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NORTHERN DISTRICT OF CALIFORNIA

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E-filing

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA**

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GERALD DULL, Individually and on Behalf of All
Others Similarly Situated,

Plaintiff,

v.

RACKABLE SYSTEMS, INC., THOMAS K.
BARTON, and MADHU RANGANATHAN,

Defendants.

CV 09

0222

CLASS ACTION

**COMPLAINT FOR VIOLATIONS
OF THE FEDERAL SECURITIES
LAWS**

DEMAND FOR JURY TRIAL

1 Plaintiff, by and through his attorneys, alleges the following upon information and belief,
2 except as to those allegations concerning Plaintiff, which are alleged upon personal knowledge.
3 Plaintiff's information and belief is based upon, among other things, his counsel's investigation,
4 which includes without limitation: (a) review and analysis of regulatory filings made by Rackable
5 Systems, Inc. ("Rackable" or the "Company") with the United States Securities and Exchange
6 Commission ("SEC"); (b) review and analysis of press releases and media reports issued by and
7 disseminated by Rackable; and (c) review of other publicly available information concerning
8 Rackable.
9

10 NATURE OF THE ACTION AND OVERVIEW

11
12 1. This is a federal class action on behalf of purchasers of Rackable's securities between
13 October 30, 2006 and April 4, 2007, inclusive (the "Class Period"), seeking to pursue remedies under
14 the Securities Exchange Act of 1934 (the "Exchange Act").

15 2. Rackable's primary business is the design, manufacture, and implementation of
16 highly scalable computer servers and high-capacity storage systems, which are sold to customers
17 such as large Internet businesses and companies in such markets as semiconductor design, enterprise
18 software, federal government, entertainment, financial services, oil and gas, biotechnology, and
19 pharmaceuticals.
20

21 3. At the start of the Class Period, Rackable held a conference call for analysts and
22 investors to discuss the Company's third quarter 2006 financial results. During the call, the
23 Company's chief executive officer, among others, told investors that Rackable would achieve fourth-
24 quarter 2006 gross margins of between 23% and 24%, "with a high degree of confidence... based on
25 an analysis of current backlog and pending opportunities, our likelihood of achieving economies of
26 scale in Q4 versus Q3 and our belief that the DRAM [dynamic random access memory] markets are
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1 Company's business, operations, and prospects. Specifically, Defendants made false and/or
2 misleading statements and/or failed to disclose: (1) that the Company was experiencing competitive
3 pressure; (2) that competition was increasing; (3) that, due to increasing competition, the only way
4 the Company was able to maintain and expand its customer base was by aggressively lowering its
5 contract prices; (4) that, as such, the Company was experiencing dramatic erosion of gross margin
6 attainment in the Company's largest accounts as focused competitors aggressively dropped prices;
7 (5) that prices increases for DDR [double data rate] memory were accelerating faster than the
8 Company represented to investors; (6) that, as a result of the above, the Company was unlikely to
9 meet its quarterly gross margin targets; (7) that the Company lacked effective internal and financial
10 controls; and (8) that, as a result of the foregoing, statements made by the Company and management
11 during the Class Period concerning the Company's business, operations, and prospects were lacking
12 any reasonable basis.

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15 11. As a result of Defendants' wrongful acts and omissions, and the precipitous decline
16 in the market value of the Company's securities, Plaintiff and other Class members have suffered
17 significant losses and damages.

18 JURISDICTION AND VENUE

19
20 12. The claims asserted herein arise under §§10(b) and 20(a) of the Exchange Act (15
21 U.S.C. §§78j and 78t(a)) and Rule 10b-5 (17 C.F.R. §240.10b- 5) promulgated thereunder by the
22 SEC (17 C.F.R. § 240.10b.5).

23
24 13. This Court has jurisdiction over the subject matter of this action pursuant to 28
25 U.S.C. §1331, §27 of the Exchange Act (15 U.S.C. §78aa).

26 14. Venue is proper in this Judicial District pursuant to §28 U.S.C. §1391(b), §27 of

1 the Exchange Act (15 U.S.C. §78aa(c)).

2 15. Substantial acts in furtherance of the alleged fraud or the effects of the fraud have
3 occurred in this Judicial District. Many of the acts charged herein, including the preparation and
4 dissemination of materially false and/or misleading information, occurred in substantial part in this
5 District. Additionally, the Company's principal executive offices are located within this Judicial
6 District.
7 District.

8 16. In connection with the acts, transactions, and conduct alleged herein, Defendants
9 directly and indirectly used the means and instrumentalities of interstate commerce, including the
10 United States mail, interstate telephone communications, and the facilities of a national securities
11 exchange.
12 exchange.

13 **PARTIES**

14 17. Plaintiff Gerald Dull, as set forth in the accompanying certification, incorporated by
15 reference herein, purchased Rackable common stock during the Class Period, and suffered damages
16 as a result of the federal securities law violations and false and/or misleading statements and/or
17 material omissions alleged herein.
18 material omissions alleged herein.

19 18. Defendant Rackable is a Delaware corporation with its principal executive offices
20 located at 46600 Landing Parkway, Fremont, California 94538.

21 19. Defendant Thomas K Barton ("Barton") was, at all relevant times, Chief Executive
22 Officer ("CEO") and a member of the Board of Directors of Rackable until April 2007. On April
23 28, 2007 Defendant Barton resigned as a member of the Board and on April 29, 2007 the Board
24 terminated Defendant Barton from the position of CEO.
25 terminated Defendant Barton from the position of CEO.

26 20. Defendant Madhu Ranganathan ("Ranganathan") was, at all relevant times, Chief
27

1 Financial Officer ("CFO") of Rackable.

2 21. Defendants Barton and Ranganathan are collectively referred to hereinafter as the
3 "Individual Defendants." The Individual Defendants, because of their positions with the Company,
4 possessed the power and authority to control the contents of Rackable's reports to the SEC, press
5 releases and presentations to securities analysts, money and portfolio managers and institutional
6 investors, *i.e.*, the market. Each defendant was provided with copies of the Company's reports and
7 press releases alleged herein to be misleading prior to, or shortly after, their issuance and had the
8 ability and opportunity to prevent their issuance or cause them to be corrected. Because of their
9 positions and access to material non-public information available to them, each of these defendants
10 knew that the adverse facts specified herein had not been disclosed to, and were being concealed
11 from, the public, and that the positive representations which were being made were then materially
12 false and/or misleading. The Individual Defendants are liable for the false statements pleaded herein,
13 as those statements were each "group-published" information, the result of the collective actions of
14 the Individual Defendants.
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16 SUBSTANTIVE ALLEGATIONS

17 Background

18 22. Rackable's primary business is the design, manufacture, and implementation of
19 highly scalable computer servers and high-capacity storage systems, which are sold to customers
20 such as large Internet businesses and companies in such markets as semiconductor design, enterprise
21 software, federal government, entertainment, financial services, oil and gas, biotechnology, and
22 pharmaceuticals.
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**Materially False and Misleading
Statements Issued During the Class Period**

23. The Class Period begins on October 30, 2006. On this day, Rackable issued a press release entitled, "Rackable Systems, Inc. Announces Third Quarter 2006 Financial Results." Therein, the Company, in relevant part, stated:

Company Raises Fourth Quarter Outlook and Expects Strong Growth in 2007

Rackable Systems, Inc. (NASDAQ: RACK), a provider of servers and storage products for large-scale data center deployments, today announced financial results for the third quarter of 2006.

Q3 Highlights

- Quarterly revenue of \$80.5 million, up 40% from Q3 '05
- Storage business accounted for 16% of revenues, up from 8% in Q3 '05
- Completed acquisition of Terrascale Technologies, a provider of clustered storage solutions

"This quarter, we continued to make significant progress in diversifying our revenue base with the addition of several key customers. We are now actively supplying our products to 9 of the top 20 Internet sites in the country and are on track to deploy to a 10th during the fourth quarter," said Tom Barton, Chief Executive Officer of Rackable Systems, "We previously announced a delay in an expected customer order from the third quarter to the fourth quarter. We are pleased to report we have secured that order, and it was larger than anticipated. Given this, as well as generally strong bookings momentum over the last 60 days, we now expect to exceed our previously announced projections for full year 2006."

Q3 Financial Results

Total revenue for the third quarter ended September 30, 2006 was \$80.5 million, up 40% from \$57.4 million in the third quarter of 2005.

During the third quarter of 2006, the company recorded stock-based compensation charges of \$6.1 million and the write-off of in-process R&D and amortization of intangibles in connection with the Terrascale acquisition of \$3.0 million resulting in a GAAP net loss of \$(389,000) or \$(0.01) per diluted share compared to a GAAP net income of \$4.4 million or \$0.20 per diluted share in the same period a year ago. Non-GAAP net income for the third quarter was \$5.4 million or \$0.19 per diluted

1 share, compared to non-GAAP net income of \$4.7 million or \$0.22 per diluted share
2 in the same period a year ago.

3 GAAP gross margin for the third quarter was 21.4% compared to 24.1% in the same
4 period a year ago. Non-GAAP gross margin for the third quarter was 22.6%
5 compared to 24.2% in the same period a year ago. Third quarter gross margin was
6 negatively impacted by rapid price increases in component pricing, specifically DDR
memory. The company expects gross margins to improve in the fourth quarter and
for the full year 2007.

7 Total revenue for the nine months ended September 30, 2006 was \$253.5 million, up
8 92% from \$131.9 million in the first nine months of 2005. GAAP net income for the
9 first nine months of 2006 was \$10.9 million or \$0.39 per diluted share, compared to
10 \$1.2 million or \$0.07 per diluted share in the same period a year ago. Non-GAAP net
income for the first nine months was \$21.4 million or \$0.76 per diluted share,
compared to \$7.5 million or \$0.43 per diluted share in the same period a year ago.

11 Rackable Systems ended the quarter with \$195.8 million of cash, cash equivalents
12 and short-term investments compared to \$ 215.3 million as of the end of the second
13 quarter. Cash balances decreased by only \$19.5 million during the quarter despite
14 payments of \$30.0 million, made during the quarter in conjunction with the
15 Terrascale acquisition. Absent the Terrascale payments, the Company would have
16 accreted \$10.5 million of cash during the quarter. Cash flow from operations for the
17 nine months ended September 30, 2006 was \$18.7 million compared to a negative
18 cash flow from operations of \$(25.7) million for the same period a year ago.

19 In the first quarter of fiscal 2006, Rackable Systems adopted Statement of Financial
20 Accounting Standards No. 123R, Share-Based Payments (FAS 123R), which requires
21 that stock-based compensation be recorded in its financial statements. The company's
22 non-GAAP financial measures exclude the following:

- 23 - Stock-based compensation expense
 - 24 - Write-off of in-process R&D and amortization of intangibles and other assets
25 recorded in connection with the Terrascale acquisition
 - 26 - Amortization of patents and customer list in connection with the acquisition
27 of the company's predecessor
 - 28 - Change in fair value of embedded derivatives in preferred stock
 - Dividends on preferred stock recorded as interest expense and
 - Related tax effects of the applicable items
- The reconciliation between GAAP and non-GAAP net income (loss), gross margin and net income (loss) per share is provided in the financial tables accompanying this press release.

26 **Business Outlook**

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Rackable Systems has increased its financial projections for the fourth quarter ending December 31, 2006.

- Revenue is projected to be in the range of \$100 – \$110 million
- GAAP net income per diluted share is projected to be \$0.10 - \$0.12 per share
- Non-GAAP net income per diluted share is projected to be \$0.25 - \$ 0.27 per share

Rackable Systems is providing the following projections for the full fiscal year ending December 31, 2007:

- Revenue is projected to be in the range of \$475 – \$525 million
- GAAP net income per diluted share is projected to be \$0.46 - \$0.58 per share
- Non-GAAP net income per diluted share is projected to be \$1.28 - \$1.40 per share

Barton concluded, "The momentum we are experiencing in the back half of the year, and specifically bookings in the past 60 days, give us the confidence to increase projections for the fourth quarter. Market and customer demand for our product set appears strong and we anticipate this will continue through 2007. Despite increasing competitive intensity in the X86 server markets, we expect to achieve gross and operating margin leverage in 2007 as we begin to recognize benefits from the Terrascale acquisition and the investments we have made in our infrastructure during 2006."

(Emphasis in original).

24. On October 30, 2006 Rackable held a conference call with analysts to discuss the Company's financial results for the quarter ending September 30, 2006 announced in the Company's October 30, 2006 press release. During the call, Defendant Barton, emphasized that the Company would have a strong fourth quarter, stating in part "We have also seen very strong general bookings momentum in the last 60 days and we see enough fairly identified demand that we are increasing Q4 estimates to the point where our fully year 2006 estimates are higher than those we provided on our last call." Barton further touted the Company's "high degree of visibility" for Q4, and added that the higher projected margins were partially the result of the softening of the DRAM markets:

1 We also have a high degree of visibility on additional pipeline for Q4 revenue
2 production and therefore, a high degree of visibility into our revenue, gross margin
3 and EPS outlook for Q4. We are projecting Q4 revenues at \$100 million to \$110
4 million and we believe we have a real possibility of exceeding the midpoint of that
5 range in Q4. The gross margin outlook is also improved.

6 *Going forward, we are projecting Q4 non-GAAP gross margins to be between 23%
7 and 24% with a high degree of confidence. These figures are based on an analysis
8 of current backlog and pending opportunities, our likelihood of achieving
9 economies of scale in Q4 versus Q3 and our belief that the DRAM markets are
10 softening. These figures also factor in our beliefs about expected pricing and
11 competitive intensity for Q4.*

12 *From the EPS standpoint, we expect to see substantial increases based on a
13 rebound in gross margins*

14 (Emphasis added).

15 25. In addition, during the October 30, 2006 conference call, Defendant Ranganathan,
16 stated the following with regard to the Company's gross margins and Q4 prospects: "[W]e believe
17 our gross margins will improve slightly during the fourth quarter compared to the third quarter due
18 to scale economies and an improved outlook in the component market. Hence, we are projecting Q4
19 gross margins in the range of 23% to 24%."

20 26. On November 14, 2006, Rackable filed its Quarterly Report with the SEC on Form
21 10-Q. The Company's 10-Q was signed by Defendant Ranganathan and reaffirmed the Company's
22 financial results previously announced on October 30, 2006.

23 27. The Company's 10-Q filed on November 14, 2006 also contained Sarbanes-Oxley
24 required certifications, signed by Defendants Barton and Ranganathan, who certified:

- 25 1. I have reviewed this quarterly report on Form 10-Q of Rackable Systems,
26 Inc.;
- 27 2. Based on my knowledge, this report does not contain any untrue statement of
28 a material fact or omit to state a material fact necessary to make the

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statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's

1 internal control over financial reporting.

2 28. The statements contained in ¶¶23-27 were materially false and/or misleading when
3 made because defendants failed to disclose or indicate the following: (1) that the Company was
4 experiencing competitive pressure; (2) that competition was increasing; (3) that, due to increasing
5 competition, the only way the Company was able to maintain and expand its customer base was by
6 aggressively lowering its contract prices; (4) that, as such, the Company was experiencing dramatic
7 erosion of gross margin attainment in the Company's largest accounts as focused competitors
8 aggressively dropped prices; (5) that prices increases for DDR [double data rate] memory were
9 accelerating faster than the Company represented to investors; (6) that, as a result of the above, the
10 Company was unlikely to meet its quarterly gross margin targets; (7) that the Company lacked
11 effective internal and financial controls; and (8) that, as a result of the foregoing, statements made
12 by the Company and management during the Class Period concerning the Company's business,
13 operations, and prospects were lacking any reasonable basis.
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16 **The Truth Begins to Emerge**

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18 29. On January 16, 2007 Rackable issued a press release entitled, "Rackable Systems
19 Announces Preliminary Fourth Quarter 2006 Results." Therein, the Company, in relevant part,
20 stated:

21 **Record Revenue of \$105.5 - \$106.8M; Non-GAAP EPS \$0.17 - \$0.18**

22 Rackable Systems, Inc., (NASDAQ: RACK) today announced preliminary results for
23 the fourth quarter ended December 30, 2006. Total revenue for the fourth quarter of
24 2006 is expected to be in the range of \$105.5 to \$106.8 million. GAAP net income
25 (loss) for the period is expected to range from a net loss of \$(683,000) to net income
26 of \$194,000 or \$(0.02) to \$0.01 per diluted share. Non-GAAP net income is expected
to be in the range of \$4.8 to \$5.3 million or \$0.17 to \$0.18 per diluted share.
Non-GAAP gross margin is expected to be between 19.2% and 19.7%.

1 "We are pleased that revenue for the fourth quarter came in toward the high-end of
2 our forecast, and that we broke the \$100 million quarterly revenue mark for the first
3 time in the company's history. However, we are disappointed that we did not achieve
4 our gross margin and EPS goals for the quarter," stated Tom Barton, Chief Executive
5 Officer of Rackable Systems. He continued, "Although it took us longer than
6 expected to roll out our new RapidScale line of products, early customer feedback
7 has been positive and we remain enthusiastic about the long-term opportunities for
8 this business."

9 Barton further stated, "We have scheduled our regular quarterly conference call to be
10 held on February 1, 2007. At that time, we will provide a full update of fourth quarter
11 and full year fiscal 2006 financial results, as well as an updated business outlook for
12 2007."

13 The primary factors that impacted gross margin for the fourth quarter included:

- 14 - DDR memory pricing that was higher than anticipated by the company at the
15 start of the quarter.
- 16 - Intense competitive conditions that caused the company to price contracts
17 more aggressively in order to maintain and expand relationships with its
18 customer base.
- 19 - Lower than expected sales of the company's RapidScale products.

20 (Emphasis in original).

21 30. On this news, shares of Rackable declined \$12.44 per share, more than 38%, to close
22 on January 17, 2007 at \$19.98 per share, on unusually heavy volume.

23 31. On February 1, 2007, Rackable issued a press release entitled, "Rackable Systems
24 Announces Record Fiscal 2006 Revenue and Earnings." Therein, the Company, in relevant part,
25 stated:

26 **Record Annual Revenue of \$360.4 M and Non-GAAP EPS of \$0.94**

27 Rackable Systems, Inc., (NASDAQ:RACK - News) a provider of servers and storage
28 products for scale out data center deployments, today announced financial results for
the quarter and year ended December 30, 2006.

Q4 Highlights

- Record quarterly revenue of \$106.9 million, up 28.6% from Q4'05
- Non-GAAP EPS of \$0.19
- Non-GAAP gross margin of 19.8%

2006 Highlights

- Record annual revenue of \$360.4 million, up 67.6% from 2005
- Record annual non-GAAP EPS of \$0.94
- Non-GAAP gross margin of 22.4%

"For the first time in Rackable System's history, we have broken the \$100 million quarterly revenue mark," stated Tom Barton, Chief Executive Officer of Rackable Systems. He continued, "However, as we noted in our press release on January 16th, during the fourth quarter we faced several unexpected challenges that negatively impacted our gross margin and earnings per share. The gross margin pressure we experienced this quarter was primarily due to increasingly competitive conditions and an unanticipated increase in DDR memory pricing. Despite these difficulties, we were able to retain and expand key customer relationships during the quarter. Additionally, while sales of our higher-margin RapidScale(TM) products were impacted by a longer than expected product rollout, we remain optimistic about long-term prospects for this business."

Q4 Financial Results

Total revenue for the fourth quarter ended December 30, 2006 was \$106.9 million, up 28.6% from \$83.1 million in the fourth quarter of 2005.

During the fourth quarter of 2006, the company recorded stock-based compensation charges of \$7.8 million, amortization of patents and customer list of \$359,000 and amortization of intangibles in connection with the Terrascale acquisition of \$553,000, resulting in a GAAP net income for the fourth quarter of \$563,000 or \$0.02 per diluted share compared to a GAAP net income of \$7.3 million or \$0.32 per diluted share in the same period a year ago. Non-GAAP net income for the fourth quarter of 2006 was \$5.6 million or \$0.19 per diluted share, compared to non-GAAP net income of \$7.6 million or \$0.33 per diluted share in the same period a year ago.

GAAP gross margin for the fourth quarter of 2006 was 18.8% compared to 24.9% in the same period a year ago. Non-GAAP gross margin for the fourth quarter was 19.8% compared to 24.9% in the same period a year ago.

2006 Financial Results

Total revenue for the twelve months ended December 30, 2006 was \$360.4 million,

1 up 67.6% from \$215.0 million in the twelve months of 2005.

2 During 2006, the company recorded stock-based compensation charges of \$20.8
3 million, amortization of patents and customer list of \$1.4 million, write-off of
4 acquired in-process R&D of \$2.8 million and amortization of intangibles in
5 connection with the Terrascale acquisition of \$690,000, resulting in GAAP net
6 income for the twelve months of 2006 of \$11.5 million or \$0.40 per diluted share,
7 compared to \$8.5 million or \$0.47 per diluted share in the same period a year ago.
8 Non-GAAP net income for 2006 was \$27.0 million or \$0.94 per diluted share,
9 compared to \$15.0 million or \$0.83 per diluted share in the same period a year ago.

GAAP gross margin for 2006 was 21.4% compared to 23.1% in the same period a
year ago. Non-GAAP gross margin for 2006 was 22.4% compared to 23.1% in the
same period a year ago.

10 * * *

11 Business Outlook

12 Rackable Systems is providing the following projections for the full fiscal year
13 ending December 31, 2007:

- 14 - Revenue is projected to be in the range of \$ 450 - \$ 525 million
- 15 - GAAP diluted net income (loss) per share is projected to be \$ (0.10) - \$ 0.20
per share
- 16 - Non-GAAP diluted net income per share is projected to be \$ 0.75 - \$ 1.05 per
share
- 17 - GAAP gross margin is projected to be in the range of 16.8% - 21.0%
- 18 - Non-GAAP gross margin is projected to be in the range of 18.0% - 22.0%

19 (Emphasis in original).

20 32. On February 1, 2007 Rackable held a conference call with analysts to discuss the
21 Company's financial results for the fourth quarter 2006 announced in the Company's February 1,
22 2007 press release. During the conference call, in relevant part, Defendant Barton, stated:

23
24 Regarding Q1, I have mentioned that we are presently projecting revenues of \$70 to
25 \$75 million. While we are not providing specific projections for other P&L items, we
26 expect gross margin to be at the low end of the annual range that we have articulated,
27 primarily due to lower economies of scale, specifically fixed-cost recovery. We
28 expect operating expenses to be flat to slightly up from Q4 figures.

1 expected results for the first quarter ended March 31, 2007. Total revenue for the first
2 quarter of 2007 is expected to be in the range of its previous projections of \$70 – 75
3 million.

4 However, the company now expects GAAP and non-GAAP gross margin for the first
5 quarter to be approximately 30% lower than previously communicated expectations.
6 The primary factor impacting gross margin in the first quarter was the intensity of
7 competition in the company's largest accounts.

8 The company also expects operating expenses in the first quarter to be higher than
9 previously anticipated due to one time charges associated with the cancellation of an
10 order from one customer, severance charges related to an internal reorganization
11 completed in January, and additional charges relating to sales and use tax exposures
12 from past sales to various customers.

13 As a result of lower than expected gross margin and operating income, the company
14 anticipates a net loss for the first quarter of 2007, on both a GAAP and non-GAAP
15 basis.

16 "Intense competitive conditions for business at our largest customers continued
17 throughout the first quarter of 2007, which negatively impacted our gross margin and
18 bottom line," stated Tom Barton, Chief Executive Officer of Rackable Systems. He
19 continued, "While we were faced with significant challenges in the first quarter, we
20 remain optimistic that our position within our top customers is strong. We won the
21 bulk of the opportunities on which we bid this quarter. We are committed to
22 stabilizing and improving the predictability of gross margin attainment in our largest
23 customers through a variety of means, including product and service innovation and
24 operational efficiency improvements."

25 The company also noted a number of positive developments in the first quarter,
26 including:

- 27 - Strong bookings momentum with a book-to-bill ratio well above 1
- 28 - Solid backlog going into Q2; the highest it has been in the past four quarters
- Increased traction with the RapidScale™ clustered storage product line, with strong gross margin attainment and key competitive wins
- Increased cash balances during the quarter with total cash and investments at approximately \$170 million as of March 31st
- Strengthened sales leadership with the addition of Carl Boisvert, Executive Vice

1 President of Worldwide Sales & Marketing and Jim Benard, Vice President of Sales
2 Operations

3 - The issuance of a patent related to Rackable Systems' DC power technology

4 - The launch of Concentro™, the company's modular datacenter technology

5 37. On April 4, 2007 Rackable held a conference call with analysts to discuss the
6 Company's preliminary financial results for the first quarter 2007 announced in the Company's April
7 4, 2007 press release. During the conference call, Defendant Barton outlined a plan to address the
8 "erosion of gross margin in [the] largest three accounts," which he identified as the "top business
9 issue" impacting Rackable's financial performance. Moreover, in relevant part, Defendant Barton
10 stated the following: "As most of you know, our three largest customers represent a large percentage
11 of our business typically approximately 60%. We have experienced a *dramatic erosion of gross*
12 *margin attainment in these largest accounts over the last several quarters* as focused competitors
13 especially Dell have dropped prices aggressively." (Emphasis added).

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16 38. On this news, shares of Rackable declined \$2.64 per share, more than 15%, to
17 close on April 5, 2007 at \$14.24 per share, on unusually heavy volume.

18 **CLASS ACTION ALLEGATIONS**

19 39. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil
20 Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those who purchased Rackable's
21 securities between October 30, 2006 and April 4, 2007, inclusive (the "Class Period") and who were
22 damaged thereby. Excluded from the Class are Defendants, the officers and directors of the
23 Company, at all relevant times, members of their immediate families and their legal representatives,
24 heirs, successors or assigns and any entity in which Defendants have or had a controlling interest.
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1 prospects of Rackable; and

2 (c) To what extent the members of the Class have sustained damages and the
3 proper measure of damages.

4 44. A class action is superior to all other available methods for the fair and efficient
5 adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the
6 damages suffered by individual Class members may be relatively small, the expense and burden of
7 individual litigation makes it impossible for members of the Class to individually redress the wrongs
8 done to them. There will be no difficulty in the management of this action as a class action.
9

10 **UNDISCLOSED ADVERSE FACTS**

11 45. The market for Rackable's securities was open, well-developed and efficient at all
12 relevant times. As a result of these materially false and/or misleading statements, and/or failures to
13 disclose, Rackable's securities traded at artificially inflated prices during the Class Period. Plaintiff
14 and other members of the Class purchased or otherwise acquired Rackable's securities relying upon
15 the integrity of the market price of the Company's securities and market information relating to
16 Rackable, and have been damaged thereby.
17

18 46. During the Class Period, Defendants materially misled the investing public, thereby
19 inflating the price of Rackable's securities, by publicly issuing false and/or misleading statements
20 and/or omitting to disclose material facts necessary to make Defendants' statements, as set forth
21 herein, not false and/or misleading. Said statements and omissions were materially false and/or
22 misleading in that they failed to disclose material adverse information and/or misrepresented the
23 truth about Rackable's business, operations, and prospects as alleged herein.
24

25 47. At all relevant times, the material misrepresentations and omissions particularized
26

1 in this Complaint directly or proximately caused or were a substantial contributing cause of the
2 damages sustained by Plaintiff and other members of the Class. As described herein, during the
3 Class Period, Defendants made or caused to be made a series of materially false and/or misleading
4 statements about Rackable's financial well-being and prospects. These material misstatements
5 and/or omissions had the cause and effect of creating in the market an unrealistically positive
6 assessment of the Company and its financial well-being and prospects, thus causing the Company's
7 securities to be overvalued and artificially inflated at all relevant times. Defendants' materially false
8 and/or misleading statements during the Class Period resulted in Plaintiff and other members of the
9 Class purchasing the Company's securities at artificially inflated prices, thus causing the damages
10 complained of herein.
11

12 LOSS CAUSATION

13
14 48. Defendants' wrongful conduct, as alleged herein, directly and proximately caused
15 the economic loss suffered by Plaintiff and the Class.

16 49. During the Class Period, Plaintiff and the Class purchased Rackable's securities at
17 artificially inflated prices and were damaged thereby. The price of the Company's securities
18 significantly declined when the misrepresentations made to the market, and/or the information
19 alleged herein to have been concealed from the market, and/or the effects thereof, were revealed,
20 causing investors's losses.
21

22 SCIENTER ALLEGATIONS

23 50. As alleged herein, Defendants acted with scienter in that Defendants knew that the
24 public documents and statements issued or disseminated in the name of the Company were
25 materially false and/or misleading; knew that such statements or documents would be issued or
26

1 disseminated to the investing public; and knowingly and substantially participated or acquiesced in
2 the issuance or dissemination of such statements or documents as primary violations of the federal
3 securities laws. As set forth elsewhere herein in detail, Defendants, by virtue of their receipt of
4 information reflecting the true facts regarding Rackable, his/her control over, and/or receipt and/or
5 modification of Rackable's allegedly materially misleading misstatements and/or their associations
6 with the Company which made them privy to confidential proprietary information concerning
7 Rackable, participated in the fraudulent scheme alleged herein.

9
10 **APPLICABILITY OF PRESUMPTION OF RELIANCE**
(FRAUD-ON-THE-MARKET DOCTRINE)

11 51. The market for Rackable's securities was open, well-developed and efficient at all
12 relevant times. As a result of the materially false and/or misleading statements and/or failures to
13 disclose, Rackable's securities traded at artificially inflated prices during the Class Period. On
14 November 22, 2006 the price of the Company's common stock reached a Class Period high of
15 \$37.18 per share. Plaintiff and other members of the Class purchased or otherwise acquired the
16 Company's securities relying upon the integrity of the market price of Rackable's securities and
17 market information relating to Rackable, and have been damaged thereby.

18
19 52. During the Class Period, the artificial inflation of Rackable's stock was caused by
20 the material misrepresentations and/or omissions particularized in this Complaint causing the
21 damages sustained by Plaintiff and other members of the Class. As described herein, during the
22 Class Period, Defendants made or caused to be made a series of materially false and/or misleading
23 statements about Rackable's business, prospects, and operations. These material misstatements
24 and/or omissions created an unrealistically positive assessment of Rackable and its business,
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1 operations, and prospects, thus causing the price of the Company's securities to be artificially inflated
2 at all relevant times, and when disclosed, negatively affected the value of the Company stock.
3 Defendants' materially false and/or misleading statements during the Class Period resulted in
4 Plaintiff and other members of the Class purchasing the Company's securities at such artificially
5 inflated prices, and each of them has been damaged as a result.

7 53. At all relevant times, the market for Rackable's securities was an efficient market
8 for the following reasons, among others:

9 (a) Rackable stock met the requirements for listing, and was listed and
10 actively traded on the NASDAQ, a highly efficient and automated market;

11 (b) As a regulated issuer, Rackable filed periodic public reports with the SEC
12 and the NASDAQ;

13 (c) Rackable regularly communicated with public investors *via* established
14 market communication mechanisms, including through regular dissemination of press releases on
15 the national circuits of major newswire services and through other wide-ranging public disclosures,
16 such as communications with the financial press and other similar reporting services; and

17 (d) Rackable was followed by securities analysts employed by major
18 brokerage firms who wrote reports about the Company, and these reports were distributed to the
19 sales force and certain customers of their respective brokerage firms. Each of these reports was
20 publicly available and entered the public marketplace.

21 54. As a result of the foregoing, the market for Rackable's securities promptly
22 digested current information regarding Rackable from all publicly available sources and reflected
23 such information in Rackable's stock price. Under these circumstances, all purchasers of Rackable's
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1 securities during the Class Period suffered similar injury through their purchase of Rackable's
2 securities at artificially inflated prices and a presumption of reliance applies.

3
4 **NO SAFE HARBOR**

5 55. The statutory safe harbor provided for forward-looking statements under certain
6 circumstances does not apply to any of the allegedly false statements pleaded in this Complaint. The
7 statements alleged to be false and misleading herein all relate to then-existing facts and conditions.
8 In addition, to the extent certain of the statements alleged to be false may be characterized as forward
9 looking, they were not identified as "forward-looking statements" when made and there were no
10 meaningful cautionary statements identifying important factors that could cause actual results to
11 differ materially from those in the purportedly forward-looking statements. In the alternative, to the
12 extent that the statutory safe harbor is determined to apply to any forward-looking statements pleaded
13 herein, Defendants are liable for those false forward-looking statements because at the time each of
14 those forward-looking statements was made, the speaker had actual knowledge that the forward-
15 looking statement was materially false or misleading, and/or the forward-looking statement was
16 authorized or approved by an executive officer of Rackable who knew that the statement was false
17 when made.
18
19

20 **FIRST CLAIM**
21 **Violation of Section 10(b) of**
22 **The Exchange Act and Rule 10b-5**
23 **Promulgated Thereunder Against All Defendants**

24 56. Plaintiff repeats and realleges each and every allegation contained above as if fully
25 set forth herein.

26 57. During the Class Period, Defendants carried out a plan, scheme and course of
27

1 conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing
2 public, including Plaintiff and other Class members, as alleged herein; and (ii) cause Plaintiff and
3 other members of the Class to purchase Rackable's securities at artificially inflated prices. In
4 furtherance of this unlawful scheme, plan and course of conduct, defendants, and each of them, took
5 the actions set forth herein.
6

7 58. Defendants (i) employed devices, schemes, and artifices to defraud; (ii) made untrue
8 statements of material fact and/or omitted to state material facts necessary to make the statements
9 not misleading; and (iii) engaged in acts, practices, and a course of business which operated as a
10 fraud and deceit upon the purchasers of the Company's securities in an effort to maintain artificially
11 high market prices for Rackable's securities in violation of Section 10(b) of the Exchange Act and
12 Rule 10b-5. All Defendants are sued either as primary participants in the wrongful and illegal
13 conduct charged herein or as controlling persons as alleged below.
14

15 59. Defendants, individually and in concert, directly and indirectly, by the use, means or
16 instrumentalities of interstate commerce and/or of the mails, engaged and participated in a
17 continuous course of conduct to conceal adverse material information about Rackable's financial
18 well-being and prospects, as specified herein.
19

20 60. These defendants employed devices, schemes and artifices to defraud, while in
21 possession of material adverse non-public information and engaged in acts, practices, and a course
22 of conduct as alleged herein in an effort to assure investors of Rackable's value and performance and
23 continued substantial growth, which included the making of, or the participation in the making of,
24 untrue statements of material facts and/or omitting to state material facts necessary in order to make
25 the statements made about Rackable and its business operations and future prospects in light of the
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1 circumstances under which they were made, not misleading, as set forth more particularly herein,
2 and engaged in transactions, practices and a course of business which operated as a fraud and deceit
3 upon the purchasers of the Company's securities during the Class Period.

4 61. Each of the Individual Defendants' primary liability, and controlling person liability,
5 arises from the following facts: (i) the Individual Defendants were high-level executives and/or
6 directors at the Company during the Class Period and members of the Company's management team
7 or had control thereof; (ii) each of these defendants, by virtue of their responsibilities and activities
8 as a senior officer and/or director of the Company, was privy to and participated in the creation,
9 development and reporting of the Company's internal budgets, plans, projections and/or reports; (iii)
10 each of these defendants enjoyed significant personal contact and familiarity with the other
11 defendants and was advised of, and had access to, other members of the Company's management
12 team, internal reports and other data and information about the Company's finances, operations, and
13 sales at all relevant times; and (iv) each of these defendants was aware of the Company's
14 dissemination of information to the investing public which they knew and/or recklessly disregarded
15 was materially false and misleading.

16 62. The defendants had actual knowledge of the misrepresentations and/or omissions of
17 material facts set forth herein, or acted with reckless disregard for the truth in that they failed to
18 ascertain and to disclose such facts, even though such facts were available to them. Such defendants'
19 material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose
20 and effect of concealing Rackable's financial well-being and prospects from the investing public and
21 supporting the artificially inflated price of its securities. As demonstrated by Defendants'
22 overstatements and/or misstatements of the Company's business, operations, financial well-being,
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1 and prospects throughout the Class Period, Defendants, if they did not have actual knowledge of the
2 misrepresentations and/or omissions alleged, were reckless in failing to obtain such knowledge by
3 deliberately refraining from taking those steps necessary to discover whether those statements were
4 false or misleading.

5
6 63. As a result of the dissemination of the materially false and/or misleading information
7 and/or failure to disclose material facts, as set forth above, the market price of Rackable's securities
8 was artificially inflated during the Class Period. In ignorance of the fact that market prices of the
9 Company's securities were artificially inflated, and relying directly or indirectly on the false and
10 misleading statements made by Defendants, or upon the integrity of the market in which the
11 securities trades, and/or in the absence of material adverse information that was known to or
12 recklessly disregarded by Defendants, but not disclosed in public statements by Defendants during
13 the Class Period, Plaintiff and the other members of the Class acquired Rackable's securities during
14 the Class Period at artificially high prices and were damaged thereby.

15
16 64. At the time of said misrepresentations and/or omissions, Plaintiff and other members
17 of the Class were ignorant of their falsity, and believed them to be true. Had Plaintiff and the other
18 members of the Class and the marketplace known the truth regarding the problems that Rackable was
19 experiencing, which were not disclosed by Defendants, Plaintiff and other members of the Class
20 would not have purchased or otherwise acquired their Rackable securities, or, if they had acquired
21 such securities during the Class Period, they would not have done so at the artificially inflated prices
22 which they paid.

23
24
25 65. By virtue of the foregoing, Defendants have violated Section 10(b) of the Exchange
26 Act and Rule 10b-5 promulgated thereunder.

1 exercised the same.

2 70. As set forth above, Rackable and the Individual Defendants each violated Section
3 10(b) and Rule 10b-5 by their acts and/or omissions as alleged in this Complaint. By virtue of their
4 positions as controlling persons, the Individual Defendants are liable pursuant to Section 20(a) of
5 the Exchange Act. As a direct and proximate result of Defendants' wrongful conduct, Plaintiff and
6 other members of the Class suffered damages in connection with their purchases of the Company's
7 securities during the Class Period.

8
9 **PRAYER FOR RELIEF**

10 WHEREFORE, Plaintiff prays for relief and judgment, as follows:

11 (a) Determining that this action is a proper class action under Rule 23 of the Federal
12 Rules of Civil Procedure;

13 (b) Awarding compensatory damages in favor of Plaintiff and the other Class members
14 against all defendants, jointly and severally, for all damages sustained as a result of Defendants'
15 wrongdoing, in an amount to be proven at trial, including interest thereon;

16 (c) Awarding Plaintiff and the Class their reasonable costs and expenses incurred in this
17 action, including counsel fees and expert fees; and

18 (d) Such other and further relief as the Court may deem just and proper.

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20 **JURY TRIAL DEMANDED**

21 Plaintiff hereby demands a trial by jury.
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DATED: January 16, 2008

GLANCY BINKOW & GOLDBERG LLP

By:  _____

Lionel Z. Glancy
Michael Goldberg

1801 Avenue of the Stars, Suite 311
Los Angeles, California 90067
Telephone: (310) 201-9150
Facsimile: (310) 201-9160

Attorneys for Plaintiff Gerald Dull

**GLANCY BINKOW & GOLDBERG LLP
SWORN CERTIFICATION OF PLAINTIFF
RACKABLE SYSTEMS INC. SECURITIES LITIGATION**

1. Gerald Dull, ("Plaintiff") declare, as to the claims asserted under the federal securities laws that

1. Plaintiff has reviewed the complaint and authorizes its filing.
2. Plaintiff did not purchase the securities that are the subject of this action at the direction of Plaintiff's counsel or in order to participate in any private action.
3. Plaintiff is willing to serve as a representative party on behalf of the class, either individually or as part of a group, including providing testimony at deposition or trial, if necessary. I understand that this is not a claim form, and that my ability to share in any recovery as a member of the class is not dependent upon execution of this Plaintiff Certification.
4. Plaintiff's transaction(s) in the Rackable Systems Inc. (NASDAQ: RACK) securities that are the subject of this action is/are as follows:

Type of Security	Number of Shares	Bought	Sold	Date	Price per share
Common stock	100	B		2/5/2007	\$16.55


(Please list additional purchase and sale information on a separate sheet of paper, if necessary)

5. Plaintiff has complete authority to bring a suit to recover for investment losses on behalf of purchasers of the subject securities described herein (including Plaintiff, any co-owners, any corporations or other entities, and/or any beneficial owners).
6. During the three years prior to the date of this Certification, Plaintiff has not sought to serve or served as a representative party for a class in an action filed under the federal securities laws, except as described below

7. Plaintiff will not accept any payment for serving as a representative party on behalf of the class beyond Plaintiff's pro rata share of any recovery, except such reasonable costs and expenses (including lost wages) directly relating to the representation of the class as ordered or approved by the court.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 16 day of January, 2009.


GERALD DULL