CRAY INC
Form 10-K/A
September 17, 2001
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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 1

FORM 10-K/A

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000

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

FOR THE TRANSITION PERIOD FROM _____ TO _____ .

COMMISSION FILE NUMBER: 0-26820

CRAY INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

WASHINGTON (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	93-0962605 (I.R.S. EMPLOYER IDENTIFICATION NO.)
411 FIRST AVENUE SOUTH, SUITE 600 SEATTLE, WASHINGTON (ADDRESS OF PRINCIPAL EXECUTIVE OFFICE)	98104-2860 (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (206) 701-2000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE EXCHANGE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE EXCHANGE ACT:
COMMON STOCK, $.01 PAR VALUE

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

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

The aggregate market value of the Common Stock held by non-affiliates of

the Registrant as of March 19, 2001 was approximately $65,600,000, based upon the last sale price of $1.78 reported for such date on the Nasdaq National Market System.

As of March 19, 2001, there were 39,375,541 shares of Common Stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement to be delivered to shareholders in connection with the Registrant's Annual Meeting of Shareholders to be held on May 16, 2001, are incorporated by reference into Part III.

CRAY INC.

FORM 10-K/A
FOR FISCAL YEAR ENDED DECEMBER 31, 2000

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any projections of earnings, revenues, or other financial items; any statements of the plans, strategies, and objectives of management for future operations; any statements concerning proposed new products, services, or developments; any statements regarding future economic conditions or performance; statements of belief and any statement of assumptions underlying any of the foregoing.

The risks, uncertainties and assumptions referred to above include the timely development, production and acceptance of products and services and their features; the level of governmental support for supercomputers; our dependency on third-party suppliers to build and deliver necessary components; our need for additional credit and financial facilities; the challenge of managing asset levels, including inventory; the difficulty of keeping expense growth at modest levels while increasing revenue; our ability to retain and motivate key employees; and other risks that are described from time to time in our Securities and Exchange Commission reports, including but not limited to the items discussed in "Factors That Could Affect Future Results" set forth in "Business" in Item 1 below in this report, and in subsequently filed reports. We assume no obligation to update these forward-looking statements.

GENERAL

On April 1, 2000, we acquired the operating assets of the Cray Research business unit from Silicon Graphics, Inc. ("SGI"), and changed our corporate name from Tera Computer Company to Cray Inc. With that acquisition we changed from a development stage company with 125 employees (almost all located in Seattle, Washington), limited revenue and one product under development, to a company with nearly 900 employees located in over 20 countries, ongoing sales of supercomputer systems with several products in development, major manufacturing operations, an established service organization and substantial inventory. For these reasons, period to period comparisons that include periods prior to April 1, 2000, are not indicative of future results. Discussions that relate to periods prior to April 1, 2000, refer to our operations as Tera Computer Company and discussions relating to periods after April 1, 2000, refer to our combined operations as Cray Inc.

PART I

ITEM 1. BUSINESS

INTRODUCTION

We design, build, sell and service high performance computer systems, commonly known as supercomputers. We have leading edge technology, multiple product platforms, nearly 900 employees, a substantial worldwide installed base of computers, major manufacturing and service capabilities and extensive global customer relationships. We believe that our current products and those under development represent the future of supercomputing.

We were incorporated under the laws of the State of Washington in December 1987. Our corporate headquarters offices are located at 411 First Avenue South, Suite 600, Seattle, Washington, 98104-2860, and our telephone number is (206)

701-2000.

Cray, Cray-1, SuperCluster, UNICOS and UNICOS/mk are federally registered trademarks of Cray Inc., and Cray C90, Cray J90, Cray T90, Cray T3E, Cray SV1, Cray SV1ex, Cray SV2, Cray MTA, Cray MTA-2 and Cray MTX are trademarks of Cray Inc. Other trademarks used in this Annual Report on Form 10-K are the property of their respective owners.

CRAY ACQUISITION

As briefly described earlier under "General," we acquired the operating assets of the Cray Research business unit from SGI on April 1, 2001, and became the leading company in the world dedicated solely to the development and sale of supercomputers. Prior to the acquisition, we had been developing for ten years one supercomputer product based on multithreaded architecture. We had sales to one customer, limited revenue, and approximately 125 employees. Through the acquisition we acquired outstanding talent, complementary product lines, leading technology, a world-wide service organization and customer relationships with most supercomputer users in the United States and overseas.

In particular, we acquired the Cray SVI and T3E current product lines and the SV2 and other products under development, a service organization supporting Cray supercomputers installed in about 200 sites in the United States and overseas, integrated design and manufacturing capabilities, software products and related experience and expertise, approximately 775 employees, product and service inventory, real property located in Chippewa Falls, Wisconsin, and the Cray brand name. Pursuant to a Technology Agreement, SGI assigned to us various patents and other intellectual property and licensed to us the rights to other patents and intellectual property. We paid SGI $15 million in cash upon closing, $35.3 million pursuant to a non-interest bearing note that we paid in full by December 2000 and 1,000,000 shares of our common stock. We assumed real property leases for other Cray offices and holiday and other benefit obligations for the personnel who transferred from SGI to us.

In acquiring the service of the installed base of Cray supercomputers, we assumed responsibility for the cost of servicing the Cray T90 vector computers. Because certain components in the T90 systems sold by SGI have unusually high failure rates, the cost of servicing these computers exceeds the related service revenue. We are continuing to take action that commenced prior to our acquisition of the Cray Research operations to address this problem, which will not be resolved until all T90 systems are removed from service. We recorded a warranty reserve of $46.3 million to provide for anticipated future losses on the T90 service contracts. We apply a portion of this reserve to offset service costs quarterly based on our T90 service activities during that quarter.

As part of the acquisition we agreed with SGI that we would not utilize specified technology to develop successor products to the T3E product line. In addition, we agreed that for a period of the earlier of three years or until SGI was sold, we would not sell or otherwise transfer any or all of the Cray products, rights under the intellectual property transferred to us under the Technology Agreement, or the service and maintenance relationships with the installed base to Hewlett-Packard Company, Sun Microsystems, Inc., International Business Machines Corporation, Compaq Computer Corporation, NEC Corporation or Gores Technology Group. We also agreed that for the same period, or until such time that our revenue for a period of four fiscal quarters from the sale of the Cray products was less than 50% of our total revenue, we would not transfer these assets to any other party without providing SGI a right of first refusal.

PRODUCT OFFERINGS AND THE HIGH PERFORMANCE COMPUTER MARKET

Since the pioneering Cray-1(R) system arrived in 1976, supercomputers -- defined simply as the most powerful class of computers at any time -- have contributed substantially to the advancement of knowledge and the quality of human life. Problems of major economic, scientific and strategic importance typically are addressed by supercomputers years before becoming tractable on less-capable systems. For scientific applications, the increased need for computing power has been driven by highly challenging problems that can be solved only through numerically intensive computation. For engineering applications, high performance computers boost productivity and decrease the time to market for companies and products in a broad range of industries. The U.S. Government has recognized that the continued development of high performance

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computer systems, which typically sell for mutiple millions of dollars each, is of critical importance to the economic, scientific and strategic competitiveness of the United States.

In conjunction with some of the world's most creative scientific and engineering minds, these formidable tools already have made automobiles safer and more fuel-efficient; located new deposits of oil and gas; saved lives and property by predicting severe storms; created new materials and life-saving drugs; powered advances in electronics and visualization; safeguarded national security; and unraveled mysteries ranging from protein-folding mechanisms to the shape of the universe.

Applications promising future competitive and scientific advantage create a demand for more supercomputer power -- 10 to 1,000 times greater than anything available today, according to users. Automotive companies are targeting increased passenger cabin comfort, improved safety and handling. Aerospace firms envision more-efficient planes and space vehicles. The petroleum industry wants to "see" subsurface phenomena in greater detail. Urban planners hope to ease traffic congestion. Integrated digital imaging and virtual surgery -- including simulated sense of touch -- are high on the wish list in medicine. The sequencing of the human genome promises to open an era of burgeoning research and commercial enterprise in the life sciences.

Our customized supercomputer products provide high bandwidth and other capabilities needed for exploiting new and existing market opportunities. Among supercomputer vendors, we offer the largest variety of products in order to address the broadest range of customer requirements and market segments.

Vector Supercomputer Systems. For certain important classes of scientific and industrial applications, vector supercomputer systems remain unequaled. Starting in 1976, Cray Research pioneered the use of vector systems in a variety of market sectors. Vector systems typically use a moderate number (one to 64) of custom processors, each of which is two to 100 times faster in practice than the fastest commercially available microprocessors at any time. Earlier, vector systems effectively were the only type of system available and therefore

dominated the supercomputer market. In the past decade, supercomputers employing alternative designs ("architectures"), including the Cray T3E(TM) highly parallel system and others, have emerged to capture substantial marketshare. Today, increasingly powerful vector systems remain an important market factor and are typically reserved for the most demanding class of applications and workloads. Our vector systems include unique features, traditionally employed by classified government customers, that in preliminary tests have demonstrated substantial performance advantages over microprocessor-based systems for mainstream problem solving in the emerging bioninformatics market. The same unique, hard-to-replicate features will be included in our forthcoming Cray MTA-2(TM) systems.

The Cray SV1ex(TM) system, scheduled for availability in mid-2001, provides substantial enhancements to the predecessor Cray SV1(TM) product. These enhancements elevate this product line from a successful upgrade path for midrange and prior-generation high-end Cray vector supercomputers, to a product that for important, non-bandwidth-intensive applications is expected to perform as well as current high-end systems. The system's clock rate, at 500 megahertz, is the fastest of any currently available supercomputer, vector or non-vector; and the Cray SV1ex system's cache-based memory, unique among vector supercomputers, significantly improves performance for problems that make good use of cache memory. The targeted selling focus for the SV1ex systems is 8 to 64 gigaflops (billions of calculations per second), with typical selling prices ranging from $1 million to $2 million. We expect to sell some Cray SV1ex systems larger than 64 gigaflops.

In February 2001, we signed an agreement with NEC Corporation to distribute and service NEC SX-5(TM) vector supercomputers and their successors. This agreement provides us with exclusive distribution and servicing rights in the United States, Canada and Mexico, and non-exclusive rights in the rest of the world. The SX-5 computers are the world's current best-selling high-end, high-bandwidth vector supercomputers, with a strong installed base in industry, government and academia. Current duties under a U.S. anti-dumping ruling effectively prohibit the importation of these computers into the U.S. We have requested that the U.S. Government remove these duties. Assuming that these duties are removed as expected, we plan on marketing NEC SX-5 series computers to customers with a need for high-end, high-bandwidth vector supercomputers, particularly in the United States. The targeted selling focus for the SX-5 supercomputers will be from 10 to 160 gigaflops, with expected selling prices ranging from $1.5 million to $15 million.

Microprocessor-based Highly Parallel Systems. In recent years highly parallel supercomputer products have captured substantial market share by providing greater performance and price/performance on a range of applications for which vector supercomputers are less well suited. Highly parallel supercomputers typically link together tens, hundreds or thousands of standard microprocessors to act either concurrently on multiple tasks, or in concert on a single computationally-intensive task. In these systems, each processor typically is directly connected to its own private ("distributed" or "local") memory and the programmer must manage the movement of data among memory units. As a result, computer systems relying on this architecture can be difficult to program and are most suited for applications that can be partitioned easily into discrete tasks that do not need to communicate often with each other and do not require the high memory and interconnect system bandwidth of supercomputers such as the forthcoming Cray SV2(TM), NEC SX-5 and Cray MTA-2 systems.

The Cray T3E system, introduced in 1996 and able to employ up to 2,048 processors, is widely recognized as the first technically and commercially successful highly parallel system. The Cray T3E holds the world record for actual ("sustained") performance on a real application and was named

"Supercomputer Product of the Year" for the year 2000 by the readers of Scientific Computing & Instrumentation magazine. We expect continued strong demand for T3E systems in 2001, driven by the product's proven superiority among highly parallel systems in handling large, complex applications and workloads. In May 2000, we sold an 816-processor T3E system upgrade to the U.S. Army High Performance Computing Research Center for $18.5 million. In August 2000, we sold the first enhanced Cray T3E-1350 system, totaling 136 processors, to Phillips Petroleum Company. We recently sold and installed a T3E system with teraflop capacity to the U.S. Department of Defense for approximately $21 million.

In January 2001, we announced plans to introduce the Cray SuperCluster(R) series, a product line designed to extend the leadership of the Cray T3E system while exploiting commercially available third-party technologies to a greater degree. With the SuperCluster system, we plan to address market demand for COTS (commercial-off-the-shelf) clusters with higher capabilities than those available today, especially by leveraging the approximately $45 million software investment that has made the Cray T3E system the most scalable, usable system in its category. In addition to our own significant software contribution, we plan to use leading COTS components, including Alpha processor technology from API NetWorks, Inc., advanced Linux system software and the highly scalable Myrinet cluster-interconnect network from Myricom, Inc. Over the next two years, we plan to add advanced data center management capabilities to the SuperCluster operating system, leveraging the Cray T3E software investment. Target markets for the SuperCluster systems include government, scientific research and select industries, such as petroleum and the life sciences. Unlike our vector and multithreaded architecture products, the SuperCluster is aimed at scalar applications and workloads, and at the growing number of customers and new prospects considering microprocessor-based COTS clusters. The SuperCluster is targeted for first customer ship in the second half of 2001.

Cray SV2 System. We are currently developing the revolutionary Cray SV2 system, which incorporates in its design both vector processing capabilities from the long line of Cray Research vector systems, and highly parallel capabilities analogous to those of our T3E system. The SV2 is an "extreme performance" supercomputer aimed at the high end of the vector processing market and the high end of the market for highly parallel systems. The SV2 has been under development since 1997, and first customer ship is scheduled for the second half of 2002. Our expected selling focus for the SV2 is 200 gigaflops to multiple tens of teraflops (trillions of calculations per second). The U.S. Government is providing substantial funding support for the development of the SV2 system and conducts rigorous progress reviews on a quarterly basis. Our SV2 development has satisfactorily completed all quarterly reviews to date.

Multithreading Systems. Tera Computer Company was originally formed to pursue a significant breakthrough in high-performance computing by developing a scalable, uniform shared memory, latency tolerant system that utilizes a multithreaded architecture and a high bandwidth interconnection system. In the past year we have been heavily engaged in reimplementing the MTA(TM) system from gallium arsenide technology to more-mainstream CMOS (complementary metal-oxide silicon) technology. In January 2001 we announced a $5.4 million contract from Logicon, a Northrup Grumman company, to deliver a 28-processor, all-CMOS MTA-2 system to the Naval Research Laboratory in the fourth quarter of 2001, with

substantial upgrade options over a four-year period. The Naval Research Laboratory plans to make this system available for investigative purposes to its own researchers and to the Department of Defense national research community. With the MTA-2 system, we are targeting customers in the defense community, in scientific research -- including burgeoning new life sciences field such as bioinformatics, and in advanced imaging. The MTA-2 is aimed at new applications not well served by vector or highly parallel systems, such as dynamically

adaptive meshes, data sorting and problems benefiting from advanced scalability, large uniform shared memory and easier parallel programming. The MTA-2 has shown a significant performance advantage, for example, on so-called Monte Carlo codes used in a wide range of sectors, from nuclear physics to medicine to finance.

SOFTWARE

We offer UNIX-based operating systems, compiler software and diagnostic tools. We currently support multiple operating systems, including UNICOS/mk(R) in the T3E, UNICOS(R) in the SV1 and earlier vector processing systems and a UNIX-based system called Cray MTX(TM) for the Cray MTA system. The SuperCluster operating system will be based on open-source version of LINUX with extensions to support high performance computing in a production environment, while the SV2 operating system will be UNIX-based with common UNICOS extensions. The NEC SX-5 systems and its successors use NEC's SUPER-UX(TM) operating system, which is also based on UNIX.

We continue to design and build highly optimizing programming environments, performance management diagnostic software products that allow our customers to obtain maximum benefit from our systems. In addition to supporting third-party applications, we also research advanced algorithms and other approaches to improving application performance. We also purchase or license software technologies from third parties when necessary to provide appropriate support to our customers, while focusing on our own resources where we add the highest value.

MAINTENANCE AND SUPPORT

Our extensive worldwide maintenance and support systems provide us with a competitive advantage. Our employees providing these services include field service engineers, product and applications specialists and product support engineers. They are usually based at customer sites. We currently have approximately 110 support personnel in the field in the U.S., another 100 support personnel in other countries and 80 employees providing central support services based in Chippewa Falls, Wisconsin, including extensive data center operations.

Support services are provided under separate maintenance contracts with our customers. These contracts generally provide for support services on an annual basis, although some cover multiple years. While most customers pay for support monthly, others pay on a quarterly or annual basis. In the nine months of our combined operations in 2000, our support revenues exceeded $71 million. At year-end we had deferred support revenue in excess of $15 million representing prepaid support.

SALES AND MARKETING

We primarily sell our system products through our direct sales force which operates throughout the United States and in all significant international markets. We serve smaller international markets through representatives and distributors.

We have 60 sales staff, including sales representatives, sales managers, pre-sale analysts and administrative personnel located in the United States and 28 sales staff located internationally.

Information with respect to our international operations and export sales is set forth in Note 14 to the Consolidated Financial Statements included in Part II, Item 8 of this Form 10-K. No single end-user customer accounted for 10% or more of our revenue for each of the last three years, but agencies of the United States government, both directly and indirectly through system integrators and other resellers, accounted for approximately 54% of our 2000

revenue.

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RESEARCH AND DEVELOPMENT

We are committed to leadership in the high performance computer market. Our leadership depends on successful development and introduction of new products and enhancements to existing products. Prior to April 2000, our primary research and development activity was the design of the hardware components and software required for our MTA system. Since April 2000, we have continued development of the MTA system, the development of the enhancements to the Cray T3E system and Cray SV1 series leading to the SV1ex, and the development of the SV2 system. We expect that the SuperCluster system will involve software development with minimal hardware engineering, and we do not anticipate any development expenditures on the NEC SX-5 and successor SX systems

Our research and development expenses, net of governmental funding, were $13.7 million in 1998, $15.2 million in 1999 and $48.4 million in 2000 (of which $43.9 million was spent in the nine months of combined operations). These amounts represent 687%, 720% and 41% (including 37% in the nine months of combined operations), respectively, of total revenue. We received government funding of $253,000 in 1998, $72,000 in 1999 and $9.3 million in 2000 (all of which was in the nine months of combined operations). While we will be required to continue to devote a substantial portion of our resources to research and development activities, our goal is to have research and development expenses represent approximately 15 -- 18% of revenue. We expect to achieve this goal primarily by increasing revenue while holding research and development expenditures to modest increases.

MANUFACTURING

While we design many of the hardware components for all of our products, we subcontract the manufacture of these components, including integrated circuits, printed circuit boards, flex circuits, memory modules, machined enclosures and support structures, cooling systems, high performance cables and other items to third-party suppliers. Our strategy is to avoid the large capital commitment and overhead associated with establishing full-scale manufacturing facilities and to maintain the flexibility to adopt new technologies as they become available without the risk of equipment obsolescence. We perform final system integration and testing, and design and maintain our system software internally.

Our manufacturing facilities are located in Chippewa Falls, Wisconsin. We maintain a development and support capability in Seattle, Washington. At December 31, 2000, we had 160 full-time employees in manufacturing, with 137 located in Chippewa Falls, Wisconsin.

Our systems incorporate components that are available from one or limited sources. Key components that are sole-sourced include our integrated circuits and processors, interconnect systems and memory products. We obtain integrated circuits for our vector systems from IBM and for the MTA-2 system from Taiwan Semiconductor Manufacturing Corporation; IBM also provides packaging for our vector systems while Kyocera America, Inc., provides packaging for our MTA-2 system; we obtain processors for our T3E system from Compaq Computer and for our SuperCluster system from API Networks, Inc.; we obtain custom interconnect components for our T3E and MTA-2 systems from InterCon Systems, Inc., and interconnect switches for our SuperCluster system from Myricom, Inc. We obtain custom memory products for our vector, MTA-2 and T3E systems from Samsung Semiconductor, Inc. We use Celestica, Inc., to assemble our vector and T3E systems and for repair of components for these systems. Our purchases from these vendors are primarily through purchase orders. We have chosen to deal with sole

sources in these cases because of specific technologies, economic advantages and other factors. We also have sole or limited sources for less critical components, such as peripherals, power supplies, cooling and chassis. Reliance on single or limited source vendors involves several risks, including the possibility of shortages of key components, long lead times, reduced control over delivery schedules and changes in direction by vendors.

COMPETITION

The high performance computer market is intensely competitive. The barriers to entry are high, as is the cost of remaining competitive. Our competitors can be divided into two general categories: established companies that are well-known in the high performance computer market and new entrants capitalizing on

developments in architecture or techniques to increase computer performance through linking together clusters or networks of microprocessor based systems -- servers, workstations or personal computers.

Participants in the market include IBM, Fujitsu, Ltd., Hitachi, Ltd., and NEC Corporation. To date, the Japanese suppliers, as a group, have been largely unsuccessful in the U.S. high performance computer market but have been enjoying success in foreign markets. Once our distribution agreement with NEC becomes effective, we will have exclusive rights to market NEC vector processing supercomputers in North America; we have non-exclusive rights to market these computers elsewhere, which means we would be competing with NEC in the rest of the world. We compete with these companies by offering systems with superior performance, coupled with our excellent post-sale service capabilities and established customer relationships.

A number of companies, including IBM, Silicon Graphics, Inc., Hitachi, Ltd., Fujitsu, Ltd., Sun Microsystems, Inc., Hewlett-Packard Corporation and Compaq Computer Corporation, offer clusters or other highly parallel systems for the high performance market. While our T3E system competes primarily on performance, we expect that our SuperCluster system will compete on price/performance, more extensive software capabilities and superior post-sale service.

Each of our competitors named above has substantially greater engineering, manufacturing, marketing and financial resources than we do.

INTELLECTUAL PROPERTY

We attempt to protect our trade secrets and other proprietary rights through formal agreements with our employees, customers, suppliers and consultants, and through patent protection. Although we intend to protect our rights vigorously, there can be no assurance that our contractual and other security arrangements will be successful. There can be no assurance that such arrangements will not be terminated or that we will be able to enter into similar arrangements on favorable terms if required in the future. In addition if such agreements were breached, there can be no assurance that we would have adequate remedies for any breach. Although we have not been a party to any material intellectual property litigation, third parties may assert proprietary rights claims covering certain of our products and technologies.

We have a number of patents relating to our hardware and software systems. We license certain patents and other intellectual property from Silicon Graphics, Inc., as part of our acquisition of the Cray Research operations. These licenses contain restrictions on use of the underlying technology, generally limiting the use to historic Cray products, vector processor computers

and the Cray SV2 system. Our general policy is to seek patent protection for those inventions and improvements likely to be incorporated into our products and services or to give us a competitive advantage. While we believe our patents and applications have value, no single patent is in itself essential to us as a whole or to any of our key products. Any of our proprietary rights could be challenged, invalidated or circumvented and may not provide significant competitive advantage.

There can be no assurance that the steps we take will be adequate to protect or prevent the misappropriation of our intellectual property. Litigation may be necessary in the future to enforce patents we obtain, and to protect copyrights, trademarks, trade secrets and know-how we own. Such litigation, if necessary, could result in substantial expense to us and a diversion of our efforts.

EMPLOYEES

As of December 31, 2000, we employed 886 employees (compared to 123 at the end of 1999 as Tera Computer Company) on a full-time basis, of whom 303 were in development and engineering, 160 were in manufacturing, 88 were in sales and marketing, 290 in field service and 45 were in administration. We also employed 57 individuals on a part-time or temporary basis or as interns. We have no collective bargaining agreement with our employees. We have never experienced a work stoppage and believe that our employee relations are excellent.

FACTORS THAT COULD AFFECT FUTURE RESULTS

The following factors should be considered in evaluating our business, operations and prospects and may affect our future results and financial condition.

LACK OF CUSTOMER ORDERS FOR OUR EXISTING SV1 AND T3E PRODUCTS AND OUR INABILITY TO SELL OUR PRODUCTS AT EXPECTED PRICES WOULD LIMIT OUR REVENUE AND OUR ABILITY TO BE PROFITABLE. We will depend on sales of our current products, the Cray SV1 series and T3E systems, for significant product revenue in 2001. To obtain these sales, we need to assure our customers of product performance and our ability to service these products. Most of our potential customers already own or lease very high-performance computer systems. Some of our competitors may offer trade-in allowances or substantial discounts to potential customers, and we may not be able to match these sales incentives. We may be required to provide discounts to make sales or to provide lease financing for our products, which would result in a deferral of our receipt of cash for these systems. These developments would limit our revenue and resources and would reduce our ability to be profitable.

OUR INABILITY TO OVERCOME THE TECHNICAL CHALLENGES OF COMPLETING THE DEVELOPMENT OF OUR SYSTEMS COULD CAUSE OUR BUSINESS TO FAIL. We expect that our success in 2002 and following years depends upon completing the development of the SuperCluster, the MTA-2 and the SV2 systems. These development efforts are lengthy and technically challenging processes, and require a significant investment of capital, engineering and other resources. Delays in completing the design of the hardware components or software of these systems or in integrating the full systems would make it difficult for us to develop and market these systems. We are dependent on our vendors to manufacture components for our systems, and few companies can meet our design requirements. If our vendors are unable to manufacture our components to our design specifications, the completion of our products will be delayed. During the development process we have had, and in the future we may have, to redesign components because of previously unforeseen design flaws. We also may find flaws in our system

software which require correction. Redesign work may be costly and cause delays in the development of these systems, and could make it more difficult for these systems to be successful as commercial products.

LACK OF GOVERNMENT SUPPORT FOR SUPERCOMPUTER SYSTEMS WOULD INCREASE OUR CAPITAL REQUIREMENTS AND DECREASE OUR ABILITY TO CONDUCT RESEARCH AND DEVELOPMENT. We have targeted U.S. and foreign government agencies and research laboratories as important sales prospects for all of our products. A few of these agencies fund a portion of our development efforts. The U.S. government historically has facilitated the development of, and has constituted a market for, new and enhanced very high-performance computer systems. The failure of U.S. and foreign government agencies to continue to fund these development efforts, due to lack of funding, change of priorities or for any other reason, would cause us to increase our need for capital and reduce our research and development expenditures.

IF THE U.S. GOVERNMENT PURCHASES FEWER SUPERCONDUCTORS, OUR REVENUE WOULD BE REDUCED. Historically, sales to the U.S. government have been a significant market for supercomputers. In the fiscal year ended December 31, 2000, approximately 54% of our revenue was derived from sales to various agencies and departments of the U.S. government. Sales to the U.S. government may be affected by factors out of our control, such as changes in procurement policies and budget considerations. If the U.S. government were to stop or reduce its use and purchases of supercomputers, our revenues would be reduced.

PROPOSALS AND PURCHASES BASED ON THEORETICAL PEAK PERFORMANCE REDUCE OUR ABILITY TO MARKET OUR SYSTEMS. Our high-performance systems are designed to provide high actual sustained performance on difficult computational problems. Many of our competitors offer systems with higher theoretical peak performance numbers, although their actual sustained performance frequently is a small fraction of their theoretical peak performance. Nevertheless, many requests for proposals, primarily from governmental agencies in the U.S. and elsewhere, have criteria based on theoretical peak performance. Until these criteria are changed, we are foreclosed from bidding or proposing our systems on such proposals, which will limit our revenue potential.

FAILURE TO OBTAIN RENEWAL OF SERVICE CONTRACTS WILL REDUCE OUR REVENUES AND EARNINGS. High-performance computer systems are typically sold with maintenance service contracts. These contracts generally are for

annual periods, although some are for multi-year periods. We have been performing most of the services under the existing Silicon Graphics maintenance contracts as a sub-contractor to Silicon Graphics and are in the process of having these contracts assigned to us. As these contracts expire, we need to sell new maintenance service contracts to these customers. Revenue from service contracts has declined from approximately $125 million in 1999 to approximately $95 million in 2000 and is expected to further decline until new products are designed and sold. If customers do not renew their maintenance service contracts with us, our revenues and earnings will be reduced.

OUR RELIANCE ON THIRD-PARTY SUPPLIERS POSES SIGNIFICANT RISKS TO OUR BUSINESS AND PROSPECTS. We subcontract the manufacture of substantially all of our hardware components for all of our products, including integrated circuits, printed circuit boards, flex circuits and power supplies, on a sole or limited source basis to third-party suppliers. The SuperCluster system will be built entirely from commercial off-the-shelf components on a sole-source basis. We also use a contract manufacturer to assemble our SV1 and T3E components, and plan to do so for our MTA-2 and SV2 systems also.

We are exposed to substantial risks because of our reliance on these and other limited or sole source suppliers. For example:

- if a reduction or interruption of supply of our components occurred, it could take us a considerable period of time to identify and qualify alternative suppliers to redesign our products as necessary and to begin manufacture of the redesigned components;

- if we were ever unable to locate a supplier for a component, we would be unable to assemble and deliver our products;

- one or more suppliers may make strategic changes in their product lines, which may result in the delay or suspension of manufacture of our components or systems; and

- some of our key suppliers are small companies with limited financial and other resources, and consequently may be more likely to experience financial difficulties than larger, well-established companies.

Cray has experienced delays in obtaining circuit boards, integrated circuits and flex circuits on a timely basis from its suppliers, which have resulted in delays in the development of our products.

THE ABSENCE OF THIRD-PARTY APPLICATION SOFTWARE COULD MAKE IT MORE DIFFICULT FOR US TO SELL OUR SYSTEMS TO COMMERCIAL CUSTOMERS. To make sales in the automotive, aerospace, chemistry and other engineering and commercial markets, we must be able to attract independent software vendors to port their software application programs so that they will run on our systems. The relatively low volume of supercomputer sales makes it difficult for us to attract these vendors. We also modify and rewrite third-party software applications to run on our systems and so facilitate the expansion of our potential markets. There can be no assurance that we will be able to induce independent software vendors to rewrite their applications, or that we will successfully rewrite third-party applications for use on our systems.

FAILURE TO OBTAIN CREDIT FACILITIES MAY RESTRICT OUR OPERATIONS. While we have obtained a $15 million secured credit facility based on domestic accounts receivables and maintenance revenue, we are seeking additional credit facilities of up to approximately $4 million, such as bank lines of credit, vendor credit and capitalized equipment lease lines. The absence of a consistent record of revenue and earnings makes obtaining such facilities more difficult; if we obtain such facilities, they may have high interest rates, contain restrictions on our operations and require security. Failure to obtain such credit facilities may limit our planned operations and our ability to acquire needed infrastructure and other capital items and would reduce or eliminate our cash reserves and increase our need for capital.

OUR QUARTERLY PERFORMANCE MAY VARY SIGNIFICANTLY AND COULD CAUSE OUR STOCK PRICE TO BE VOLATILE. One or a few system sales may account for a substantial percentage of our quarterly and annual revenue. This is due to the high average sales price of our products, particularly the Cray T3E system, and the expected high average sales prices for our MTA-2 and SV2 systems, and the timing of purchase orders and product acceptances. Because a number of our prospective customers receive funding from the U.S. or foreign governments, the

timing of orders from such customers may be subject to the appropriation and funding schedules of the relevant government agencies. The timing of orders and shipments also could be affected by other events outside our control, such as:

- changes in levels of customer capital spending;

- the introduction or announcement of competitive products;

- the availability of components;

- timing of the receipt of necessary export licenses; or

- currency fluctuations and international conflicts or economic crises.

Because of these factors, revenue, net income or loss and cash flow are likely to fluctuate significantly from quarter to quarter.

THE COST OF SERVICE OF THE T90 INSTALLED BASE WILL REDUCE OUR EARNINGS. Some of the components in the T90 vector computers sold by Silicon Graphics before our acquisition of the operations of Cray Research have an unusually high failure rate. The cost of servicing the T90 computers exceeds the related service revenue. We are continuing to take action that commenced before the acquisition to address this problem, and have recorded a warranty reserve, with a balance of $31.5 million as of December 31, 2000, to provide for anticipated future losses on the T90 maintenance service contracts.

OUR UNCERTAIN PROSPECTS FOR EARNINGS COULD CAUSE OUR STOCK PRICE TO DECLINE. While we have had a substantial increase in revenue with the acquisition of the business operations of Cray Research, whether we will continue to achieve earnings will depend upon a number of factors, including:

- our ability to market and sell our existing products, the SV1 and T3E, and complete the development of the SV1ex, SuperCluster, MTA-2, and SV2 systems;

- the level of revenue in any given period;

- the cost of servicing the T90 installed base;

- the terms and conditions of sale or lease for our products; and

- our expense levels, particularly for research and development and manufacturing and service costs.

IF WE CANNOT ATTRACT, RETAIN AND MOTIVATE KEY PERSONNEL, WE MAY BE UNABLE TO IMPLEMENT EFFECTIVELY OUR BUSINESS PLAN. Our success also depends in large part upon our ability to attract, retain and motivate highly skilled management, technical and marketing and sales personnel. Competition for highly skilled management, technical, marketing and sales personnel is intense, and we may not be successful in attracting and retaining key personnel. In particular we have an ongoing project to add software developers to assist our development efforts. We have no employment contracts with any of our employees.

A SUBSTANTIAL NUMBER OF OUR SHARES ARE ELIGIBLE FOR FUTURE SALE AND COULD DEPRESS MARKET PRICES OF OUR STOCK AND HINDER OUR ABILITY TO OBTAIN ADDITIONAL FINANCING. Sale of a substantial number of our shares of common stock in the public market or the prospect of sales could cause the market price of our common stock to decline. As of December 31, 2000, we had outstanding:

- 35,280,785 shares of common stock;

- warrants to purchase 14,801,096 shares of common stock;

- 8% convertible promissory notes due March 31, 2001, in the principal amount of $494,291, convertible at $5.00 per share into 98,858 shares of common stock; and

- stock options to purchase an aggregate of 8,224,005 shares of common stock, of which 2,428,813 options were then exercisable.

Almost all of our outstanding shares of common stock may be sold without substantial restrictions. All of the shares purchased under the options are available for sale in the public market, subject in some cases to volume and other limitations.

Sales in the public market of substantial amounts of our common stock, including sales of common stock issuable upon the exercise of warrants and options, could depress prevailing market prices for the common stock. Even the perception that such sales could occur may impact market prices.

The existence of outstanding warrants and options may prove to be a hindrance to our future equity financings. Further, the holders of the warrants and options may exercise them at a time when we would otherwise be able to obtain additional equity capital on terms more favorable to us. Such factors could impair our ability to meet our capital needs.

ADDITIONAL FINANCINGS MAY BE DILUTIVE TO EXISTING SHAREHOLDERS. Over the next twelve months our significant cash requirements relate to operational expenses, consisting primarily of personnel costs, costs of inventory and third-party engineering expenses, and acquisition of capital goods. We expect to have positive cash flow from our anticipated product sales and maintenance services over the next twelve months. We secured a $15 million credit facility in March 2001 and, upon completion of the NEC distribution agreement in May 2001, NEC invested $25 million in us. At any particular time, given the high average selling price of our products, our capital position is impacted by the timing of particular product sales, and the receipt of prepaid maintenance. Delays in the completion of the SV1ex system and the development of the MTA-2 and SuperCluster systems, all planned to be completed in 2001, or delays in the SV2 development program may require additional capital earlier than planned. We may raise additional equity or debt capital through our shelf registration statement covering $20 million of common stock, private placements or enhanced credit facilities to provide sufficient working capital and enhance our capital position. Financings may not be available to us when needed or, if available, may not be available on satisfactory terms and may be dilutive to our shareholders.

U.S. EXPORT CONTROLS COULD HINDER OUR ABILITY TO MAKE SALES TO FOREIGN CUSTOMERS AND OUR FUTURE PROSPECTS. The U.S. government regulates the export of high-performance computer systems such as our products. Occasionally we have experienced delays in receiving appropriate approvals necessary for sales, which have delayed the shipment of our products. Delay or denial in the granting of any required licenses could make it more difficult to make sales to foreign customers, eliminating an important source of potential revenue.

OUR STOCK PRICE MAY BE VOLATILE. The trading price of our common stock is subject to significant fluctuations in response to:

- changes in analysts' estimates;

- our future capital raising activities;

- announcements of technological innovations by us or our competitors; and

- general conditions in our industry.

The stock market has been and is subject to price and volume fluctuations

that particularly affect the market prices for small capitalization, high technology companies like ourselves.

IF WE ARE NOT ABLE TO KEEP UP WITH RAPID TECHNOLOGICAL CHANGE, OUR PRODUCTS WILL NOT BE COMPETITIVE. Our market is characterized by rapidly changing technology, accelerated product obsolescence and continuously evolving industry standards. Our success will depend upon our ability to enhance our current products, to complete development of the SuperCluster, the MTA-2 and the SV2 systems and to develop successor systems in the future. We will need to introduce new products and features in a timely manner to meet evolving customer requirements. We may not succeed in these efforts. Even if we succeed, products or technologies developed by others may render our products or technologies noncompetitive or obsolete. If we incur delays in developing our products or if such products do not gain broad market acceptance or become obsolete, our ability to develop and market our products will be reduced.

IF WE ARE UNABLE TO COMPETE SUCCESSFULLY IN THE HIGH-PERFORMANCE COMPUTER MARKET OUR REVENUES WILL DECLINE. The performance of our products may not be competitive with the computer systems offered by our competitors, and we may not compete successfully over time against new entrants or innovative competitors at the lower end of the market. Periodic announcements by our competitors of new high-performance computer systems and price adjustments may reduce customer demand for our products.

Our competitors are established companies that are well known in the high-performance computer market, including IBM, Sun Microsystems, Compaq Computer, Hewlett-Packard, Silicon Graphics, NEC Corporation, Fujitsu and Hitachi. Each of these competitors has broader product lines and substantially greater research, engineering, manufacturing, marketing and financial resources than we do.

We also compete with new entrants capitalizing on developments in parallel processing and increased computer performance through networking and clustering systems. Currently, these products are limited in applicability and scalability and can be difficult to program. A breakthrough in architecture or software technology could make parallel systems more attractive to potential customers. Such a breakthrough would impair our ability to sell our products and reduce our revenue.

WE MAY NOT BE ABLE TO PROTECT OUR PROPRIETARY INFORMATION AND RIGHTS ADEQUATELY. We rely on a combination of patent, copyright and trade secret protection, non-disclosure agreements and licensing arrangements to establish, protect and enforce our proprietary information and rights. We have a number of patents and have additional applications pending. There can be no assurance, however, that patents will be issued from the pending applications or that any issued patents will protect adequately those aspects of our technology to which such patents will relate. Despite our efforts to safeguard and maintain our proprietary rights, we cannot be certain that we will succeed in doing so or that our competitors will not independently develop or patent technologies that are substantially equivalent or superior to our technologies.

Although we are not a party to any present litigation disputing proprietary rights, third parties may assert intellectual property claims against us in the future. These claims, if proved, could require us to pay substantial damages or redesign our existing products. Even meritless claims would require management attention and would cause us to incur significant expense to defend.

The laws of some countries do not protect intellectual property rights to the same extent or in the same manner as do the laws of the United States.

Although we continue to implement protective measures and intend to defend our proprietary rights vigorously, these efforts may not be successful.

OUR ABILITY TO BUILD SOME PRODUCTS IS LIMITED BY OUR AGREEMENT WITH SILICON GRAPHICS, WHICH MAY LIMIT OUR ABILITY TO COMPETE WITH SILICON GRAPHICS AND OTHER COMPANIES. The technology agreement through which we acquired and licensed patent, know-how and other intellectual property rights from Silicon Graphics contains restrictions on our ability to develop some products, including specified successors to the T3E system, and restrictions on the use of other technology, such as SGI's IRIX operating system in the SV2.

IT MAY BECOME MORE DIFFICULT TO SELL OUR STOCK IN THE PUBLIC MARKET. Our common stock is quoted on the Nasdaq National Market. To keep our listing on this market, Cray must meet Nasdaq's listing maintenance standards. If the bid price of our common stock falls below $5.00 for an extended period, or we are unable to continue to meet Nasdaq's standards for any other reason, our common stock could be delisted from the Nasdaq National Market. If our common stock were delisted, we likely would seek to list the common stock on the Nasdaq SmallCap Market or for quotation on the American Stock Exchange or a regional stock exchange. However, listing or quotation on these markets or exchanges could reduce the liquidity for our common stock. If our common stock were not listed or quoted on another market or exchange, trading of our common stock would be conducted in our over-the-counter market on an electronic bulletin board established for unlisted securities or in what are commonly referred to as the pink sheets. If our common stock was trading in the over-the-counter market, an investor would find it more difficult to dispose of, or to obtain accurate quotations for the price of, the common stock. A delisting from the Nasdaq National Market and failure to obtain listing or quotation on such other market or exchange would subject our securities to so-called penny stock rules that impose additional sales practice and market-making requirements on broker-dealers who sell or make a market in such securities. Consequently, removal from the Nasdaq National Market and failure to

obtain listing or quotation on another market or exchange could affect the ability or willingness of broker-dealers to sell or make a market in our common stock and the ability of purchasers of our common stock to sell their securities in the secondary market. If the market price of our common stock falls to below $5.00 per share, we may become subject to penny stock rules even if our common stock is still quoted on the Nasdaq National Market. While the penny stock rules should not affect the quotation of our common stock on the Nasdaq National Market, these rules may further limit the market liquidity of our common stock and the ability of investors to sell our common stock in the secondary market.

PROVISIONS IN OUR AGREEMENT WITH SILICON GRAPHICS MAKE IT MORE DIFFICULT FOR SPECIFIED COMPANIES TO ACQUIRE US. The terms of our purchase of the assets of Cray Research contain provisions restricting our ability to transfer the assets of Cray Research. Sales of these assets to Hewlett-Packard, Sun Microsystems, IBM, Compaq Computer, NEC or Gores Technology Group, or their affiliates, are prohibited until the earlier of March 31, 2003 or if Silicon Graphics were sold. We must also give Silicon Graphics a right of first refusal for any sale of these assets to other purchasers for the period expiring on the earlier of March 31, 2003, the sale of Silicon Graphics or, if over a period of four fiscal quarters, the revenue from product sales of Cray products is less than 50% of our total revenue.

PROVISIONS OF OUR ARTICLES AND BYLAWS COULD MAKE A PROPOSED ACQUISITION THAT IS NOT APPROVED BY OUR MANAGEMENT MORE DIFFICULT. Provisions of our restated articles of incorporation and restated bylaws could make it more difficult for a third party to acquire us. These provisions could limit the

price that investors might be willing to pay in the future for our common stock. For example, our articles of incorporation and bylaws provide for:

- a staggered board of directors, so that only three of nine directors are elected each year;
- removal of a director only in limited circumstances and only upon the affirmative vote of not less than two-thirds of the shares entitled to vote to elect directors;
- the issuance of preferred stock, without shareholder approval, with rights senior to those of the common stock;
- no cumulative voting of shares;
- calling a special meeting of the shareholders only upon demand by the holders of not less than 30% of the shares entitled to vote at such a meeting;
- amendments to our restated articles of incorporation require the affirmative vote of not less than two-thirds of the outstanding shares entitled to vote on the amendment, unless the amendment was approved by a majority of our continuing directors who are defined as directors who have either served as a director since August 31, 1995 or were nominated to be a director by the continuing directors;
- special voting requirements for mergers and other business combinations, unless the proposed transaction was approved by a majority of continuing directors;
- special procedures must be followed to bring matters before our shareholders at our annual shareholders' meeting; and
- special procedures must be followed for nominating members for election to our board of directors.

WE DO NOT ANTICIPATE DECLARING ANY DIVIDENDS. We have never paid any dividends on our common stock and we intend to continue our policy of retaining any earnings to finance the development and expansion of our business.

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ITEM 2. PROPERTIES

The Company's principal properties are as follows:

LOCATION OF PROPERTY	USES OF FACILITY	APPROXI SQUARE F
Chippewa Falls, Wisconsin.....	Manufacturing, hardware development, service, and warehouse	222,0
Seattle, Washington.....	Executive offices, MTA hardware and software development	85,0
Mendota Heights, Minnesota.....	Software development, sales and marketing operations	40,0

We lease the properties described above except that we own 179,000 square

feet of manufacturing, development, service and warehouse space in Chippewa Falls, Wisconsin.

We also lease a total of approximately 10,654 square feet, primarily for sales and service offices, in various domestic locations. In addition, various foreign sales and service subsidiaries have leased an aggregate of approximately 22,720 square feet of office space. We believe our facilities are adequate to meet our needs in 2001.

ITEM 3. LEGAL PROCEEDINGS

We are not a party to any legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our shareholders during the fourth quarter of 2000.

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ITEM E.O. EXECUTIVE OFFICERS OF THE COMPANY

Our executive officers as of March 19, 2001, were as follows:

NAME	AGE	POSITION
Burton J. Smith	60	Chief Scientist and Director
James E. Rottsolk	56	Chief Executive Officer, President and Chairman
Rene G. Copeland	53	Vice President -- Sales and Marketing
Kenneth W. Johnson	58	Vice President -- Finance, Chief Financial Officer, and Secretary
David R. Kiefer	52	Vice President -- Hardware Development
Brian D. Koblenz	40	Vice President -- Software Development
Gerald E. Loe	51	Vice President -- Worldwide Service
John D. Neale	59	Vice President -- Human Resources
Douglas C. Ralphs	42	Vice President -- Corporate Controller
Katherine L. Rowe	44	Vice President -- Manufacturing
Richard M. Russell	56	Vice President -- International

Burton J. Smith is one of our co-founders and has been our Chief Scientist and a Director since our inception in 1987. He is a recognized authority on high performance computer architecture and programming languages for parallel computers, and is the principal architect of the MTA system. Mr. Smith was a Fellow of the Supercomputing Research Center (now Center for Computing Sciences), a division of the Institute for Defense Analyses, from 1985 to 1988. He was honored in 1990 with the Eckert-Mauchly Award given jointly by the Institute for Electrical and Electronic Engineers and the Association for Computing Machinery, and was elected a Fellow of both organizations in 1994. Mr. Smith received S.M., E.E. and Sc.D. degrees from the Massachusetts Institute of Technology.

James E. Rottsolk is one of our co-founders and has served as our Chief Executive Officer, President and a Director since our inception in 1987. He became Chairman of the Board in December 2000. Prior to 1987, Mr. Rottsolk served as an executive officer with several high technology start-up companies. Mr. Rottsolk received a B.A. degree from St. Olaf College and A.M. and J.D. degrees from the University of Chicago.

Rene G. Copeland joined us as Vice President -- Sales and Marketing in February 2000. From 1998 to joining us, Mr. Copeland worked at IBM, where he served as the Manager of the Worldwide Manufacturing Segment for the RS6000 SP Supercomputer. Prior to joining IBM, Mr. Copeland held a variety of senior management, marketing and sales positions at Silicon Graphics, Inc., and Cray Research, Inc. Mr. Copeland graduated from the U.S. Military Academy at West Point with a B.S. Electrical Engineering, and received a M.B.A. from the University of Chicago.

Kenneth W. Johnson joined us in September 1997 as Vice President -- Finance, Chief Financial Officer and Secretary. Prior to joining us, Mr. Johnson practiced law in Seattle for twenty years with Stoel Rives LLP and predecessor firms, where his practice emphasized corporate finance. Mr. Johnson received an A.B. degree from Stanford University and a J.D. degree from Columbia University Law School.

David R Kiefer joined us as Vice President -- Hardware Engineering in April 2000. From 1996 to 2000, Mr. Kiefer was Director of Hardware Engineering at the Cray Research operations of Silicon Graphics, Inc. Prior to joining Silicon Graphics, he held a variety of engineering and engineering management positions with Univac and Cray Research, Inc. Mr. Kiefer received his B.S. in Electrical Engineering from the University of Wisconsin.

Brian D. Koblenz served as our Group Leader, Languages and Compilers, from 1990 until May 1994, when he assumed his present position as Vice President -- Software Development. Prior to joining us, Mr. Koblenz was Principal Software Engineer at Digital Equipment Corporation from 1986 to 1989. He was lead designer of Digital's high performance vector FORTRAN compiler and participated in the Alpha architecture and VAX vectorization efforts. He received a B.S. from the University of Vermont and a M.S. from the University of Washington.

Gerald E. Loe joined us in 1992 as Vice President -- Hardware Engineering and Manufacturing. He was named Vice President -- Hardware Engineering in 1996, and Vice President -- Worldwide Service in April 2000. Prior to joining us, he was Vice President of Operations at Siemens Quantum Inc., a high-end radiology ultrasound company, from 1989 to 1992. Mr. Loe received a B.S.M.E. from the Massachusetts Institute of Technology and a M.B.A. from Harvard Business School.

John D. Neale joined us as Vice President -- Human Resources in December 2000. He served in various positions with Battelle Memorial Institute in Columbus, Ohio, from 1988 to 2000, most recently as Director of Human Resources. From 1974 to 1988, Mr. Neale held various managerial positions with components of General Electric Co. He received a Masters in Industrial Relations at the University of Wisconsin and his undergraduate degree at St. Francis College in Ft. Wayne, Indiana.

Douglas C. Ralphs joined us as Vice President -- Corporate Controller in November 2000. He was chief financial officer at Interpoint, Inc. from 1998 until he joined us, and held various financial management positions at Itron, Inc. from 1989 to 1998, serving as treasurer from 1997 to 1998. He previously held financial positions with Hewlett-Packard Co. and Morrison Knudsen. He received a M.B.A. from the University of Chicago and a B.A. from Boise State University.

Katherine L. Rowe joined us as Director of Manufacturing in 1994 and was named Vice President -- Manufacturing in 1996. Prior to joining us, Ms. Rowe was an Engineering Manager at ELDEC Corporation, an aerospace electronics company,

and was Manufacturing Manager and Project Manager in new product development at Physio-Control Corporation, a medical electronics company. She received her S.M. from Massachusetts Institute of Technology and her B.S.M.E. from Purdue University.

Richard M. Russell joined us as Director of New Business Development in 1995 and was named Vice President -- Marketing in March 1998. In February 2000 he was appointed Vice President -- International. Prior to joining us, he worked in a variety of sales and marketing positions at several high technology companies, including Cray Research, Inc. from 1976 through 1990 and Kendall Square Research Corporation from 1991 through 1994. Mr. Russell was educated in England.

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PART II

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the Nasdaq National Market under the symbol CRAY; prior to April 1, 2000, our stock traded under the symbol TERA. On March 19, 2001, we had 39,375,541 shares of common stock outstanding that were held by 763 holders of record. We have not paid cash dividends on our common stock. We currently anticipate that we will retain all available funds for use in our business and do not anticipate paying any cash dividends on our common stock in the foreseeable future. In addition our credit facilities restrict our ability to pay cash dividends.

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

	1999			2000		
	HIGH	LOW	CLOSE	HIGH	LOW	CLOS
First Quarter	9 3/	4	7 1/4	11 1/	4 1/	6 7
Second Quarter	7	4 1/2	5 1/2	6 7/8	3	3 7
Third Quarter	6 3/1	2 7/8	4 1/8	7 5/8	3 9/3	4 1
Fourth Quarter	5 5/	2 15/1	4 1/2	4 1/2	1 1/	1 1/

On March 19, 2001, the closing sale price for the common stock was $1.78. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

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ITEM 6. SELECTED FINANCIAL DATA

Financial data for fiscal year 2000 in the following table includes nine months of activity of the Cray Research business acquired on April 1, 2000.

	YEARS ENDED DECEMBER 31,			
	1996	1997	1998	1999

	(IN THOUSANDS, EXCEPT FOR PER SHARE AMOUNTS AND STATIS			
Operating Data:				
Product Revenue	$	$	$ 1,274	$ 1,794
Service Revenue			714	320
Cost of Product Revenue			3,759	15,165
Cost of Service Revenue			584	273
Research and Development	10,319	13,142	13,664	15,216
Net Loss	(12,077)	(15,755)	(19,803)	(34,532)
Comprehensive Loss	(18,806)	(18,672)	(20,736)	(34,647)
Net Loss per Common Share	$ (3.53)	$ (2.13)	$ (1.70)	$ (1.74)
Weighted Average Outstanding Shares	5,321	8,785	12,212	19,906
Balance Sheet Data:				
Cash and Cash Equivalents	$ 929	$ 13,329	$ 3,162	$ 10,069
Working Capital	(22)	14,342	7,269	9,208
Warranty Reserves, Long-term Portion				
Capital Leases, Long-term Portion	114	532	573	390
Notes Payable, Long-term Portion				1,022
Total Assets	4,617	20,859	20,288	23,410
Redeemable Securities		9,478		
Shareholders' Equity	1,128	6,368	11,889	14,307
Statistical Data:				
Number of Full-time Employees	61	84	109	123

ITEM 7.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

PRELIMINARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The information set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" below includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, and is subject to the safe harbor created by that Section. Factors that realistically could cause results to differ materially from those projected in the forward looking statements are set forth in this section and under "Business -- Factors That Could Affect Future Results." The following discussion should also be read in conjunction with the Financial Statements and accompanying Notes thereto.

OVERVIEW

We design, develop, market and service high-performance computer systems, commonly known as supercomputers. We presently market two computer systems, the Cray SV1 and T3E, and provide maintenance services to the world-wide installed base of these and earlier models of Cray computers. We are developing enhancements to the Cray SV1, and we are developing three new computer systems, the MTA-2, based on our multithreaded architecture system, the SuperCluster, a highly parallel system using leading commercial off-the-shelf components, and the SV2, which will combine elements of the SV1 and T3E computers.

In 2000 we largely were involved in the separation of the Cray Research operations from those of SGI and integrating them with our own. This process included establishing separate network, communications and other infrastructure services, reconstituting the marketing and sales operations, setting up subsidiary opera-

tions for international sales and services, implementing new operational policies and procedures, and identifying and filling openings in management, administration and other areas.

We have experienced net losses in each year of operations. We incurred net losses of approximately $25.4 million in 2000, $34.5 million in 1999 and $19.8 million in 1998.

We recognize revenue from sales of our computer systems upon acceptance by the customer, although depending on sales contract terms, revenue may be recognized when title passes upon shipment or may be delayed until funding is certain. We recognize service revenue from the maintenance of our computer systems ratably over the term of each maintenance agreement.

Factors that should be considered in evaluating our business, operations and prospects and that may affect our future results and financial condition are set forth above, beginning on page 9.

RESULTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

With the acquisition of the Cray Research business unit on April 1, 2000, period-to-period comparisons of our operating results that include periods prior to the acquisition are not indicative of results for any future period.

Revenue. We had revenue from product sales of $46.6 million for 2000, up from $1.8 million in 1999 and $1.3 million in 1998. Product revenue represented 39% of total revenues for 2000 and consisted primarily of $19.1 million for our SV1 product line and $27.3 million for our T3E product line. Product sales for Cray Research products declined during each of the three years prior to our acquisition of the Cray Research business unit, primarily because SGI had stopped development funding on new Cray Research products. We expect that our product sales revenue will increase as we introduce upgrades to the current product line and our new products currently under development. 1999 revenues included $1.7 million from the upgrade of the MTA system at the San Diego Supercomputer Center ("SDSC") to eight processors, and 1998 revenues included $1.3 million from the sale of the two-processor MTA system to SDSC, our first revenue as Tera Computer Company from product sales.

We had service revenue of $71.5 million for 2000, up from $320,000 in 1999 and $714,000 in 1998. Services are provided under separate maintenance contracts with our customers. These contracts generally provide for maintenance services for one year, although some are for multi-year periods. The overall increase in service revenue is due to the acquisition of the Cray product line and related service business in April 2000. Service revenue has continued to decline over the periods prior to our acquisition of the Cray Research business unit and we expect this decline to continue over the next year or so as older systems are withdrawn from service and then to stabilize as our new systems are placed in service. Service revenue represented 61% of total revenues for 2000.

Operating Expenses. Cost of product revenue was $32.5 million for 2000, $15.2 million for 1999 and $3.8 million for 1998. Cost of product revenue for 2000 represented 70% of product revenue for 2000. The high cost of product revenue in 2000 is due to the age of the SV1 and T3E product lines and inventory adjustments for SV1 and MTA gallium arsenide parts. Cost of product revenue was high in 1999 and 1998 as a percentage of the revenue due to the inclusion of manufacturing costs and inventory adjustments relating to the MTA product line and favorable pricing terms provided to our first MTA customer.

Cost of service revenue was $34.1 million for 2000, $273,000 for 1999 and $584,000 for 1998. Cost of service revenue for 2000 was net of $18.4 of warranty

reserve utilization. Cost of service revenue represented 48% of service revenue for 2000.

Research and development expenses reflect our costs associated with the enhancements to the Cray SV1 and T3E systems and the development of the MTA and SV2 systems, including related software development. These costs also include personnel expenses, allocated overhead and operating expenses, software, materials and engineering expenses, including payments to third parties. These costs are offset in part by governmental development funding. Net research and development expenses were $48.4 million in 2000, $15.2 million for

1999 and $13.7 million for 1998 with governmental developmental funding being $9.3 million in 2000, $72,000 in 1999 and $253,000 in 1998. Research and development expenses in 2000 represented 41% of revenue. We expect that research and development expenses will decrease slightly in 2001, with increases in engineering personnel, principally software engineers, being offset by decreases in third-party non-recurring engineering expenses as we complete development of the MTA-2 and SV-2 systems. In subsequent years, unless we obtain additional governmental development funding to replace funding for projects as they are completed, the net amount of research and development expenditures will increase. Over time, with receipt of increased revenue from products currently under development and sales of the NEC SX-5 series of computers, we expect research and development expenses to decrease as a percentage of overall revenue.

Marketing and sales expense were $14.4 million in 2000, $2.5 million in 1999 and $1.8 million in 1998. The increase in these expenses for 2000 over 1999 was due to the acquisition of the Cray Research business unit, which required us to re-establish the Cray sales and customer support staff and increase expenditures in connection with sales and marketing, benchmarks and development of third party applications software. The increase in these expenses for 1999 over 1998 was due largely to higher wages and operating costs.

General and administrative expenses were $7.0 million for 2000, $3.1 million in 1999 and $2.1 million in 1998. The increase in these expenses for 2000 over 1999 was due to the acquisition of the Cray Research operations, which required us to add managerial and administrative staff and increases in legal, accounting and consulting expenses in connection with establishing foreign operations and implementing new accounting systems. The increase in 1999 expenses over 1998 was due largely to higher wages, and operating costs associated with being a publicly owned company. General and administrative expenses are expected to increase as we complete our administrative staffing, but should decline as a percentage of revenue.

We incurred amortization expense of $5.2 million in 2000 primarily related to the goodwill and intangible assets from the acquisition of the Cray Research business unit.

Interest Income (Expense). Interest income was $690,000 for 2000, $537,000 for 1999, and $366,000 for 1998, reflecting the Company's increased cash position due to the sales of equity securities in the first quarter of 2000, and in 1999 and 1998.

Interest expense was $2.4 million for 2000, $815,000 for 1999 and $189,000 for 1998. The increase in 2000 was largely due to imputed interest expense of $1.4 million for 2000 on the non-interest bearing note issued to SGI, a non-cash interest expense of approximately $336,000 associated with the value of the conversion feature of certain investor promissory notes, a non-cash expense of $200,000 for the value of warrants issued in conjunction with investor

promissory notes and $92,000 of interest paid on a line of credit. The increase in 1999 was largely due to a non-cash interest expense of approximately $278,000 associated with the value of the conversion feature of certain convertible promissory notes issued in the first quarter of 1999. The 1999 results also include a non-cash expense for the value of detachable warrants issued in conjunction with convertible promissory notes, of which $249,000 was recognized upon conversion in the second quarter of 1999.

Taxes. We made a provision of $831,000 for international income taxes in 2000. As of December 31, 2000, we had net operating loss carryforwards of approximately $119.4 million which expire in years 2003 through 2020, if not utilized.

Net Loss. Our net loss in 2000 of $25.4 million was less than our net loss in 1999 of $34.5 million and greater than our net loss of $19.8 million in 1998. The 2000 net loss includes a loss of $8.0 million during the first quarter, prior to our acquisition of the Cray Research business operations. We continue to incur substantial research and development expenses, particularly as a percentage of revenue. To become profitable we need to increase our product revenue from sales of our enhancements of our current products and our products under development in order to support this level of research and development expenditures. See "Business -- Product Offerings and the High Performance Computer Market" and "Business -- Research and Development."

Preferred Stock. In the second quarter of 1999, all of our outstanding preferred stock was converted to common stock. The dividends for 1998 were accrued on our Series A Convertible Preferred Stock, and were

higher than that accrued during the comparable period of 1999 because we had more shares of Preferred Stock then outstanding.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled $4.6 million at December 31, 2000 compared to $10.1 million at December 31, 1999. Restricted cash balances, which serve as collateral for capital equipment loans and leases, totaled $761,000 at December 31, 2000, and $1.1 million at December 31, 1999.

Net cash provided by operating activities was $5.1 million for the year ended December 31, 2000, compared to net cash used of $26.3 million in 1999. On a pro forma basis, in the nine months subsequent to the Cray acquisition we had net cash provided by operating activities of $13.7 million. For 2000, net operating cash flows were primarily attributed to increases in depreciation and amortization, accounts payable and deferred revenue offset in part by increases in accounts receivable and warranty reserves.

Net cash used in investing activities was approximately $57.4 million for the year ended December 31, 2000, compared to $427,000 for 1999. In 2000, we paid a total of $50.2 million to SGI to acquire the Cray Research business unit. We also spent $5.8 million on fixed assets, primarily consisting of computer hardware and software and electronic test equipment.

Net cash provided by financing activities was $47.0 million for the year ended December 31, 2000, compared to $33.6 million for 1999. In 2000, we raised $25.2 million in a private placement of 5.2 million shares of common stock and $8.9 million from the exercise of common stock warrants. We also raised $12.5 million through the issuance of promissory notes to two investors, retiring $4.2 million of these notes by year-end through conversion into common stock. Subsequent to December 31, 2000, we have paid the remaining $8.3 million principal amount and interest through sales of common stock to the investors.

Over the next twelve months our significant cash requirements relate to operational expenses, consisting primarily of personnel costs, costs of inventory and third-party engineering expenses, and acquisition of property and equipment. These expenses include our commitments to acquire components and manufacturing and engineering services. We expect that anticipated product sales and maintenance services over the next twelve months will generate positive cash flow from operations. We secured a $15 million credit facility in March 2001, and expect that the NEC distribution agreement will be completed in the second quarter of 2001, at which time NEC will invest $25 million in us. At any particular time, given the high average selling price of our products, our cash position is affected by the timing of product sales and the receipt of prepaid maintenance revenue. In addition, delays in the development of the SV1ex, MTA-2 and SuperCluster systems, all planned to be completed in the next twelve months, and the SV2 system may require additional capital earlier than planned. While we believe our cash resources will be adequate for the next 12 months, we may need to raise additional equity and/or debt capital through our shelf registration statement, private placements and/or enhanced credit facilities. If we are successful in our product development and market conditions were favorable, we may wish to consider financings to enhance our cash position and working capital position. Financings may not be available to us when needed or, if available, may not be available on satisfactory terms and may be dilutive to our shareholders.

RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, in June 1998, which is effective for us beginning January 1, 2001. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designed as part of a hedge transaction and, if it is, the type of hedge transaction. Since we do not currently hold any derivative instruments, SFAS No. 133 is not expected to have any impact on the consolidated financial statements.

In December 1999, the United States Securities and Exchange Commission (SEC) released Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, which was required to be

adopted in our fourth fiscal quarter of 2000. SAB No. 101 provides guidance on revenue recognition and the SEC staff's views on the application of accounting principles to selected revenue recognition issues. The adoption of SAB No. 101 did not have a material impact on our consolidated financial statements.

In March 2000, the FASB issued Interpretation No. 44 (FIN 44), Accounting for Certain Transactions Involving Stock Compensation -- an Interpretation of Accounting Principles Board (APB) Opinion No. 25, which addresses certain accounting issues which arose under the previously established accounting principles relating to stock-based compensation. The adoption of this interpretation did not have a material effect on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Substantially all of our cash equivalents and marketable securities are held in money market funds or commercial paper of less than 90 days that is held to maturity. Accordingly, we believe that the market risk arising from our holdings of these financial instruments is minimal. We sell our products

primarily in North America, but with significant sales in Asia and Europe. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Our products are generally priced in U.S. dollars, and a strengthening of the dollar could make our products less competitive in foreign markets. While we commonly sell products with payments in U.S. dollars, our product sales contracts occasionally call for payment in foreign currencies and to the extent we do so, we are subject to foreign currency exchange risks. We believe that a 10% change in foreign exchange rates would not have a material impact on the financial statements. Our foreign maintenance contracts are paid in local currencies and provide a natural hedge against local expenses. To the extent that we wish to repatriate any of these funds to the United States, however, we are subject to foreign exchange risks. We do not hold any derivative instruments and have not engaged in hedging transactions.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO FINANCIAL STATEMENTS*

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* The Financial Statements are located following page 30.

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QUARTERLY FINANCIAL DATA
(IN THOUSANDS, EXCEPT PER SHARE DATA)

The following table presents unaudited quarterly financial information for the two years ended December 31, 2000. In the opinion of management, this information contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation thereof. The operating results are not necessarily indicative of results for any future periods.

	1999				20	
FOR THE QUARTER ENDED	3/31	6/30	9/30	12/31	3/31	6/30
Revenue	$ 661	$ 260	$ 850	$ 343	$ 43	$50,973
Cost of Sales	3,017	1,785	9,039	1,597	2,029	27,503
Gross margin	(2,356)	(1,525)	(8,189)	(1,254)	(1,986)	23,470

Research and Development.....	3,033	3,686	4,752	3,745	4,483	13,865
Marketing and Sales.....	632	545	611	729	768	2,822
General and Administrative....	465	638	551	1,437	1,101	1,898
Net Loss.....	(6,811)	(6,672)	(13,934)	(7,115)	(8,005)	2,661
Comprehensive loss.....	(6,881)	(6,717)	(13,934)	(7,115)	(8,005)	2,661
Net Income (Loss) Per Common Share, Basic and Diluted....	$ (0.47)	$ (0.40)	$ (0.59)	$ (0.29)	$ (0.27)	$ 0.08

On April 1, 2000, we acquired the operating assets of the Cray Research business unit from Silicon Graphics, Inc. ("SGI"), and changed our corporate name from Tera Computer Company to Cray Inc. With that acquisition we changed from a development stage company with 125 employees (almost all located in Seattle, Washington), limited revenue and one product under development, to a company with nearly 900 employees located in over 20 countries, ongoing sales of supercomputer systems with several products in development, major manufacturing operations, an established service organization and substantial inventory. For these reasons, period to period comparisons that include periods prior to April 1, 2000, are not indicative of future results. For discussions that relate to periods prior to April 1, 2000, refer to our operations as Tera Computer Company and for discussions relating to periods after April 1, 2000, refer to our combined operations as Cray Inc. Revenue in the quarter ended June 30, 2000 was high due to the sale of a $17.1 million T3E system while revenue decreased in the subsequent two quarters of 2000 due to lower than planned product sales. Net loss for the quarter ended December 31, 2000 increased over the quarter ended September 30, 2000 primarily due to an impairment loss of $3.3 million on MTA test equipment, higher prototype expenses for the MTA2 and SV2, as well as higher sales expenses from our foreign subsidiaries.

The Company's future operating results may be subject to quarterly fluctuations as a result of a number of factors, including the timing of deliveries of the Company's products. See "Business -- Factors That Could Affect Future Results." Quarter-to-quarter comparisons should not be relied upon as indicators of future performance.

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

None.

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PART III

Certain information required by Part III is omitted from this Report as we will file a definitive proxy statement for the Annual Meeting of Shareholders to be held on May 16, 2001, pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this Report, and certain information included in the Proxy Statement is incorporated herein by reference. Only those sections of the Proxy Statement which specifically address the items set forth herein are incorporated by reference.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

Information with respect to our Directors may be found under the captions "The Board of Directors" and "Election of Three Directors" in our Proxy Statement. Such information is incorporated herein by reference. Information with respect to Executive Officers may be found beginning on page 16 above, under the caption "The Executive Officers of the Company." Information with respect to compliance with Section 16(a) of the Exchange Act by the persons subject thereto may be found under the caption "Information About Our Common

Stock Ownership" in the Proxy Statement and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions "How We Compensate Directors," "How We Compensate Executive Officers," "The Board of Directors" and "The Committees of the Board" is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information in the Proxy Statement set forth under the caption "Information About Our Common Stock Ownership" is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information set forth under the caption "Certain Transactions" in the Proxy Statement is incorporated herein by reference.

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Exhibit Listing

EXHIBIT NUMBER	DESCRIPTION
2.1	Asset Purchase Agreement between Silicon Graphics, Inc. and the Company, dated as of March 1, 2000(3)
2.2	Amendment No. 1 to the Asset Purchase Agreement between Silicon Graphics, Inc., and the Company, dated as of March 31, 2000(3)
2.3	Technology Agreement between Silicon Graphics and the Company, effective as of March 31, 2000(4)
2.4	Services Contract Agreement between Silicon Graphics, Inc. and the Company, dated as of March 31, 2000(4)
2.5	Transition Services Agreement between Silicon Graphics, Inc., and the Company, dated as of March 31, 2000(4)
3.1	Restated Articles of Incorporation(1)
3.2	Restated Bylaws.(7)
10.1	1988 Stock Option Plan(2)
10.2	1993 Stock Option Plan(2)
10.3	1995 Stock Option Plan(2)

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EXHIBIT NUMBER	DESCRIPTION
10.4	1995 Independent Director Stock Option Plan(2)
10.5	1999 Stock Option Plan(5)
10.6	2000 Non-Executive Stock Option Plan(5)
10.7	Lease Agreement between Merrill Place, LLC and the Company, dated November 21, 1997(6)

10.8 Agreement between CIT Group/Business Credit, Inc. and the Company, dated June 29, 2000(1)
10.9 Fab I Building Lease Agreement between Union Semiconductor Technology Corporation and the Company, dated as of June 30, 2000.(7)
10.10 Conference Center Lease Agreement between Union Semiconductor Technology Corporation and the Company, dated as of June 30, 2000.(7)
10.11 Mendota Heights Office Lease Agreement between the Teachers Retirement System of the State of Illinois and the Company, dated as of August 10, 2000.(7)
23.1 Independent Auditors' Consent.

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(1) Incorporated by reference to the Company's Report on Form 10-Q as filed with the Commission on August 14, 2000.

(2) Incorporated by reference to Form SB-2 Registration Statement, Registration No. 33-95460-LA, as filed with the Commission on August 3, 1995.

(3) Incorporated by reference to the Company's Report on Form 8-K, as filed with the Commission on April 17, 2000.

(4) Incorporated by reference to the Company's Report on Form 8-K, as filed with the Commission on May 15, 2000.

(5) Incorporated by reference to the Company's Registration Statement on Form S-8, Registration No. 333-57970, as filed with the Commission on March 30, 2001.

(6) Incorporated by reference to the Company's Report on Form 10-K, as filed with the Commission for the fiscal year ended December 31, 1997.

(7) Incorporated by reference to the Company's Report on Form 10-K, as filed with the Commission for the fiscal year ended December 31, 2000.

(b) Reports on Form 8-K

We filed no reports on Form 8-K in the fourth quarter of 2000.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Company caused this report to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Seattle, State of Washington, on September 14, 2001.

CRAY INC.

By /s/ JAMES E. ROTTSOLK

James E. Rottsolk
Chief Executive Officer and President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of Company and in the capacities indicated on September 14, 2001.

SIGNATURE	TITLE
By /s/ JAMES E. ROTTSOLK James E. Rottsolk	Chief Executive Officer, President and Chairman of the Board of Directors
By /s/ BURTON J. SMITH Burton J. Smith	Chief Scientist and Director
By /s/ KENNETH W. JOHNSON Kenneth W. Johnson	Chief Financial Officer
By /s/ DOUGLAS C. RALPHS Douglas C. Ralphs	Chief Accounting Officer
By /s/ DAVID N. CUTLER David N. Cutler	Director
By /s/ DANIEL J. EVANS Daniel J. Evans	Director
By /s/ KENNETH W. KENNEDY Kenneth W. Kennedy	Director
By /s/ STEPHEN C. KIELY Stephen C. Kiely	Director
By /s/ WILLIAM A. OWENS William A. Owens	Director
By /s/ TERREN S. PEIZER Terren S. Peizer	Director
By /s/ DEAN D. THORNTON Dean D. Thornton	Director

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(7) Incorporated by reference to the Company's Report on Form 10-K, as filed with the Commission for the fiscal year ended December 31, 2000.

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

ASSETS

	DECEMBER 31, 1999	DECEMBER 31, 2000
Current assets:		
Cash and cash equivalents	$ 10,069	$ 4,626
Restricted cash	1,132	761
Accounts receivable	641	25,159
Inventory, net	4,513	23,637
Prepaid expenses and other assets	544	2,835
Total current assets	16,899	57,018
Property and equipment, net	5,829	25,535
Service spares, net		21,139
Goodwill and intangible assets, net	186	29,578
Other assets	496	2,923
Total	$ 23,410	$ 136,193

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 4,366	$ 16,247
Accrued payroll and related expenses	2,147	12,028
Accrued loss on purchase commitment		6,006
Other accrued liabilities	209	6,574
Deferred revenue	68	17,666
Current portion of warranty reserves		17,996
Current portion of obligations under capital leases	612	349
Current portion of notes payable	289	8,357
Total current liabilities	7,691	85,223
Warranty reserves		14,285
Obligations under capital leases	390	284
Notes payable	1,022	254
Commitments and contingencies		
Shareholders' equity:		
Common Stock, par $.01 -- Authorized, 100,000 shares; issued and outstanding, 25,212 and 35,250 shares	111,443	158,799
Accumulated deficit	(97,136)	(122,524)
Accumulated other comprehensive income:		
Cumulative currency translation adjustment		(128)
	14,307	36,147
Total	$ 23,410	$ 136,193

See accompanying notes.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEARS ENDED DECEMBER 31,		
	1998	1999	2000
Revenue:			
Product	$ 1,274	$ 1,794	$ 46,617
Service	714	320	71,455
Total revenue	1,988	2,114	118,072
Operating expenses:			
Cost of product revenue	3,759	15,165	32,505
Cost of service revenue	584	273	34,077
Research and development	13,664	15,216	48,426
Marketing and sales	1,830	2,517	14,365
General and administrative	2,131	3,091	7,033
Amortization of goodwill and intangible assets			5,217
Total operating expenses	21,968	36,262	141,623
Loss from operations	(19,980)	(34,148)	(23,551)
Other income (expense), net		(106)	675
Interest income (expense), net	177	(278)	(1,681)
Loss before income taxes	(19,803)	(34,532)	(24,557)
Provision for income taxes			831
Net loss	(19,803)	(34,532)	(25,388)
Preferred stock dividend	(468)	(115)	
Amortization of preferred stock discount	(465)		
Net loss for common shareholders	(20,736)	(34,647)	(25,388)
Other comprehensive income:			
Currency translation adjustment			(128)
Comprehensive loss	$(20,736)	$(34,647)	$(25,516)
Basic and diluted net loss per common share	$ (1.70)	$ (1.74)	$ (0.78)
Weighted average shares outstanding, basic and diluted	12,212	19,906	32,699

See accompanying notes.

CRAY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(IN THOUSANDS)

	SERIES B CONVERTIBLE PREFERRED STOCK	COMMON STOCK

	NUMBER OF SHARES	AMOUNT	NUMBER OF SHARES	AMOUNT	PREFERRED STOCK DIVIDEND	ACCU DE
BALANCE, January 1, 1998.....		$	11,248	$ 49,168	$	$ (
Exercise of stock options.....			153	220		
Exercise of warrants.....			433	125		
Issuance of shares under Employee Stock Purchase Plan.....			30	271		
Issuance of common stock for leasehold improvements.....			176	1,314		
Issuance of common stock for services.....			3	27		
Common stock issued in private placement.....			800	8,000		
Issuance of common stock for prepaid rent.....			13	97		
Conversion of Series A preferred shares.....			1,342	9,478		
Issuance of Series B preferred stock, net of issuance costs of $326.....	6	5,674				
Issuance of common stock for accrued dividends.....			6	45		
Preferred stock dividend.....					75	
Net loss.....						(
	--	-------	-------	--------	----	---
BALANCE, December 31, 1998.....	6	5,674	14,204	68,745	75	(
Issuance of shares under Employee Stock Purchase Plan.....			55	270		
Preferred stock dividend distributed in common stock.....			36	190	(75)	
Common stock issued in private placement, net of issuance costs of $1,378.....			7,685	33,148		
Beneficial conversion feature in notes and interest expense recognized on convertible warrants.....				595		
Conversion of Series B preferred shares.....	(6)	(5,674)	1,275	5,559		
Issuance of shares under Company 401(k) Plan.....			36	144		
Exercise of stock options.....			112	55		
Exercise of warrants.....			1,375	14		
Options issued for services...				77		
Warrants issued for services.....				602		
Common stock issued in exchange for notes.....			434	2,046		
Net loss.....						(
	--	-------	-------	--------	----	---
BALANCE, December 31, 1999.....			25,212	111,443		(
Issuance of shares under Employee Stock Purchase Plan.....			179	754		
Cash received on subscribed						

common stock.....			900		
Common stock issued in private placement, net of issuance costs of $1,847.....		5,227	24,287		
Beneficial conversion feature in notes and interest expense of $200 recognized on options.....			1,283		
Common stock issued in exchange for notes, net of issuance costs of $294.....		1,671	3,906		
Issuance of shares under Company 401(k) Plan.....		14	92		
Exercise of stock options.....		69	182		
Exercise of warrants.....		1,878	8,885		
Options issued for services...			156		
Warrant issued for services...			211		
Issuance of common stock to SGI.....		1,000	6,700		
Other comprehensive income:					
Cumulative currency translation adjustment.....					
Net loss.....					(
BALANCE, December 31, 2000.....		$ 35,250	$158,799	$	$(1

See accompanying notes.

CRAY INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 1998, 1999, AND 2000
(IN THOUSANDS)

	1998	1999	2000
Operating activities			
Net loss.....	$(19,803)	$(34,532)	$(25,388)
Adjustments to reconcile net loss to net cash used by operating activities:			
Depreciation and amortization.....	803	1,881	14,349
Amortization of goodwill and intangible assets.....			5,217
Loss on disposal of assets.....			3,289
Imputed interest on non interest bearing note.....			1,437
Beneficial conversion feature of notes payable.....		595	336
Non-cash warrant and option expense.....		602	567
Inventory write down.....		6,589	
Cash provided (used) by changes in operating assets and liabilities, net of effects of the Cray Research acquisition:			
Accounts receivable.....	(279)	78	(20,483)
Inventory.....	(5,955)	(2,047)	2,681
Other assets.....	(837)	467	(2,416)
Accounts payable.....	3,332	(501)	11,587

Other accrued liabilities		(49)	5,331
Accrued payroll and related expenses	(169)	603	6,032
Warranty reserves			(15,053)
Deferred revenue	19	49	17,598
Net cash provided by (used by) operating activities	(22,889)	(26,265)	5,084
Investing activities			
Cash used for acquisition			(51,585)
Purchases of property and equipment	(2,076)	(427)	(5,835)
Net cash used by investing activities	(2,076)	(427)	(57,420)
Financing activities			
Restricted cash		(1,132)	371
Related party (receivable)/payments	61	(34)	(129)
Issuance of notes payable		1,900	12,500
Issuance of common stock	8,860	33,488	26,033
Proceeds from exercise of options		55	182
Proceeds from exercise of warrants			8,885
Principal payments on bank note		(71)	(253)
Sale of preferred stock	5,674		
Capital leases	203	(607)	(568)
Net cash provided by financing activities	14,798	33,599	47,021
Effect of foreign exchange rate changes on cash and cash equivalents			(128)
Net increase (decrease) in cash and cash equivalents	(10,167)	6,907	(5,443)
Cash and cash equivalents			
Beginning of period	13,329	3,162	10,069
End of period	$ 3,162	$ 10,069	$ 4,626
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 202	$ 174	$ 347
Non-cash investing and financing activities			
Inventory reclassified to property and equipment		1,191	5,233
Common stock issued for acquisition of business			6,700
Fixed asset additions through common stock	1,314	164	
Fixed asset additions through notes payable		933	
Fixed asset additions through capital leases		493	199
Note payable converted to common stock		2,045	4,200
Accounts payable converted to notes		594	
Stock dividends	250	190	
Beneficial conversion feature on notes payable			1,083

See accompanying notes.

CRAY INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
($ TABLES IN THOUSANDS)

NOTE 1. DESCRIPTION OF BUSINESS

Cray Inc. ("Cray" or the "Company") (formerly "Tera Computer Company") designs, develops, markets and services high-performance computer systems, commonly known as supercomputers. The Company presently markets two computer systems, the Cray SV1 and T3E, and provides maintenance services to the installed base of these and earlier models of Cray computers. The Company is

developing enhancements to the Cray SV1, and is developing three new computer systems, the MTA-2, based on the Company's multithreaded architecture system; the SuperCluster, a highly parallel system using leading commercial off-the-shelf components; and the SV2, which will combine elements of the SV1 and T3E computers.

The Company has a net loss of $25.4 million for the year ended December 31, 2000. Management's plans project sufficient cash flows to finance its planned operations for the next twelve months. In addition, subsequent to December 31, 2000, the Company entered into a $15 million financing agreement. (See Note 15 -- Subsequent Events). The Company also plans on finalizing a distribution agreement with NEC, which will provide an equity investment of $25 million.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles

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

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated. Investments in affiliates which are not majority owned are reported using the equity method.

Business Combinations

For business combinations that have been accounted for under the purchase method of accounting, the Company includes the results of operations of the acquired business from the date of acquisition. Net assets of the companies acquired are recorded at their fair value at the date of acquisition. The excess of the purchase price over the fair value of tangible net assets acquired is included in goodwill and intangible assets in the accompanying consolidated balance sheets.

Use of Estimates

Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid financial instruments that are readily convertible to cash and have original maturities of three months or less at the time of acquisition.

Restricted Cash

Restricted cash consists of cash equivalents that serve as collateral

pursuant to lease and indebtedness agreements entered into in 1999 for the acquisition of capital equipment.

Goodwill and Intangible Assets

Goodwill and intangible assets are amortized on a straight-line basis over five years.

The Company periodically analyzes the carrying value of its goodwill and intangible assets to determine that the recorded amounts are reasonable and are not impaired. Management considers whether specific events have occurred, such as a loss of a major customer or abandonment or loss of a product line, in determining whether goodwill is impaired at each balance sheet date. The determination of whether an impairment exists is based on any excess of the carrying value over the expected future cash flows, as estimated through undiscounted cash flows, excluding interest charges. Any resulting necessary impairment charge would be measured based on the difference between the carrying value of the asset and its fair value, as estimated through expected future discounted cash flows, discounted at a rate of return for an alternate similar investment. Based on its most recent analysis, Cray believes that no material impairment exists at December 31, 2000.

Fair Values of Financial Instruments

At December 31, 2000, the Company had the following financial instruments: cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and notes payable. The carrying value of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and notes payable approximates their fair value based on the liquidity of these financial instruments or based on their short-term nature.

Revenue Recognition

Cray generally recognizes revenue from product sales upon customer acceptance; however, depending on sales contract terms, revenue may be recognized upon shipment, or delayed until funding is definite. Service revenues from the maintenance of computers are recognized ratably over the term of the maintenance contract. Funds from maintenance contracts that are paid in advance are recorded as deferred revenue.

Foreign Currency Translation

The functional currency of the Company's foreign subsidiaries is the local currency. Assets and liabilities of foreign subsidiaries are translated into US dollars at year-end exchange rates, and revenues and expenses are translated at average rates prevailing during the year. Translation adjustments are included in accumulated other comprehensive loss and as a separate component of shareholders' equity. Transaction gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved, which have been insignificant, are included in the consolidated statements of operations.

Research and Development

Research and development costs include costs incurred in the development and production of the Company's hardware and software, costs incurred to enhance and support existing software features and expenses related to future implementations of systems. Research and development costs are expensed as incurred. Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed, requires the capitalization of certain software product costs after technological feasibility of the software is established. Due to the relatively

short period

between the technological feasibility a product and completion of product development and the insignificance of related costs incurred during this period, no software development costs were capitalized.

Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market (LCM). The Company regularly evaluates the technological usefulness of various inventory components. When it is discovered that previously inventoried components do not function as intended in a fully operational system, the costs associated with these components are expensed.

Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives of the related assets, ranging from three to seven years. Equipment under capital leases is depreciated over the lease term. Leasehold improvements are amortized over the lesser of their estimated useful lives or the term of the lease.

Service Spares

Service spares are stated at cost, less accumulated depreciation. Depreciation on service spares is computed using the straight-line method over the estimated useful lives of three or four years.

Impairment of Long-Lived Assets

Pursuant to SFAS No. 121, management periodically evaluates long-lived assets, consisting primarily of property and equipment and goodwill and intangible assets, to determine whether there has been any impairment of these assets and the appropriateness of their remaining useful lives. The Company evaluates impairment whenever events or changes in circumstances indicate that the carrying amount of the Company's assets might not be recoverable. Accordingly, during 2000, the Company recorded an impairment loss of $3.3 million on certain obsolete fixed assets included in cost of product sales in the Consolidated Statement of Operations and Comprehensive Loss.

The fixed assets consisted primarily of test equipment used to support the gallium arsenide Cray MTA-1 product line. As the Company transitioned from gallium arsenide technology to CMOS (complementary metal-oxide silicon) technology, the gallium arsenide equipment had no further value to the Company and was written off completely. Fair value is zero as there is no future use or salvage value for this equipment. The equipment has not yet been disposed of.

Income Taxes

The Company accounts for income taxes under SFAS No. 109, Accounting for Income Taxes. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated

realizable value.

Reclassifications

Certain prior-year amounts have been reclassified to conform with the current-year presentation.

Net Loss Per Share

Basic and diluted net loss per share is computed based on the weighted average number of shares of common stock outstanding.

Net loss per share has been computed in accordance with SFAS No. 128, Earnings per Share. Under the provisions of SFAS No. 128, basic net loss per share is computed by dividing the net comprehensive loss for the period by the weighted average number of common shares outstanding. Common stock equivalent shares related to stock options, warrants and shares subject to repurchase are excluded from the calculation as their effect is antidilutive. Accordingly, basic and diluted net loss per share are equivalent.

Segment Information

The Company has organized and managed its operations in a single operating segment providing global sales and service of high performance computers. See Note 14 -- Segment Information.

Warranty Reserve

Certain components in the T90 vector computers sold by Silicon Graphics Inc. ("SGI") prior to the Company's acquisition of the Cray Research operations have an unusually high failure rate. The cost of servicing the T90 computers exceeds the related service revenues. The Company is continuing to take action that commenced prior to the acquisition to address this problem, and has recorded a reserve to provide for anticipated future losses on the T90 maintenance service contracts. Included in warranty reserves at December 31, 2000, is an accrual of $31.5 million for estimated losses on service contracts covering the Cray Business' T90 product line. The reserve is calculated as the excess of estimated service costs over estimated service revenues for the term of the related contracts. Estimated service costs include cost of repair parts, direct costs of service, indirect labor, and overhead allocations based on management estimates of time dedicated to service T-90 contracts. Stated contract terms are adjusted for management estimates of when T-90 products will be replaced before the expiration of the service contract term. A summary of warranty reserve is as follows (in thousands):

	BALANCE DECEMBER 31, 1999	2000 ADDITIONS	2000 DEDUCTIONS	BALA DECEMB 20
Warranty Reserve	$ --	$47,461	$(15,180)	$32,

Recent Accounting Pronouncements

The Financial Accounting Standards Board issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, in June 1998, which is effective for the Company beginning January 1, 2001. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designed as part of a hedge transaction and, if it is, the type of hedge transaction. Since the Company does not currently hold any derivative instruments, SFAS No. 133 is not expected to have any impact on the consolidated financial statements.

In December 1999, the United States Securities and Exchange Commission (SEC) released Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, which was required to be adopted in the Company's fourth fiscal quarter of 2000. SAB No. 101 provides guidance on revenue recognition and the SEC staff's views on the application of accounting principles to selected revenue

recognition issues. The adoption of SAB No. 101 did not have a material impact on the consolidated financial statements.

In March 2000, the FASB issued Interpretation No. 44 (FIN 44), Accounting for Certain Transactions Involving Stock Compensation -- an Interpretation of Accounting Principles Board (APB) Opinion No. 25, which addresses certain accounting issues which arose under the previously established accounting principles relating to stock-based compensation. The adoption of this interpretation did not have a material effect on the Company's consolidated financial statements.

NOTE 3. PROPERTY AND EQUIPMENT, NET

A summary of property and equipment is as follows (in thousands):

	DECEMBER 31,	
	1999	2000
Land	$	$ 139
Building		8,130
Furniture and equipment	736	1,504
Computer equipment	8,458	28,754
Leasehold improvements	1,974	2,309
	11,168	40,836
Accumulated depreciation	(5,339)	(15,301)
Property and equipment, net	$ 5,829	$ 25,535

NOTE 4. INVENTORY, NET

A summary of inventory is as follows (in thousands):

	DECEMBER 31,	
	1999	2000
Components and subassemblies	$ 8,044	$14,884
Work in process	806	10,148
Finished goods	1,137	936
	9,987	25,968
LCM adjustment	(5,474)	(2,331)
Inventory, net	$ 4,513	$23,637

	BALANCE DECEMBER 31, 1999	2000 ADDITIONS	2000 DEDUCTIONS	BALANCE DECEMBER 31, 2000
LCM adjustment	$5,474	$3,200	$(6,343)	$2,331

NOTE 5. SERVICE SPARES, NET

A summary of service spares is as follows (in thousands):

	DECEMBER 31,	
	1999	2000
Service spares	$--	$27,697
Accumulated depreciation	--	(6,558)
Service spares, net	$--	$21,139

NOTE 6. ACQUISITION

The Company acquired certain assets of the Cray Research business unit from

Silicon Graphics, Inc. ("SGI") on April 1, 2000, in exchange for cash of $15.0 million, the issuance of one million shares of common stock valued at $6.7 million, and the issuance of a $35.3 million non-interest bearing promissory note. Commencing April 1, 2000, the Company has included the results of operations of the Cray Research business unit in its consolidated results of operations.

The Company has accounted for this transaction under the purchase method of accounting in accordance with the APB Opinion No. 16. Under the purchase method of accounting, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values.

The following table summarizes the purchase accounting for the acquisitions (in thousands):

Current and long term assets	$ 80,165
Goodwill and intangible assets	34,906
Liabilities assumed	(58,223)
Net assets acquired	56,848
Less: acquisition costs	(1,326)
Purchase price	$ 55,522

The following table presents the results of operations of the Company on a pro forma basis. These results are based on the individual historic results of the Company and the Cray Research business unit and reflect adjustments to give effect to the acquisitions as if they had occurred at the beginning of the periods presented (in thousands):

	DECEMBER 31,	
	1999	2000
	(UNAUDITED)	
Revenue	$287,771	$183,820
Net income	$ 31,536	$ 5,142
Basic and diluted net income per common share	$ 1.51	$ 0.16
Weighted average shares used to compute basic and diluted net income per common share	20,906	32,949

NOTE 7. RELATED PARTY TRANSACTIONS

During 2000, the Company accepted promissory notes in the aggregate principal amount of $326,000 as collateral for payment by the Company of option exercises and federal income taxes due from the exercise of employee stock options. These notes replaced promissory notes in the aggregate principal amount of $341,000 originally issued during 1999. The notes are due and payable in twelve months and bear interest at a rate

of 5.74% per year. These notes and the unpaid accrued interest are secured by a pledge of shares of Cray's common stock. The Company's rights to payment are not limited to such security. The options exercised under these notes are considered to be variable employee stock options under current accounting literature. Accordingly, compensation is recognized to the extent the fair value of the Company's stock exceeds the options' exercise price.

The Company also has an unsecured promissory note in the aggregate principal amount of $138,000 from the Chief Executive Officer of the Company. The note is due and payable on March 31, 2001, including accrued interest at a rate of 9.5%. The Company recorded interest income of $1,100 for year ended December 31, 2000, on the note. The note was paid in full on February 6, 2001.

The Company paid fees of $1.8 million as part of a private placement completed in February 2000 to a company whose Chairman, CEO and principal shareholder is one of the Company's directors.

As part of a common stock purchase agreement in October and December 2000 (See Note 12 -- Shareholders' Equity) the Company has accrued fees of $294,000 to a company whose Chairman, CEO and principal shareholder is one of the Company's directors.

NOTE 8. LEASE AGREEMENTS

The Company leases certain property and equipment under capital leases pursuant to master equipment lease agreements. Under such agreements, the Company has acquired computer and other equipment in the amount of $1,856,000 and $2,114,000, for which $1,023,000 and $1,550,000 of accumulated depreciation was recorded as of December 31, 1999, and 2000, respectively.

Minimum lease commitments are (in thousands):

	CAPITAL LEASES	OPERATING LEASES
2001	$403	$ 3,474
2002	218	3,529
2003	88	3,013
2004	5	3,083
2005		2,929
Thereafter		8,251
	714	$24,279
Less amounts representing interest	(81)	
	$633	

Rent expense for 1998, 1999, and 2000 was $961,000, $1,929,000 and $2,520,000, respectively.

NOTE 9. COMMITMENTS

The Company is contractually committed to acquire components, and manufacturing and engineering services totaling $16.3 million. Commitments are for goods and services to be provided to Cray by either specific dates or by achieving milestones identified in the contracts.

NOTE 10. FEDERAL INCOME TAXES

Due to continued losses from operations, there has been no provision for federal income taxes for any period. The provision for income taxes consisted of (in thousands):

	DECEMBER 31,		
	1998	1999	2000
Federal:			
Current	$	$	$
Deferred			
State:			
Current			
Deferred			
Foreign:			
Current			831
Deferred			
Total provision for income taxes	$	$	$831

The Company did not pay any income taxes in 1998, 1999 and 2000 due to losses from operations. In 2000, the company purchased the assets of the Cray Research business unit from SGI. Consequently, this is the Company's first year with foreign income tax liabilities.

Loss before provision for income taxes consisted of (in thousands):

	DECEMBER 31,		
	1998	1999	2000
United States	$(19,803)	$(34,532)	$(27,219)
International			1,831
	$(19,803)	$(34,532)	$(25,388)

The following table reconciles the federal statutory income tax rate to the Company's effective tax rate.

	1998	1999	2000
Federal income tax rate	(34.00)%	(34.00)%	(34.00)%
State taxes			
Foreign taxes			3.27%
Other			0.82%
Effect of net operating loss carryforwards and valuation allowance	34.00%	34.00%	33.18%
Effective income tax rate	0.00%	0.00%	3.27%

Deferred income taxes reflect the net tax effects of temporary differences between the tax basis of assets and liabilities and the corresponding financial statement amounts. Significant components of the Company's deferred income tax assets are as follows:

	1999	2000
Warranty reserve	$ 68	$ 10,976
Inventory reserve	1,862	699
Accrued compensation	246	735
Stock issued for services	231	
Fixed assets	123	3,340
Research and experimentation	3,022	4,541
Net operating loss carryforwards	29,986	40,587
State tax loss carryforwards	1,577	1,500
Net deferred tax assets	37,115	62,378
Valuation allowance for deferred tax assets	(37,115)	(62,378)
Deferred tax balance	$	$

As of December 31, 1998, 1999 and 2000, the Company had federal net operating loss carryforwards of approximately $60.7 million, $88.3 million and $119.4 million, respectively. The Company also had federal research and experimentation tax credit carryforwards of approximately $2.5 million, $3.0 million and $4.5 million, respectively. The net operating loss credit carryforwards will expire at various dates beginning in 2003 through 2020 if not utilized. The utilization of the federal net operating loss and credit carryforwards are subject to annual limitations due to ownership changes of stock in prior years.

The Company has fully reserved its deferred tax assets. Management believes sufficient uncertainty exists regarding the realizability of the deferred tax assets such that a full valuation allowance is required. The net change in the valuation allowance during the years ended December 31, 1999 and 2000 was $13.0 million and $25.3 million, respectively.

NOTE 11. NOTES PAYABLE

Notes payable consists of the following at December 31, 1999 and 2000 (in thousands except original principal and discount amounts):

	1999	2000
Note payable to bank, dated August 31, 1999, original principal of $544,000, interest at 10.48%, due August 31, 2002, secured by equipment	$ 492	$ 323
Note payable to bank, dated October 7, 1999, original principal of $389,000, interest at 8.71%, due October 7, 2002, secured by equipment	370	249
Convertible note payable to vendor, dated March 25, 1999, original principal of $494,000, interest at 8.00%, due March 31, 2001, unsecured, net of remaining discount of $45,000 and $8,000 for 1999 and 2000, respectively	449	486
Notes payable to investors, dated October 18, 2000, original principal of $7,500,000, interest at 6.00%, due February 1, 2001, unsecured. (Note 12)		3,300
Notes payable to investors, dated December 12, 2000, original principal of $5,000,000, interest at 6.00%, due April 3, 2001, unsecured, net of discount of $747,000. (Note 12)		4,253
	1,311	8,611
Less current portion	(289)	(8,357)
Total long-term notes payable	$1,022	$ 254

The aggregate maturities of notes payable for the years 2001 through 2002 are as follows: $8,357,000 and $254,000.

The Company has an unused $5,000,000 revolving credit agreement. The agreement contains a minimum tangible net capital covenant with which the Company was not in compliance at December 31, 2000. Subsequent to December 31, 2000, the Company has entered into a new credit agreement. See note 15 -- Subsequent Events.

NOTE 12. SHAREHOLDERS' EQUITY

Common Stock Purchase Agreements: In October and December 2000, the Company agreed to issue shares of common stock to certain investors covered by the

Company's shelf registration statement and to apply the purchase price for the shares against repayment of principal and interest on certain notes payable. Through December 2000, the Company repaid $4.2 million of the notes by delivering an aggregate of 1,671,094 shares of common stock at an average price of $2.51 per share, which reflects an 8% discount from the daily volume weighted average trading price for the Company's stock. Unless the Company prepays the notes, it will repay the remaining $8.3 million of the notes by issuing additional shares of common stock to the investors, using a 9% discount from the average of the daily volume weighted average trading prices over the period from the first week of January through March 2001. The discounts of 8% or 9%, respectively, from the daily volume weighted average trading price for the Company's stock resulted in beneficial conversion features on the notes payable. These beneficial conversion features were accounted for in accordance with EITF 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios, resulting in the recording of additional paid in capital and a discount on the notes payable for the intrinsic value of the beneficial conversion features.

Shareholder Warrants: At December 31, 2000, the Company had outstanding and exercisable warrants to purchase an aggregate of 14,801,096 shares of common stock, as follows:

SHARES OF COMMON STOCK	EXERCISE PRICE PER SHARE	EXPIRATION DATE OF WARRANTS
90,488	$6.00	December 31, 2001
97,208	$6.00	February 28, 2002
282,500	$3.94	April 21, 2002
7,311,055	$4.72	June 21, 2002
155,000	$4.50	June 25, 2002
87,500	$6.00	December 23, 2002
80,672	$4.72	September 28, 2003
100,000	$6.00	January 20, 2004
200,000	$4.72	March 9, 2004
25,000	$5.16	March 9, 2004
1,111,111	$4.72	March 9, 2004
100,000	$6.00	March 30, 2004
14,829	$5.00	March 31, 2004
5,801	$6.00	November 7, 2005
524	$6.00	May 21, 2006
5,139,408	$2.53	June 21, 2009
14,801,096		

For expense recorded in the three years ended December 31, 2000, warrants were valued at their fair values using the Black-Scholes model based on the volatility of the Company's stock, the contractual life of the warrants, and the risk-free rate of return.

As part of a financing completed on June 21, 1999, the Company issued a

warrant to a director of the Company, in exchange for cash of $200,000, exercisable for a minimum of 1,591,723 shares of common stock. In 2000, the number of shares subject to this warrant increased to 10% of the Company's issued and outstanding shares, on a fully diluted basis, with certain limited exceptions to 5,139,408 shares.

Stock Option Plans: The Company has six stock option plans that provide for option grants to employees, directors and others. Four of these plans, the 1988 Employee Stock Option Plan, the 1993 Employee Stock Option Plan, the 1995 Employee Stock Option Plan, and the 1995 Independent Director Stock Option Plan were terminated by the Board of Directors in 1995 and 1999. Options granted under the Company's option plans generally vest over four years or as otherwise determined by the plan administrator. Options to purchase shares expire no later than ten years after the date of grant.

A summary of Cray's stock option activity and related information follows:

	OPTIONS OUTSTANDING	OUTSTANDING WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
Balance, January 1, 1998	2,035,905	$4.37	931,309	$3.25
Granted	742,090	8.44		
Exercised	(153,234)	1.43		
Canceled	(41,725)	6.61		
Balance, December 31, 1998	2,583,036	5.68	1,158,125	4.15
Granted	1,320,439	5.17		
Exercised	(107,513)	0.56		
Canceled	(100,616)	4.65		
Balance, December 31, 1999	3,695,346	5.68	1,158,125	5.29
Granted	4,924,513	5.48		
Exercised	(69,479)	2.69		
Canceled	(326,375)	5.16		
Balance, December 31, 2000	8,224,005	$5.61	2,428,813	$5.59
Available for grant at December 31, 2000	6,535,839			

Outstanding and exercisable options by price range as of December 31, 2000 are as follows:

OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	WEIGHTED	WEIGHTED		WEIGHTED

RANGE OF EXERCISE PRICE PER SHARE	NUMBER OUTSTANDING	AVERAGE REMAINING LIFE (YEARS)	AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	AVERAGE EXERCISE PRICE
$ 0.35 - $ 3.00	256,782	5.3	$ 1.89	148,448	$ 1.64
3.01 - 6.00	5,445,424	8.3	4.88	1,574,596	5.11
6.01 - 9.00	2,512,799	8.5	7.54	699,769	7.44
9.01 - 12.00	--	--	--	--	--
12.01 - 15.00	9,000	7.3	13.69	6,000	13.69
$ 0.35 - $15.00	8,224,005	8.3	$ 5.61	2,428,813	$ 5.59

In 1996, the Company established an Employee Stock Purchase Plan (1996 ESPP). The maximum number of shares of the Company's common stock that employees may acquire under the 1996 ESPP is 1,000,000 shares. Eligible employees are permitted to acquire shares of the Company's common stock through payroll deductions not exceeding 15% of base wages. The purchase price per share under the 1996 ESPP is the lower of (a) 85% of the fair market value of the Company's Common Stock at the beginning of each six month offering period or (b) the fair market value of the Common Stock at the end of each six month offering period.

Fair Value Information: The Company applies APB Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations in accounting for its stock option and purchase plans. Had compensation cost for the Company's stock option plans and its stock purchase plan been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS No. 123, Accounting for Stock-Based Compensation, the Company's net loss for common stock and net loss per

common share for the years ended December 31, 1998, 1999, and 2000 would have been increased to the pro forma amounts indicated below:

Net loss for common shareholders (in thousands):

	1998	1999	2000
As reported	$(20,736)	$(34,647)	$(25,388)
Pro forma	$(22,933)	$(37,444)	$(41,971)

Basic and diluted net loss per common share:

	1998	1999	2000
As reported	$(1.70)	$(1.74)	$(0.78)
Pro forma	$(1.88)	$(1.88)	$(1.28)

The weighted average Black-Scholes value of options granted under the stock option plans during 1998, 1999, and 2000 was $9.35, $4.42, and $5.29. Fair values were estimated as of the dates of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: no dividend yield, expected volatility of 94%, 85 % and 98% for 1998, 1999, and 2000, respectively, risk-free interest rate of 5.7%, 5.4%, and 5.2% for 1998, 1999 and 2000, respectively, and an expected term of 9.6, 8.4, and 8.4 years for 1998, 1999, and 2000, respectively.

NOTE 13. 401(K) PLAN

The Company has a defined contribution retirement plan covering substantially all employees that provides for voluntary salary deferral contributions on a pre-tax basis in accordance with Section 401(k) on the Internal Revenue Code of 1986, as amended. The Company may make voluntary matching contributions in amounts determined annually by the Board of Directors. Defined contribution pension expense was $139,000, $183,000 and $713,000 for 1998, 1999, and 2000, respectively.

NOTE 14. SEGMENT INFORMATION

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, establishes standards for reporting information about operating segments and for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions on allocating resources and assessing performance. Cray's chief decision-maker, as defined under SFAS No. 131, is the Chief Executive Officer and the executive management team. As of December 31, 2000, Cray operates in one business segment: global sales and service of high performance computers.

Revenue from U.S. Government agencies or commercial customers primarily serving the U.S. Government totaled approximately $63.4 million in 2000.

The Company's significant operations outside the United States include sales and service offices in Europe, the Middle East, and Africa (EMEA), Japan, and Asia Pacific (Australia, Korea, China and Taiwan). Intercompany transfers between operating segments and geographic areas are primarily accounted for at prices that approximate arm's length transactions.

Geographic revenue and long-lived assets related to operations as of and for the year ended December 31, 2000, were as follows:

	UNITED STATES	EMEA	JAPAN	ASIA PACIFIC	TOTAL
Product revenue	$41,368	$ 2,748	$2,501	$ --	$46,617
Service revenue	$43,926	$17,706	$7,015	$2,808	$71,455

Long lived assets	$69,009	$ 5,245	$3,406	$1,515	$79,175

No prior year comparative information has been presented as the Company did not have significant operations outside the United States prior to the Cray Research acquisition on April 1, 2000.

NOTE 15. SUBSEQUENT EVENTS

In February 2001 the Company signed a distribution agreement with NEC Corporation to distribute and service NEC SX-5 vector processor computers and its successors. This agreement provides the Company with exclusive distribution and servicing in the United States, Canada and Mexico, and non-exclusive rights in the rest of the world. Current duties under the U.S. anti-dumping laws effectively prohibit the importation of these computers into the U.S. The Company has requested that the U.S. Government remove these duties. Assuming these duties are removed as expected, the Company plans on marketing NEC SX-5 series computers to customers and industries with a need for significant performance improvements, particularly in the United States. As part of the agreement, NEC will invest $25 million of cash in Cray, in exchange for 3,125,000 non-voting, preferred shares, convertible into Cray common stock at a fixed conversion price of $8.00 per share.

In March 2001, the Company entered into a credit agreement with Foothill Capital Corporation. This line of credit replaced the Company's existing credit agreement in place at December 31, 2000. The credit agreement makes available $15 million through March 2004. The credit agreement provides $7.5 million of borrowings in the form of a revolving line of credit based on eligible domestic and foreign product accounts receivable, and $7.5 million of borrowings in the form of a term loan. Borrowings under the credit agreement are secured by property, plant and equipment and bear interest at the prime rate plus 2% for the revolving line of credit and at the prime rate plus 3.25% for the term loan. The credit agreement contains financial covenants relating to tangible net worth, EBITDA and domestic service revenue.

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders
Cray Inc.
Seattle, Washington

We have audited the accompanying consolidated balance sheets of Cray Inc. and subsidiaries (the Company) as of December 31, 2000 and 1999, and the related consolidated statements of operations and comprehensive loss, shareholders'

equity, and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards 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 Cray Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche Signature

February 9, 2001
(March 28, 2001 as to Note 15)

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