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Sales and marketing expense increased $1.2 million to $12.2 million for the year ended December 31, 2010 compared to $11.0 million for the year ended December 31, 2009. This increase was primarily due to an increase in customer-related evaluation product expenses of $0.5 million, an increase in marketing research, public relations and promotional expenses of $0.5 million, an increase in salaries and payroll related expenses of $0.3 million, and an increase in travel expenses of $0.1 million. These increases were partially offset by decreases in facilities and common costs of $0.2 million as a result of our 2010 restructuring activities.

The increase in customer-related evaluation product expenses is due to new product releases in 2010, including those products acquired in the Cloverleaf acquisition. The increase in marketing research, public relations and promotional costs is primarily the result of various marketing and branding activities in 2010 for our new products and the continued expansion of our channel programs. The increase in salary and payroll related expenses is primarily a result of additional employees engaged in sales and marketing activities as a result of an increase in the number of sales territories we support and the continued expansion of our channel program. The increase in travel expenses was primarily the result of an increase in customer visits.

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General and Administrative Expenses

	2009	% of Net Revenue	2010	% of Net Revenue	(Decrease)	% Change
			(in thousands, except percentages)			
General and Administrative Expenses	$ 10,139	4.3%	$ 9,928	3.9%	$ (211)	(2.1)%

General and administrative expenses decreased $0.2 million to $9.9 million for the year ended December 31, 2010 compared to $10.1 million for the year ended December 31, 2009. This decrease was primarily attributable to a reduction in legal fees of $0.4 million, changes in foreign currency gains and losses of $0.3 million, a reduction in Sarbanes-Oxley fees of $0.3 million and a reduction in board of director fees of $0.2 million. These decreases were partially offset by an increase in salaries and payroll related expenses of $0.8 million and an increase in travel expenses of $0.2 million.

The change in foreign currency gains and losses were primarily the result of changes in the value of the Euro and British pound in relation to the United States dollar. The reduction in legal fees was primarily the result of lower fees associated with litigation matters as certain claims against us were dismissed in the first quarter of 2010. The reduction in Sarbanes-Oxley fees were primarily the result of negotiating lower fees with our service provider. Board of director fees decreased as a result of a reduction in the number of members of our Board of Directors.

Salaries and payroll related expenses and travel expenses increased primarily as a result of our transition of certain of our administrative functions to Longmont, Colorado from Carlsbad, California in 2010, including the costs of duplicative personnel.

Restructuring Charge

	2009	% of Net Revenue	2010	% of Net Revenue	(Decrease)	% Change
			(in thousands, except percentages)			
Restructuring Charge	$ 2,430	1.0%	$ 2,196	0.9%	$ (234)	(9.6)%

In December 2008, our management approved, committed to, and initiated a restructuring plan, or the 2008 Plan, to improve efficiencies in our operations, which was largely driven by our plan to consolidate our facility in Carlsbad, California into the Longmont, Colorado facility. For the year ended December 31, 2009, we incurred severance and related costs of $1.0 million for various California employees whose positions have been relocated to Colorado. As part of the 2008 Plan, we also incurred contract termination costs of $1.4 million for the year ended December 31, 2009 primarily for facility lease and other associated costs that we continued to incur without economic benefit and due to revisions to our assumptions regarding the timing and amount of tenant sublease income.

In the second quarter of 2010, our management approved, committed to, and initiated a restructuring and cost reduction plan, or the 2010 Plan, to better align our resources in order to lower our breakeven point. The 2010 Plan included severance and related costs for the reduction of approximately 10% of our workforce, and fees associated with the acceleration of the closure of our Carlsbad, California facility. For the year ended December 31, 2010, we incurred severance and related costs of $0.6 million related to both our 2008 Plan and 2010 Plan. We also incurred contract termination costs of $1.5 million for the year ended December 31, 2010 primarily for facility lease and other associated costs that we continued to incur without economic benefit and due to revisions to our assumptions regarding the timing and amount of tenant sublease income under both our 2008 Plan and 2010 Plan.

We also incurred additional severance-related restructuring charges of approximately $0.1 million in 2010 related to the termination of a former employee of Cloverleaf. All of the severance-related costs were paid to this employee in 2010.

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See Note 6 of Notes to Consolidated Financial Statements for more details regarding our restructuring activities.

Other Income

	2009	% of Net Revenue	2010	% of Net Revenue	(Decrease)	% Change
			(in thousands, except percentages)			
Other Income, net	$ 167	0.1%	$ (2)	0.0%	$ (169)	(101.2)%

The decrease in other income, net for the year ended December 31, 2010 is primarily attributable to a decrease in interest income primarily due to declining interest rates and lower cash balances.

Income Taxes

We recorded an income tax provision of $0.2 million for the year ended December 31, 2010 compared to an income tax benefit of $0.1 million for the year ended December 31, 2009. The 2010 provision for income taxes primarily represents state, local and foreign taxes. The 2009 benefit from income taxes primarily represents federal tax credits, partially offset by state, local and foreign income taxes. The federal tax credits available to us for the year ended December 31, 2009 were not available in 2010.

Liquidity and Capital Resources

The primary drivers affecting cash and liquidity are the cash portion of our net losses, working capital requirements and capital expenditures. Historically, the payment terms we have had to offer our customers have been relatively similar to the terms received from our creditors and suppliers. We typically bill customers on an open account basis subject to our standard credit quality and payment terms ranging between net 30 and net 45 days. If our net revenue increases, it is likely that our accounts receivable balance will also increase. Our accounts receivable could further increase if customers, in particular large OEM customers, delay their payments or if we grant them extended payment terms.

As of December 31, 2011, we had $46.2 million of cash and cash equivalents and $41.4 million of working capital compared to $45.7 million of cash and cash equivalents and $49.9 million of working capital as of December 31, 2010. Cash equivalents include highly liquid investments purchased with an original maturity of 90 days or less and consist principally of money market funds. In addition, we had $0.1 million in short-term debt at December 31, 2011, consisting of a note payable issued in connection with the acquisition of certain intangible assets from Ciprico.

As of December 31, 2011, $5.9 million of the $46.2 million of cash, cash equivalents, and marketable securities was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Operating Activities

Net cash provided by operating activities for the year ended December 31, 2011 was $2.2 million compared to $9.1 million of cash used in operating activities for the year ended December 31, 2010. The operating activities that affected cash consisted primarily of a net loss which totaled $22.0 million for the year ended December 31, 2011 compared to $13.3 million for the year ended December 31, 2010. The increase in our net loss was significantly attributable to asset impairment charges totaling $7.1 million taken in 2011.

The adjustments to reconcile net loss to net cash used in operating activities for the year ended December 31, 2011 that did not affect cash consisted of depreciation and amortization of $4.8 million, stock-based compensation expense of $5.4 million, goodwill and long-lived asset impairment charges of $7.1 million, issuance of warrants of $1.0 million and a bad debt charge of $0.2 million. Cash flows from operations reflects the positive impact of $3.3 million related to a decrease in accounts receivable, which was primarily due to a decrease in net revenue in 2011. However, this was offset somewhat by an increase in our days sales outstanding which increased to 62 days for the three-months ended December 31, 2011 compared with 49 days for the three months ended December 31, 2010 primarily due to the timing of intra-quarter sales. Cash flows from operations also reflects the positive impact of $2.1 million related to an overall decrease in inventories at December 31, 2011, as a larger portion of our inventory in 2011 was purchased directly from vendors by our contract manufacturers as opposed to in 2010 where we more often acted as a middleman in these transactions.

An additional source of cash flows from operations is $6.2 million related to an increase in accrued compensation and other expenses which was the result of a $5.5 million increase in contingent liabilities related to the recognition of potential payouts on the issue of the power supply failures, an increase of $0.8 million in accrued management bonuses as a result of management attaining certain bonus criteria, a $0.3 increase in accrued commissions and bonuses as a result of the sales force attaining certain of its goals, and an offsetting $0.4 net decrease in miscellaneous accrued accounts. Cash flows from operations include uses of cash of $4.3 million related to an increase in prepaid expenses and other assets due to $1.2 million of asset recovery, the timing of other receivables from our contract manufacturing partners for component parts we buy and ship to them and also due to the timing of payments for various miscellaneous receivables. In addition, cash flows from operations include uses of cash of $0.6 million of other long-term liabilities primarily related to payments of deferred rent, $0.5 million of deferred revenues and $0.3 million in restructuring payments.

Investing Activities

Cash used in investing activities for the year ended December 31, 2011 was approximately $2.5 million compared to $2.1 million for the year ended December 31, 2010. Cash used in investing activities for the year ended December 31, 2011 was due primarily to the continuous expansion of our laboratories associated with the development of new products.

Financing Activities

Cash provided by financing activities for the year ended December 31, 2011 was $0.6 million compared to cash used in financing activities of $0.7 million for the year ended December 31, 2010. Cash provided by financing activities for the year ended December 31, 2011 is attributable to $1.0 million of proceeds from the sale of stock to employees under our employee stock plans, offset by $0.4 million for the ongoing pay-down of our note payable associated with our 2008 acquisition of certain intangible assets from Ciprico.

Based on current macro-economic conditions and conditions in the state of the data storage systems markets, our own organizational structure and our current outlook for 2012, we presently expect our cash and cash equivalents will be sufficient to fund our operations, working capital and capital requirements for at least the next 12 months.

Our standard warranty provides that if our systems do not function to published specifications, we will repair or replace the defective component or system without charge generally for a period of approximately three years. We generally extend to our customers the warranties provided to us by our suppliers and, accordingly, the majority of our warranty obligations to customers are intended to be covered by corresponding supplier warranties. There can be no assurance that our suppliers will continue to provide such warranties to us in the future or that our warranty obligations to our customers will be covered by corresponding warranties from our suppliers, the absence of which could have a potentially significant adverse effect on our operating results and financial condition.

In October 2009, we discovered a quality issue associated with certain power supply devices provided by a long-term component supplier, which resulted in a higher than expected level of power supply failures to us and our customers. While we were able to promptly identify and resolve the cause of the failures, we are required to provide replacement products or make repairs to the affected power supply units that had been sold between March and October 2009. Through June 30, 2011, our component supplier had repaired all of the faulty power supplies at no cost to us, and reimbursed us for our out-of-pocket costs which has constituted a reimbursement to customers for certain out-of-pocket costs they incurred in connection with these power supply failures. The total amount reimbursed to us by our component supplier approximated $1.0 million through June 30, 2011.

During the third and fourth quarters of 2011 and into the first quarter of 2012, we entered negotiations for a settlement with a material customer. Based on our current expectation of how any such additional product quality claims will ultimately be settled, we believe that we will probably incur a liability of $5.5 million. Consequently, we recorded an additional liability of $2.7 million on our consolidated balance sheet as of December 31, 2011 to increase this liability to $5.5 million. In addition we have agreed to extend the original three year warranty on the affected power supplies to six years.

In addition, we entered into negotiations with our component supplier during the third and fourth quarters of 2011 and into the first quarter of 2012, to attempt to recover any losses not previously reimbursed relating to the failed power supply units. In February 2012, we signed a non-binding letter of intent with our component supplier whereby we expect to receive $0.6 million upon signing of the final settlement agreement and a $0.6 million note receivable to be paid out in four, equal installments commencing three months after signing the final settlement agreement, regardless of future purchases from this supplier. In addition, this supplier will extend the warranty on the impacted power supplies from three years to six years and we will be eligible to receive incremental product discounts which are not reasonably estimable. We have increased the previously recorded current asset of $0.5 million within Prepaid expenses and other assets to $1.2 million as of December 31, 2011.

Furthermore, we have commenced discussions with our General Liability and Errors and Omissions Insurance and underwriters and will continue to pursue our rights to cover any damages we incur and not reimbursed by our supplier. The insurance company has issued a reservation of rights letter to us and at this time it is not possible to estimate to what extent, if any, will be covered by our carrier. As of December 31, 2011, we have not assumed or recorded any insurance reimbursement.

To the extent that we are unsuccessful in negotiating settlement agreements with our customer and our component supplier on mutually beneficial terms, or our component supplier does not continue to reimburse us for the expenses incurred by us or our customers, and we are unsuccessful in recovering such expenses from our insurance provider, we could incur additional expenses which could potentially have a material effect on our financial statements.

Recently, the hard disk drive component supply chain has been significantly disrupted as a result of severe flooding in Thailand. In addition, some disk drive manufacturers have substantial manufacturing facilities in Thailand that have been closed down due to flooding. It is estimated that over 30% of the worldwide production of hard disk drives or critical component occurs in Thailand. While over 75% of our revenue typically comes from customers who purchase our AssuredSAN products on a drive-less basis, hard disk drives are a critical component in our AssuredSAN storage array products and can represent 30-70% of the cost of such products. Given the severity of the situation and the potential for extensive hard disk drive shortages for us and our customers, we believe the effects on our business and the data storage industry are likely to be substantial and could extend over multiple quarters.

We will make every effort to secure and hold inventory of hard disk drives to incorporate into our products**.** Any purchase of hard drives beyond our immediate requirements, will likely result in increased inventory and a use of cash, but we expect any increase in hard drive inventory holdings to be consumed through our normal sales to customers over the near term. Given that approximately only one quarter of revenue are dependent on hard disk drive supplies, and given our current cash balances and the availability of additional working capital through Silicon Valley Bank, we do not believe we would be constrained in our ability to secure hard disk drives.

The actual amount and timing of working capital and capital expenditures that we may incur in future periods may vary significantly and will depend upon numerous factors, including the timing and extent of net revenue and expenditures from our core business and strategic investments, the ability to maintain payment terms with our suppliers consistent with the credit terms of our customers, the overall level of net profits or losses, our ability to manage our relationships with our contract manufacturers, the potential growth or decline in inventory to support our customers, costs associated with product quality issues and the recovery, if any, of such costs by a supplier, the status of our relationships with key customers, partners and suppliers, the timing and extent of the introduction of new products and services, growth in operations and the economic environment.

We maintain a credit facility with Silicon Valley Bank for cash advances and letters of credit of up to an aggregate of $30 million based upon an advance rate of 85% of eligible accounts receivable. In February 2011, we amended our credit agreement with Silicon Valley Bank. The amendment extends the maturity date to July 21, 2013, revises the definition of eligible accounts receivable to be less restrictive and also revises the definition of net worth to add stock-based compensation expense, goodwill and long-lived asset impairment charges, subject to certain limitations. Borrowings under the credit facility bear interest at the prime rate and are secured by substantially all of our accounts receivable, deposit and securities accounts. The agreement provides for a negative pledge on our inventory and intellectual property, subject to certain exceptions, and contains usual and customary covenants for an arrangement of its type, including an obligation that we maintain at all times a net worth, as defined in the agreement, of $50 million (subject to certain increases). The agreement also includes provisions to increase the financing facility by $20 million subject to our meeting certain requirements, including $40 million in borrowing base for the immediately preceding 90 days, and Silicon Valley Bank locating a lender willing to finance the additional facility. In addition, if our cash and cash equivalents net of the total amount outstanding under the credit facility fall below $20 million (measured on a rolling three-month basis), the interest rate will increase to prime plus 1% and additional restrictions will apply. Our credit facility also provides for a cash management services sublimit under the revolving credit line of up to $300,000. As of December 31, 2010 we had an outstanding letter of credit issued to our contract manufacturer in China in the amount of $5.0 million. As of December 31, 2011, we are no longer required to carry this letter of credit.

As of December 31, 2011, there were no amounts outstanding under the Silicon Valley Bank line of credit.

The following table summarizes our contractual obligations as of December 31, 2011 (in thousands).

Contractual Obligations	**Total**	**2012**	**2013**	**2014**	**Thereafter**
Operating lease obligations	$ 2,861	$ 2,196	$ 665	$	$
Inventory related purchase obligations	18,487	18,487			
Other purchase obligations	1,654	1,654			
Note payable	71	71			
Total	$ 23,073	$ 22,408	$ 665	$	$

We lease office space, equipment and automobiles under non-cancelable operating leases, which expire at various dates through June 2013. For purposes of the table above, the operating lease obligations exclude common area maintenance, real estate taxes and insurance expenses.

Inventory related purchase obligations represent contractual purchase commitments to our suppliers for certain components in order to ensure supply of select key components at the most favorable pricing.

Other purchase obligations represent purchase commitments made in the ordinary course of business.

In addition to the amounts shown in the table above, $0.2 million of unrecognized tax benefits have been recorded as liabilities in accordance with FASB Interpretation 48, and we are uncertain as to if or when such amounts may be settled.

Off-Balance Sheet Arrangements

At December 31, 2011, we did not have any relationship with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance variable interest, or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we did not engage in trading activities involving non-exchange traded contracts. As a result, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships. We do not have relationships and transactions with persons and entities that derive benefits from their non-independent relationship with us or our related parties except as disclosed herein.

We enter into indemnification agreements with third parties in the ordinary course of business that generally require us to reimburse losses suffered by the third party due to various events, such as lawsuits arising from patent or copyright infringement. These indemnification obligations are considered off-balance sheet arrangements under accounting guidance. It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. Historically, we have not incurred material costs as a result of obligations under these agreements.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) No. 2011-05, *Comprehensive Income (ASC Topic 220) Presentation of Comprehensive Income.* The ASU requires companies to report comprehensive income, including items of other comprehensive income, for all periods presented in a single continuous financial statement in the Consolidated Statements of Operations or split between the Consolidated Statements of Operations and a separate Consolidated Statements of Other Comprehensive Income. The ASU is effective for our first quarter of fiscal year 2012. Other than requiring additional disclosures, the adoption of this new guidance will not have a material impact on our consolidated financial statements. In addition, in December 2011, the FASB issued Accounting Standards Update 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05* (ASU 2011-12). ASU 2011-12 defers the specific requirement within ASU 2011-05 to present on the face of the financial statements items that are reclassified from accumulated other comprehensive income to net income separately with their respective components of net income and other comprehensive income. The effective dates for ASU 2011-12 are consistent with the effective dates for ASU 2011-05 and, similar to our evaluation for the adoption of ASU 2011-05, the adoption of this guidance does not have a material effect on our consolidated financial statements.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***
Interest Rate Risk

We place our cash equivalents with high-credit-quality financial institutions, investing primarily in money market accounts. We have established guidelines relative to credit ratings, diversification and maturities that seek to maintain safety and liquidity. Our investment strategy generally results in lower yields on investments but reduces the risk to principal in the short term prior to these funds being invested in our business. Our interest income is sensitive to changes in the general level of interest rates. In this regard, changes in interest rates can affect the interest earned on our cash equivalents. A 10% unfavorable change in the interest rate would not materially impact our December 31, 2011 balance sheet.

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We have a line of credit agreement, which accrues interest on any outstanding balances at the prime rate. As of December 31, 2011, there were no amounts outstanding under this line. If we make borrowings under this line, we will be exposed to interest rate risk on such debt.

Indicated changes in interest rates are based on hypothetical movements and are not necessarily indicative of the actual results that may occur. Future earnings and losses will be affected by actual fluctuations in interest rates.

Foreign Currency Exchange Rate Risk

We conduct a portion of our business in currencies other than the U.S. dollar, the currency in which our consolidated financial statements are reported. The most significant foreign currencies that subjected us to foreign currency exchange rate risk for the year ended December 31, 2011 were the Euro, British Pound, Japanese Yen and the Israeli New Shekel. Correspondingly, our operating results could be adversely affected by foreign currency exchange rate volatility relative to the U.S. dollar. Although we continue to evaluate strategies to mitigate risks related to the effect of fluctuations in currency exchange rates, we will likely continue to recognize gains or losses from international transactions and foreign currency changes. Although foreign currency transaction gains and losses have not historically been material, we incurred 0.3 million in foreign currency transaction gains during the year ended December 31, 2011, primarily resulting from the remeasurement process of certain of our European subsidiaries that maintain their books of record in a currency other than the functional currency. Future changes in foreign currency rates could adversely impact our operating results. A 10% unfavorable change in exchange rates would result in foreign currency losses of approximately $4.2 million.

Item 8. ***Financial Statements and Supplementary Data***

The information required by this Item is incorporated by reference from the financial statements beginning on page F-1 of this annual report on Form 10-K.

Item 9. ***Changes In and Disagreements With Accountants On Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

Based on management s evaluation (with the participation of our CEO and CFO), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of consolidated financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Management assessed our internal control over financial reporting as of December 31, 2011, the end of our fiscal year. Management based its assessment on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management s assessment included evaluation of elements such as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and our overall control environment.

Based on our assessment, management has concluded that our internal control over financial reporting was effective as of the end of the fiscal year to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Our independent registered public accounting firm, Deloitte and Touche LLP, independently assessed the effectiveness of the company s internal control over financial reporting, as stated in their attestation report, which is included at the end of Part II, of this Form 10-K.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Dot Hill Systems Corp. and subsidiaries

Longmont, Colorado

We have audited the internal control over financial reporting of Dot Hill Systems Corp. and subsidiaries (the Company) as of December 31, 2011, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

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

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel 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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance the 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 (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2011 of the Company and our report dated March 15, 2012 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

Denver, Colorado

March 15, 2012

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Item 9B. ***Other Information***
None.

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***
Some of the information required by this item is incorporated by reference to our Definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A in connection with our 2012 annual meeting of stockholders under the headings Election of Directors and Section 16(a) Beneficial Ownership Reporting Compliance. Other information required by this item is incorporated by reference to Item 1 of Part I of this annual report on Form 10-K under the heading Named Executive Officers and Key Employees of the Registrant.

We have adopted a code of ethics that applies to our principal executive officer and principal financial officer, who is also our principal accounting officer. This code of ethics is incorporated in our code of business conduct and ethics that applies to all of our officers, directors and employees. A copy of our code of business conduct and ethics is available on our web site at www.dothill.com. We intend to satisfy the SEC s disclosure requirements regarding amendments to, or waivers of, the code of business conduct and ethics by posting such information on our web site. A paper copy of our code of business conduct and ethics may be obtained free of charge by writing to our Investor Relations Department at our principal executive office.

Item 11. ***Executive Compensation***
The information required by this item is incorporated by reference to our Definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A in connection with our 2012 annual meeting of stockholders under the headings Executive Compensation, Compensation Committee Report and Compensation Committee Interlocks and Insider Participation.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***
The information under the heading Security Ownership of Certain Beneficial Owners and Management in our Definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A in connection with our 2012 annual meeting of stockholders is incorporated by reference.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth our equity securities authorized for issuance under equity compensation plans as of December 31, 2011.

Stock Plan	**Number of Securities to be Issued Upon Exercise of Outstanding Options and Rights**	**Weighted Average Exercise Price of Outstanding Options and Rights**	**Number of Securities Remaining Available for Future Issuance**
2000 EIP	4,253,299	$ 4.19	
2009 EIP	2,600,742	$ 2.20	6,931,498
2000 ESPP	Not Applicable	Not Applicable	2,542,630
2000 NEDSOP	460,000	$ 2.81	433,124
Total	7,314,041	$ 3.39	9,907,252

All of our equity compensation plans have been approved by our stockholders.

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

The information required by this item is incorporated by reference to our Definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A in connection with our 2012 annual meeting of stockholders under the headings Election of Director(s), Transactions with Related Persons and Policies and Procedures with Respect to Related Party Transactions.

Item 14. ***Principal Accounting Fees and Services***

The information required by this item is incorporated by reference to our Definitive Proxy Statement to be filed with the SEC pursuant to Regulation 14A in connection with our 2012 annual meeting of stockholders under the heading Ratification of Selection of Independent Auditors.

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PART IV

Item 15. ***Exhibits, Financial Statement Schedules***

a) The following documents are filed as part of this report:

(1) Financial statements:

The consolidated balance sheets as of December 31, 2010 and 2011, and the consolidated statements of operations and comprehensive loss, stockholders equity and cash flows for the years ended December 31, 2009, 2010 and 2011, together with notes thereto included elsewhere in this annual report on Form 10-K are incorporated herein by reference.

(2) All other schedules have been omitted from this annual report on Form 10-K because they are not applicable or because the information required by any applicable schedule is included in the consolidated financial statements or the notes thereto.

(3) Exhibits:

Exhibit Number	Description
2.1	Agreement and Plan of Merger dated as of February 23, 2004, by and among Dot Hill Systems Corp., DHSA Corp., Chaparral Network Storage, Inc., and C. Timothy Smoot, as Stockholders Representative.(1)
2.2	Amended and Restated Asset Purchase and Technology License Agreement dated September 17, 2008 by and between Dot Hill Systems Corp. and Ciprico Inc.(2)
2.3	Agreement and Plan of Merger and Reorganization dated as of January 4, 2010, among Dot Hill Systems Corp., Telluride Acquisition Sub, Inc., Cloverleaf Communications Inc., Cloverleaf Communications (Israel) Ltd., Cloverleaf Communications Corporation (BVI) and E. Shalev Management 2000 (1999) Ltd.(8)
3.1	Certificate of Incorporation of Dot Hill Systems Corp.(3)
3.2	Amended and Restated By-laws of Dot Hill Systems Corp.(4)
4.1	Certificate of Incorporation Dot Hill Systems Corp.(3)
4.2	Amended and Restated By-laws of Dot Hill Systems Corp.(4)
4.3	Form of Common Stock Certificate.(5)
4.4	Certificate of Designation of Series A Junior Participating Preferred Stock, as filed with the Secretary of State of Delaware on May 19, 2003.(6)
4.5	Form of Rights Certificate.(6)
4.6	Warrant to Purchase Shares of Common Stock dated January 4, 2008.(9)
10.1	Rights Agreement dated as of May 19, 2003 by and between Dot Hill Systems Corp. and American Stock Transfer and Trust Company.(6)
10.2	2000 Amended and Restated Equity Incentive Plan.(10)
10.3	2009 Equity Incentive Plan.(11)
10.4	Form of Stock Option Agreement (Incentive and Non-statutory Stock Options) used in connection with the 2000 Amended and Restated Equity Incentive Plan.(10)
10.5	Form of Stock Option Grant Notice used in connection with the 2000 Amended and Restated Equity Incentive Plan.(10)

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Exhibit

Number	**Description**
10.6	Amended and Restated 2000 Employee Stock Purchase Plan.(11)
10.7	Amended and Restated 2000 Non-Employee Directors Stock Option Plan.(12)
10.8	Form of Stock Option Agreement used in connection with the 2000 Non-Employee Directors Stock Option Plan.(13)
10.9	Amended and Restated Employment Agreement between Dot Hill Systems Corp. and Dana Kammersgard, effective as of December 18, 2008.(14)
10.10	Amended and Restated Employment Agreement between Dot Hill Systems Corp. and Hanif I. Jamal, effective as of March 16, 2009.(32)
10.11	Description of 2008 Executive Compensation Plan.(15)
10.12	Description of Amended and Restated Policy for Director Compensation.(16)
10.13	Form of Indemnity Agreement.(17)
10.14	Lease Agreement by and between Dot Hill Systems Corp. and Equastone 2200 Faraday, LLC effective as of September 1, 2005 and dated as of September 16, 2005.(18)
10.15	Lease Agreement by and between Dot Hill Systems Corp. and Circle Capital Longmont LLC as of April 12, 2007.(19)
10.16	Loan and Security Agreement dated August 1, 2008 by and between Dot Hill Systems Corp. and Silicon Valley Bank.(20)
10.17	Manufacturing Agreement between Dot Hill Systems Corp. and Flextronics Corporation dated May 20, 2002.(21)*
10.18	Amendment to Manufacturing Agreement between Dot Hill Systems Corp. and Solectron Corporation dated April 5, 2005.(22)*
10.19	Second Amendment to Manufacturing Agreement dated September 16, 2005 between Dot Hill Systems Corp. and Solectron Corporation.(23)*
10.20	Second Award Letter dated September 16, 2005 between Dot Hill Systems Corp. and Solectron Corporation.(23)*
10.21	Manufacturing Agreement by and among Dot Hill Systems Corp., MiTAC International Corporation and SYNNEX Corporation dated February 20, 2007.(24)*
10.22	Manufacturing and Purchase Agreement dated September 24, 2008 by and between Dot Hill Systems Corp. and Hon Hai Precision Industry LTD.(2)*
10.23	Amended and Restated Technology License Agreement, dated as of October 29, 2010 among NetApp, Inc., NetApp Holding and Manufacturing B.V. and Dot Hill Systems Corp.(33)*
10.24	Product Purchase Agreement dated September 10, 2007 by and between Dot Hill Systems Corp. and Hewlett-Packard Company.(30)*
10.25	Amendment One to Product Purchase Agreement dated January 4, 2008, by and between Dot Hill Systems Corp. and Hewlett-Packard Company.(30)*
10.26	Amendment Eight to Product Purchase Agreement dated September 30, 2008 by and between Dot Hill Systems Corp. and Hewlett Packard Company.(2)*
10.27	Patent Cross License dated December 29, 2005 between Dot Hill Systems Corp. and International Business Machines Corporation.(27)*
10.28	Amended Settlement and License Agreement dated October 5, 2006 by and between Dot Hill Systems Corp. and Crossroads, Inc.(31)*

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Exhibit Number	Description
10.29	Amendment One to Manufacturing and Purchase Agreement dated January 28, 2009 by and between Dot Hill Systems Corp. and Hon Hai Precision Industry LTD.(29)*
10.30	Amendment to Loan and Security Agreement dated July 30, 2009 by and between Dot Hill Systems Corp. and Silicon Valley Bank.(25)
10.31	Second Amendment to Loan and Security Agreement dated February 3, 2011 by and between Dot Hill Systems Corp. and Silicon Valley Bank. (28)
10.32	Israeli Appendix to the 2009 Equity Incentive Plan.(26)
10.33	Israeli Appendix to the Amended and Restated 2000 Employee Stock Purchase Plan.(33)
10.34	Amendment Eleven to Product Purchase Agreement and Amendment One to Warrant to Purchase Shares of Common Stock dated September 30, 2008 by and between Dot Hill Systems Corp. and Hewlett Packard Company.*
10.35	Amendment Two to Manufacturing and Purchase Agreement dated January 28, 2009 by and between Dot Hill Systems Corp. and Hon Hai Precision Industry Co., LTD.*
21.1	Subsidiaries of Dot Hill Systems Corp.(7)
23.1	Consent of Deloitte & Touche LLP.
24.1	Power of Attorney. Reference is made to the signature page hereto.
31.1	Certification pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Indicates management or compensatory plan or arrangement.

* Confidential treatment has been granted by, or requested from, the SEC.

Dot Hill s Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K have a Commission File Number of 001-13317.

(1) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on February 24, 2004 and incorporated herein by reference.

(2) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 and incorporated herein by reference.

(3) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on September 19, 2001 and incorporated herein by reference.

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(4) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on December 26, 2007 and incorporated herein by reference.

(5) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on January 14, 2003 and incorporated herein by reference.

(6) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on May 19, 2003 and incorporated herein by reference.

(7) Filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2002 and incorporated herein by reference.

(8) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on January 5, 2010 and incorporated herein by reference.

(9) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on January 7, 2008 and incorporated herein by reference.

(10) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on August 23, 2000 and incorporated herein by reference.

(11) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on June 19, 2009 and incorporated herein by reference.

(12) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 and incorporated herein by reference.

(13) Filed as an exhibit to our Registration Statement on Form S-8 (No. 333-43834) and incorporated herein by reference.

(14) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on December 24, 2008 and incorporated herein by reference.

(15) Filed as item 5.02(e) of our Current Report on Form 8-K filed with the SEC on April 3, 2008 and incorporated herein by reference.

(16) Incorporated herein by reference to the description contained in our Current Report on Form 8-K filed with the SEC on July 29, 2005.

(17) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on December 13, 2005 and incorporated herein by reference.

(18) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on September 21, 2005 and incorporated herein by reference.

(19) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on April 16, 2007 and incorporated herein by reference.

(20) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on August 5, 2008 and incorporated herein by reference.

(21) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 and incorporated herein by reference.

(22) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 and incorporated herein by reference.

(23) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 and incorporated herein by reference.

(24) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 and incorporated herein by reference.

(25) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on August 4, 2009 and incorporated herein by reference.

(26) Filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2009 and incorporated herein by reference.

(27) Filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2005 and incorporated herein by reference.

(28) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on February 7, 2011 and incorporated herein by reference.

(29) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 and incorporated herein by reference.

(30) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 and incorporated herein by reference.

(31) Filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 and incorporated herein by reference.

(32) Filed as an exhibit to our Current Report on Form 8-K filed with the SEC on March 20, 2009 and incorporated herein by reference.

(33) Filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2010 and incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DOT HILL SYSTEMS CORP.

By: /s/ Dana W. Kammersgard
Dana W. Kammersgard
Chief Executive Officer and President

Date: March 15, 2012

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Dana W. Kammersgard and Hanif I. Jamal, and each of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place, and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming that all said attorneys-in-fact and agents, or any of them or their or his substitute or substituted, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ Dana W. Kammersgard **Dana W. Kammersgard**	Chief Executive Officer, President and Director (Principal Executive Officer)	March 15, 2012
/s/ Hanif I. Jamal **Hanif I. Jamal**	Chief Financial Officer, and Treasurer (Principal Financial and Accounting Officer)	March 15, 2012
/s/ Charles Christ **Charles Christ**	Chairman of the Board of Directors	March 15, 2012
/s/ Tom Marmen **Tom Marmen**	Director	March 15, 2012
/s/ Richard Mejia **Richard Mejia, Jr.**	Director	March 15, 2012
/s/ Barry Rudolph **Barry Rudolph**	Director	March 15, 2012
/s/ Roderick M. Sherwood III	Director	March 15, 2012

Roderick M. Sherwood III

/s/ DEBBIE TIBEY	Director	March 15, 2012
Debbie Tibey		

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INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Dot Hill Systems Corp. and subsidiaries

Longmont, Colorado

We have audited the accompanying consolidated balance sheets of Dot Hill Systems Corp. and subsidiaries (the Company) as of December 31, 2010 and 2011, and the related consolidated statements of operations and comprehensive loss, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Dot Hill Systems Corp. and subsidiaries as December 31, 2010 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principals generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2012 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ Deloitte & Touche, LLP

Denver, Colorado

March 15, 2012

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DOT HILL SYSTEMS CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2010 AND 2011

(In thousands, except par value data)

	2010	2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 45,732	$ 46,168
Accounts receivable, net	35,202	31,697
Inventories	7,340	5,251
Prepaid expenses and other assets	3,540	7,896
Total current assets	91,814	91,012
Property and equipment, net	3,597	4,972
Goodwill	4,140	
Intangible assets, net	7,581	2,601
Other assets	370	294
Total assets	$ 107,502	$ 98,879
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 30,555	$ 31,434
Accrued compensation	3,899	5,049
Accrued expenses	4,171	10,860
Deferred revenue	1,371	883
Restructuring accrual	1,664	1,328
Current portion of long-term note payable	275	71
Total current liabilities	41,935	49,625
Long-term note payable	71	
Other long-term liabilities	1,118	552
Total liabilities	43,124	50,177
Commitments and Contingencies (Note 13)		
Stockholders Equity:		
Preferred stock, $.001 par value, 10,000 shares authorized, no shares issued and outstanding at December 31, 2010 and 2011, respectively		
Common stock, $.001 par value, 100,000 shares authorized, 55,953 and 57,699 shares issued and outstanding at December 31, 2010 and 2011, respectively	56	58
Additional paid-in capital	315,257	321,681
Accumulated other comprehensive loss	(3,584)	(3,662)
Accumulated deficit	(247,351)	(269,375)
Total stockholders equity	64,378	48,702
Total liabilities and stockholders equity	$ 107,502	$ 98,879

See accompanying notes to consolidated financial statements.

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DOT HILL SYSTEMS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(In thousands, except per share amounts)

	2009	2010	2011
NET REVENUE	$ 234,383	$ 252,494	$ 197,461
COST OF GOODS SOLD	196,556	209,664	155,828
GROSS PROFIT	37,827	42,830	41,633
OPERATING EXPENSES:			
Research and development	28,120	31,578	35,551
Sales and marketing	10,970	12,164	13,876
General and administrative	10,139	9,928	9,268
Restructuring charge	2,430	2,196	668
Goodwill impairment charge			4,140
Total operating expenses	51,659	55,866	63,503
OPERATING LOSS	(13,832)	(13,036)	(21,870)
OTHER INCOME (LOSS):			
Interest income (expense), net	161	(19)	16
Other income (expense), net	6	17	(41)
Total other income (loss), net	167	(2)	(25)
LOSS BEFORE INCOME TAXES	(13,665)	(13,038)	(21,895)
INCOME TAX (BENEFIT) EXPENSE	(40)	213	129
NET LOSS	$ (13,625)	$ (13,251)	$ (22,024)
NET LOSS PER SHARE:			
Basic and diluted	$ (0.29)	$ (0.25)	$ (0.40)
WEIGHTED AVERAGE SHARES USED TO CALCULATE NET LOSS PER SHARE:			
Basic and diluted	47,094	53,015	54,908
COMPREHENSIVE LOSS:			
Net loss	$ (13,625)	$ (13,251)	$ (22,024)
Foreign currency translation adjustments	35	(145)	(78)
Comprehensive loss	$ (13,590)	$ (13,396)	$ (22,102)

See accompanying notes to consolidated financial statements.

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DOT HILL SYSTEMS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(In thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders Equity
	Shares	Amount				
Balance, January 1, 2009	46,308	46	300,555	(3,474)	(220,475)	76,652
Common stock issued under stock plans	2,644	3	464			467
Share-based compensation expense			2,822			2,822
Foreign currency translation adjustment				35		35
Net loss					(13,625)	(13,625)
Balance, December 31, 2009	48,952	$ 49	$ 303,841	$ (3,439)	$ (234,100)	$ 66,351
Shares issued in connection with acquisition	4,759	5	8,127			8,132
Common stock issued under stock plans	2,242	2	286			288
Share-based compensation expense			3,003			3,003
Foreign currency translation adjustment				(145)		(145)
Net loss					(13,251)	(13,251)
Balance, December 31, 2010	55,953	$ 56	$ 315,257	$ (3,584)	$ (247,351)	$ 64,378
Issuance of warrant to customer			1,007			1,007
Common stock issued under stock plans	1,746	2	1,026			1,028
Share-based compensation expense			4,379			4,379
Excess tax benefit			12			12
Foreign currency translation adjustment				(78)		(78)
Net loss					(22,024)	(22,024)
Balance, December 31, 2011	57,699	$ 58	$ 321,681	$ (3,662)	$ (269,375)	$ 48,702

See accompanying notes to consolidated financial statements.

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DOT HILL SYSTEMS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(In thousands)

	2009	2010	2011
Cash Flows From Operating Activities:			
Net loss	$ (13,625)	$ (13,251)	$ (22,024)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	2,871	4,032	4,755
Adjustment to contingent consideration	(649)	(144)	
Provision for (reduction in) bad debt reserve	(63)		203
Share-based compensation expense	2,822	3,003	5,385
Issuance of warrant to customer			1,007
Long-lived assets impairment charge			2,928
Goodwill impairment charge			4,140
Changes in operating assets and liabilities, net of effects of business acquisition:			
Accounts receivable	6,888	(816)	3,309
Inventories	9,794	(2,938)	2,091
Prepaid expenses and other assets	(445)	1,702	(4,263)
Accounts payable	(2,564)	1,543	(92)
Accrued compensation and other expenses	(415)	(1,394)	6,169
Deferred revenue	(1,658)	147	(501)
Restructuring accrual	1,016	(33)	(336)
Other long-term liabilities	(539)	(946)	(571)
Net cash (used in) provided by operating activities	3,433	(9,095)	2,200
Cash Flows From Investing Activities:			
Purchases of property and equipment	(2,939)	(1,490)	(2,548)
Acquisition, net of cash required		(625)	
Net cash used in investing activities	(2,939)	(2,115)	(2,548)
Cash Flows From Financing Activities:			
Principal payment of note and loan payable	(249)	(1,036)	(398)
Payments on bank borrowings		(5,800)	
Proceeds from bank borrowings		5,800	
Shares withheld for tax purposes		(477)	(422)
Common stock issued under stock plans	467	765	1,450
Net cash provided by (used in) financing activities	218	(748)	630
Effect of Exchange Rate Changes on Cash and Cash Equivalents	12	116	154
Net (Decrease) Increase in Cash and Cash Equivalents	724	(11,842)	436
Cash and Cash Equivalents, beginning of year	56,850	57,574	45,732
Cash and Cash Equivalents, end of year	$ 57,574	$ 45,732	$ 46,168

Supplemental Disclosures of Cash Flow Information:						
Cash paid for income taxes	$	78	$	90	$	235
Supplemental Disclosures of Non-Cash Investing and Financing Activities:						
Capital assets acquired but not paid	$	170	$	67	$	1,540
Common stock issued in connection with acquisition	$		$	8,132	$	

See accompanying notes to consolidated financial statements.

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DOT HILL SYSTEMS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 and 2011

1. Organization and Summary of Significant Accounting Policies

Description of Business

Dot Hill Systems Corp (referred to herein as Dot Hill, we, our or us) is a provider of software and hardware storage systems for the entry and mid-range storage markets for organizations requiring high reliability, high performance networked storage and data management solutions in an open systems architecture. Our storage solutions consist of integrated hardware, firmware and software products employing a modular system that allows end-users to add various capacity or data protection schemes as needed. Our broad range of products, from medium capacity standalone storage units to complete multi-terabyte storage area networks, or SANs, provide end-users with a cost-effective means of addressing increasing storage demands without sacrificing performance.

Basis of Presentation

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

Principles of Consolidation

The accompanying consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Foreign Currency Translation

For our foreign subsidiaries whose functional currency is the local currency, assets and liabilities are translated into United States dollars at period-end exchange rates. Revenues and expenses, and gains and losses, are translated at rates of exchange that approximate the rates in effect on the transaction date. Resulting translation gains and losses are recognized as a component of other comprehensive loss.

For our foreign subsidiaries that maintain their books of record in a currency other than the functional currency, the subsidiaries remeasure monetary assets and liabilities using current rates of exchange at the balance sheet date and remeasure non-monetary assets and liabilities using historical rates of exchange. Gains and losses from remeasurement for such subsidiaries are recognized currently in income as a component of general and administrative expenses.

Foreign currency translation adjustments comprise the entire amount of our accumulated other comprehensive loss at December 31, 2010 and 2011. We incurred foreign currency transaction losses of $0.1 million for the year ended December 31, 2009, and foreign currency transaction gains of $0.2 million and $0.3 million for the years ended December 31, 2010 and 2011, respectively.

Use of Accounting Estimates

The preparation of our financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of net revenue and expenses in the reporting periods. The accounting estimates that require management s most significant and subjective judgments include revenue recognition, inventory valuation, the valuation and recognition of stock-based compensation expense, and the valuation of long-lived assets, goodwill and other intangibles, as well as any other assets and liabilities acquired and accounted for under the purchase method of accounting for business combinations. In addition, we have other accounting policies that involve estimates such as the determination of useful lives of long-lived assets, warranty reserves, accruals for restructuring and valuation allowance for deferred tax assets. Actual results may differ from these estimates under different assumptions or conditions and such differences could be material.

Revenue Recognition

We derive our revenue from sales of our hardware products, software and services.

Hardware

Hardware product revenue consists of revenue from sales of our AssuredSAN storage systems and our AssuredUVS appliance products that includes our AssuredUVS software which is integrated with industry standard hardware which is essential to the functionality of the integrated system product. We recognize hardware product revenue when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) the price is fixed or determinable; and (iv) collectability is reasonably assured. Revenue is recognized for hardware product sales upon transfer of title and risk of loss to the customer and in addition, upon installation for certain of our AssuredUVS appliance products. We record reductions to revenue for estimated product returns and pricing adjustments in the same period that the related revenue is recorded. These estimates are based on historical sales returns, analysis of credit memo data and other factors known at the time. If actual future returns and pricing adjustments differ from past experience and our estimates, additional revenue reserves may be required.

Software

In accordance with the specific guidance for recognizing software revenue, where applicable, we recognize revenue from perpetual software licenses at the inception of the license term assuming all revenue recognition criteria have been met. We use the relative method to allocate revenue to software licenses at the inception of the license term when vendor-specific objective evidence, or VSOE, of fair value for all unspecified software updates and enhancements related to our products through service contracts. We have established VSOE for the fair value of our support services as measured by the stated renewal prices paid by our customers when the services are sold separately on a standalone basis.

Service

Our service revenue primarily includes out-of-warranty repairs and product maintenance contracts. Out-of warranty repairs primarily consist of product repair services performed by our contract manufacturers for those customers that allowed their original product warranty to expire without purchasing one of our higher level support service plans. Revenue from these out-of-warranty repairs, and the associated cost of sales, is recognized in the period these services are provided. Service revenue also consists of product maintenance contracts. Revenue from our product maintenance contracts is deferred and recognized ratably over the contract term, generally 12 to 36 months. Net revenue derived from services was less than 10% of total revenue for all periods presented.

Revenue Recognition for Arrangements with Multiple Deliverables

For multi-element arrangements that include hardware products containing software essential to the hardware product s functionality, undelivered software elements that relate to the hardware product s essential software, and undelivered non-software services, the Company allocates revenue to all deliverables based on their relative selling prices. In such circumstances, the Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) VSOE of fair value, (ii) third-party evidence of selling price, or TPE, and (iii) best estimate of the selling price, or ESP. VSOE generally exists only when the Company sells the deliverable separately and represents the actual price charged by the Company for that deliverable. ESPs reflect the Company s best estimates of what the selling prices of elements would be if they were sold regularly on a standalone basis.

From time to time, the Company enters into arrangements with customers that include acceptance criteria. In such instances, the Company defers all revenue on the arrangement until customer acceptance is obtained or the acceptance clause lapses.

Revenue Recognition for Sales to Channel Partners

On sales to channel partners, we evaluate whether fees are considered fixed or determinable by considering a number of factors, including our ability to estimate returns, payment terms and our relationship and past history with the particular channel partner. If fees are not considered fixed or determinable at the time of sale to a channel partner, revenue recognition is deferred until there is persuasive evidence indicating the product has sold-through to an end-user. Persuasive evidence of sell-through may include reports from channel partners documenting sell-through activity or data indicating an order has shipped to an end-user.

Deferred Revenue

We also defer revenue on upfront nonrefundable payments from our customers and recognize it ratably over the term of the agreement, unless the payment is in exchange for products delivered that represent the culmination of a separate earnings process. When we provide consideration to a customer we normally recognize the value of that consideration as a reduction in net revenue, except in limited circumstances where consideration is provided in relation to previously recorded obligations to the customer. In those situations, consideration will be presented as a component of the financial statement caption related to the original obligation. We may be required to maintain inventory with certain of our largest OEM customers, which we refer to as hubbing arrangements. Pursuant to these arrangements we deliver products to a customer or a designated third-party warehouse based upon the customer s projected needs, but do not recognize product revenue unless and until the customer has removed our product from the warehouse to incorporate into its end products.

We report taxes collected from customers on behalf of governmental authorities on a net basis and are excluded from revenues.

Advertising Costs

We expense advertising costs in the period incurred. Advertising expense is included as a component of sales and marketing expense. Advertising expense was $0.4 million, $1.1 million and $1.2 million for the years ended December 31, 2009, 2010 and 2011, respectively.

Shipping and Handling

Cost related to the shipping and handling of our products is included in cost of goods sold for all periods presented.

Research and Development

Research and development costs are expensed as incurred. In conjunction with the development of our products, we incur certain software development costs. No costs have been capitalized because the period between achieving technological feasibility and completion of such software is relatively short and software development costs qualifying for capitalization have been insignificant.

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Stock-Based Compensation

Stock-based compensation expense for all share-based payment awards granted is determined based on the grant-date fair value. We recognize these compensation costs net of an estimated forfeiture rate, and recognize compensation cost only for those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the vesting term of the share-based payment awards. We estimate forfeiture rates based on our historical experience.

Income Taxes

We recognize deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts using enacted tax rates in effect for the year the differences are expected to reverse. We record a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized.

Cash and Cash Equivalents

We classify investments as cash equivalents if they are readily convertible to cash and have original maturities of three months or less at the time of acquisition. Cash and cash equivalents consist primarily of money market funds issued or managed in the United States. At December 31, 2010 and 2011, the carrying value of cash and cash equivalents approximates fair value due to the short period of time to maturity.

As of December 31, 2011, $5.9 million of the $46.2 million of cash, cash equivalents, and marketable securities was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we will be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Allowance for Doubtful Accounts

We establish an allowance for doubtful accounts for accounts receivable amounts that may not be collectible. We determine the allowance for doubtful accounts based on the aging of our accounts receivable balances and an analysis of our historical experience of bad debt write-offs. Bad debt expense was $0.0, $0.0 and $0.2 million for the year-ended December 31, 2009, 2010 and 2011, respectively.

Balance sheet details were as follows for the following fiscal years ended December 31, (in thousands):

	2009	2010	2011
Balance, beginning of year	$	$	$
Additions to allowance			203
Balance, end of year	$	$	$ 203

Inventories

The components of inventories consist of the following as of December 31, (in thousands):

	2010	2011
Purchased parts and materials	$ 4,901	$ 3,994
Finished goods	2,439	1,257
Total inventories	$ 7,340	$ 5,251

Inventories are valued at the lower of cost (first-in, first-out method) or market value. The valuation of inventory requires us to estimate excess or obsolete inventory. The determination of excess or obsolete inventory

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requires us to estimate the future demand for our products. Our markets are volatile, subject to technological risks and price changes and inventory reduction programs by our customers. In addition, we are required to make last time buys of certain components on occasion. These factors result in a risk that we will forecast incorrectly and produce excess inventories of particular products or have commitments to purchase excess inventory components from our suppliers. As a result, actual demand will differ from forecasts, and such a difference has in the past and may in the future have a material adverse effect on our gross margin and our results of operations. Any write downs to inventory due to the existence of excess quantities, physical obsolescence, changes in pricing, damage, or other causes establish a new cost basis for the inventory. When we sell or dispose of reserved inventory the new cost basis is charged to cost of sales.

Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation. Property and equipment are depreciated for financial reporting purposes using the straight-line method over the following estimated useful lives: machinery and equipment, furniture, fixtures and computer software, 3-5 years; leasehold improvements are amortized using the straight-line method over the shorter of the useful lives of the assets or the terms of the leases. Significant improvements to our property and equipment are capitalized while expenditures for maintenance and repairs are charged to expense in the period incurred.

The components of property and equipment consist of the following as of December 31, (in thousands):

	2010	2011
Machinery and equipment	$ 8,678	$ 11,577
Furniture, fixtures, and computer software	274	854
Leasehold improvements	836	1,034
Construction in progress	171	855
Total property and equipment, at cost	9,959	14,320
Less accumulated depreciation	(6,362)	(9,348)
Total property and equipment, net	$ 3,597	$ 4,972

Depreciation expense was $1.7 million, $2.0 million and $2.7 million for the years ended December 31, 2009, 2010 and 2011, respectively.

Long-lived Asset Impairment

We periodically review the recoverability of the carrying value of long-lived assets for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment in the carrying value of an asset group is recognized whenever anticipated future undiscounted cash flows from an asset group are estimated to be less than its carrying value. The amount of impairment recognized is the difference between the carrying value of the asset group and its fair value. Fair value estimates are based on assumptions concerning the amount and timing of estimated future cash flows and assumed discount rates, reflecting varying degrees of perceived risk. All long-lived assets identified with the Israel Technology Center, or ITC reporting unit are considered one asset group, and are included as a component of the Standalone Storage Software reportable segment. Recent events involving our ITC reporting unit resulted in a significant decline in actual and planned earnings.

As of September 30, 2011, we identified a change in circumstances that indicated the carrying amount of our long-lived assets may not be recoverable, as our primary AssuredUVS customer informed us that the AssuredUVS software would no longer be a component of its business strategy, which would result in a significant decline in revenues for the Company. Our long-lived assets consist of the intangible assets associated with our acquisition of certain identified Cloverleaf Communications, Inc., or Cloverleaf, assets acquired in January 2010 with a carrying value of $5.0 million and property and equipment of $1.2 million.

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Since we did not have an immediate replacement for our AssuredUVS customer, management s forecasted undiscounted cash flows indicated that the assets were potentially not recoverable, and proceeded to estimate the fair value of each long-lived asset. Property and equipment comprise mostly machinery and equipment used for testing and development of our AssuredUVS technology. Management determined that carrying value approximated fair value, as property was either acquired in the 2010 acquisition of Cloverleaf, has been purchased subsequently, or could be re-deployed, establishing recent evidence of fair value. It is depreciated over a 3 5 year estimated useful life.

Intangible assets consist primarily of acquired software of $4.9 million and a trade name of $0.1 million. We determined the fair value of the acquired software by estimating the replacement cost of the software, taking into account both the software as acquired and subsequent development work, as well as the business alternatives we were considering and the corresponding value of the software in these alternative approaches. We estimated the value of the software based on the probabilities of each of the business alternatives. We determined the fair value of the trade name using an income approach and considered the fact that the software s trade name at the time of acquisition was no longer being used. All estimates were based on management using appropriate assumptions and projections.

Our impairment analysis at September 30, 2011 identified $2.9 million of impaired long-lived assets, consisting entirely of intangible assets recognized as part of the Cloverleaf acquisition in 2010. Long-lived asset impairment charges are recorded consistent with our treatment of related amortization expense specific to each acquired intangible assets. We recorded $2.8 million of impaired acquired software and $0.1 million of impaired acquired trade name as a component of cost of goods sold for the year ended December 31, 2011. We are evaluating numerous alternatives to monetize the software asset including, developing an appliance based on industry standard servers, developing storage bundles with our AssuredSAN products, developing and porting the software to be based on open source code such as Linux, integrating some of the AssuredUVS features into some of our AssuredSAN products and making substantial changes to the AssuredUVS operations.

In February 2012, our Board of Directors approved a plan to exit our AssuredUVS business and close down our Israel Technology Development Center (see Note 3). We evaluated the potential impact, if any, on our valuation of our acquired software and other long-lived assets maintained at our Israel Technology Development Center, and based on the facts and circumstances in existence at December 31, 2011, we believe the current valuations are appropriate. However, as a result of our decision in the 2012 fiscal year to shut down our AssuredUVS business, we will assess the recorded long-lived asset valuation for Israel Technology Development Center in the first quarter of 2012.

Valuation of Goodwill

We review goodwill for impairment on an annual basis at November 30 and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Our ITC reporting unit, which develops our AssuredUVS software, is a component of the Standalone Storage Software reporting segment identified in the notes to our consolidated financial statements. During September 2011, our primary AssuredUVS customer became delinquent on the settlement of its payables to us and upon our investigation it became evident that its financial resources were limited. It also informed us that they were changing their strategy which would result in a significant decline in revenue for the Company, and we determined it was more-likely-than-not that the reporting unit was less than its carrying value.

Current accounting standards require that a two-step impairment test be performed on goodwill. In the first step, we compare the fair value of our reporting unit to its carrying value. We determine the fair value of our reporting unit using a combination of the income approach and market capitalization approach. If the fair value of the reporting unit exceeds the carrying value of the net assets, goodwill is not impaired, and we are not required to perform further testing. If the carrying value of the net assets exceeds the fair value of the reporting unit, then we must perform the second step in order to determine the implied fair value of the reporting unit s goodwill and compare it to the carrying value of the reporting unit s goodwill. If the carrying value of the reporting unit s goodwill exceeds its implied fair value, then we must record an impairment charge equal to the difference.

Under the income approach, we calculate the fair value of a reporting unit based on the present value of estimated future discounted cash flows. Under the market capitalization approach, valuation multiples are calculated based on operating data from publicly traded companies within our industry. Multiples derived from companies within our industry provide an indication of how much a knowledgeable investor in the marketplace would be willing to pay for a company. These multiples are applied to the operating data for the reporting unit to arrive at an indicated fair value. Significant management judgment is required in the forecasts of future operating results that are used in the estimated future discounted cash flow method of valuation. The estimates we have used are consistent with the plans and estimates that we use to manage our business. We base our fair value estimates on forecasted revenue and operating costs along with business plans. Our forecasts consider the effect of a number of factors including, but not limited to, the current future projected competitiveness and market acceptance of the product, technological risk, the ease of use and ease of implementation of the product, the likely outcome of sales and marketing efforts and projected costs associated with product development, customer support and selling, general and administrative costs. The assumptions and forecasts used were consistent with those used to evaluate certain of our long-lived assets for impairment at September 30, 2011. It is possible, however, that the plans may change and that actual results may differ significantly from our estimates. The valuation resulted in the recognition of an impairment charge to goodwill of $4.1 million, for the quarter ended September 30, 2011. No additional goodwill remains on the balance sheet of the Company as of December 31, 2011.

Product Warranties

Our standard warranty provides that if our systems do not function to published specifications, we will repair or replace the defective component or system without charge generally for a period of approximately three years. We generally extend to our customers the warranties provided to us by our suppliers and, accordingly, the majority of our warranty obligations to customers are intended to be covered by corresponding supplier warranties. For warranty costs not covered by our suppliers, we provide for estimated warranty costs in the period the revenue is recognized. There can be no assurance that our suppliers will continue to provide such warranties to us in the future or that our warranty obligations to our customers will be covered by corresponding warranties from our suppliers, the absence of which could have a material effect on our financial statements. Estimated liabilities for product warranties are included in accrued expenses.

In October 2009, we discovered a quality issue associated with certain power supply devices provided by a long-term component supplier, which resulted in a higher than expected level of power supply failures to us and our customers. While we were able to promptly identify and resolve the cause of the failures, we are required to provide replacement products or make repairs to the affected power supply units that had been sold between March and October 2009. Through June 30, 2011, our component supplier had repaired all of the faulty power supplies at no cost to us, and reimbursed us for our out-of-pocket costs which has constituted a reimbursement to customers for certain out-of-pocket costs they incurred in connection with these power supply failures. The total amount reimbursed to us by our component supplier approximated $1.0 million through June 30, 2011.

In the second and third quarters of 2011, a material customer provided us with a framework estimating the potential claims precipitated by the power supply failures. As previously disclosed, the customer s preliminary framework of potential claims provided to us included additional costs related to the customer s internal overhead for other internal indirect costs, in addition to third-party direct costs. Based on preliminary discussions for settlement and our analysis of the framework provided by the customer including future potential claims through the warranty period, we estimated that we had incurred a probable loss of approximately $2.8 million. Consequently, in addition to the $1.3 million previously recognized as of June 30, 2011, we recorded an estimated liability of $1.5 million as of September 30, 2011 within Accrued expenses on our condensed consolidated balance sheet.

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Negotiations continued with our customer throughout the fourth quarter of 2011 into the first quarter of 2012. In our judgment, the negotiations have resulted in an increase in our estimated liability at December 31, 2011 to $5.5 million, resulting in a charge of $2.7 million during the fourth quarter of 2011 within Accrued expenses on our condensed consolidated balance sheet, and are reported gross of any third-party recoveries.

While our estimated liability relating to failed power supply units is subject to some uncertainty until settled, based on our current expectation of what the terms of the final negotiated settlement will stipulate , we do not believe the incurrence of an additional loss is either probable or reasonably possible at this time.

During the second quarter of 2011, based on the advice of legal counsel, we established that our component supplier is contractually obligated to reimburse us for fair and reasonable costs we incur with our customers associated with these power supply failures. Our component supplier had continued to re-work and distribute to our customer the affected population of power supplies at no cost to us. In addition, at the time, our collection experience with similar amounts already reimbursed to us by our supplier and our belief that our component supplier and its parent companies had the financial ability to continue to reimburse us for any additional costs we may incur, we recorded a current asset within Prepaid expenses and other assets on our consolidated balance sheet of $1.3 million as of June 30, 2011.

During the third quarter of 2011, as the claims from our customer became clearer, we commenced negotiations with our component supplier for fair and reasonable costs that we have and are likely to incur through the warranty period associated with this component failure. While we have not agreed to an amount to cover the costs associated with replacing customers power supplies, we continue to maintain that we have legal recourse against this component supplier. Originally we determined that the supplier was unlikely to make an up-front cash payment for the original settlement amount of $1.3 million, but it indicated a willingness to provide some form of reimbursement for costs incurred, in the form of cash and/or note receivable of $0.5 million plus future product rebates. Based on our judgment at the time, we reduced the previously recorded current asset of $1.3 million within Prepaid expenses and other assets to $0.5 million as of September 30, 2011. We continued to negotiate this settlement with our supplier and subsequent to December 31, 2011, the supplier signed a letter of intent providing for additional reimbursements above what was recognized as of September 30, 2011. Pursuant to the signed letter of intent, the supplier has agreed to cash consideration of $1.2 million, of which $0.6 million will be received upon the subsequent signing of the Settlement Agreement, with the remainder to be received in four quarterly installments commencing three months from the date the Settlement Agreement is signed. Additionally, our supplier committed to product rebates and/or price concessions on post-2011 product orders for a period of approximately three years, commencing three months from the date of signing the Settlement Agreement, in return for our agreement to release our supplier from all obligations relating to the power supply failures known by us to date. This agreement is not subject to any required future purchases. Based on our judgment, we have increased the previously recorded current asset of $0.5 million within Prepaid expenses and other assets to $1.2 million as of December 31, 2011.

In addition, we have commenced discussions with our General Liability and Errors and Omissions Insurance and underwriters and will continue to pursue our rights to cover any damages we incur and not reimbursed by our supplier. The insurance company has issued a reservation of rights letter to us and at this time, it is not possible to estimate to what extent, if any, we will be covered by our carrier. As of December 31, 2011, we have not assumed or recorded any insurance reimbursement.

To the extent that we are unsuccessful in negotiating settlement agreements with our customer and our component supplier on mutually beneficial terms, or our component supplier does not continue to reimburse us for the expenses incurred by us or our customers, and we are unsuccessful in recovering such expenses from our insurance provider, we could incur additional expenses which could potentially have a material effect on our financial statements.

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Our warranty accrual and cost activity is as follows as of and for the twelve months ended December 31, (in thousands):

	2009	2010	2011
Balance, beginning of year	$ 1,560	$ 993	$ 982
Charged to operations	2,061	2,623	8,244
Deductions for costs incurred	(2,628)	(2,634)	(2,355)
Balance, end of year	$ 993	$ 982	$ 6,871

The table above includes $5.5 million of charges recorded to cost of sales in 2011 related to the liability established for certain third-party material and service costs incurred by our customer related to replacing failed power supplies. The table above does not include the corresponding $1.2 million benefit recorded within cost of sales in 2011 related to the current asset established for the recovery of such costs incurred by our customer which are to be reimbursed to us by our component supplier.

Concentrations of Credit Risk, Customers and Suppliers

A majority of our net revenue is derived from a limited number of customers. We currently have one customer that accounts for more than 10% of our total net revenue: Hewlett Packard, or HP. Our agreements with our original equipment manufacturers, or OEM, partners do not contain any minimum purchase commitments, do not obligate our OEM partners to purchase their storage solutions exclusively from us and may be terminated at any time upon notice from the applicable partner.

Net revenue by major customer is as follows (as a percentage of total net revenue):

	2009	2010	2011
Hewlett Packard	51%	57%	73%
NetApp, Inc.	25%	26%	0%
Oracle (formerly Sun Microsystems)	4%	0%	0%
Other customers less than 10%	20%	17%	27%
Total	100%	100%	100%

Due to the discontinuance of our agreement with NetApp, Inc., or NetApp, our sales to HP represented a substantially higher percentage of our total net revenue in 2011 compared to 2010. If our relationship with HP were disrupted or declined significantly, we would lose a substantial portion of our anticipated net revenue and our business could be materially harmed. We cannot guarantee that our relationship with HP or our other customers will expand or not otherwise be disrupted. Related to the power supply failures, if we are unable to reach a satisfactory settlement with the material customer, it could result in a material reduction in revenue.

In the fourth quarter of 2010, we decided to exit our low margin business with NetApp beginning on or about December 1, 2010. As a result, no revenue from NetApp was generated in 2011.

We expect that the sale of our products to a limited number of customers will continue to account for a high percentage of net revenue for the foreseeable future. On October 31, 2011, we amended, or the Amendment, the Product Purchase Agreement originally entered into with HP on September 10, 2007. The Amendment extends the agreement with HP for a five year period through October 30, 2016. In addition, the Amendment provides that we will continue to comply with the contractually required cost reduction process and to support HP with respect to certain products or statements of work upon any assignment of the agreement for a specified period of time. The Amendment does not contain any minimum purchase commitments by HP (see Note 13).

Simultaneously with the extension of the Product Purchase Agreement, we agreed to extend until October 30, 2016 the expiration date of the warrant previously issued to HP to purchase 1,602,489 shares of our

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common stock at the original exercise price of $2.40 per share. The impact of this extension on our financial statements is an expected non-cash contra-revenue charge of approximately $1.0 million in Dot Hill s 2011 GAAP financial results. We currently rely on a limited number of contract manufacturing partners to produce substantially all of our products. As a result, should any of our current manufacturing partners such as Foxconn Technology Group, or parts suppliers not produce and deliver inventory for us to sell on a timely basis, operating results may be adversely impacted.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) No. 2011-05, *Comprehensive Income (ASC Topic 220) Presentation of Comprehensive Income.* The ASU requires companies to report comprehensive income, including items of other comprehensive income, for all periods presented in a single continuous financial statement in the Consolidated Statements of Operations or split between the Consolidated Statements of Operations and a separate Consolidated Statements of Other Comprehensive Income. The ASU is effective for the Company s first quarter of fiscal year 2012. In addition, in December 2011, the FASB issued Accounting Standards Update 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05* (ASU 2011-12). ASU 2011-12 defers the specific requirement within ASU 2011-05 to present on the face of the financial statements items that are reclassified from accumulated other comprehensive income to net income separately with their respective components of net income and other comprehensive income. The effective dates for ASU 2011-12 are consistent with the effective dates for ASU 2011-05 and, similar to the Company s evaluation for the adoption of ASU 2011-05, the adoption of this guidance does not have a material effect on the Company s consolidated financial statements.

2. Net Loss Per Share

Basic net loss per share is calculated by dividing net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing net loss for the period by the weighted average number of shares of common stock outstanding during the period and including the dilutive effect of common stock that would be issued assuming conversion or exercise of outstanding warrants, stock options, share based compensation awards and other dilutive securities. No such items were included in the computation of diluted loss per share in the twelve months ended December 31, 2009, 2010 or 2011 because we incurred a net loss in each of these periods and the effect of inclusion would have been anti-dilutive.

Outstanding equity awards not included in the calculation of diluted net loss per share because their effect was anti-dilutive were as follows:

	31-Dec-09		31-Dec-10		31-Dec-11	
	Number of Potential Shares	Range of Exercise Prices	Number of Potential Shares	Range of Exercise Prices	Number of Potential Shares	Range of Exercise Prices
Stock options	6,142,901	$ 0.47 - $16.36	6,179,547	$ 0.47 - $16.36	7,314,039	$ 0.47 - $16.36
Unvested restricted stock awards	1,511,205	$	2,099,523	$	2,221,205	$
Warrants	1,602,489	$ 2.40	1,602,489	$ 2.40	1,602,489	$ 2.40

3. Acquisitions

Cloverleaf

On January 26, 2010, or the acquisition date, Dot Hill acquired 100% of the voting equity interests of Cloverleaf Communications Inc., a Delaware corporation, or Cloverleaf. Prior to the acquisition, Cloverleaf was a privately held software company focused on heterogeneous storage virtualization and unified storage technologies. Following the acquisition, Dot Hill changed its operating segment reporting structure and

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Cloverleaf joined Dot Hill s Standalone Storage Software business segment, augmenting its existing software offering portfolio of products. The acquisition of Cloverleaf is intended to broaden Dot Hill s market opportunities and help accelerate Dot Hill s transition from a provider of storage arrays to a provider of storage solutions and software. The Cloverleaf acquisition also provided Dot Hill with a new team of software developers and other professionals located in Israel.

Dot Hill acquired all of the outstanding equity interests in Cloverleaf in exchange for: (i) $0.7 million of cash; (ii) 4,758,530 shares of Dot Hill common stock valued at $8.1 million, or $1.71 per share, which represents the closing price of Dot Hill common stock on the acquisition date, or January 26, 2010; (iii) $1.8 million of specified assumed outstanding liabilities of Cloverleaf at the acquisition date, and (iv) 327,977 shares of restricted common stock that were issued to the employees of Cloverleaf who became employees of Dot Hill on the acquisition date pursuant to Dot Hill s 2009 Equity Incentive Plan.

Dot Hill also incurred direct transaction costs in connection with the acquisition of approximately $0.8 million, of which $0.5 million was recognized as expense in the fourth quarter of 2009 and $0.3 million was recognized as expense in the first quarter of 2010. Dot Hill recorded these costs as general and administrative expenses in its statement of operations. The majority of these costs were paid in the first quarter of 2010. Equity issuance costs incurred in connection with the transaction were not material.

Dot Hill did not assume or exchange any Cloverleaf stock options or other stock-based payment awards in connection with the acquisition of Cloverleaf. Under the terms of the Merger Agreement, all Cloverleaf stock options and warrants that were outstanding immediately prior to the acquisition date and not exercised prior to the acquisition date expired and became null and void as of the acquisition date. All outstanding options expired and had no fair value. In connection with the employment of certain Cloverleaf employees, Dot Hill granted 327,977 shares of restricted common stock. The fair value of the 327,977 shares of restricted common stock that were issued on the acquisition date will be recognized as compensation cost in the post-combination financial statements over the period in which the shares of restricted common stock vest. These shares vest as follows: one-third of such shares vest upon issuance; one-third of such shares vest one year from the date of issuance; and one-third of such shares vest two years from the date of issuance.

The consideration transferred in connection with the acquisition of Cloverleaf approximated $8.8 million as follows (in thousands):

Cash consideration	$ 703
Dot Hill common stock issued to Cloverleaf	8,132
Consideration transferred	$ 8,835

The acquisition of Cloverleaf has been accounted for under the purchase method of accounting in accordance with the requirements of Accounting Standard Codification topic 805 Business Combinations . Under the purchase method of accounting, the purchase price is allocated to the assets acquired and liabilities assumed based on their estimated fair values.

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The allocation of the acquisition date fair value of the total consideration transferred in connection with the acquisition of Cloverleaf is summarized below (in thousands):

Cash	$ 78
Accounts receivable	55
Inventory	67
Other current assets	37
Property and equipment	452
Other non-current assets	23
Amortizable intangible assets:	
Acquired software	6,375
Trade name	181
Goodwill	4,140
Accounts payable	(269)
Current maturities of long-term loan	(775)
Accrued compensation	(401)
Accrued expenses	(172)
Accrued Cloverleaf transaction costs	(924)
Other non-current liabilities	(32)
	$ 8,835

The acquired software consists of heterogeneous storage virtualization and unified storage technologies that can simplify data center management, eliminate downtime and reduce storage costs. The Cloverleaf Intelligent Storage Networking System iSN trade name is an intelligent, network resident, storage network management system that provides a combination of benefits, features and capabilities targeted to meet the demands of mid to large-sized data centers. Dot Hill expects to amortize the fair value of the acquired software and the trade name on a straight-line basis over a period of seven years and five years, respectively, which management believes to reasonably reflect the pattern over which the economic benefits are being derived.

The goodwill of $4.1 million arising from the Cloverleaf acquisition was deemed impaired and has been written off as of December 31, 2011 (see Note 6).

Revenue of $0.6 and $0.5 million and a net loss of $5.5 and $13.4 million attributable to the operations of Cloverleaf since the acquisition date are included in our consolidated results of operations for the years ended December 31, 2010 and 2011, respectively. The $5.5 million net loss includes $0.1 and $0.0 million of non-recurring restructuring costs and $0.5 and $0.2 million of stock-based compensation expense for the years ended December 31, 2010 and 2011, respectively.

Pro forma results

The following unaudited pro forma financial information presents the combined results of operations of Dot Hill and Cloverleaf as if the acquisition had occurred on January 1, 2010 and excludes certain non-recurring charges related to the acquisition. The unaudited pro forma financial information is not intended to represent or be indicative of the consolidated results of operations or financial condition of Dot Hill that would have been reported had the acquisition been completed as of the dates presented, and should not be taken as representative of the future consolidated results of operations or financial condition of Dot Hill.

(in thousands, except per share data)	**Year Ended December 31, 2010**
Net revenue	$ 252,571
Net loss	$ (13,237)

Basic and diluted net loss per share	$	(0.25)

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4. Identifiable Intangible Assets

Identifiable intangible assets are follows as of December 31, (in thousands):

	Estimated Useful Life	Gross	2010 Accumulated Amortization	Net
RaidCore technology	4 years	$ 4,256	$ (2,415)	$ 1,841
NAS technology	3 years	214	(162)	52
Software	7 years	6,375	(835)	5,540
Trade name	5 years	181	(33)	148
Total intangible assets		$ 11,026	$ (3,445)	$ 7,581

	Estimated Useful Life	Gross	2011 Accumulated Amortization	Net
RaidCore technology	4 years	$ 4,256	$ (3,477)	$ 779
NAS technology	3 years	214	(214)	
Software	3 years	2,050	(228)	1,822
Total intangible assets		$ 6,520	$ (3,919)	$ 2,601

During the third quarter of 2011, we recorded a $2.8 million impairment of our acquired software and $0.1 million impairment of our trade name (see Note 1). Additionally, as part of the process of valuing the acquired software we revised the estimated remaining useful life to approximately three years from five, which is subject to further revisions as the facts and circumstances may change in the future. Amortization expense related to identifiable intangible assets totaled $1.1 million, $2.0 million and $2.1 million, for the years ended December 31, 2009, 2010 and 2011, respectively.

Estimated future amortization expense related to identifiable intangible assets is as follows as of December 31, 2011 (in thousands):

2012	2,601
2013	
Thereafter	
Total	$ 2,601

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5. Goodwill

The changes in the carrying amount of goodwill are as follows during the years ended December 31, (in thousands):

	Storage Systems	Standalone Storage Software	Total
Balance as of January 1, 2010			
Goodwill	$ 40,700	$	$ 40,700
Accumulated impairment losses	(40,700)		(40,700)
Goodwill acquired during year		4,140	4,140
Impairment losses			
Balance as of December 31, 2010			
Goodwill	40,700	4,140	44,840
Accumulated impairment losses	(40,700)		(40,700)
	$	$ 4,140	$ 4,140

	Storage Systems	Standalone Storage Software	Total
Balance as of January 1, 2011			
Goodwill	$ 40,700	$ 4,140	$ 44,840
Accumulated impairment losses	(40,700)		(40,700)
		4,140	
Goodwill acquired during year			
Impairment losses		(4,140)	(4,140)
Balance as of December 31, 2011			
Goodwill	40,700	4,140	44,840
Accumulated impairment losses	(40,700	(4,140)	(44,840)
	$	$	$

During the third quarter-ended September 30, 2011, we recorded a $4.1 million impairment of our goodwill associated with the 2010 acquisition of Cloverleaf (see Note 3) which was included in earnings.

6. Restructuring Charge

2008 Plan

In December 2008, our management approved, committed to, and initiated a restructuring plan, or the 2008 Plan, to improve efficiencies in our operations, which was largely driven by our plan to consolidate our facility in Carlsbad, California into the Longmont, Colorado facility. As a result of this relocation, we terminated approximately 70 California employees whose positions have been relocated to Colorado and incurred approximately $1.5 million in severance-related costs since the inception of the 2008 Plan, all of which was recognized as of December 31, 2010. The remainder of the restructuring costs, all of which represent future minimum lease payments relating to the Carlsbad, California facility, will be paid out over the remainder of the lease term ending in April 2013.

As part of the 2008 Plan, we also incurred contract termination costs of $3.8 million since the inception of the 2008 Plan through December 31, 2011. We record charges for contract termination and other associated costs as restructuring expense, which is presented as a separate component within operating expenses. We expect to pay these contract lease termination costs over the remainder of the lease term ending in April 2013. Based on our estimates, we do not expect to receive any material amounts of sublease income beginning in the fourth

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quarter of 2011 through the remainder of the lease term, and accordingly recognized an additional $0.6 million of contract lease termination costs as of the year ended December 31, 2011.

All of the 2008 Plan activity relates to our storage systems operating segment.

The following table summarizes our 2008 Plan activities (in thousands):

2008 Plan

	Severance and Related Costs	Contract Termination and Other Associated Costs	Total
Accrued restructuring balance as of December 31, 2009	$ 439	$ 1,258	$ 1,697
Restructuring plan charges	233	1,289	1,522
Cash payments	(672)	(1,047)	(1,719)
Accrued restructuring balance as of December 31, 2010		1,500	1,500
Restructuring plan charges		621	621
Cash payments		(909)	(909)
Accrued restructuring balance as of December 31, 2011	$	$ 1,212	$ 1,212

2010 Plan

In the second quarter of 2010, our management approved, committed to, and initiated a restructuring and cost reduction plan, or the 2010 Plan, to better align our resources in order to lower our breakeven point. The 2010 Plan includes severance and related costs for the reduction of approximately 10% of our workforce, and fees associated with the acceleration of the closure of our Carlsbad, California facility. As a result of these actions, we intend to terminate approximately 26 employees located in the United States, of which 25 have been terminated as of December 31, 2011. We expect to incur approximately $0.4 million in severance-related costs, all of which was recognized as of December 31, 2010. The remainder of the severance and related restructuring costs attributable to our 2010 Plan were paid out in the third quarter of 2011.

As part of the 2010 Plan, we also incurred contract termination costs of $0.3 million since the plan inception through December 31, 2011 for facility lease and other associated costs that we continue to incur without economic benefit, as we exited the remaining portion of our Carlsbad, California facility. We record charges for contract termination costs and other associated costs as restructuring expense, which is presented as a separate component within operating expenses. We expect to pay these contract lease termination costs over the remainder of the lease term ending in April 2013. Based on our estimates, we do not expect to receive any material amounts of sublease income beginning in the fourth quarter of 2011 through the remainder of the lease term, and accordingly, recognized an additional $0.6 million of contract lease termination costs in the third quarter of 2011.

The majority of the 2010 Plan activity relates to our storage systems operating segment.

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The following table summarizes our 2010 Plan activities (in thousands):

2010 Plan

	Severance and Related Costs	Contract Termination and Other Associated Costs	Total
Accrued restructuring balance as of December 31, 2009	$	$	$
Restructuring plan charges	377	188	565
Cash payments	(357)	(44)	(401)
Accrued restructuring balance as of December 31, 2010	20	144	164
Restructuring plan charges		62	62
Cash payments	(20)	(90)	(110)
Accrued restructuring balance as of December 31, 2011	$	$ 116	$ 116

We also incurred additional severance-related restructuring charges of approximately $0.1 million in the first quarter of 2010 related to the termination of a former employee of Cloverleaf. All of the severance-related costs were paid to this employee in the first quarter of 2010.

All costs related to the 2008 and 2010 Plans are recorded in the restructuring accrual line on our consolidated balance sheets and restructuring charge line on our consolidated statement of operations.

7. Credit Facilities

We maintain a credit facility with Silicon Valley Bank for cash advances and letters of credit of up to an aggregate of $30 million based upon an advance rate of 85% of eligible accounts receivable. In February 2011, we amended our credit agreement with Silicon Valley Bank. The amendment extends the maturity date to July 21, 2013. Borrowings under the credit facility bear interest at the prime rate and are secured by substantially all of our accounts receivable, deposit and securities accounts. The agreement provides for a negative pledge on our inventory and intellectual property, subject to certain exceptions, and contains usual and customary covenants for an arrangement of its type, including an obligation that we maintain at all times a net worth, as defined in the agreement, of $50 million (subject to certain increases). The definition of net worth adds stock-based compensation expense, goodwill and long-lived asset impairment charges, subject to certain limitations. The agreement also includes provisions to increase the financing facility by $20 million subject to our meeting certain requirements, including $40 million in borrowing base for the immediately preceding 90 days, and Silicon Valley Bank locating a lender willing to finance the additional facility. In addition, if our cash and cash equivalents net of the total amount outstanding under the credit facility fall below $20 million (measured on a rolling three-month basis), the interest rate will increase to prime plus 1% and additional restrictions will apply. Our credit facility also provides for a cash management services sublimit under the revolving credit line of up to $300,000. As of December 31, 2011 we had no outstanding letters of credit.

As of December 31, 2010 and 2011, there were no amounts outstanding under the Silicon Valley Bank line of credit.

8. Financial Instruments

The Company s financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, notes payable, bank borrowings and certain other long-term liabilities. The carrying values on our balance sheet of our cash and cash equivalents, accounts receivable, accounts payable and bank borrowings approximate their fair values due to their short maturities. The carrying value on our balance sheet of our notes payable and contingent consideration due to Ciprico, Inc. or Ciprico, in connection with the acquisition of certain

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intangible assets approximates fair value as our credit-adjusted interest rate continues to represent a market participant rate.

9. Fair Value Measurements

Assets Measured at Fair Value on a Recurring Basis

Description	December 31, 2010	Fair Value Measurements Using Quoted Prices for Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Losses)
Cash and cash equivalents	$ 45,732	45,732			

Description	December 31, 2011	Fair Value Measurements Using Quoted Prices for Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Losses)
Cash and cash equivalents	$ 46,168	46,168			

Assets Measured at Fair Value on a Non-Recurring Basis

Description	December 31, 2011	Fair Value Measurements Using Quoted Prices for Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Losses)
Property and equipment, net	$ 1,150			$ 1,150	$
Software	2,050			2,050	(2,807)
Trade Name					(121)
Goodwill					(4,140)
					$ (7,068)

Property and equipment, net with a carrying amount of $1.2 million was tested for impairment as part of our measurement of fair value for long-lived assets held and used and included as a component of our ITC reporting unit. We did not identify any impaired assets classified as property and equipment, net and included within our ITC asset group.

Software acquired as part of our Cloverleaf acquisition in 2010 with a carrying amount of $4.9 million was written down to its fair value of $2.1 million, resulting in an impairment charge of $2.8 million, which was included in earnings for the year-ended December 31, 2011.

The iSN™ trade name acquired as part of our Cloverleaf acquisition in 2010 with a carrying amount of $0.1 million was written down to its fair value of $0.0 million, resulting in an impairment charge of $0.1 million, which was included in earnings for year-ended December 31, 2011.

Goodwill acquired as part of our Cloverleaf acquisition in 2010 with a carrying amount of $4.1 million was written down to its fair value of $0.0 million, resulting in an impairment charge of $4.1 million, which was included in earnings for the year-ended December 31, 2011.

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10. Income Taxes

Components of income (loss) before taxes are as follows for the years ended December 31, (in thousands):

	2009	2010	2011
Income (loss) before taxes:			
U.S.	$ (17,084)	$ (7,958)	$ (6,310)
Foreign	3,419	(5,080)	(15,585)
Total income (loss) before taxes	$ (13,665)	$ (13,038)	$ (21,895)

Components of the income tax provision (benefit) are as follows for the years ended December 31, (in thousands):

	2009	2010	2011
Current:			
Federal	$ (205)	$	$
State, local and foreign	145	213	129
	(60)	213	129
Deferred:			
Federal			
State, local and foreign	20		
	20		
Total income tax provision (benefit)	$ (40)	$ 213	$ 129

The reconciliation of the income tax provision computed using the federal statutory income tax rate to the recognized income tax provision (benefit) is as follows for the years ended December 31, (in thousands):

	2009	2010	2011
Federal statutory rate	$ (4,646)	$ (4,432)	$ (7,444)
State and local income taxes, net of federal benefit	46	(153)	(85)
State rate change and other adjustments		737	160
Increase in valuation allowance	4,225	3,298	6,302
Foreign tax differential	(23)	(76)	(716)
Research and development credits	(253)	(48)	(49)
Goodwill impairment			1,408
Share based compensation	555	532	484
Other	56	203	69
Income tax provision (benefit)	$ (40)	$ 213	$ 129

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The tax effect of temporary differences that give rise to deferred income taxes are as follows as of December 31, (in thousands):

	2010	2011
Deferred tax assets:		
Net operating loss and tax credit carry forwards	$ 87,204	$ 88,675
Inventory reserve and uniform capitalization	1,707	1,959
Stock options and warrants	2,070	2,807
In-process research and development	248	241
Allowance for bad debts	21	265
Vacation accrual	411	354
Deferred rent	513	283
Warranty accrual	364	494
Depreciation and amortization	1,753	1,579
Other accruals and reserves	2,508	4,252
Acquired intangibles	656	1,386
Total deferred tax assets	97,455	102,295
Deferred tax liabilities:		
State taxes	(3,677)	(3,568)
Cloverleaf intangibles	(1,214)	(456)
Total deferred income tax liabilities	(4,891)	(4,024)
Valuation allowance	(92,564)	(98,271)
Net deferred tax assets	$	$

As a result of certain realization requirements of ASC 718, the table of deferred tax assets and liabilities shown above does not include deferred tax assets for net operating losses as of December 31, 2011 that arose directly from tax deductions related to equity compensation in excess of compensation recognized for financial reporting. Equity will be increased by $0.3 million if and when such excess tax benefits are recognized through current taxes payable. The Company uses ASC 740 ordering when determining when excess tax benefits have been realized.

U.S. income and withholding taxes have not been recognized on the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries that are essentially permanent in duration. This amount becomes taxable upon a repatriation of assets from the subsidiary or a sale or liquidation of the subsidiary. The amount of such temporary differences totals $ 0.5 million at December 31, 2011. Determination of the amount of any unrecognized deferred tax liability on this temporary difference is not practicable.

The following table summarizes the activity related to our unrecognized tax benefits (in thousands):

	2009	2010	2011
Balance, January 1	$ 4,756	$ 4,842	$ 5,111
Increase related to prior period positions	167	367	
Increase related to current year tax positions		91	124
Decrease related to prior period positions		(101)	(210)
Decrease related to change in prior year estimate	(81)	(88)	
Balance, December 31	$ 4,842	$ 5,111	$ 5,025

At December 31, 2009, December 31, 2010, and December 31, 2011 we had cumulative unrecognized tax benefits of approximately $4.8 million, $5.1 million, and $5.0 million respectively, of which approximately $0.2 million, $0.2 million, and $0.2 million, respectively, are included in other long term liabilities that, if recognized,

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would affect the effective tax rate. The remaining $4.6 million, $4.9 million and $4.8 million of unrecognized tax benefits will have no impact on the effective tax rate due to the existence of net operating loss carryforwards and a full valuation allowance. Consistent with previous periods, penalties and tax related interest expense are reported as a component of income tax expense. As of December 31, 2009, December 31, 2010 and December 31, 2011, the total amount of accrued income tax related interest and penalties included in the consolidated balance sheet was less than $0.1 million. We do not expect that our unrecognized tax benefit will change significantly within the next 12 months.

Due to net operating losses and other tax attributes going forward, we are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending March 31, 1999 through December 31, 2010. With few exceptions, our state income tax returns are open to audit for the years ended December 31, 2007 through 2010.

We periodically evaluate the likelihood of the realization of deferred tax assets, and adjust the carrying amount of the deferred tax assets by the valuation allowance to the extent the future realization of the deferred tax assets is not judged to be more likely than not. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income or loss, the carryforward periods available to us for tax reporting purposes, and other relevant factors.

At December 31, 2011, based on the weight of available evidence, including cumulative losses in recent years and expectations regarding future taxable income, we determined that it was not more likely than not that our deferred tax assets would be realized and have a $98.3 million valuation allowance associated with our deferred tax assets.

As of December 31, 2011, we had federal and state net operating losses of approximately $194.5 million and $102.3 million, respectively, which begin to expire in the tax years ending 2017 and 2012, respectively. We had foreign net operating losses of $37.0 million, which have no expiration date. In addition, we had federal tax credit carryforwards of $4.2 million, of which approximately $0.5 million can be carried forward indefinitely to offset future tax liability, and the remaining $3.7 million begin to expire in the tax year ending 2012. We also had state tax credit carryforwards of $3.5 million, of which $0.1 million will begin expiring in 2012, and the remaining $3.4 million have no expiration date.

As a result of our equity transactions, an ownership change, within the meaning of IRC Section 382, occurred on September 18, 2003. As a result, annual use of our federal net operating loss and credit carry forwards is limited to (i) the aggregate fair market value of Dot Hill immediately before the ownership change multiplied by (ii) the long-term tax-exempt rate (within the meaning of Section 382 (f) of the IRC) in effect at that time. The annual limitation is cumulative and, therefore, if not fully utilized in a year, can be utilized in future years in addition to the IRC Section 382 limitation for those years.

As a result of our acquisition of Chaparral Network Storage, Inc., or Chaparral, a second ownership change, within the meaning of IRC Section 382, occurred on February 23, 2004. As a result, annual use of Chaparral s federal net operating loss and credit carry forwards may be limited. The annual limitation is cumulative and, therefore, if not fully utilized in a year, can be utilized in future years in addition to the Section 382 limitation for those years.

As a result of our acquisition of Cloverleaf, a third ownership change, within the meaning of IRC Section 382, occurred on January 26, 2010. As a result, annual use of Cloverleaf s federal net operating loss and credit carry forwards may be limited. The annual limitation is cumulative and, therefore, if not fully utilized in a year, can be utilized in future years in addition to the Section 382 limitation for those years.

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11. Stockholders Equity, Equity Incentive Plans and Warrants

Stock Incentive Plans

2009 EIP. Our stockholders approved the 2009 Equity Incentive Plan, or the 2009 EIP, at our Annual Meeting of Stockholders held on June 15, 2009. The 2009 EIP authorizes the issuance or grant of incentive stock options, non-statutory stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, performance awards, performance cash awards and other stock awards to our employees, directors and consultants and is intended as the successor to and continuation of our 2000 EIP. Following the approval of the 2009 EIP by our stockholders, no additional stock awards may be granted under the 2000 Amended and Restated Equity Incentive Plan, or the 2000 EIP. All outstanding stock awards granted under the 2000 EIP will remain subject to the terms of the 2000 EIP provided, however, that any shares subject to outstanding stock awards granted under the 2000 EIP that expire or terminate for any reason prior to exercise or settlement shall become available for issuance pursuant to awards granted under the 2009 EIP. Awards granted under the 2000 EIP expire 10 years from the date of grant. Awards granted under the 2009 EIP expire seven years from the date of grant. As of June 15, 2009, the total number of shares of our common stock reserved for issuance under the 2009 EIP consisted of 4,500,000 shares plus 7,112,217 shares that are subject to outstanding stock awards under the 2000 EIP that may become available for grant under the 2009 EIP if they expire or terminate for any reason prior to exercise or settlement under the 2000 EIP. On May 2, 2011 shareholders approved our Amended 2009 Equity Incentive Plan, primarily to increase the share reserve by 8,000,000 shares. Unless sooner terminated by our Board of Directors, the 2009 EIP shall automatically terminate on April 26, 2019, the day before the tenth anniversary of the date the 2009 EIP was adopted by the Board. The Board of Directors may also amend the 2009 EIP at any time subject to applicable laws and regulations, including the rules and regulations of The NASDAQ Stock Market LLC. In general, no amendment or termination of the 2009 EIP may adversely affect any rights under awards already granted to a participant unless agreed to by the affected participant.

During 2010 and 2011, we granted restricted stock and options to purchase common stock with various vesting as approved by the Board upon each grant. As of December 31, 2011, 2,027,414 shares of restricted stock were outstanding under the 2009 EIP, of which 438,313 were performance-based restricted stock awards. These performance based awards consist of 131,334 shares that were issued in January 2010, 28% of which will vest in the first quarter of 2012 provided that the time-based objectives are achieved, and 306,979 shares granted in 2011, that will vest in 2012 and 2013 provided that the performance objectives are achieved. We will determine the actual number of shares the recipient receives based on results achieved versus goals based on internal non-financial operational targets. Additionally, 194,124 shares of restricted stock were outstanding under the 2000 EIP. As of December 31, 2011, options to purchase 2,600,742 and 4,253,297 shares of common stock were outstanding under the 2009 EIP and 2000 EIP, respectively. 6,931,498 shares of common stock remained available for grant under the 2009 EIP.

2000 NEDSOP. Under our 2000 Non-Employee Directors Stock Option Plan, or 2000 NEDSOP, nonqualified stock options to purchase common stock are automatically granted to our non-employee directors upon appointment to our Board of Directors (initial grants) and upon each of our annual meeting of stockholders (annual grants). Options granted under the 2000 NEDSOP expire 10 years from the date of the grant. Initial grants vest over four years, with 25% of the shares subject to the option vesting one year from the date of grant and the remaining shares subject to the option vesting ratably thereafter on a monthly basis. Annual grants are fully vested on the date of grant. 1,000,000 shares of common stock are reserved for issuance under the 2000 NEDSOP. As of December 31, 2011, options to purchase 460,000 shares of common stock were outstanding under the 2000 NEDSOP and options to purchase 433,124 shares of common stock remained available for grant under the 2000 NEDSOP.

2000 ESPP. Our stockholders approved our Amended and Restated Employee Stock Purchase Plan, or 2000 ESPP, at our Annual Meeting of Stockholders held on June 15, 2009, primarily to increase the share reserve under the 2000 ESPP by 4,000,000 shares. The 2000 ESPP qualifies under the provisions of Section 423 of the Internal Revenue Code, or IRC, and provides our eligible employees, as defined in the 2000 ESPP, with an

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opportunity to purchase shares of our common stock at 85% of fair market value. There were 895,071 and 667,265 shares issued under the 2000 ESPP for the years ended December 31, 2010 and 2011, respectively. As of December 31, 2011, the 2000 ESPP had a total of 2,542,630 shares available for purchase.

As of December 31, 2011, total unrecognized share-based compensation cost related to unvested stock options, restricted stock awards, management stock incentive plan and our 2000 ESPP was $5.5 million, which is expected to be recognized over a weighted-average period of approximately 2.9 years. The following table summarizes share-based compensation expense for the years ended December 31, (in thousands):

	2009	2010	2011
Cost of goods sold	$ 382	$ 489	828
Sales and marketing	288	333	540
Research and development	1,112	1,231	2,382
General and administrative	1,040	950	1,635
Share-based compensation expense before taxes	2,822	3,003	5,385
Related deferred income tax benefits			
Share-based compensation expense	$ 2,822	$ 3,003	$ 5,385
Share-based compensation expense is derived from:			
Stock options	$ 2,237	$ 1,589	1,478
Restricted stock awards	310	1,052	2,482
Stock bonus plan			1,006
2000 ESPP	275	362	419
Total	$ 2,822	$ 3,003	$ 5,385

We estimate forfeitures at the time of grant and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We have historically and continue to estimate the fair value of share-based awards using the Black-Scholes option-pricing model.

A summary of stock option activity is as follows:

	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2011	6,179,547	$ 3.57		
Granted	1,902,500	2.58		
Exercised	(291,984)	1.90		
Forfeited	(204,919)	2.12		
Expired	(190,593)	4.83		
Outstanding at December 31, 2011	7,394,551	$ 3.39	5.17	$ 81,196
Vested and expected to vest at December 31, 2011	7,076,011	$ 3.43	5.08	$ 80,547
Exercisable at December 31, 2011	4,877,883	$ 3.96	4.82	$ 55,672

A summary of restricted stock award activity for 2011 is as follows:

	Number of shares	Weighted average grant date fair value

Outstanding at January 1, 2011	2,099,523	$	1.47
Granted	1,362,329		2.68
Vested	(825,760)		1.67
Forfeited	(402,529)		1.73
Outstanding and unvested at December 31, 2011	2,233,563	$	2.09

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The weighted average grant-date fair values of options granted during the years ended December 31, 2009, 2010 and 2011 were $0.45 per share, $0.97 per share, and $1.78 per share, respectively. The total intrinsic value of options exercised during the years ended December 31, 2009, 2010 and 2011 were $0.0 million, $0.0 million, and $0.8 million, respectively.

The weighted average grant-date fair values of restricted stock awards granted during the years ended December 31, 2009, 2010 and 2011 were $0.55, $1.68 and $2.68 per share, respectively. The fair value of restricted stock awards that vested during the years ended December 31, 2009, 2010 and 2011 was $0.1, $0.8 and $1.4, respectively.

Cash generated from options exercised under all share-based compensation arrangements for the years ended December 31, 2009, 2010 and 2011 were $0.0 million, $0.1 million and $0.5 million, respectively. Cash generated from the purchase of shares through the 2000 ESPP for the years ended December 31, 2009, 2010 and 2011, was $0.5 million, $0.7 million, and $0.9 million respectively. We issue new shares from the respective plan share reserves upon exercise of options to purchase common stock and for purchases through the 2000 ESPP.

The aggregate intrinsic value in the stock option summary table above is based on our closing stock price of $1.33 per share as of the last business day of the fiscal year ended December 31, 2011, which value would have been realized by the optionees had all options been exercised on that date. The total fair value of options to purchase common stock that vested during the years ended December 31, 2009, 2010 and 2011 was $2.4 million, $1.1 million, and $1.2 million, respectively.

To estimate compensation expense for the years ended December 31, 2009, 2010, and 2011 we used the Black-Scholes option-pricing model with the following weighted-average assumptions for equity awards granted:

		EIP and NEDSOP Years Ended December 31,			ESPP Years Ended December 31,	
	2009	**2010**	**2011**	**2009**	**2010**	**2011**
Risk-free interest rate	2.01%	2.25%	1.84%	0.32%	0.19%	0.17%
Expected dividend yield	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Volatility	69%	74%	85%	120%	101%	70%
Expected Term	5.5 years	5.9 years	5.36 years	0.5 years	0.5 years	0.5 years
Forfeiture Rate	0%-12.37%	0%-12.69%	0%-12.25%	0%	0%	0%

The risk-free interest rate is based on the implied yield available on United States Treasury issues with an equivalent remaining term. We have not paid dividends in the past and do not plan to pay any dividends in the future.

The expected volatility is based on historical volatility of our stock for the related vesting period. The expected life of the equity award is based on historical experience.

The forfeiture rate is estimated when awards are granted and updated if information becomes available indicating that actual forfeitures will differ.

Warrants

In January 2008, we amended our Product Purchase Agreement, or Agreement, originally entered into with HP in September 2007, to allow for sales to additional divisions within HP. In connection with the Agreement, we issued a warrant to HP to purchase 1,602,489 shares of our common stock (approximately 3.5% of our outstanding shares prior to the issuance of the warrant) at an exercise price of $2.40 per share.

On October 31, 2011, we amended again the Product Purchase Agreement originally entered into with HP on September 10, 2007. In part, this Amendment extends until October 30, 2016 the expiration date of the warrant previously issued to HP to purchase 1,602,489 shares of our common stock at the original exercise price of $2.40 per share. The impact of this extension on our financial statements is a non-cash contra-revenue charge of approximately $1.0 million in Dot Hill s 2011 statement of operations.

12. Employee Retirement Benefit Plans

Dot Hill Retirement Savings Plan

The Dot Hill Retirement Savings Plan, which qualifies under Section 401(k) of the IRC, is open to eligible employees over 21 years of age. Under the plan, participating United States employees may defer up to 100% of their pretax salary, but not more than statutory limits. At our discretion we may make contributions to this plan for plan participants. Our matching contributions vest to employees as a percentage based on years of employment from one to five years, and matching contributions are fully vested to employees after five years of employment. Our matching contributions to the retirement savings plan for the years ended December 31, 2009, 2010 and 2011 were $0.2 million, $0.1 million and $0.1 million, respectively.

13. Commitments and Contingencies

Operating Leases

We lease office space, equipment and automobiles under non-cancelable operating leases, which expire at various dates through June 2013. Rent expense for the years ended December 31, 2009, 2010 and 2011 was $1.4 million, $1.6 million and $1.6 million, respectively. We record rent expense on a straight line basis based on contractual lease payments.

Future minimum lease payments due under all non-cancelable operating leases as of December 31, 2011 are as follows (in thousands):

2012	$ 2,196
2013	665
2014	
Total minimum lease payments	$ 2,861

For purposes of the table above, the operating lease obligations exclude common area maintenance, real estate taxes and insurance expenses.

Warranty

Our standard warranty provides that if our systems do not function to published specifications, we will repair or replace the defective component or system without charge generally for a period of approximately three years. We generally extend to our customers the warranties provided to us by our suppliers and, accordingly, the majority of our warranty obligations to customers are intended to be covered by corresponding supplier warranties. For warranty costs not covered by our suppliers, we provide for estimated warranty costs in the period the revenue is recognized. There can be no assurance that our suppliers will continue to provide such warranties to us in the future or that our warranty obligations to our customers will be covered by corresponding warranties from our suppliers, the absence of which could have a material effect on our financial statements. Estimated liabilities for product warranties are included in accrued expenses (see Note 1).

Unconditional Purchase Obligations

We have unconditional inventory related purchase obligations to certain suppliers for certain commodities in order to ensure supply of select key components at the most favorable pricing. Additionally, we have non-inventory related purchase obligations that represent purchase commitments made in the ordinary course of business. At December 31, 2011 we had approximately $20.1 million of unconditional purchase obligations.

Legal Proceedings

We are involved in certain legal actions and claims from time to time arising in the ordinary course of business. Management believes that the outcome of such litigation and claims could have a material effect on our financial statements. Historically the outcome of such litigation and claims has not had a material adverse effect on our financial condition or results of operations.

14. Segment Information

Primarily as a result of our acquisition of Cloverleaf in January 2010, as well as our ongoing strategic development, planning and evaluation, we changed the structure of our internal organization to focus on our storage systems and standalone software products. As a result, we now have two operating segments, which include storage systems and standalone storage software. Our storage hardware operating segment consists predominantly of our business prior to the acquisition of Cloverleaf and includes our AssuredSAN products. Our standalone storage software operating segment consists primarily of the business we acquired from Cloverleaf and the intellectual property assets we purchased from Ciprico and includes our AssuredUVS and AssuredVRA products.

All prior period amounts have been adjusted to reflect the new operating segment structure.

The Chief Operating Decision Maker, or CODM, is our President and Chief Executive Officer. The CODM allocates resources to and assesses the performance of each operating segment using information about its revenue and operating income (loss).

The CODM does not evaluate operating segments using discrete asset information. Although the CODM uses operating income to evaluate the segments, operating costs included in one segment may benefit other segments. The accounting policies Dot Hill uses to derive operating segment results are substantially the same as those the consolidated Company uses.

Description of Segments

Storage Systems

We offer, primarily through our AssuredSAN products, a flexible, broad line of networked data storage solutions composed of standards-based hardware and embedded software for open systems environments including Fiber Channel, Internet Small Computer Systems Interface, or iSCSI, and Serial Attached SCSI, or SAS, storage markets. We incorporate many of the performance attributes and other features demanded by high-end/data center end-users into our products, at prices that are suitable for the entry-level or mid-range markets. Our end-users consist of entry-level and mid-range users, requiring cost-effective, easily managed, high-performance, reliable storage systems. Our AssuredSAN product lines range from approximately 146 gigabyte, or GB, to large 192 terabyte, or TB, storage systems. These offerings allow our products to be integrated in a modular building block fashion or configured into a complete storage solution, increasing OEM flexibility in creating differentiated products. Modular products also allow our OEM partners to customize solutions, bundling our products with value-added hardware, software and services.

Our storage systems segment products and services are sold worldwide to facilitate server and storage area network, or SAN, storage implementations, primarily through OEMs, and supplemented by system integrators, or SIs, distributors and value added resellers, or VARs.

Standalone Storage Software

We offer a line of unified virtual storage appliances called the AssuredUVS product line. To OEM customers, we market this technology as a software-only product with a license based business model. To end-user customers, we market this as complete appliance products (hardware servers, software, and storage options) through our indirect sales channel under the Dot Hill brand. The AssuredUVS product line delivers the following:

Simplified Unified Storage Management. The AssuredUVS provides the ability to create and manage virtual volumes for block (SAN) and file (NAS) storage with complete storage ecosystem management using a unified set of management tools so IT personnel can do more with the same resources.

Storage Virtualization. The AssuredUVS provides a full set of virtualization tools for volume management, thin provisioning, snapshots, replication, and tiered storage across a set of heterogeneous storage arrays.

Business Continuity. The AssuredUVS delivers data protection through snapshots, virtual replicas and mirroring both local and remote. Our communications layer over WAN connections supports policy-based Recovery Point Objective, or RPO, and Recovery Time Objective, or RTO, quality of service as the globally distributed geographical scale.

Scaling and Maximizing assets. The AssuredUVS offers support for existing and new storage arrays in a data center, eliminating the need to replace existing storage systems. The technology allows non-disruptive data migration from existing storage volumes to new virtual volumes and the ability to integrate existing storage volumes as proxy volumes without moving data.

During the third quarter of 2011, we identified certain assets assigned to our ITC reporting unit, which is a component of our Standalone Storage Software operating segment, as impaired and their carrying amounts on the balance sheet were reduced to reflect their estimated fair value as of December 31, 2011 (see Note 1).

Through our acquisition of Ciprico s RAIDCore assets in September 2008, we offer a high-performance, feature rich, host-based RAID stack that can be included as a key ingredient of an entry-level or mid-level enterprise class server built by OEMs or SIs. This product line, called AssuredVRA, provides a cost effective solution for standard Windows and Linux servers that utilizes existing built in SATA or SAS I/O capabilities of motherboards or simple storage I/O adapters to replace expensive dedicated hardware RAID adapter solutions.

Net revenue and operating loss were as follows (in thousands):

	Year Ended December 31,		
	2009	**2010**	**2011**
Storage Systems net revenue	$ 234,360	$ 250,631	$ 192,965
Standalone Storage Software net revenue	23	2,112	5,022
Total segment net revenue	234,383	252,743	197,987
Elimination of intersegment net revenue		(249)	(526)
Total Dot Hill consolidated net revenue	$ 234,383	$ 252,494	$ 197,461
Storage Systems operating loss	$ (10,618)	$ (5,046)	$ (8,386)
Standalone Storage Software operating loss	(3,214)	(7,990)	(13,484)
Total operating loss	$ (13,832)	$ (13,036)	$ (21,870)
Total other income (loss), net	167	(2)	(25)
Loss before income taxes	$ (13,665)	$ (13,038)	$ (21,895)

Total assets were as follows (in thousands)

	December 31, 2010	December 31, 2011
Storage Systems total assets	$ 95,227	$ 94,224
Standalone Storage Software total assets	12,275	4,655
Total Dot Hill consolidated total assets	$ 107,502	$ 98,879

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Depreciation and amortization expense by operating segment were as follows (in thousands):

	Year Ended December 31,		
	2009	2010	2011
Storage Systems depreciation expense	$ 1,698	$ 1,681	$ 2,132
Standalone Storage Software depreciation expense	37	347	569
	$ 1,735	$ 2,028	$ 2,701
Storage Systems amortization expense	$	$	$
Standalone Storage Software amortization expense	1,136	2,004	2,054
	$ 1,136	$ 2,004	$ 2,054

The following is a summary of geographical information (in thousands):

	Year Ended December 31,		
	2009	2010	2011
Net revenue:			
United States	$ 215,093	$ 245,379	$ 194,780
Europe	16,813	5,624	601
Asia	2,477	1,491	2,080
	$ 234,383	$ 252,494	$ 197,461
Long-lived assets:			
United States	$ 6,851	$ 5,140	$ 4,945
Europe	11	6,408	2,922
Asia			
	$ 6,862	$ 11,548	$ 7,867

Net revenue is recorded in the geographic area in which the sale is originated.

Long-lived assets include property and equipment, net, identifiable intangible assets, net, and other non-current assets.

2011 Standalone Storage operating loss includes a $2.9 million loss on impairment of long-lived assets and $4.1 million loss on impairment of goodwill (see Notes 1 and 5) relating to our Israel Technology Development Center asset group, which is a component of the Standalone Storage Software operating segment.

15. Quarterly Financial Information (Unaudited)

The information presented below reflects all adjustments, which, in the opinion of management, are of a normal and recurring nature necessary to present fairly the results of operations for the periods presented (in thousands, except per share amounts).

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year Ended December 31, 2010:				

Net revenue	$ 59,974	$ 65,493	$ 61,586	$ 65,441
Gross profit	8,125	9,669	11,295	13,741
Income (Loss) before income taxes	(6,378)	(5,799)	(1,260)	399
Net income (loss)	(6,427)	(5,834)	(1,269)	279
Basic and diluted net income (loss) per share	$ (0.12)	$ (0.11)	$ (0.02)	$ 0.01

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	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year Ended December 31, 2011:				
Net revenue	$ 49,174	$ 53,179	$ 48,071	$ 47,037
Gross profit	12,102	13,195	8,042	8,294
Income (Loss) before income taxes	(1,221)	(1,880)	(12,107)	(6,687)
Net income (loss)	(1,271)	(1,945)	(12,182)	(6,626)
Basic and diluted net income (loss) per share	$ (0.02)	$ (0.04)	$ (0.22)	$ (0.12)

During the first, second, third and fourth quarters of 2010, we incurred approximately $0.3 million, $1.4 million, $0.1 million and $0.4 million, respectively, of restructuring charges related to our 2008 restructuring plan. During the first, second, third and fourth quarters of 2011, we incurred approximately $0.0 million, $0.0 million, $0.7 million and $0.0 million, respectively, of restructuring charges related to our 2008 and 2010 restructuring plans. See further discussion of our restructuring activities in Note 6.

On January 26, 2010, we acquired 100% of the voting equity interests of Cloverleaf in exchange for (i) $0.7 million of cash, (ii) 4,758,530 shares of Dot Hill common stock valued at $8.1 million, or $1.71 per share, (iii) $1.8 million of specified assumed outstanding liabilities of Cloverleaf at the acquisition date, and (iv) 327,977 shares of restricted common stock that were issued to the employees of Cloverleaf who became employees of Dot Hill on the acquisition date pursuant to Dot Hill s 2009 Equity Incentive Plan. See further discussion of our acquisition of Cloverleaf in Note 3.

16. Subsequent Events

2012 Restructuring and Cost Reduction Plan

On February 2, 2012, our Board of Directors approved the implementation of a restructuring and cost reduction plan or the 2012 Plan that will include severance and related costs, contractual obligations, administrative costs and long-lived asset impairments associated with the closure of our Israel Technology Development Center totaling $4.7 to $5.9 million. The 2012 Plan is designed to re-align our software investments to focus on accelerating the development of embedded software features, in order to launch a competitive set of mid-range storage array products in 2012, and to provide more differentiated entry-level products for both OEM and channel customers. The majority of the activities comprising the 2012 Plan are expected to be completed by the end of 2012. We expect to record severance costs in the range of $1.2 to $1.4 million, record contractual obligations in the range of $1.2 to $1.5 million, incur legal and other administrative costs in the range of $0.2 to $0.4 million and recognize long-lived asset impairments of approximately $2.1 to $2.6 million in connection with the 2012 Plan.