any expenses or liability resulting from claimed infringements of patents, trademarks or copyrights of third parties. The terms of these indemnification agreements are generally perpetual any time after execution of the agreement. The maximum amount of potential future indemnification is unlimited. To date the Company has not paid any amounts to settle claims or defend lawsuits. The Company is unable to reasonably estimate the maximum amount that could be payable under these arrangements since these obligations are not capped but are conditional to the unique facts and circumstances involved. Accordingly, the Company has no liabilities recorded for these agreements as of March 31, 2009 and 2008.

Employee Agreements

The Company has signed various employment agreements with key executives pursuant to which if following a change of control of the Company their employment is terminated by the Company without cause or by the employees for good reason, the employees are entitled to receive certain benefits, including, severance payments, accelerated vesting of stock and options, and certain insurance benefits. In addition, the Company s agreement with its chief executive officer provides similar benefits if he is terminated in the absence of a change of control.

12. Segment Information and Customer Concentration

FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, defines operating segments as components of an enterprise about which separate financial information is available and which is regularly evaluated by management, namely the chief operating decision maker of an organization, in order to make operating and resource allocation decisions. The Company has concluded that it operates in one business segment, the development, marketing and sale of information storage solutions. The Company s headquarters and most of its operations are located in the United States; however, it conducts limited sales, marketing and customer service activities through small offices in Europe and Asia. Revenue is attributed by geographic location based on the ship-to location of the Company s reseller or customer, as applicable. The Company s assets are primarily located in the United States of America. For all periods presented, long-lived assets located in the Company s international offices were not material. Therefore, geographic information is presented for total revenue only.

The following presents total revenue by geographic region based on the location of the reseller or customer, as applicable:

	Year Ended March 31,		
	2009	2008	2007
	(in thousands)		
United States	$ 155,740	$ 98,329	$ 59,347
International	28,981	19,689	6,821
Total	$ 184,721	$ 118,018	$ 66,168

For the years ended March 31, 2009, 2008 and 2007 no customer accounted for 10% or more of total revenue. One customer accounted for 12% and another customer for 11% of accounts receivable, net at March 31, 2009. One customer accounted for 11% of accounts receivable, net at March 31, 2008. The loss of any of these customers could have a material adverse effect on the Company s results of operations and cash flows.

3PAR Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Stock Repurchase Program

On July 29, 2008 the Company s board of directors authorized a stock repurchase program for up to $10.0 million worth of the Company s common stock. The Company is authorized to make purchases in the open market and any such purchases will be funded from available working capital. The number of shares to be purchased and the timing of purchases will be based on the price of the Company s common stock, general business and market conditions, and other investment considerations. Shares are retired upon repurchase. During fiscal 2009, the Company purchased 227,200 shares under this program for an aggregate purchase price of $1.5 million. The Company is authorized to purchase up to an additional $8.5 million worth of shares under this program as of March 31, 2009. The Company s policy related to repurchases of its common stock is to charge any excess of cost over par value entirely to additional paid-in capital in absence of retained earnings.

14. Employee Benefit Plans

The Company sponsors a 401(k) defined contribution plan covering all employees. Matching contributions and profit sharing contributions to the plan are at the discretion of the Company. To date, there have been no employer contributions under this plan.

15. Quarterly Financial Data-Unaudited:

The following tables present certain unaudited consolidated quarterly financial information for each of the eight quarters ended March 31, 2009. This quarterly information has been prepared on the same basis as the Consolidated Financial Statements and includes, in the opinion of management, all adjustments necessary to state fairly the information for the periods presented.

	Three Months Ended			
	March 31, 2009	December 31, 2008	September 30, 2008	June 30, 2008
	(in thousands, except per share amounts)			
Fiscal 2009:				
Total revenue	$ 48,462	$ 48,159	$ 45,147	$ 42,953
Gross profit	31,517	31,073	29,439	27,926
Income (loss) from operations	(1,204)	507	(1,420)	95
Net income (loss)	(907)	461	(1,191)	678
Net income (loss) per share basic and diluted (1)	$ (0.01)	$ 0.01	$ (0.02)	$ 0.01

	Three Months Ended			
	March 31, 2008	December 31, 2007	September 30, 2007	June 30, 2007
	(in thousands, except per share amounts)			
Fiscal 2008:				
Total revenue	$ 35,467	$ 30,762	$ 27,981	$ 23,808
Gross profit	22,919	20,017	18,616	15,482
Loss from operations	(2,370)	(2,349)	(2,441)	(4,836)
Net loss	(1,172)	(1,877)	(2,363)	(4,684)
Net loss per share basic and diluted (1)	$ (0.02)	$ (0.05)	$ (0.13)	$ (0.26)

(1) Basic and diluted net income (loss) per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted net income (loss) per share.

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

Not applicable

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of March 31, 2009, the end of the period covered by this Annual Report on Form 10-K, our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control over financial reporting

MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of our Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of our Company;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of our Company; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our 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.

Management assessed the effectiveness of our internal control over financial reporting as of March 31, 2009. In making this assessment, our management used the criteria set forth in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment, management has concluded that, as of March 31, 2009, our internal control over financial reporting was effective.

The effectiveness of our internal control over financial reporting as of March 31, 2009 has been audited by PricewaterhouseCoopers, LLP our independent registered public accounting firm, as stated in their report which appears in Item 8 of this Annual Report on Form 10-K.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item with respect to directors may be found in the section entitled Proposal 1 Election of Directors appearing in the Proxy Statement and is incorporated herein by reference. Information on executive officers is included in Part I, Item 1 of this Annual Report on Form 10-K under the caption Executive Officers of the Registrant.

The information required by this Item with respect to our audit committee and audit committee financial expert may be found in the section entitled Proposal 1 Election of Directors Audit Committee appearing in the Proxy Statement. Such information is incorporated herein by reference.

We have adopted a code of business conduct and ethics for directors, officers and employees. This code of business conduct and ethics is available on our website at www.3PAR.com and any waivers from or amendments to the code of business conduct and ethics, if any, will be posted on our website.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this item is included in our proxy statement for our 2009 annual meeting of stockholders under the sections entitled Executive Compensation, Compensation Committee Interlocks and Insider Participation and Compensation Committee Report and is incorporated herein by reference.

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

The information required by this item relating to security ownership of certain beneficial owners and management is included in our proxy statement for our 2009 annual meeting of stockholders under the section entitled Security Ownership of Certain Beneficial Owners and Management and is incorporated herein by reference.

The information required by this item with respect to securities authorized for issuance under our equity compensation plans is incorporated herein by reference to the information from the proxy statement for our 2008 annual meeting of stockholders under the section entitled Equity Compensation Plan Information and is incorporated herein by reference.

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

The information required by this item is included in our proxy statement for our 2008 annual meeting of stockholders under the sections entitled Certain Relationships and Related Transactions and Proposal 1 Election of Directors and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information required by this item is incorporated herein by reference to the information included in our proxy statement for our 2008 annual meeting of stockholders under the section entitled Proposal 2 Ratification of Selection of Independent Registered Public Accounting Firm.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) *Financial Statements*: The financial statements filed as part of this report are listed on the index to financial statements on page 59.

(2) *Financial Schedules*: Schedule II Valuation and Qualifying Accounts appears below and should be read in conjunction with the Consolidated Financial Statements included in this report.

	Balance at Beginning of Year	Additions	Deductions	Balance at End of Year
		(in thousands)		
Allowance for Doubtful Accounts				
Year ended March 31, 2007	$	$ 128	$	$ 128
Year ended March 31, 2008	128	313	(214)	227
Year ended March 31, 2009	227	1,328	(429)	1,126
Income Tax Valuation Allowance				
Year ended March 31, 2007	$ 61,427	$ 6,675	$	$ 68,102
Year ended March 31, 2008	68,102	3,819		71,921
Year ended March 31, 2009	71,921	4,782	(5,125)	71,578

All other schedules are omitted because they are inapplicable or the requested information is shown in the consolidated financial statements of the registrant or related notes thereto.

(b) *Exhibits.* The exhibits listed on the Exhibit Index (following the Signatures section of this report) are included, or incorporated by reference, in this annual report.

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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, on June 11, 2009.

3PAR Inc.

By: /s/ DAVID C. SCOTT
David C. Scott
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David C. Scott and Adriel G. Lares, and each of them, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any and all amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may 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 Registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ DAVID C. SCOTT	President, Chief Executive Officer, and Director	June 11, 2009
David C. Scott	(Principal Executive Officer)	
/s/ ADRIEL G. LARES	Vice President of Finance and Chief Financial Officer	June 11, 2009
Adriel G. Lares	(Principal Accounting and Financial Officer)	
/s/ KEVIN FONG	Chairman of the Board	June 11, 2009
Kevin Fong		
/s/ MARK A. JUNG	Director	June 11, 2009
Mark A. Jung		
/s/ CHRISTOPHER B. PAISLEY	Director	June 11, 2009
Christopher B. Paisley		
/s/ JEFFREY A. PRICE	Chief Technical Officer of System Design, Co-Founder and Director	June 11, 2009
Jeffrey A. Price		
/s/ MICHAEL J. SHERIDAN	Director	June 11, 2009
Michael J. Sheridan		

/s/ MARK A. SIEGEL	Director	June 11, 2009
Mark A. Siegel		
/s/ JAMES WEI	Director	June 11, 2009
James Wei		

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EXHIBIT INDEX

Exhibit Number	Description	Incorporated by Reference Herein Form	File Number	Date
3.01*	Amended and Restated Certificate of Incorporation of Registrant	S-1/A	333-145437	11/2/2007
3.02*	Amended and Restated Bylaws of Registrant	S-1/A	333-145437	11/2/2007
4.01*	Specimen common stock certificate	S-1/A	333-145437	11/13/2007
4.02*	Fourth Amended and Restated Shareholder Rights Agreement between Registrant and certain holders of Registrant s common stock named therein	S-1	333-145437	8/14/2007
10.01*	Form of Indemnification Agreement between Registrant and its directors and officers	S-1/A	333-145437	11/2/2007
10.02*	1999 Stock Plan of Registrant, as amended	S-1	333-145437	8/14/2007
10.02.1*	Forms of Stock Option Agreements under the 1999 Stock Plan	S-1	333-145437	8/14/2007
10.03*	2000 Management Stock Option Plan of Registrant, as amended	S-1	333-145437	8/14/2007
10.03.1*	Forms of Stock Option Agreements under the 2000 Management Stock Option Plan	S-1	333-145437	8/14/2007
10.04*	Amended and Restated 2007 Equity Incentive Plan	10-Q	001-33823	11/12/2008
10.04.1*	Forms of Agreements under the 2007 Equity Incentive Plan	S-1/A	333-145437	11/2/2007
10.04.2*	Notice of Grant of Restricted Stock under the 2007 Equity Incentive Plan	10-Q	001-33823	2/13/2009
10.05*	2007 Employee Stock Purchase Plan (as amended to reflect the one-for-two reverse stock split that was effected on October 25, 2007)	10-K	001-33823	6/12/2009
10.06*	Employee and Executive Incentive Compensation Plan	S-1/A	333-145437	11/2/2007
10.07*	Standard Industrial Lease by and between Registrant and The Realty Associates Fund V, L.P. dated April 28, 2005	S-1/A	333-145437	9/26/2007
10.08*	Standard Industrial Lease by and between Registrant and The Realty Associates Fund V, L.P. dated March 23, 2007	S-1/A	333-145437	9/26/2007
10.09*	Revised Offer Letter Agreement by and between Registrant and Adriel G. Lares dated November 5, 2001	S-1	333-145437	8/14/2007
10.10*	Offer Letter Agreement by and between Registrant and Jeffrey A. Price dated April 19, 1999	S-1	333-145437	8/14/2007
10.11*	Offer Letter Agreement by and between Registrant and Ashok Singhal dated April 19, 1999	10-Q	001-33823	2/13/2009
10.12*	Offer Letter Agreement by and between Registrant and James L. Dawson dated March 10, 2004	S-1	333-145437	8/14/2007
10.13*	Offer Letter Agreement by and between Registrant and Mark A. Jung dated December 11, 2006	S-1	333-145437	8/14/2007
10.14*	Offer Letter Agreement by and between Registrant and Christopher B. Paisley dated July 26, 2006	S-1	333-145437	8/14/2007
10.15*	Form of Amendment to Management Retention Agreement entered into between the Registrant and each of James Dawson and Jeannette Robinson.	10-Q	001-33823	2/13/2009

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Exhibit Number	Description	Incorporated by Reference Herein Form	File Number	Date
10.16*	Form of Amended and Restated Management Retention Agreement entered into between the Registrant and Alastair Short.	10-Q	001-33823	2/13/2009
10.17*	Form of Amended and Restated Management Retention Agreement entered into between the Registrant and each of its executive officers (other than James Dawson, Jeannette Robinson and Alastair Short).	10-Q	001-33823	2/13/2009
10.18*	Amended and Restated Employment Agreement by and between the Registrant and David Scott dated December 19, 2008.	10-Q	001-33823	2/13/2009
10.19 *	Production Purchase Agreement by and between Registrant and Xyratex Technology Limited dated January 31, 2006	S-1/A	333-145437	11/11/2007
10.20 *	Manufacturing and Purchase Agreement by and between Registrant and Flash Electronics, Inc. dated September 5, 2003	S-1/A	333-145437	11/11/2007
10.21*	Warrant to Purchase Stock Agreement by and between Registrant and Gold Hill Venture Lending 03, LP dated June 30, 2005	S-1/A	333-145437	9/26/2007
10.22*	Warrant to Purchase Stock Agreement by and between Registrant and Silicon Valley Bank dated June 30, 2005	S-1/A	333-145437	9/26/2007
10.23*	Amended and Restated Standard NNN Lease between Registrant and Brandin Court Partners, LLC dated October 16, 2008	10-Q	001-33823	11/12/2008
10.24*	Agreement of Lease between Registrant and One Whitehall L.P., dated January 9, 2008	10-K	001-33823	6/12/2008
10.25	Amended and Restated Loan and Security Agreement by and between Registrant and Silicon Valley Bank dated May 30, 2008	10-K	001-33823	6/12/2008
10.26	First Amendment to Amended and Restated Loan and Security Agreement by and between Registrant and Silicon Valley Bank dated May 29, 2009			
21.01	List of subsidiaries of Registrant			
23.01	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm			
24.1	Power of Attorney (incorporated by reference to the signature page of this Annual Report on Form 10-K)			
31.1	Certification of Principal Executive Officer Pursuant to Exchange Act Rule 13a-14(a) or 15d 14(a), as Adopted Pursuant to Section 302 of The Sarbanes Oxley Act of 2002.			
31.2	Certification of Principal Financial Officer Pursuant to Exchange Act Rule 13a-14(a) or 15d 14(a), as Adopted Pursuant to Section 302 of The Sarbanes Oxley Act of 2002.			
32.1	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.			

* Previously filed.
Confidential treatment has been requested for portions of this exhibit. These portions have been omitted from the exhibit and submitted separately to the Securities and Exchange Commission.