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Super Micro Computer, Inc.

Second Quarter Fiscal 2020 Earnings Call

February 6, 2020

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Ananda Baruah, *Loop Capital Markets*

Aaron Rikers, *Wells Fargo Securities*

Mehdi Hosseini, *Susquehanna Financial Group*

Nehal Chokshi, *Maxim Group*

Jon Lopez, *The Vertical Trading Group*

PRESENTATION

Operator

Good day, ladies and gentlemen. Thank you for standing by. Welcome to the Super Micro Computer, Inc. Second Quarter Fiscal 2020 Earnings Conference Call. The Company's news releases, issued earlier today, are available from its website at www.supermicro.com.

During the Company's presentation, all participants will be in a listen-only mode. Afterwards, securities analysts will be invited to participate in a question-and-answer session. The entire call is open to all participants on a listen-only basis.

As a reminder, this call is being recorded, Thursday, February 6, 2020. A replay of the call will be accessible until midnight, Thursday, February 20, 2020, by dialing 1 (844) 512-2921 and entering replay pin 9606207. International callers should dial in at 1 (412) 317-6671.

With us today are Charles Liang, Chairman and Chief Executive Officer; Kevin Bauer, Senior Vice President and Chief Financial Officer; and Perry Hayes, Senior Vice President, Investor Relations.

I would now like to turn the conference over to Mr. Hayes. Mr. Hayes, please go ahead, sir.

Perry Hayes, *Senior Vice President, Investor Relations*

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Good afternoon and thank you for attending Super Micro's financial results conference call for the second quarter of fiscal 2020, which ended December 31, 2019.

By now, you should have received a copy of the news release from the Company that was distributed at the close of regular trading and is available on the Company's website.

As a reminder, during today's call, the Company will refer to a presentation that is available to participants in the Investor Relations section of the Company's website under the Events & Presentations tab. We have also published Management's scripted commentary on this quarter's results on our website.

Before we start, I'll remind you that our remarks include forward-looking statements. There are a number of risk factors that could cause Super Micro's future results to differ materially from our expectations. You can learn more about these risks in the press release we issued earlier this afternoon, our most recent 10-K filing for 2019 and our other SEC filings. All of these documents are available on the Investor Relations page of Super Micro's website. We assume no obligation to update any forward-looking statements.

Most of today's presentation will refer to non-GAAP financial results and outlook. For an explanation of our non-GAAP financial measures, please refer to the accompanying presentation or to our press release published earlier today. In addition, a reconciliation of GAAP to non-GAAP results is contained in today's press release and in the supplemental information attached to today's presentation. At the end of today's prepared remarks, we will have a Q&A session for sell-side analysts to ask questions.

I'll now turn the call over to Charles Liang, Chairman and Chief Executive Officer.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Thank you, Kevin, and good afternoon, everyone. Over the last couple of years, the Super Micro has been continuing our journey of becoming a strong global leader of server and storage solutions. We have added many new product lines and roughly doubled our operational capacity worldwide to build our products more efficiently and with high quality. Now Super Micro is the most complete company it's ever been, supporting enterprise customers and data centers with optimized solutions, plus management software and services, and providing our industry-best system building blocks to the channel. "Better, faster and greener" is what our customers demand, and it's exactly what we deliver.

Today is also an important milestone of our Company as it is our first quarter after relisting on the NASDAQ Stock Exchange. We begin this new era for Super Micro, a stronger company with better financial and operational controls. Combined with the latest technology and total solutions for our customers, we are more optimistic than ever about our business opportunities ahead. I can confidently say that we are back, stronger and ready for growth.

Before we discuss this quarter's results, let me remind our shareholders about what makes Super Micro unique in our industry.

First, product innovation is our DNA. We are the only server and storage solutions provider with a majority of our engineering, product development and final assembly based in the U.S.A. With over 1,700 engineering staff, mostly in the heart of Silicon Valley and some worldwide, our dedicated engineering strength allows us to quickly offer the most advanced technology with the broadest range of products in our industry.

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We have capitalized on the industry convergence of cloud, artificial intelligence and 5G from data center to edge. These emerging technologies enable businesses and industries to utilize the growing pools of data and data analytics. Super Micro's technology innovation DNA uniquely positions us to provide timely and optimized solutions to service these key high-growth markets.

We are delivering world-class solutions for global enterprises. From the private to the public cloud, our enterprise data center solutions have been widely deployed around the world. As a certified provider of enterprise solutions from leading software applications, such as SAP, Oracle, Red Hat to name a few, we offer complete, seamless solutions based on our hardware products, service and firmware/software design capabilities.

Finally, we are positioned to be one of the fastest-growing solution providers in the growing $100 billion server/storage market. Super Micro's growth strategy, based on our building block solutions business model, which configures solutions directly to enterprise companies, data centers, OEMs and also indirectly through the channel. We plan to discuss our business opportunities and strategy in more detail with investors at events later this year.

Now turning to our Q2 results. Our second quarter net sales were $871 million, which exceeded the high end of our initial guidance and up 9% sequentially, consistent with typical seasonal patterns. Sales were down 6.5% year-over-year, in large part due to steep declines in component pricing.

Our indirect or channel business grew to represent 51% of this quarter's revenue and grew both sequentially and year-over-year. This quarterly result follows our successful launch of improved channel partner programs. At the same time, our direct and OEM businesses also grew sequentially, with the most of the growth coming from large enterprise accounts. Other than our current market focus, we are also enhancing our product offerings to hyperscale installations with highly optimized cloud DC and mega DC product lines.

Here are some key product highlights. We saw growth for our Rackmounts and multiple node product lines in data centers. This quarter, Rackmounts grew sequentially primarily due to a strong growth in our Ultra platform, which was up 30% sequentially, and BigTwin, which grew over 20% quarter-on-quarter. Ramping of AMD products and some other new Intel processor-based systems will help continue this strong momentum.

We saw sequential growth in accelerated computing and launched multiple new GPU-based product offerings. Our customers choose Super Micro GPU solution over the competition because they provide the best pure performance with the fastest GPU interconnects and highest performance per dollar.

Our 5G, Embedded and IoT solution for edge computing, telco data center and appliance also grew, and we anticipate these product lines to grow significantly later this calendar year. We announced new additions for 5G cell tower deployments, leveraging fully configurable SuperServer to the edge, bringing standard x86 compute design to a traditional proprietary telco market. We also brought AI to the edge, combining ruggedized hardware and optimized software stacks to accelerate the most demanding AI workloads at the network edge.

We continue to focus on our mission to lead the IT industry with Green Computing Solutions and resource saving platforms, including the introduction of our first 12-year longevity power supply, a new part of the disaggregated architecture. With investor attention on ESG consideration, we anticipate increased demand for resource saving solutions.

Summarizing this quarter, we were pleased to see our revenue start to reaccelerate. We are also pleased to be able to move forward this quarter as a NASDAQ traded public company. We will continue to focus

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on transforming server and storage technologies by building upon our robust engineering fundamentals. Super Micro is ready to provide the best products to customers who are demanding innovation, quality, lower TCO and environmental-friendly solutions.

I will now turn the call over to Kevin to review the results of the quarter in more detail.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Thank you, Charles.

Our fiscal second quarter revenue was $871 million, exceeding the upper end of our prior guidance range. This reflects a 9% quarter-on-quarter increase from the first quarter of fiscal 2020 but a 6.5% decrease from the same quarter of last year. Systems comprised 77% of total revenue, and volumes of systems and nodes shipped were up sequentially and year-over-year. However, ASPs for systems fell due to declines in commodity component costs.

Geographic performance was mixed on a challenging year-over-year comparison, with the U.S. up 3%, EMEA down 20%, and Asia 16% lower. On a sequential basis, the U.S. market continued to be our strongest market with sequential growth of 12%. However, this quarter, EMEA also grew sequentially, increasing by 12%. Asia had modest sequential growth with Taiwan, Korea and other Asia countries, offsetting weakness in China.

Working down the P&L, our gross margin on a GAAP and non-GAAP basis was 15.9%, 210 basis points higher than last year driven by lower key component costs as well as favorable customer, geographic and product mix.

Q2 operating expenses increased quarter-on-quarter and year-on-year, primarily due to higher employee costs, including higher R&D expense, targeting new opportunities. We had a strong central urgency to get current with our SEC filings by including the fiscal '18, '19—and '19 10-K audit as well as the first quarter '20 10-Q review. We also completed a tax restructuring project on December 1, 2019, that results in a lower corporate tax rate of approximately 20% on a go-forward basis. Including these three projects increased G&A expense by approximately $6.4 million in the December quarter as compared to the September quarter of 2019.

Other income and expense was a $1 million loss as compared to a $1 million gain last quarter, primarily related to the foreign exchange impact on our Taiwan dollar denominated term loan. Our tax rate for this quarter was 8% on a GAAP basis and 12% on a non-GAAP basis, both of which benefited from a release of reserves, following the conclusion of a tax audit in a foreign jurisdiction of $1.6 million.

Lastly, our share of earnings in a joint venture was a $1 million loss this quarter as compared to a $1 million gain in the previous quarter and a $1.8 million loss in the same quarter a year ago. Second quarter non-GAAP diluted earnings per share totaled $0.57 per diluted share compared to $0.68 last quarter and $0.66 last year. Cash flow generated from operations totaled $82 million. After deducting for cap ex and investments of $11 million, we generated free cash flow of $71 million. Our closing cash position was $309 million.

This quarter, our cash conversion cycle was 80 days, which is below our target of 85 to 90 days. Days sales outstanding was 38 days. Days payable outstanding totaled 46 days, and inventory days was 87.

In summary, we are pleased to see revenues reaccelerate. We are also pleased to be able to report this quarter as a NASDAQ traded public company with stronger financial controls.

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Now turning to our outlook. The Company expects net sales for the quarter ending March 31, 2020 in a range of $770 million to $830 million. In addition to typically weaker seasonal trends, we are increasingly cautious given the unfolding impacts of the coronavirus outbreak. Barring further significant disruption from the outbreak, we expect this quarter to represent a trough and see constructive trends fueling healthy year-over-year growth going forward. In particular, we are encouraged by a healthy customer pipeline, supported by a number of technology refreshes and product cycles in the second half of calendar 2020.

With regard to operating expenses, we will continue to invest in personnel to fuel growth. We are also aggressively remediating material weaknesses with the goal of full remediation by June 2020. Therefore, while OpEx will decline sequentially in the March quarter, it will grow sequentially in the June and September quarter due to the audit of our financials and testing of our remediation efforts. We expect audit and remediation costs to revert to normal levels after the September quarter.

We also announced that we expect to incur additional charges of $35 million to $40 million in the third or fourth fiscal quarter that are onetime in nature. These onetime charges address residual cleanup matters from our extended blackout period. We are taking actions to address benefits that were not be able to be realized by certain of our long-term and most dedicated key employees. Further, the Board is considering an additional retention bonus to certain employees. Lastly, our Board is considering appropriate forms of compensation for both of these matters.

Regarding the use of cash through the rest of fiscal '20, we will apply cash to completing two buildings, one in San Jose and the other in Taiwan, which will be completed over two years. As I mentioned earlier, we expect higher than normal costs related to audit and remediation for several more quarters. Assuming this revenue range, we expect non-GAAP earnings per diluted share of approximately $0.35 to $0.55 for the quarter. And as a reminder, these onetime charges are not included to non-GAAP EPS range.

In closing, let me highlight an upcoming event for the financial community. We will be attending Susquehanna's 9th Annual Technology Conference in New York City on March 12.

With that, I'll turn it back to Perry for Q&A.

Perry Hayes, *Senior Vice President, Investor Relations*

Thank you, Kevin. I'd just like to remind shareholders who are listening in on the call, I understand that the audio may not have been very clear. At this point, I'll remind you that the transcript will be available on our website, in fact, is at this time. If you had any questions understanding part of it, please refer to the transcript.

Operator, we're now ready for questions.

Operator

Thank you, sir. Ladies and gentlemen, a question-and-answer session will be conducted electronically. To ask a question, firmly press the star key, followed by the digit one on your telephone and we will take your question in order that you signal, and if you find your question has been asked or answered before you can ask it or would like to remove yourself from the queue, please press star, two. Also if you're on a speakerphone, please make sure that your mute function is designated so that your signal may reach our equipment. Finally, we ask that you limit yourself to one question and one follow-up until all the queue have had an opportunity to ask a question. We will then come back to you for additional questions. Again, that is star, one if you would like to ask a question.

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Our first question will go to Ananda Baruah with Loop Capital.

Ananda Baruah, *Loop Capital Markets*

Hi. Good afternoon, you guys. Thank you for taking my questions and congratulations on continued progress forward. This could be for both Charles and Kevin. Just starting with the revenue trajectory, you guys—there's two comments. Kevin, I believe you said Q-o-Q growth going forward, and then you also talked about, I think, in the second half of the year, a stronger R&D expense—I'm paraphrasing here but you see revenue opportunities. The guide for the March quarter, it was 7% to 8% at the midpoint. Could you talk about how you'd like us to think about sequential revenue tempo and trajectory in the coming quarters, to the extent that you're comfortable? Just so we can get a sense of that. Then what some of those upcoming revenue opportunities are? Then I have a follow up on OpEx, thanks.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes, so maybe first the levels that we're talking about via the year-over-year comparison. As we highlighted this quarter, we have costs—or caution a little bit with the coronavirus that is out there. What I tried to convey is that once we get through this quarter and say there are no residual effects of that, then we like what we see in terms of what our new customer pipeline looks like, as well as knowing that the technology refreshes itself at the end of the year. We don't normally give a longer-term guidance, but just giving you a little bit of color for the investment community (inaudible).

Ananda Baruah, *Loop Capital Markets*

I appreciate that. That's at the end of the calendar year?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Correct.

Ananda Baruah, *Loop Capital Markets*

Got it. Great. Thanks. Then just quickly on OpEx, if I could. You mentioned OpEx increasing in this—there's actually a couple of moving parts (inaudible) for the OpEx. You actually—magnitude of OpEx increasing. When you mentioned OpEx increasing in the second half of the year, can you give us a sense, just for modeling purposes out of the gate here, how you'd like us to think about magnitude? Then I missed the part with regards to the audit costs. I think it's December quarter, it sounds like you're saying that normalizes. I just want to get a sense of what we—how we should expect impact on—when that rolls out as well or normalizes as well.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. Let's first talk about our R&D investments. We mentioned that we continue to invest in R&D for future products. Another (inaudible) of the Company is to enhance our software capabilities. Some of that is really focused on software engineers. We are signaling that we continue to invest here.

As it relates to OpEx, I understand that certainly, as we really, really focused on getting compliance in this quarter, that $6.5 million is maybe not comprehended in model. Therefore, I wanted to address that thing that, when we had our audited booking concurrently on both '18, '19 as well as first quarter '20, we went through a peak and that's why I tried to call that out. That $6.4 million, I think it is safe to model that, that will not occur in the March quarter, and so use that (inaudible) keep that in mind.

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Then I was trying to give you the pathology of the way audits play thereafter. Therefore, we're going to be dealing in a lot of remediation activity internally. Then as funded by—we'll be working with the audit firm for (inaudible) audit 2020 results as well as the intensity of their auditing our performance on internal control, hopefully, such that it would be remediated by 2020.

That's the shape that I tried to give you, a reset, including into the March quarter, and then increasing through to September.

Ananda Baruah, *Loop Capital Markets*

Okay, great. I appreciate it, gentlemen. Thanks, guys.

Operator

Thank you. We'll take our next question from Mehdi Hosseini with SIG.

Mehdi Hosseini, *Susquehanna Financial Group*

Thank you for taking my questions. A couple of follow-ups. First one is for both Charles and Kevin. Commodity prices are on the rise, and your OpEx is also going to increase by June and September quarter. You're also talking about our (inaudible) opportunities. When I look at the trend, it seems like we shouldn't really expect any margin expansion until a year from now or early 2021 given the commodity prices with GAAP, gross margin expansion and also increase in OpEx. Am I thinking that it's the right way? Or am I missing something? I have a follow-up.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Well, I think we're always looking for ways to improve, but I think, Mehdi, the increase in commodity prices, as a margin percentage, I think I articulated that, that could be a little bit of a headwind. I think you're on track there.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

(Inaudible) quarter, maybe two years ago. We start with investing much more in Korea. Super Micro (inaudible) provide most of total solution to our enterprise customer. Unlike 10 years ago, we pretty (inaudible). We can (inaudible) as a total solution company. This (inaudible) we are adding more value to our product.

Mehdi Hosseini, *Susquehanna Financial Group*

Sure. That's actually a good point. It leads to my second question, I guess for Charles. It's good that you're not currently (inaudible) NASDAQ, and there's significant growth opportunity. Hopefully, we get the margin expansion, if not this year then next year. But can you share with us, Charles, what are you doing to improve governance? What are you doing so that as you grow the business, there's also checks and balances that would help with increased confidence and—so that we could look forward and the (inaudible) would be just a rear view?

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Yes. That is why we are saying—I mean, in (inaudible) we start to invest more and more in the firmware, software solutions. We are ready to focus much more on the enterprise, including governance and some

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other mission-critical patent. From this point of view, we feel very comfortable to grow our (inaudible) both in OEM and in (inaudible).

Mehdi Hosseini, *Susquehanna Financial Group*

Sure. That's well understood. But what are the key checks and balances that you put in place? As you grow, there's also a more systematic approach in scaling the business so that the top line and bottom line are consistent.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Kevin, (inaudible).

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. Sure. Maybe, I think I can share with you that Charles has been very, very forward and very supportive in terms of investing in the (inaudible) and ensuring that, for instance, the internal audit and the compliance group are all joined at the hip. I will tell you that now with Don at the helm at sales and Alex being our COO, the communication of—and training across the entire organization is light years ahead of what it was a year or two ago.

To give you a little bit of color, I think, just this quarter, we were very enhanced in terms of the way that we closed this quarter and being very interactive with the operational people to understand everything that's going on to make sure that we are fully aware of what impacts the financials. Charles certainly helps us make sure that we have all the resources to be able to do that. As you know, we have other remediation efforts that we need to attend to. We brought on a wonderful (inaudible) chair that has helped us in terms of helping to get and understand ideas of how an apps deal company needs to perform revenue on a daily basis, as well as follow up with requisite investments in IT. There's a lot going on in the ecosystem there.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Yes. Especially the SAP system has been much mature than two years ago or three years ago. We're now adding operational (inaudible). I would have to say, we pretty much double our (inaudible) in compliance and financial department compared with two years ago. All of those kind of dramatically improved our operations and financial function.

Mehdi Hosseini, *Susquehanna Financial Group*

Great. Thank you.

Operator

Thank you. Then we'll move on to our next question from Aaron Rikers with Wells Fargo.

Aaron Rikers, *Wells Fargo Securities*

Thanks for taking the questions. Also congratulations on being out on the results. Building on Mehdi's question. I'm just curious, I heard the comment in the prepared remarks about positive views on the pipeline of opportunities looking through the course of this year. I guess the simple question of that is, how would you define pipeline? How has the methodology around looking at the pipeline changed? Then

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again, what is pipeline to you guys given, obviously, the nature of your business, is fairly turns-oriented? I'm just curious of how you—what underlies the comment as we look forward, and I do have a follow-up.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. I think it's probably pretty traditional in that the pipeline that I was referring to was really the targeted customers that we're trying to obtain and understanding that—what is in front of us and the level of efforts that we find to land new customers. Sometimes pipeline is referred to growing backlog and all those kind of things, which is not our business. What we're talking about is landing new customers.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Especially (inaudible), we start to have a more enterprise accounts. Those enterprise and large accounts in the area continues by the products and commerce distribution and regular data center. They change vendor kind of more (inaudible).

Aaron Rikers, *Wells Fargo Securities*

Okay. Then the follow-up question is tied to the pipeline commentary, is that as you move through the course of 2020, there seems to be a little bit of a different cadence to server cycle dynamics. I guess particularly around the cadence of Intel's product cycles, what that means for your business. How do you see—there's a lot of discussion out there around Cascade Lake and the ramp of that going to Cooper Lake, and whether or not there could be any delays on Icelake. How do you see the cadence of the server CPU cycle through the course of this year? How relevant has AMD (inaudible) as compared to (inaudible) in the context of your business?

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Yes. I mean, obviously AMD is growing quickly, and NPLs are more dynamic new product. By the way, when they have new technology, new generation products always outperform the older product. We have a very strong engineering team and fully focused on delivering the new economies in the market. Taking AMD alone (inaudible), we are well prepared. That's why we believe (inaudible) on this calendar year and next year, I believe we will have a big chance to grow much faster.

Aaron Rikers, *Wells Fargo Securities*

Just to slip in one other question. How quickly can you pass through upward pricing on the component front?

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Your question again?

Aaron Rikers, *Wells Fargo Securities*

As we look at component pricing potentially moving higher, I guess particularly around DRAM, as we move through the course of this year, how do I think about your guys' ability to pass through pricing on the way up? Obviously, it's had an impact on ASPs on the way down. But as pricing comes back, how quickly do I think, in your business model, you pass that back through from a pricing perspective?

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

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Okay. Basically, we have a much stronger relationship with our vendor already. Pretty much, we are able to be deflect any price to our customers. That overall effect should be (inaudible).

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

You're trying to understand the delay, and I think there is always a delay, but we try to be very nimble in that. (Inaudible).

Aaron Rikers, *Wells Fargo Securities*

Okay. Thank you. Please go ahead.

Operator

Thank you. We'll move on to our next question from Nehal Chokshi with Maxim Group. Please go ahead.

Nehal Chokshi, *Maxim Group*

Thank you. Congratulations on a really strong cash from operations quarter. Looks like the drivers were across the board in terms of cash conversion cycle. Is this now at a level where you expect it to be? Or did you guys actually over-index a little bit on the construction of the cash conversion cycle?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes, I think we had a good quarter. I did refer to fact that it was better than what our near-term target range was. Like every new watermark, I'm not sure it will be there because—forever because we have seasonalities that we have to live with. But I think what we'll do now is revisit our target and, over the course of time, see if that target can be shifted, so a little bit better performance, and we'll give an update on that.

Nehal Chokshi, *Maxim Group*

Okay. I apologize if this has been asked earlier, I am having trouble hearing you guys clearly. But did you guys give any metrics on the large enterprise customer segment?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

No, we did not. We broke it down basically, in terms of our direct and our indirect channel.

Nehal Chokshi, *Maxim Group*

Okay. I've got a couple more questions. On the performance within the quarter, obviously, you guys did—came in just above the high end of your guidance. That's great to see. What do you think was the delta (inaudible) performance? Do you think it was the industry performed better? Or you guys performed better than what you had expected? Then relative to the prior few quarters, Super Micro revenue year-over-year growth had been underperforming the industry. Do you have a sense as far as how you guys did perform relative to the industry for the December quarter?

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

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Yes. We see the—before, we always grew much faster than the industry. (Inaudible) see a slow-down. Now it's time to get back to faster growth again. We expect that we will be able to grow a better (inaudible).

Nehal Chokshi, *Maxim Group*

Is that what's embedded in the March Q guidance?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

I'm sorry, your question was a little muffled. Can you repeat it?

Nehal Chokshi, *Maxim Group*

Yes. Charles mentioned that expect to grow faster than the industry going forward. Now, is that embedded in the March Q guidance?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

I mean, March is a very difficult quarter. I think we're talking about beyond the March quarter, just given all of the macro dynamics that we talked about.

Nehal Chokshi, *Maxim Group*

Okay. Good. Then could you comment particularly on—you did mention that geographic performance was uneven, but what was the reason behind that? Was that industry or Super Micro specific?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

We haven't seen everyone else in the industry breakout. We haven't compared it necessarily. But in Europe, I think we were a little soft from data center customers.

Nehal Chokshi, *Maxim Group*

Okay. Thank you.

Operator

Thank you. We'll now take our next question from Jon Lopez with Vertical Group.

Jon Lopez, *The Vertical Trading Group*

Thanks so much. I have three. I hope you can bear with me. The first one, the deferred revenue continues to grow a lot, and it's comfortably over $200 million. Can you just remind us what's driving that? Then does that yield you any different for better visibility looking forward than was the case before the deferred balance really started to come up?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. I think, first and foremost, it's good that we're starting to get stronger service business. Certainly, when you're attacking enterprise customers who want that white glove performance or rather expectations, that helps to do that. It is a little bit of a proxy build out. There's a lot when we add on in that

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deferred service revenue in terms of the length of contracts that people are signing up for. Also pricing over the course of time ends up being in the service revenue line item as well. But I think you're right in terms of it growing is a healthy thing for Super Micro. What I've said in past calls is that, so far, it is a small number from a revenue perspective, but it hopefully will be giving us some buffer in the margin area as time goes by.

It's all just a big (inaudible) client to Super Micro, and is a proof point, to a certain degree, of the increase in software and service profit for the Company that Charles outlined earlier.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Yes. At this stage, we start to see (inaudible) more than 15% here. We believe the trend will continue for next many years to come.

Jon Lopez, *The Vertical Trading Group*

All right. Great. That's helpful. My second one, if we just look at the December quarter, I don't have the exact numbers here, but if I ballpark your commentary, it looks like the nonservice systems business, that's subsystems and accessories segment, was up a lot. A, do I have that right, and B, what was driving that to a disproportionately high level of growth relative to service systems?

Perry Hayes, *Senior Vice President, Investor Relations*

Yes, the indirect channel was higher than what we've typically seen. I just want to call out, though, that both the direct and OEM business and the indirect channel business both grew sequentially. The indirect channel, we've had a number of programs that we've launched in support of the channel. That, I think, has been helpful. Also, we've seen that the channel also includes the logistic part where we sell subsystems, but it also includes bars we have some larger customers buying systems from them. That's primarily what we saw, larger purchases through the indirect channel from some of our larger customers.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. I think the key thing there that Perry broke out a little bit is that one cannot make a direct connection to systems versus subsystems and channel versus direct. It is quite a bit of a mix in there.

Jon Lopez, *The Vertical Trading Group*

That makes sense. Just thinking about the March, I'm not looking for segment guidance, but would you expect that growth rate to normalize between the two segments, looking into March?

Perry Hayes, *Senior Vice President, Investor Relations*

I think we'll see contribution from both, probably in the same degree.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. That would be a sequential comment. We might see the same mix shift when we compare year-over-year, however.

Jon Lopez, *The Vertical Trading Group*

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Okay. Got you. Thanks. The last one, I'm hoping to come back to the OpEx real quick because there's a lot of moving pieces here, but if I could just ask it this way. The March quarter, it looks like you're guiding us to something in the high 80s on a non-GAAP basis. From there, what level of increase should we expect for the balance of the year? Is there just—I'm trying to (inaudible) qualitatively. Is there a scenario where OpEx actually declines from the calendar third to the calendar fourth as some of these one-time things move to completion?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Well, I'm glad you asked that question because you've misinterpreted what I said. We had OpEx and non-GAAP OpEx in the quarter be a little over $100 million, right? What I tried to say is that $6.5 million will (inaudible) will come off for the March quarter. Strip off $6.5 million. Then from that new baseline, we would have some trending upward expense in that. Glad you asked that one.

Jon Lopez, *The Vertical Trading Group*

Okay. Sorry, just the last part of that, is there—are you guys embedding some kind of interim peak here in the middle to late part of the second, third quarter that then declines into the fourth? Or we'll just continue to ramp through the year?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

It'll be continuing to ramp. Then actually first quarter '21, I think, would be a peak from an audit cost perspective.

Jon Lopez, *The Vertical Trading Group*

First quarter calendar '21?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. That's when the bulk of the work of the audit is done on June 5.

Jon Lopez, *The Vertical Trading Group*

Okay. Great. Thanks. I appreciate it.

Operator

Thank you. Once again, if you would like to ask a question, that is star, one.

We'll take our next question from Ananda Baruah with Loop Capital.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

I just want to (inaudible) that I was speaking in fiscal quarter near the ending. 1Q '21 would be September of 2020.

Ananda Baruah, *Loop Capital Markets*

Cool. Kevin, just sticking with that theme. This is a—more of a—definitely calendar '21—calendar '21 going to calendar '22 question. More philosophically about how we should think of—how you would like to

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think about business model evolution, once all the audit costs have rolled off and you have these new programs running? How would you like us to think about the op margin, not guidance, but leveraging the model, how you guys are thinking about anecdotally and philosophically funding—funding new programs? It sounds like you have at least a handful of things you're pretty excited about right now. What's the right way for us to think about, as we think about calendar '21 and moving towards normalized (inaudible)?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. It's a little bit mature—premature for us to be able to call that out right now. In our interactions in the past quarter or so, we've mentioned that now that we're back on the market, that we might take a little bit of time redescribing the Company and preparing for an Analyst Day in which we would then present a model going forward. I'm not quite ready to answer that question, please.

Ananda Baruah, *Loop Capital Markets*

Okay. Got it. Are you—have you guys decided upon doing an Analyst Day at some point this year?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. We've said late spring, early summer.

Ananda Baruah, *Loop Capital Markets*

Okay.

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

We would do it—we would do so in New York.

Ananda Baruah, *Loop Capital Markets*

Excellent. I look forward to it.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

As you may know, right? I mean, from last year, previous, we see a Super Micro (inaudible) and extend our business to a total solution, not like the five years ago from the (inaudible) hardware company. Now we are moving to not just hardware company, but total solution, including firmware, software and service. There, we're putting more value to our business.

Operator

Thank you. We'll take our next question from Nehal Chokshi.

Nehal Chokshi, *Maxim Group*

Yes. Thank you. On your last slide of your presentation deck, you have 3.0 solutions, management software and then global services and support that's been driving us for the past three years. What is the level of your global service and support personnel to date?

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

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Our global support team is getting stronger, too. In terms of hardware, we feel we are more completed system, higher value, even improving our security management feature and the whole cloud in those pipeline. Other than that, we started overall inside the (inaudible) in some other (inaudible).

Nehal Chokshi, *Maxim Group*

Okay. Could you give any commentary as far as how large is the global support staff at this point in time?

Kevin Bauer, *Senior Vice President & Chief Financial Officer*

Yes. We don't have that number on our fingertips. But what I can tell you is there are some reasons that we work with partners through our offices as well. Our strategy has been work with partners in new markets and then (inaudible) where we have scale, so to speak. I think (inaudible) next time. I think they're providing that there's going to be (inaudible) as it becomes more meaningful for the company.

Nehal Chokshi, *Maxim Group*

Great. Okay. Thank you.

Operator

It appears at this time we have no further questions. At this time, I'd like to turn the conference back over to Mr. Liang for any additional or closing remarks.

Charles Liang, *Founder, Chairman, President & Chief Executive Officer*

Yes. Thank you for joining us today, and have a great one. Thank you.

Operator

Thank you. Ladies and gentlemen, that does conclude the Super Micro Second Quarter Fiscal 2020 Earnings Conference Call. We do appreciate your participation. You may disconnect at this time.

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