XYRATEX LTD
Form 20-F
February 23, 2010

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XYRATEX LTD

ANNUAL REPORT FOR THE YEAR ENDED

NOVEMBER 30, 2009

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As filed with the Securities and Exchange Commission on February 23, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

or

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

For the Fiscal Year Ended November 30, 2009

or

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

or

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

(Commission file number **000-50799**)

XYRATEX LTD

(Exact Name of Registrant as Specified in Its Charter)

Bermuda

(Jurisdiction of Incorporation or Organization)

Langstone Road
Havant PO9 1SA
United Kingdom
(011) 44 2392 496000

(Address of Principal Executive Offices)

Brad Driver
46831 Lakeview Blvd
Fremont, CA 94538
USA
Tel: +1 510 687-5260
Email: bdriver@us.xyratex.com

(Name, telephone number, e-mail and/or facsimile number and address of Company contact person)

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

Title of each class	Name of each Exchange on which registered
Common Shares, par value $0.01 per share	Nasdaq Stock Market

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

None

(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report:

29,578,613 common shares, par value $0.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No ý

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No ý

Note checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer ý Non-accelerated filer o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ý	International Financial Reporting Standards as issued by the International Accounting Standards Board o	Other o

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No ý

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INTRODUCTION

Xyratex Ltd is a limited liability company incorporated under the laws of Bermuda. Xyratex Ltd was incorporated on April 10, 2002 and is registered with the Registrar of Companies in Bermuda under registration number EC 31989. As a Bermuda company we are governed by the Companies Act 1981 of Bermuda. We maintain a registered office in Bermuda at Clarendon House, Church Street, Hamilton, Bermuda. Our principal executive offices are located at Langstone Road, Havant PO9 1SA, United Kingdom and the telephone number for these offices is (011) 44 2392 496000. Our agent for service of process in the United States is Chris Sharman, 46831 Lakeview Blvd, Fremont, California 94538, USA (telephone: (510) 687 5200).

We conducted an initial public offering in the United States and listing of our common shares on the Nasdaq National Market on June 29, 2004. Our common shares trade on The NASDAQ Stock Market LLC under the symbol "XRTX" and are listed on the NASDAQ Global Select Market.

Our business began as part of IBM in 1966. We conducted our business as a manufacturing and development operation until December 1994, at which time we separated from IBM in a management buy-out. Today Xyratex is a leading provider of enterprise class data storage subsystems and storage process technology. The Company designs and manufactures enabling technology that provides original equipment manufacturer (OEM) and disk drive manufacturer customers with data storage products to support high-performance storage and data communication networks. Xyratex has over 25 years of experience in research and development relating to disk drives, storage systems and high-speed communication protocols.

In this Annual Report, except as otherwise indicated or as the context otherwise requires, the "Company", "Group", "Xyratex", "we", "us" and "our" refers to Xyratex Ltd and its subsidiaries.

INDUSTRY DATA

In this Annual Report, we refer to information regarding the Networked Storage Solutions Market and the Storage Infrastructure Market from the following independent research companies: Coughlin Associates; International Data Corporation or IDC; and TrendFocus.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report includes forward-looking statements. All statements other than statements of historical fact included in this Annual Report regarding our business, financial condition, results of operations and certain of our plans, objectives, assumptions, expectations or beliefs with respect to these items and statements regarding other future events or prospects, are forward-looking statements. These statements include, without limitation, those concerning: our strategy and our ability to achieve it; expectations regarding sales, profitability and growth; our possible or assumed future results of operations; capital expenditure and investment plans; adequacy of capital; and financing plans. The words "aim," "may," "expect," "anticipate," "believe," "future," "continue," "help," "estimate," "plan," "intend," "should," "could," "would," "shall" or the negative or other variations thereof as well as other statements regarding matters that are not historical fact, are or may constitute forward-looking statements. In addition, this Annual Report includes forward-looking statements relating to our potential exposure to various types of market risks, such as foreign exchange rate risk, interest rate risks and other risks related to financial assets and liabilities. We have based these forward-looking statements on our management's current view with respect to future events and financial performance. These views reflect the best judgment of our management but involve a number of risks and uncertainties which could cause actual results to differ materially from those predicted in our forward-looking statements and from past results, performance or achievements. Although we believe that the estimates reflected in the forward-looking statements are reasonable, such estimates may prove to be incorrect. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from these expressed or implied by these forward-looking statements. For further discussion of these factors and other risks, see "Part I, Item 3D Risk Factors" and "Item 5 Operating and Financial Review and Prospects."

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PART I

ITEM 1: IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2: OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

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ITEM 3: KEY INFORMATION

Item 3A: Selected Financial Data

The selected historical consolidated statement of operations data for the years ended November 30, 2009, 2008 and 2007 and balance sheet data for the years ended November 30, 2009 and 2008 presented below have been derived from our audited consolidated financial statements included elsewhere in this Annual Report. The selected historical consolidated statement of operations data for the years ended November 30, 2006 and 2005 and balance sheet data for the years ended November 30, 2007, 2006 and 2005 presented below have been derived from the audited consolidated financial statements not included in this report.

	Year Ended November 30,				
	2009	2008	2007	2006	2005
	(U.S. dollars in thousands)				
Consolidated Statement of Operations Data:					
Revenues:					
Networked Storage Solutions	$ 762,028	$ 855,770	$ 693,990	$ 598,752	$ 415,379
Storage Infrastructure	105,863	193,946	237,643	384,881	264,230
Total revenues	867,891	1,049,716	931,633	983,633	679,609
Gross profit:					
Networked Storage Solutions	97,981	107,275	100,573	82,762	64,831
Storage Infrastructure	28,202	52,566	69,716	115,447	79,463
Non-cash equity compensation	(907)	(1,264)	(1,238)	(923)	
Total gross profit	125,276	158,577	169,051	197,286	144,294
Operating expenses:					
Research and development	71,062	85,897	77,559	71,391	54,327
Selling, general and administrative	56,463	63,686	61,977	60,449	38,842
Amortization of intangible assets	3,939	4,882	7,304	5,123	3,218
Impairment of goodwill(1)		34,256			
Restructuring costs	5,898				
In process research and development					3,230
Total operating expenses	137,362	188,721	146,840	136,963	99,617
Operating income (loss)	(12,086)	(30,144)	22,211	60,323	44,677
Other income			890	3,167	
Interest income, net	114	1,618	3,283	1,162	1,176
Income (loss) from continuing operations before income taxes	(11,972)	(28,526)	26,384	64,652	45,853
Provision (benefit) for income taxes(1)	4,442	19,383	(1,725)	6,474	3,964
Net income (loss) from continuing operations	(16,414)	(47,909)	28,109	58,178	41,889
Income from discontinued operations					280

Net income (loss)	(16,414)	(47,909)	28,109	58,178	42,169
Net earnings (loss) per common share basic	$ (0.56)	$ (1.64)	$ 0.97	$ 2.03	$ 1.49
Net earnings (loss) per common share diluted(2)	$ (0.56)	$ (1.64)	$ 0.94	$ 1.97	$ 1.45
Weighted average common shares (in thousands) used in calculating net earnings (loss) per share:					
Basic	29,402	29,157	28,985	28,663	28,329
Diluted	29,402	29,157	29,866	29,604	29,031

(1) In our 2008 fiscal year we recorded a $34.3 million impairment of goodwill arising from acquisitions in 2004 and 2005 and a $19.9 million valuation allowance against U.K. deferred tax assets. These primarily resulted from the impact of the global economic environment on our actual and forecast operating results.

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(2)

In our 2005 fiscal year the basic net earnings from continuing operations per common share was $1.48 and the diluted net earnings per common share was $1.44. In our 2006, 2007, 2008 and 2009 fiscal years the net earnings from continuing operations per common share, basic and diluted, was the same as the net earnings per common share, basic and diluted.

	As of November 30,				
	2009	2008	2007	2006	2005
	(U.S. dollars in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 51,935	$ 28,013	$ 70,678	$ 56,921	$ 41,240
Working capital	161,277	145,653	161,922	129,320	74,284
Total assets	354,250	373,187	410,275	375,680	301,290
Short-term borrowings and current portion of acquisition note payable				4,000	7,000
Long-term debt and acquisition note payable, net of current portion				3,000	7,000
Total debt				7,000	14,000
Total shareholders' equity	$ 219,238	$ 213,589	$ 273,261	$ 234,494	$ 161,382
Number of shares issued and outstanding:					
Common shares	29,461	29,146	29,117	28,793	28,437

Item 3B: Capitalization and Indebtedness

Not applicable.

Item 3C: Reason for the Offer and Use of Proceeds

Not applicable.

Item 3D: Risk Factors

The key risks relating to our business and industry are included below. Additional risks of which we are presently not aware or that we currently deem immaterial may also impair our business.

Sales to a small number of customers represent a substantial portion of our revenues. The loss of any major customers could significantly harm our financial condition.

We derive a substantial portion of our revenues from a relatively small number of customers. In our 2009 fiscal year, sales to our top six customers accounted for 87% of our revenues with sales to NetApp and Dell accounting for 48% and 15% for our revenues respectively. In our 2008 fiscal year, sales to our top six customers accounted for 83% of our revenues with sales to NetApp accounting for 54% of our revenues. It is likely that a small number of customers will continue to account for a substantial portion of our revenues in the future. If we were to lose one of our major customers, experience any material reduction in orders from any of these customers or experience a deterioration in our relationships with any of these customers, our financial condition could be significantly harmed.

In 2006, Seagate acquired Maxtor Corp., which was an emerging customer of Xyratex. This represented a significant consolidation in the disk drive marketplace and created a reduction in demand for our products in 2007 and 2008. Further industry consolidation involving our customers could also result in a reduction in demand for our products. In particular, if one of our major customers is acquired by one of its competitors that is not one of our customers our business with that major customer could reduce or cease altogether. The new parent company may impose a divergent strategy away from our existing technology base, potentially resulting in the loss of business to Xyratex.

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In 2008, we reached an agreement with NetApp which enabled them to utilize contract manufacturers, under license, as an alternative source for a proportion of the products we supply. Any large penetration of contract manufacturers into our major customers could adversely affect our revenues and financial condition.

Our customers operate in an industry that experiences frequent volatility. If any of our top customers were to suffer financial difficulties, whether as a result of downturns in the markets, loss of market share in which they operate or otherwise, our financial condition could be significantly harmed.

The markets in which we operate are cyclical and a reduction in customer demand in any particular financial period could significantly harm our financial condition.

Customer demand is cyclical in the technology industry in general, and the disk drive production equipment market in particular. One reason for the particular variability in demand for these products is that, for our customers, the decision to invest in new or upgraded production facilities is a strategic decision that involves a significant commitment of their financial resources. A customer's decision is dependent upon several factors, including its financial condition, the condition and obsolescence of its existing production facilities, the expected demand for its products and general confidence in its business. Our revenues are likely to continue to reflect the cyclical nature of the technology industry.

Demand for our disk drive production equipment products is also linked to developments in the disk drive market. The market for disk drives has historically experienced periods of production over-capacity which have in turn led to the deterioration of market prices for data storage products. Consolidation activity could impact the normal pattern of demand versus supply as the hard disk customers move business away from the consolidated entity to achieve an independent dual source strategy. Competitive activity usually increases during this period of market share realignment as each company tries to grow their share and often results in increased disk drive inventories in the channel. The confidence of our customers to invest in new disk drive production equipment does not usually recover until supplies of disk drives are reduced or new technologies are introduced. Future over-capacity and further consolidation in the disk drive market could result in a significant decrease in demand for our products, and this could significantly harm our financial condition.

Because original equipment manufacturers comprise a substantial portion of our customer base, we have limited control over the volume and pricing of our products, which could significantly harm our financial condition.

We sell our Networked Storage Solutions (NSS) products primarily to original equipment manufacturers, or OEMs, and our Storage Infrastructure (SI) products primarily to disk drive manufacturers. As a result, the quantity of products that we sell is significantly affected by our OEM customers' volume requirements, over which we have little control. We are subject to continued pricing pressures from our customers, particularly our OEM customers. If these volume requirements decrease or pricing pressures increase, our financial condition could be significantly harmed.

Our operating results are subject to substantial quarterly and annual fluctuations, our period to period comparisons are not necessarily meaningful and we may not meet the expectations of public market analysts and investors.

Our revenues in any quarter are substantially dependent upon customer orders in that quarter. We attempt to project future orders based in part on estimates from our major customers. For this purpose, arrangements with major customers will usually include the estimated future volume requirements of that customer. Our customers' estimated requirements are not always accurate and we therefore cannot predict our quarterly revenues with any degree of certainty.

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Our typical pricing model is based on several variables (including overall volume of products ordered and the type and cost of components) which also makes it difficult for us to accurately predict future revenues. In addition, we regularly develop new products. Revenues from new products are difficult for us to predict accurately and are usually at a higher initial cost due to the low initial volumes. Any delay in the development of new products could further complicate revenue predictions and result in a reduction in our expected revenues.

Our quarterly operating results have fluctuated significantly in the past, as shown in the table below.

Quarter	Revenues	Net Income (Loss)
	(unaudited)	
	(U.S. dollars in thousands)	
First Quarter 2008	$ 217,054	$ (2,219)
Second Quarter 2008	266,455	2,244
Third Quarter 2008	280,780	7,813
Fourth Quarter 2008	285,427	(55,747)
First Quarter 2009	183,885	(16,128)
Second Quarter 2009	194,739	(9,643)
Third Quarter 2009	246,294	7,807
Fourth Quarter 2009	$ 242,973	$ 1,550

In addition, we may derive a significant portion of our revenues in each quarter from a small number of relatively large orders. If one or more of our major customers decides to defer a purchase order in any given quarter, this is likely to result in reduced total revenues for that quarter. Accordingly, comparisons of our quarterly results of operations or other period to period comparisons are not necessarily meaningful and should not be relied on as an indication of our future performance.

Our quarterly and annual revenues and results of operations may also fluctuate significantly if one or more of the risk factors identified in this Annual Report occurs and, depending upon the timing of that event, may have a disproportionate effect in any given quarter or year. In addition, it is possible that some future results of operations may be below the expectations of public market analysts and investors.

Our gross margins may vary based on the configuration of our products and the mix in a period.

We derive a significant proportion of our sales from the sale of disk drives as components of our storage systems and the market is highly competitive and subject to intense pricing pressures. Our sales related to disk drives generate lower gross margins than other components of our storage systems. As a result if we sell systems with greater disk content our overall gross margins may be negatively affected.

Our gross margins have been and may continue to be affected by a variety of other factors, including:

Changes in product mix and the component content of products.

Shipment volumes a proportion of our cost of sales is fixed and therefore increases or decreases in volumes result in increases or decreases in gross margins.

New product introductions or product enhancements.

Inventory valuation adjustments as a result of changes in demand forecasts or product defects as we transition our product.

Additional freight, transportation and other one-time costs to expedite component purchases or move finished product between locations to satisfy short term changes in demand.

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Commoditization of hardware. As hardware becomes more commoditized our overall margins are affected. Without significant differentiation, services and software, our margins will be impacted in the future.

Decreases in our gross margin from any of these factors could significantly harm our financial condition.

Our market is highly competitive and we may not be able to compete effectively.

We operate in markets that are highly competitive and subject to rapid change and that are significantly affected by new product introductions and other market activities of industry participants. We expect competition to persist and intensify in the future. Our principal sources of competition include:

companies providing storage subsystems and components to OEMs, including Dot Hill Systems Corp., LSI Corporation, MiTAC International Corporation and Sanmina-SCI Corporation (doing business as Newisys), together with larger suppliers such as EMC Corporation and Hitachi, Ltd.;

electronic manufacturing services (EMS) companies acquiring the necessary skills and intellectual property to enter the Storage Systems marketplace. For example, Sanmina-SCI competes with us through its subsidiary, Newisys, a company formed after the acquisition of certain assets from Adaptec Inc., a competitor to our storage systems business;

companies providing capital equipment to disk drive manufacturers, including existing suppliers of products such as Aries-MRS Inc., Flexstar Technology Inc., Hitachi High-Technologies Corp., SpeedFam Clean System Co., Ltd. (a subsidiary of SpeedFam Co., Ltd.) and Teradyne, Inc.;

in-house development efforts by existing and potential customers;

collaborations between in-house development teams and a combination of EMS, contract electronic manufacturing (CEM) or emerging technology companies.

In addition, we face potential competition from new entrants including our current technology suppliers.

Some of our current and potential competitors may have longer operating histories, lower operating costs, or greater financial, technical, marketing or other resources than we do and we cannot assure you that we will have the resources to compete successfully in the future. In addition, some of our competitors have the resources to enable them to adopt aggressive pricing policies to gain market share or to shift production to lower cost regions. If we are unable to compete successfully against our current and future competitors, we could experience profit margin reductions or loss of market share, which could significantly harm our financial condition.

Our competitors may consolidate or form alliances with each other in the future. The successful consolidation of two or more of our competitors could result in the combination of their resources and technological capabilities. This could result in a more formidable competitor with improved access to a wider customer base and improved economies of scale and could result in the loss by us of significant market share. In addition, any future consolidation between any of our competitors and any of our suppliers could result in increased costs for the supply of components from that supplier or the need to find an alternative source for the supply of those components. If we are unable to identify an alternative supplier then our ability to manufacture our products at acceptable prices or to deliver our products on time could be impaired. Moreover, future consolidation between any of our competitors and any of our customers could result in a decrease in the volume of purchases from that customer or the loss of that customer altogether. Industry consolidation within the markets in which we operate could adversely affect our revenues and negatively impact our competitive position.

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The recent financial crisis, the resulting recession in many countries and future changes in the world economy could negatively impact our business.

The global financial markets have recently experienced significant turmoil which has led to, among other things, a loss in consumer confidence, rising unemployment, reduced availability of credit, concerns over solvency of financial and other institutions and stock market volatility. As a result there was a recession in 2009 in many parts of the world including the U.S., Europe and certain countries in Asia which resulted in a decline in our revenues in 2009. While we have seen signs of economic stabilization and a recovery in the world economy and in the market for our products, if this is not sustained our business could be negatively affected in a number of ways, including customers reducing or delaying orders, increased pricing pressures, risks to the solvency of customers and suppliers, reduced ability to forecast demand and manage inventory, reduced ability to collect receivables and shorter payment terms with suppliers.

The reduced availability of credit may also impact our business. For example, we may not be able to utilize our credit facilities with HSBC if we are unable to comply with the associated financial covenants and alternative sources of financing may be more difficult or impossible to obtain.

These factors could cause a reduction in profits or increased losses, increase our cash requirements or require us to take a material impairment charge related to our assets, any of which may result in a decline in our share price.

The success of our business depends on the continued high growth of the volume of digital information and the market for data communication networks. If this growth does not occur at the rate anticipated our business may be significantly harmed.

Virtually all of our products find application in data storage and in the establishment and operation of data communication networks. If the growth that we and others have forecasted in the data storage and data communication networking markets does not occur at the rate we expect, our business may be significantly harmed.

Claims by third parties that we infringe their intellectual property or that patents on which we rely are invalid could significantly harm our financial condition, and the enforcement of our intellectual property rights may be expensive and could divert valuable company resources.

We operate in an industry characterized by frequent disputes over intellectual property. Third parties have in the past asserted, and in the future may assert, patent, copyright, trademark and other intellectual property rights to technologies that are important to our business and make claims that our products and technologies infringe their intellectual property, which could result in infringement lawsuits being filed against us. Any claims, whether made directly against us or through the arrangements we often enter into with our customers, could result in costly litigation, divert the attention of our technical and management personnel from operating our business, cause product shipment delays, or prevent us from making or selling certain products. In addition, we cannot give assurances that we would prevail in any litigation related to infringement claims against us. Generally, our liability insurance does not cover claims of this type. Moreover, as a result of these sorts of claims, we could be required to enter into royalty or licensing agreements which, if available, may not be available on commercially reasonable terms. We expect that providers of storage products will increasingly be subject to infringement claims as the number of products and competitors increases.

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We may also need to assert claims against others in the future to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of the proprietary rights of others, and we cannot be certain that we would prevail in any future litigation. For example, in July 2008 we filed a complaint against Teradyne, Inc. in connection with our belief that they were breaching one of our patents. In December 2009, a confidential settlement agreement was reached. Any litigation of this nature, whether or not determined in our favor or settled by us, would be costly and could divert valuable company resources. The enforcement by third parties of their intellectual property rights against us or the failure to successfully protect our intellectual property rights could significantly harm our financial condition.

The markets for our products are characterized by frequent technological innovation. If we do not successfully develop new products in a timely manner our future operating results and competitive position could be significantly harmed.

The markets for our products are characterized by rapid technological change, frequent new product introductions and technology enhancements, uncertain product life cycles and changes in customer demands. We cannot give assurances that the design of future products will be completed as scheduled, that we will not experience difficulties that delay or prevent successful development, introduction, marketing and licensing of new products, or that any new products that we may introduce will achieve market acceptance or commercial success. In addition, the introduction of products based on new technologies and new industry standards could render our existing products obsolete and unmarketable and could devalue our previous investment in research and development. If we do not successfully develop new products in a timely manner our future profitability and competitive position could be significantly harmed. As a result of rapid technological changes, we may have to exit markets in which we operate. If we cannot manage the impact of the disruption on our existing customer base, our financial condition could be harmed.

The markets for our products are also characterized by technological change driven in part by the adoption of new industry standards. These standards coordinate the natural competitive behavior within the technology spaces and provide mechanisms to ensure technology component interoperability can occur. If any of our markets or technology space becomes completely defined by such standards it would reduce any capability for differentiation or innovation and our affected products would revert to commodity status. This could lower the barriers to entry to our market away from our specialist research and development skills and enable entry for the general-purpose design skills found in some large EMS and CEM companies. Commodity markets are driven by extremely low margins and very aggressive competitive pricing. If our market becomes more commoditized and we fail to deliver innovative value-added alternatives to our customers we will have great difficulty competing against the larger EMS and CEM companies and our financial condition could be harmed.

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We are dependent on single source suppliers and limited source suppliers for certain key components.

Our manufacturing process depends on the availability and timely supply of components which meet our specifications and quality demands. Some of the components that we integrate into our own products are highly specialized and may only be available from a single source or a limited number of suppliers, particularly semi conductor suppliers. In addition, we depend on Flextronics International Ltd. as our sole source supplier for the provision of electronic printed circuit board assemblies (PCBAs). Our reliance on Flextronics reduces our control over the manufacturing process, exposing us to risks including reduced control over quality assurance, increased production costs and reduced product supply. If we fail to manage effectively our relationship with Flextronics, or if Flextronics experiences delays, disruptions, capacity constraints or quality control problems in their manufacturing operations, our ability to ship products to our customers could be impaired and our competitive position and reputation could be damaged. Moreover, if any of our suppliers were to cancel or materially change their commitments to us or fail to meet the quality or delivery requirements needed to satisfy customer demand for our products, we could lose time-sensitive orders, be unable to develop or sell some products cost-effectively or on a timely basis, if at all, and have significantly decreased revenues, margins and earnings, which would have a material adverse effect on our business. In addition, our suppliers may go out of business, be impacted by natural disasters or may cease production of components, and it can take a substantial period of time to qualify a new supplier of components. Moreover, we obtain these components through purchase order arrangements and do not have long-term supply agreements in place with our suppliers.

We have recently experienced constraints on the supply of certain key components, particularly semi-conductors, resulting from a global increase in demand for these components following a period when the suppliers reduced production capacity in response to the global recession. Due to the time required to install production capacity, the supply constraints may worsen or component prices may increase more than we expect which could reduce our revenues and gross margins and harm our financial condition.

We often aim to lead the market in new technology deployments and leverage unique technology from single source suppliers who are early adopters in the emerging market. Our options in supplier selection in these cases are limited and the supplier based technology may consequently be single sourced until wider adoption of the technology occurs. In such cases any technical issues in the supplier's technology may cause us to delay shipments of our new technology deployments and therefore harm our financial position.

We are heavily dependent on our proprietary technology and our competitors may gain access to this technology.

We depend heavily on our proprietary technology and rely on a combination of patent, copyright and trade secret laws to protect our intellectual property and expertise. We also attempt to protect our trade secrets and other proprietary information through confidentiality agreements with our customers, suppliers and employees and through other security measures. Despite these efforts, we cannot give assurances that others will not gain access to our trade secrets or that we can fully protect our intellectual property. In addition, effective trade secret protection may be unavailable or limited in certain countries in which we operate. Nor can we guarantee that our competitors will not independently develop comparable technologies. We cannot rely on our patents to provide us with any significant competitive advantage. Failure to protect our proprietary rights could significantly harm our financial condition.

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Our products are complex and may contain defects that are detected only after deployment in complex networks and systems.

Our products are highly complex and are designed to form part of larger complex networks and systems. Defects in our products, or in the networks and systems of which they form a part, may directly or indirectly result in:

- increased costs and product delays until complex solution level interoperability issues are resolved;
- costs associated with the remediation of any problems attributable to our products;
- loss of or delays in revenues;
- loss of customers;
- failure to achieve market acceptance and loss of market share;
- increased service and warranty costs; and
- increased insurance costs.

Defects in our products could also result in legal actions by our customers for property damage, injury or death. Product liability claims could exceed the level of insurance coverage that we have obtained to cover defects in our products. Any significant uninsured claims could significantly harm our financial condition.

Our future growth depends in part on our successfully identifying and executing acquisitions, joint ventures and strategic relationships.

Our growth strategy may involve acquisitions, strategic alliances or joint ventures. These transactions involve certain risks resulting from the difficulties of integrating employees, operations, technologies and products. We may incur significant acquisition, administrative and other costs in connection with these transactions, including costs related to the integration of acquired or restructured businesses. In order to successfully integrate acquired operations into our business we may be required to expend significant funds, incur debt or assume liabilities, any of which could negatively affect our operations. In addition, the successful integration of acquired operations may also require substantial attention from our senior management, which may limit the amount of time available to be devoted to the day-to-day operations of our business or the execution of our business strategy. There can be no assurances that any of the businesses we acquire can be successfully integrated or that they will perform well once integrated. Additionally, we may be required to record expenses for write-downs of goodwill or other intangible assets associated with our acquisitions.

We have a long and unpredictable sales cycle.

Our products are technically complex and we typically supply them in high quantities to a small number of customers. Many of our products are also tailored to meet the specific requirements of individual customers, and are often integrated by our customers into the systems and products that they sell. Factors that affect the length of our sales cycle include:

- the time required for testing and evaluating our products before they are deployed;
- the size of the deployment; and
- the degree of system configuration necessary to deploy our products.

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As a result, our sales cycle may take up to 18 months, and the length of our sales cycle is frequently unpredictable. In addition, the emerging and evolving nature of the market for the products that we sell may lead prospective customers to postpone their purchasing decisions. We invest resources and incur costs during this cycle that may not be recovered if we do not successfully conclude sales. These factors lead to difficulty in matching revenues with expenses, and to increased expenditures which together may contribute to declines in our results of operations and our share price.

We operate in the United States, Asia and the United Kingdom and we cannot predict the impact that risks typically associated with conducting business internationally will have on our business.

We have operations in the United States, Asia and the United Kingdom, and we market and sell our products throughout the world. As a result, we are exposed to risks typically associated with conducting business internationally, many of which are beyond our control. These risks include:

- significant currency fluctuations between the U.S. dollar (in which our revenues are principally denominated) and the U.K. pound (in which certain of our costs are denominated);
- complexities of managing our operations in the United States, the United Kingdom and Malaysia;
- uncertainty owing to the overlap of different legal regimes, a possibly disadvantageous legal position due to the application of foreign law as well as problems in asserting contractual or other rights across international borders, for example, warranty claims against suppliers and claims for payment against customers;
- potentially adverse tax consequences, such as transfer pricing arrangements between the countries in which we operate or a deemed change in the tax residence of one or more of our subsidiaries;
- potential tariffs and other trade barriers;
- unexpected changes in regulatory requirements;
- the burden and expense of complying with the laws and regulations of various jurisdictions;
- the impact of an outbreak of a viral pandemic, such as swine flu, severe acute respiratory syndrome, or SARS, or the avian flu virus, on our employees or suppliers;
- the impact of a natural disaster affecting a large geographical region, for example, the Asian earthquake and resulting widespread tsunami in 2004, could affect either supply lines, our ability to produce products internally or our customers ability to pay or purchase new products; and
- the world is experiencing sustained levels of unusual weather patterns in all geographies, which could deteriorate further in the future. As a global operation, we are affected by any adverse weather patterns that cause us to invest in extensive plant and machinery to protect our buildings and production operations across the globe or which adversely affect our ability to ship on time to customers, design product, receive material, or relocate out of a specific geography.

The occurrence of any of these events could significantly harm our financial condition.

We have experienced operating losses in the past and there can be no assurance that we will be profitable in the future. We do not currently anticipate paying any dividends on our common shares.

We recorded operating losses of $12.1 million and $30.1 million in our 2009 and 2008 fiscal years, respectively. We expect to continue to incur significant product development, administrative and sales and marketing expenses as well as costs associated with potential future acquisitions and therefore we will need to generate significant revenues in order to achieve profitability. We cannot assure you that we can achieve operating income on a quarterly or annual basis in the future.

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We are dependent upon hiring and retaining highly qualified management and technical personnel.

We operate in the storage and networking technology markets. Our key management and technical staff are located in the United Kingdom, the United States, and in Malaysia. Particularly in the United Kingdom and California there is strong competition for the highly qualified management and technical personnel with experience in our markets that we need to run our business and to develop new technologies and products. In California, in particular, the rate of turnover of key personnel in our markets is high. Our future success depends in part on our continued ability to hire and retain well-qualified technical personnel. We also rely heavily on our senior management and their ability to maintain relationships with our key customers. Many of our senior managers would be difficult to replace. In addition, we do not maintain key-person life insurance on any member of our senior management, with the exception of our Chief Executive Officer. The loss of any of our key management or technical personnel could significantly harm our financial condition.

We may incur expenses related to obsolescence or devaluation of unsold inventory, or to reserves necessary to protect us against future write-offs of unsold inventory.

Failure by us to accurately estimate product demand could cause us to incur expenses related to obsolescence or devaluation of unsold inventory. Due to the nature of our sales arrangements and supply and production arrangements, we may carry a significant amount of unsold inventory. As part of our internal controls, we have comprehensive inventory controls which include management approval for significant inventory purchases and monthly reviews of inventory levels and obsolescence. In the final quarter of our 2008 fiscal year we recorded reserves related to inventory obsolescence of approximately $5 million as a result of reduced forecast demand for our products. This was primarily related to the effect of a deterioration in the world economy on the markets we serve. Historically our costs related to obsolescence have been less than 0.5% of revenues. If we fail to accurately estimate product demand, our inventory may lose value or become obsolete before it is sold. This may require us to increase our reserves for obsolete inventory which could significantly harm our financial condition.

If our Malaysian subsidiary ceases to receive favorable tax treatment by the Malaysian government we may be subject to tax liability that could significantly harm our financial condition.

A large proportion of our SI revenues and a significant proportion of our NSS products are recorded by our Malaysian subsidiary, which benefits from tax incentives granted by the Malaysian government. These are currently in force until May 2012 for SI products and 2017 for NSS products. Our favorable tax treatment in Malaysia is dependent upon the success of the new application and on meeting certain requirements set out by the Malaysian authorities and demonstrating to both the Malaysian and the U.K. tax authorities that transactions between the relevant parties take place on an arm's-length basis. The loss of these tax benefits could increase our tax liabilities for past, current and future years, which could significantly harm our financial condition.

Geopolitical military conditions, including terrorist attacks and other acts of war, may materially and adversely affect the markets on which our common shares trade, the markets in which we operate, our operations and our financial condition.

Terrorist attacks and other acts of war, and any response to them, may lead to armed hostilities and such developments would likely cause instability in financial markets. Armed hostilities and terrorism may directly impact our facilities, personnel and operations which are located in the United States and internationally, as well as those of our customers and suppliers. Furthermore, severe terrorist attacks or acts of war may result in temporary halts of commercial activity in the affected regions, and may result in reduced demand for our products. These developments could have a material adverse affect on our business and the trading price of our common shares.

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We could incur substantial costs, including clean-up costs, fines and civil or criminal sanctions, as a result of violations of or liabilities under environmental laws.

Our operations inside and outside the United States are subject to laws and regulations relating to the protection of the environment, including those governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes and the clean-up of contaminated sites. Certain of our operations involve the use of substances regulated under various federal, state and international environmental laws. It is our policy to apply strict standards for environmental protection to sites inside and outside the United States, even if not subject to regulations imposed by local governments. We could incur substantial costs, including clean-up costs, fines and civil or criminal sanctions, third-party property damage or personal injury claims if we were to violate or become liable under environmental laws or become non-compliant with environmental permits required at our facilities.

Increasing Environmental Legislation could adversely affect our business if we are unable to comply with regional legislation and hence be unable to supply products to certain global regions.

The European Parliament has enacted the Restriction on Use of Hazardous Substances Directive (RoHS Directive), which restricts the sale of new electrical and electronic equipment containing certain hazardous substances, including lead, which is currently used in some of the products we manufacture. A further iteration of this legislation is currently being developed. China has introduced similar legislation being the "Administration on the Control of Pollution Caused by Electronic Information Products" (China RoHS), with further similar such legislation anticipated in the future by other countries. We have modified our manufacturing processes to eliminate these hazardous materials from our products and have complied with the RoHS directive since the restrictions came into force on July 1, 2006. Moreover, we believe we have complied with the currently defined China RoHS requirements. By working closely with our suppliers to redesign or reformulate their components containing the hazardous substances we have reduced or eliminated these materials from our products. However, if we do not continue to comply with these directives in the future, we may suffer a loss of revenue, be unable to sell in certain markets or countries and suffer competitive disadvantage.

The European Parliament also enacted the Waste Electrical and Electronic Equipment Directive, (WEEE Directive), which makes producers of electrical and electronic equipment financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. We may incur financial responsibility for the collection, recycling, treatment or disposal of products covered under the WEEE Directive. To meet certain legal requirements under this Directive, Xyratex has become a member of a business to business recycling scheme. Similar laws and regulations have been or may be enacted in other regions including the United States, China and Japan. These new restrictions may expand the list of banned hazardous substances or reduce the level of acceptable concentrations of other materials in our products. Although we do not expect any material adverse effects based on the nature of our operations and the effect of such laws, there is no assurance that such existing or future laws will not have a material adverse effect on our business.

The Registration Evaluation Authorisation (and restriction) of CHemicals (REACH) regulations came into force across European Union Member States in June 2007. The focus of REACH is to ensure that approximately 30,000 of the most frequently used substances, and all new substances, are registered along with the appropriate level of safety data. REACH stipulates that the use of 'substances of very high concern' (SVHC) may need to be authorized, which could impose significant costs to industry. While the direct involvement of Xyratex is small, this legislation may impact our supply chain, raising costs, potentially putting some suppliers out of business and making some materials and components unavailable. Other countries outside Europe may seek to introduce similar legislation to control hazardous substances. To date, Xyratex believes that none of the identified SVHCs is used within our products, but the list of SVHCs is expected to grow.

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Legislation is also being released from various sources, including the U.S. and E.U., in relation to batteries. Such legislation restricts hazardous materials, requires marking such materials and specifies permissible packaging and transportation configurations.

Customers and potential customers may require compliance with environmental controls more stringent than those required by European legislation. These may be nationally driven or company driven, as leading players in an industry take specific unilateral initiatives in pursuit of a corporate environmental strategy. For example, in Japan some of our potential customers have developed their own environmental standards which include, amongst other things, restrictions on the type of insulation surrounding copper wire and cables.

In general, the global level of environmental control is rapidly increasing. While we endeavor to comply with these environmental controls, any failure to do so may harm our ability to work with certain customers or markets.

We may identify weaknesses and/or deficiencies with our controls over financial reporting when evaluating these controls for compliance with section 404 of the Sarbanes-Oxley Act.

We are required by Section 404 of the Sarbanes-Oxley Act of 2002 to report annually on our evaluation of our internal controls over financial reporting. Although our assessment, testing, and evaluation resulted in our conclusion that as of November 30, 2009, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. If our internal controls are ineffective in future periods, our business and reputation could be harmed. We may incur additional expenses and commitment of management's time in connection with further evaluations, either of which could materially increase our operating expenses and accordingly reduce our net income.

There are inherent uncertainties involved in estimates, judgments and assumptions used in the preparation of financial statements in accordance with U.S. GAAP. Any changes in estimates, judgments and assumptions could have a material adverse effect on our business, financial position and results of operations.

The consolidated financial statements included in the periodic reports we file with the SEC are prepared in accordance with U.S. GAAP. The preparation of financial statements in accordance with U.S. GAAP involves making estimates, judgments and assumptions that affect reported amounts of assets (including intangible assets), liabilities and related reserves, revenues, expenses and income. Estimates, judgments and assumptions are inherently subject to change in the future, and any such changes could result in corresponding changes to the amounts of assets, liabilities, revenues, expenses and income. Any such changes could have a material adverse effect on our financial position and results of operations.

Changes in securities laws and regulations have increased and may continue to increase our costs.

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules promulgated by the Securities and Exchange Commission (SEC), have increased and may continue to increase our expenses as we evaluate the implications of these rules and devote resources to respond to their requirements. In particular, we are incurring additional administrative expense to comply with Section 404 of the Sarbanes-Oxley Act, which requires management and our Independent Registered Public Accounting Firm to report on our internal control over financial reporting.

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In addition, The NASDAQ Stock Market LLC, on which our shares are listed, has also adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices. These developments may also make it more difficult and more expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, our board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficultly attracting and retaining qualified board members and executive officers, which would adversely affect our business.

If securities or industry analysts do not publish research or reports about our business, or if they change their recommendations regarding our shares adversely, our share price and trading volume could decline.

The trading market for our common shares will be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of the analysts who cover us downgrade our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our share price or trading volume to decline.

Fluctuations in the price and volume of shares of technology companies or of listed companies generally could result in the volatility of our share price.

We are a storage and networking technology company. Stock markets generally have recently experienced extensive price and volume fluctuations, and the market prices of securities of technology companies in particular have experienced fluctuations that often have been unrelated or disproportionate to the operating results of those companies. Our share price has been subject to significant volatility and the price fell by 81% in the final quarter of our 2008 fiscal year, largely reflecting the market for shares such as ours. These market fluctuations are likely to continue to result in extreme volatility in the price of our common shares. You should also be aware that price volatility may be more pronounced if the trading volume of our common shares is low.

Our principal shareholders and management own a significant percentage of our company and will be able to exercise significant influence over our company, and their interests may differ from those of our other shareholders.

Our executive officers and directors and principal shareholders and their affiliated entities together control approximately 27.1% of our issued and outstanding common shares. Accordingly, these shareholders, if they act together, have significant influence over our affairs. They may exercise this influence by voting at a meeting of the shareholders in a manner that advances their best interests and not necessarily those of other shareholders. This concentration of ownership also could have the effect of delaying or preventing a change in control of our company or otherwise discouraging a potential acquirer from attempting to obtain control of us.

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We are incorporated in Bermuda and, as a result, it may not be possible for shareholders to enforce civil liability provisions of the securities laws of the United States.

We are incorporated under the laws of Bermuda and a substantial portion of our assets and the majority of our executive officers and directors are located outside the United States. As a result, it may not be possible for the holders of our common shares to effect service of process upon us or our directors or officers within the United States or to enforce against us or our directors or officers in the United States court judgments based on the civil liability provisions of the securities laws of the United States. In addition, there is significant doubt as to whether the courts of Bermuda would recognize or enforce judgments of United States courts obtained against us or our directors or officers based on the civil liability provisions of the securities laws of the United States or any state thereof. Consequently, there is also significant doubt as to whether the courts of Bermuda would be prepared to entertain an original action in Bermuda based on those laws. We have been advised by our United States and Bermuda legal advisors that the United States and Bermuda do not currently have a treaty providing for the reciprocal recognition and enforcement of judgments in civil and commercial matters. Therefore, a final judgment for the payment of money rendered by any federal or state court in the United States based on civil liability, whether or not based on United States federal or state securities laws, would not be automatically enforceable in Bermuda.

Bermuda law differs from the laws in effect in the United States and may afford less protection to shareholders.

Holders of our common shares may have more difficulty in protecting their interests than would shareholders of a corporation incorporated in a jurisdiction of the United States. We are a Bermuda company and, accordingly, we are governed by the Companies Act 1981 of Bermuda, as amended. The Companies Act differs in certain material respects from laws generally applicable to United States corporations and shareholders, including:

Interested director transactions: Under the terms of our bye-laws, any director, or any director's firm, partner or any company with whom any director is associated, may act in a professional capacity for the company, other than as auditor, and such director or such director's firm, partner or such company is entitled to remuneration for professional services. Our bye-laws require that a director who is directly or indirectly interested in a proposed contract or arrangement declare the nature of that interest as required by the Companies Act 1981, but after such a declaration, unless disqualified by the Chairman of the relevant board meeting, such director may vote in respect of any contract or proposed contract or arrangement in which he or she is interested and may be counted in the quorum at such meeting. United States companies are generally required to obtain the approval of a majority of disinterested directors or the approval of shareholders before entering into any transaction or arrangement in which any of their directors has an interest, unless the transaction or arrangement is fair to the company at the time it is authorized by the company's board of directors or shareholders.

Business combinations with interested shareholders: United States companies in general may not enter into business combinations with interested shareholders, namely certain large shareholders and affiliates, unless the business combination has been approved by the board of directors in advance or by a supermajority of shareholders or the business combination meets specified conditions. Under Bermuda law, and under our bye-laws, our board of directors may approve certain business combinations with interested shareholders without the need for a shareholder vote although certain business combinations, such as amalgamations, an arrangement under Bermuda law whereby two corporate entities combine and continue as a combined corporate entity but where neither of the original corporate entities cease to exist, usually require shareholder approval.

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Shareholder suits: The circumstances in which a shareholder may bring a derivative action in Bermuda are significantly more limited than in the United States. In general, under Bermuda law, derivative actions are permitted only when the act complained of is alleged to be beyond the corporate power of the company, is illegal or would result in the violation of the company's memorandum of association or bye-laws. In addition, Bermuda courts would consider permitting a derivative action for acts that are alleged to constitute a fraud against the minority shareholders or, for instance, acts that require the approval of a greater percentage of the company's shareholders than those who actually approved them.

Limitations on directors' liability: Our bye-laws provide that each shareholder agrees to waive any claim or right of action he or she may have, whether individually or in the right of the company, against any director, except with respect to claims or rights of action arising out of the fraud or dishonesty of a director. This waiver may have the effect of barring certain claims against directors arising under U.S. federal securities laws. In general, United States companies may limit the personal liability of their directors as long as they acted in good faith and without knowing violation of law.

We have provisions in our bye-laws that may discourage a change of control.

Our bye-laws contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. These provisions include:

a classified board of directors with staggered three-year terms;

the ability of our board of directors to determine the rights, preferences and privileges of our preference shares and to issue the preference shares without shareholder approval; and

the need for an affirmative vote of the holders of not less than 66% of our voting shares for certain business combination transactions which have not been approved by our board of directors.

These provisions could make it more difficult for a third party to acquire us, even if the third party's offer may be considered beneficial by many shareholders. As a result, shareholders may be limited in their ability to obtain a premium for their shares.

ITEM 4: INFORMATION ON THE COMPANY

Item 4A: History and Development

See INTRODUCTION

Item 4B: Business Overview

Company Overview

We are a leading provider of modular enterprise-class data storage solutions and storage process technology. We design, develop and manufacture enabling technology that provides our customers with data storage products to support high-performance storage and data communication networks. We operate in two business segments: Networked Storage Solutions (NSS) and Storage Infrastructure (SI).

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Our NSS products provide modular, highly scalable, high-speed, high-density, high-availability, reliable, and flexible data storage. Our hard disk drive (HDD) and Solid State Drive (SSD) based storage subsystems support a range of high-speed communication technologies to demanding cost and performance specifications. Our modular subsystem architecture allows us to support many segments within the networked storage market by enabling different specifications of storage subsystem designs to be created from a standard set of interlocking technology modules. Using data published by the independent research company International Data Corporation, or IDC, on the number of petabytes shipped in 2008 and 2009, we estimate that we are responsible for between 14% and 16% of the worldwide external storage system storage capacity shipments through our original equipment manufacturer (OEM) customer base. This amounted to approximately 1,534 petabytes in 2009, an increase from 1,169 petabytes in 2008 and 662 petabytes in 2007. A petabyte is a unit of measurement equal to one million gigabytes (GBs) of information. This significant growth was further validated by IDC's Worldwide Disk Storage Systems 2008 Vendor Shares: Year in Review (Doc #220229, December 2009), which showed Xyratex as the world's largest OEM Supplier in 2008 by revenue.

Our SI product portfolio includes process, inspection and test equipment utilized in disk drive head fabrication, disk drive substrate and media manufacturing and disk drive final assembly and test. The company estimates that over 760,000 HDDs are formatted and qualified each day on SI equipment. Based on the September 2008 bi-annual HDD capital equipment report from the independent market research firm Coughlin Associates, we also estimate that our overall SI revenue represents approximately 11% of the HDD industry's capital equipment spending.

We have over 25 years of experience in research and development relating to HDDs, storage systems, high-speed communication protocols and manufacturing process technology. This experience has enabled us to establish long-term strategic relationships with customers and related technology suppliers. We believe that we have been first to market with several data storage system and test equipment products that complement our customers' core competencies and objectives. For example, we were first to market with an automated test process solution for the HDD manufacturing industry and first-to-market with the introduction of a switch to replace the traditional Fibre Channel (FC) loop architecture in a storage subsystem. In 2005 we announced a number of significant patent filings in the areas of optical backplane interconnect. In 2006 we were first to volume ship mixed SAS/SATA storage systems (where SAS stands for Serial Attached SCSI, SCSI stands for Small Computer System Interface, and SATA stands for Serial Advanced Technology Architecture). Our leadership position continues to be enhanced with our first to market advantage of both the 4 Gigabits per second (Gb/s) FC system delivered in 2007 and the first public demonstration of a SAS 6 Gb/s storage enclosure in November 2008.

Xyratex continues to be committed to protecting our planet and reducing our carbon footprint through responsible product development, active waste management, and encouragement of environmental stewardship throughout the organization. Xyratex products are designed for energy efficiency and new feature and function introduced in 2008 further reduces power consumption, deepening our commitment to the customer and to the environment.

Our storage subsystem and process equipment products enable our customers to improve asset utilization, reduce capital costs, improve energy efficiencies, and better focus on their value-added objectives.

Our patent portfolio continues to reflect our innovation with 384 filings worldwide. In addition, we manage a number of research consortia, with industrial and academic partners, focusing on long term needs of storage system users and markets.

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We have research and development, manufacturing, sales and customer support operations at our major locations in the United States, Asia and Europe. In addition, we have research and development activities located in India and we provide local support to major customer locations in Asia. We continually look for efficiencies and improvements in supply lines that can benefit our customers. For example, in 2007 we established NSS product manufacturing in Malaysia as our customers' demand in the Asia region increases. We also review our technology suppliers and sources to optimize operational and development costs.

We sell our NSS products primarily to OEMs, and our SI products primarily to HDD manufacturers or their component suppliers. We form long-term strategic relationships with our customers, which include such names as NetApp, Dell, IBM, Seagate Technology, and Western Digital. We enter into joint development projects with our key customers and suppliers in order to research and introduce new technologies and products.

We believe that we derive advantages from the technology and skill synergies and requirements across our NSS and SI business segments. Both segments require the integration of many types of high-speed HDD technologies into a range of high-density, high-availability, scalable solutions.

Industry Overview

Worldwide storage demand continues to increase, despite the economic uncertainties. This is largely driven by the volume of data that is being captured, processed, stored and manipulated as digital information. This information is generated from many sources, including critical business applications, e-mail communications, the Internet and multimedia applications, which have collectively fueled an increase in demand for data storage capacity. The adoption of virtualized technologies, the replication of information to improve recoverability, data retention mandates, as well as the significant growth in the creation and archiving of unstructured data (fixed content) in both traditional business and emerging internet based businesses changes the scope and the type of storage systems that need to be deployed to customers. This growing diversification of markets and customers, coupled with the volatility in the market, creates both challenges and opportunities for Xyratex. Additionally, regulatory requirements and company policies requiring data preservation are expanding the use of storage resources in the enterprise. According to recent IDC data, shipments of storage in terms of petabytes are expected to increase at a compound annual growth rate (CAGR) of 43.6% through 2013, reaching over 52,000 petabytes in 2013 (Worldwide Enterprise Storage Systems 2009-2013 Forecast Update, IDC, December 2009).

The increased demand for electronic data storage is primarily being satisfied by hardware solutions incorporating HDDs, requiring an increase in both HDD unit volumes and average storage capacities. NAND Flash based drives called SSDs (Solid State Drives) are also now shipping in Xyratex and competitor storage systems. While we believe that HDDs will continue to provide the best value for mass storage and will remain the dominant technology for large capacity storage applications for many years to come, SSDs are now providing a higher performance tier of storage, Tier-0, that is enhancing the performance of our storage systems. SSDs show today a competitive advantage in several market niches: (a) very low density storage, where the HDD base cost does not favorably compete with the low-end SSD cost, determined mostly by the NAND chip cost and therefore scalable down to fairly low prices for very low densities; (b) very high-speed enterprise applications, where individual high-end SSDs can substitute for multiple high-speed HDDs, providing higher IOPS (Input/Output operations Per Second) per dollar, (c) ruggedized applications where the mechanical nature of HDDs does not provide equivalent reliability, and (d) high performance read intensive applications such as blade computing boot devices. These SSD market niches are expected to remain relatively small in the years to come, with HDD unit shipments expected to reach 556 million in 2009 and growing to 776 million in 2013, while SSD unit shipments are forecasted to be only 62 million in 2013 (Focus on Update: SSDs begin to Mature, TrendFocus, June 2009).

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In addition to the growth in data volume, the market for data storage products and services is also affected by the variety in data sources and purposes within the enterprise and consumer markets. Businesses face the challenge of managing the accessibility, prioritization, and protection of data in a cost-efficient manner. We believe that the realization that not all data is of equal value is driving a proliferation of disk drive storage and networking technologies developed to address different data management requirements. We also believe that businesses are now increasingly focusing on the issues surrounding increasing power consumption and thermal management to maintain compliance with emerging environmental legislation and to reduce energy costs. Because of the increased storage requirement and proliferation of storage technologies, we believe that there is a growing opportunity for outsourced product and service offerings within the data storage and Information Technology (IT) marketplace. According to a preliminary forecast by IDC, growth will return to the IT industry in 2010, rebounding from a decline of 3.0% in 2009 to an increase of 3.2% in 2010 (IDC Predictions 2010: Recovery and Transformation, December 3, 2009). External storage is one of the technologies expected to move the IT industry into positive growth in 2010, and is forecasted to grow 3.9% over 2009 (Worldwide Enterprise Storage Systems 2009-2013 Forecast Update, IDC, December 2009).

NSS Industry Overview

There are a number of dynamics that affect the market for the NSS division's storage subsystem products and services, some of which, we believe, are as follows:

OEM outsourcing of storage products and changes in partners typically takes place at the time of technology transitions.

Continued growth of networked storage (both Networked Attached Storage or NAS and Storage Area Networks or SAN) rather than direct attached storage.

Shift in storage locale from on-site internal systems to remote cloud-based storage.

High Capacity/Low Cost Disk Storage as a growing segment of the market.

Compliance and regulatory policies continue to drive increased need for storage.

Power efficiencies needed to support global environmental initiatives and pressures.

High performance storage solutions are key to addressing markets such as video and rich media markets.

Convergence of storage systems and traditional servers into an integrated storage server.

OEM outsourcing of storage products typically taking place at the time of technology transitions: Technology transitions provide opportunities to introduce new products such as the transition of FC based storage systems to SAS which is well established in internal disk drive interfaces of servers. We believe that we were first to market with 4 Gb/s technology and analysts confirmed that we were the first to announce 8 Gb/s FC technology leadership. Our strategy is to provide new capabilities to our OEM customers on a timely basis such that they can either add their own value through other advanced functionality or package solutions to the various market segments. In 2009, drive vendors introduced their final generation of Fibre Channel-based 3.5" form factor performance drives. All storage system vendors have now transitioned or are planning transitions to SAS-based technology. While Fibre Channel and IP-based networks will continue to dominate the switched storage network architectures, SAS will become the dominant JBOD storage attachment protocol due to its lower cost and high performance. Xyratex is now sampling its 6 Gb/s SAS JBOD controllers and plans to support the recent SAS 2.1 advanced connectivity options. We expect this transition to continue into the higher price band products as well as new growth markets, providing additional opportunity for enterprise class subsystems and solutions.

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Continued growth of networked storage (both NAS and SAN) rather than direct attached storage: Over the last few years we have seen the gradual transition from direct attached storage (typically using SAS or SATA as its interface) to networked storage, typically employing either FC or Gigabit Ethernet. We address these markets through our OEM customers who provide both SAN and NAS storage solutions with a wide range of products. For those customers requiring direct attach connectivity, Xyratex provides SAS solutions. Other trends, such as server and storage virtualization are driving the increase in shared storage and the mixing of heterogeneous storage to support divergent storage performance requirements. We expect that the trend toward this type of enterprise consolidation through virtualization is going to continue and to allow lower level storage systems to be utilized more readily.

Shift in storage locale from on-site internal systems to remote cloud storage: We believe that the increasing adoption of cloud storage could dramatically influence the storage system market. Aggregating storage in private or public clouds provides distinct advantages to customers in all industries and stages of maturity startups can lower their initial investment in IT by utilizing the "pay per use" model of cloud storage, corporations with complex regulatory requirements for storage archiving can outsource this storage to a specialty storage provider to insure compliance. These emerging cloud storage providers have a diverse range of storage requirements which could provide large opportunities for existing OEM customers and potentially a new market opportunity for Xyratex and other low-cost bulk storage providers.

High capacity/low cost disk storage: We believe that data retention, management of fixed content and disk-to-disk backup (and disk-to-disk-to-tape) are leading the way for the growth in capacity-oriented disk drives. From a capacity perspective these high capacity-low cost systems are projected to grow almost three times as fast as the performance oriented (SAS/FC). This was evidenced by IDC's 2009 update report which stated that the revenue for storage systems containing capacity optimized disk drive technology will grow from $8.1 billion in 2009 to $17.4 billion in 2013, representing a CAGR of 16% (Worldwide Enterprise Storage Systems 2009-2013 Forecast Update, IDC, December 2009). The same report also stated that the compound growth in petabyte shipments for this segment is expected to be 59.5% over this period. We believe that this significant growth is driven by emerging storage intensive markets such as rich media archives, healthcare and vaulting and is addressed through ultra-high disk density storage solutions.

Compliance and regulatory storage needs: We believe that regulatory compliance, such as the Sarbanes-Oxley Act of 2002, is a growing concern for most industries on a global basis and is driving a significant volume of data which must be stored over an extended period of time. We are particularly seeing this trend in vertical markets such as health care and government.

Power efficient global initiatives and environmental pressures: Another key driver that we believe has grown in importance over the past few years is the provision of power efficient or 'Green' solutions. Xyratex has invested and continues to invest in improvements in both the basic hardware capabilities and advanced enclosure management technology to minimize power consumption (reduced cost of ownership) and also designs products to minimize ecological impact throughout a product's lifecycle. We believe that data protection, distributed environments, and disk-based backup will drive networked storage growth and that "green credentials" will be an increasingly important decision point for many customers in the future. Xyratex is also involved in multi-organization projects investigating the improvement of data center design and management from an energy consumption standpoint.

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High performance storage solutions addressing markets such as video and rich media markets: We believe that the creation and distribution of entertainment content is the largest driver in the growth of digital storage. Acquisition, editing, archiving and distribution of digital content together with increasing distribution over the internet and digital cinema technology deployment all require large amounts of storage. High Definition digital camera technology continues to replace film in movie production and high definition television channels increase both the performance and capacity demanded of data storage systems.

Convergence of storage systems and traditional servers into an integrated storage server: OEM customers increase reliability and reduce costs by combining external storage systems and traditional server platforms into an integrated storage server. Integrated application and storage servers remove the requirement for expensive Host Bus Adapters (HBAs), switches and cables used in connecting more traditional server platforms with external storage. Xyratex has developed two types of application platforms to address this trend. Our products combine extended ATX (EATX) or Storage Bridge Bay (SBB) form factor motherboards integrated with a storage enclosure to fulfill many different storage application requirements. These products allow OEMs to deliver customizable solutions that address the requirements of the healthcare, video, IP storage, data deduplication and cloud storage markets with highly reliable and proven storage capacity.

SI Industry Overview

We provide capital process equipment to the HDD industry targeting three primary market segments: Head Fabrication, Substrate and Media Manufacturing and HDD Final Assembly and Test. SI revenue is closely linked to the HDD industry capital equipment expenditures, which are strongly correlated to the HDD industry revenue.

The HDD industry includes vertically integrated HDD suppliers, as well as independent suppliers of magnetic heads, substrates, and media (disks). HDD industry capital equipment expenditures were estimated to be $2.51 billion in 2008 growing to $6.06 billion in 2013 (Coughlin Associates, 2008-2013 Capital Equipment and Technology Report for the Hard Disk Drive Industry, September 2008).

HDD suppliers' 2009 revenues are estimated at $29.2 billion and are forecasted to grow at a 5.4% CAGR to $35.9 billion in 2013. The number of HDD units sold in 2009 is estimated at 556 million, an increase of 3.1% from the year before, and is forecasted to increase at an 8.7% CAGR to 776 million in 2013 (IDC Worldwide Hard Disk Drive 2009-2013 Forecast Update, December 2009).

Various applications are driving this HDD growth (the source for the five paragraphs below is the IDC Worldwide Hard Disk Drive 2009-2013 Forecast Update, December 2009):

HDDs for Mobile Computing: The mobile computing market, primarily using the 2.5" disk, is expected to grow faster than that for desktop computers, because the price and performance of laptops continue to improve at a time when user's mobility continues to increase. In 2009, the number of HDDs sold for portable computer applications grew 26.2% to 200 million and is forecast to grow at a 13.8% CAGR to 335 million in 2013.

HDDs for Consumer Electronics: DVRs (Digital Video Recorders), PVRs (Personal Video Recorders) and gaming consoles remained the consumer electronics HDD growth drivers. After being the fastest growing HDD application from 2002 through 2005, the demand for consumer electronics HDDs has slowed down somewhat in the years since then, mostly due to the competition from NAND Flash devices, which have significantly undermined sales and prospects for the smaller HDD form factors (1.8 inch and below). In 2008, consumer electronics HDDs again started to grow, but in 2009 there was an estimated 18.4% decline to 63.8 million units due to the overall macroeconomic conditions. Overall, the number of consumer electronics HDDs is forecast to grow at a 9.1% CAGR to 90 million in 2013.

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HDDs for Enterprise Storage: In 2009, the number of HDDs shipped for enterprise applications declined an estimated 14.8% from 2008 to an estimated 38 million. This decline is consistent with general economic conditions, which directly affected companies' willingness to renew and/or increase their IT needs. For the future, demand for HDDs for enterprise storage is forecast to grow only 4.4% per year, to 45 million units in 2013.

HDDs for Desktop Computing: As a currently declining market segment, desktops were surpassed by mobile applications in 2009 with only an estimated 194 million desktop HDDs sold. However, because of the shift to mobile computing, only 162 million units are forecast for 2013, corresponding to a 4.5% year upon year reduction.

HDDs for External Storage: The market for external storage is the fastest growing market, with a 24.7% CAGR through 2013, at which point it will reach 143 million units. The market continues to grow as consumers seek solutions for their increasing capacity needs as well as back-up requirements.

HDD unit volumes as well as the industry's transition to higher capacity HDDs directly affect our sales of HDD test equipment and servo track writers. Precision cleaning equipment, head test equipment and automation are more closely linked to technology changes in head fabrication, substrate manufacturing and media manufacturing. In particular, the transition to higher capacity HDDs is particularly beneficial to our HDD test equipment because these drives require longer process test and characterization times which results in an increase in the number of servo-fill, serial input-output and interface test cells. Overall, the market for HDD final test equipment was estimated to grow at a 23% CAGR, from $256 million in 2007 to $759 million in 2013 (Coughlin Associates, 2008-2013 Capital Equipment and Technology Report for the Hard Disk Drive Industry, September 2008).

Disk storage capacity for any given HDD form factor, and the corresponding disk areal density (i.e., storage capacity per square inch on the recording surface of a disk), has been constantly increasing over the years. The average HDD capacity was estimated to be 311 GB in 2008 and forecasted to grow to 840 GB in 2012 (TrendFocus Storage Revised Long-Term Forecast Update, August 2008). We believe that this increase in bits per square inch also increases the sensitivity of the magnetic media process to contamination, as smaller defects are capable of affecting the magnetic performance of the disk, and that this should result in increased investment cycles in precision cleaning equipment and related automation. Together with their areal density, the disks themselves, as well as the substrates they come from, have been significantly increasing over the years. In 2009, finished media (i.e., disk) shipments were estimated to decline by 5.4% to 869.7 million, while substrate shipments were estimated to decline by 21.6% to 896 million. This decline is representative of overall macroeconomic conditions in the industry, and growth is forecasted to occur again starting in 2010. We believe the trend will reverse primarily driven by the continuing market demand for 2.5" drives. By 2013, shipments of media units are forecast to grow at a 7.8% CAGR to 1.17 billion, while shipments of substrate units are projected to grow at a 10.0% CAGR to 1.3 billion (TrendFocus Media & Substrate Revised Long-Term Forecast, August 2009). This increase is forecast to drive additional demand for media-substrate equipment, including precision cleaners, sales of which are estimated to grow from $99 million in 2008 to $266 million in 2013, a CAGR of 19% (Coughlin Associates, 2008-2013 Capital Equipment and Technology Report for the Hard Disk Drive Industry, September 2008).

Company Products

NSS Products

We design, develop and manufacture modular, highly scalable, high-speed, high-density, high-availability, reliable and flexible data storage solutions. Our storage subsystems comprise modules, such as our storage controllers and disk drive enclosures, and support a range of high-speed communication technologies and cost and performance specifications.

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Storage products can typically be differentiated by capacity, performance, price and feature set to address three market segments:

- Entry-level storage products are designed for relatively low capacity, simple, stand-alone data storage needs for which price and simplicity are the main purchasing considerations often these are the requirements of small and medium sized businesses (SMBs);

- Midrange or departmental/workgroup/remote office storage products are designed for higher capacity and performance than entry-level products, but still feature ease of use and manageability, and are attached to a local server or a network of servers tailored to the needs of the local users; and,

- High-end or enterprise storage products are designed for use by larger organizations where data storage and management is critical. These organizations require large capacity storage systems that feature high performance, automation, extreme reliability, continuous availability, operating systems interoperability and global service and support.

Our products are generally aimed at the mid-range and enterprise markets.

Our technology and design capabilities are matched by our global manufacturing and configuration services to deliver a customer package unique to the industry. Our focus areas include strategic alliances and partnerships that provide industry technology leadership through organizations such as the Storage Bridge Bay (SBB) working group, the SCSI Trade Association (STA), the Storage Network Industry Association (SNIA), the Green Grid and the International Disk Drive Equipment and Materials Association (IDEMA). We operate close partnerships with key suppliers both of technology and manufacturing services. To expand our available markets and increase interoperability, we embrace international industry standards, including the American National Standards Institute (ANSI) and industry collaborative standards, driving specifications such as SBB working alongside other leaders of the storage industry including Dell, EMC, IBM, LSI and NetApp.

Our customer partnerships often include the manufacturing and supply of customer developed product elements as well as customization of generic platforms, providing a cohesive bond between ourselves and the customer more than that experienced with standard product sales.

Excellent hardware and software design enables us to provide highly modular, energy efficient products both as generic designs and OEM specific derivatives. Our products provide the high speed digital interfaces to multiple disk drives using FC, SAS, and SATA technologies. These interfaces are provided with redundancy and enhanced diagnostic capabilities ensuring system availability even during maintenance. Disk drives must be provided with an essentially benign physical environment with effective cooling and mechanical structure to ensure that reliability is not compromised. Improvements in the design and materials ensure maximum efficiency and device management as well as end of life recyclability, all of which combine to provide the most ecologically friendly and power efficient product. These products that we provide to OEMs are typically referred to as JBOD (Just a Bunch of Disks) subsystems. We further refine the JBOD designation as SBOD (Switched Bunch of Disks) and EBOD (Expandable Bunch of Disks) subsystems. The SBOD subsystems combine the performance and scalability of FC connectivity with the increased resiliency of a switch-based architecture. The EBOD subsystems combine the performance and scalability of SAS Connectivity with the increased flexibility to support high performance enterprise SAS drives and high capacity low cost SAS or SATA drives in the same system.

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Our OneStor™ family of products, first announced in November 2007, complies with the latest industry standard SBB Version 2 specification and incorporates dynamic cooling, high efficiency power, and modularity, allowing us and our OEM customers to create a wide range of storage solutions with maximum re-use of design and components. This product range, our fourth generation of OEM subsystems, is our most modular and flexible product to date. It provides failsafe/redundant power, interconnects, cooling and serviceability. In 2009 we completed production release of three OneStor configurations including our first Small Form Factor (SFF) enclosure. Current products, including OneStor and our legacy 3U and 4U platforms, support 12, 14, 16, 24, and 48 disk drive configurations. These systems offer our customers the flexibility of utilizing 3.5" drives for capacity or 2.5" drives for improved IOPS performance.

Our application storage systems integrate EATX or SBB motherboards inside a storage enclosure integrated with the necessary device drivers, BIOS, and server and enclosure management software modules to fulfill many different storage application requirements. These storage application platforms are our fastest growing product segment. Various network connections can be integrated into the storage enclosures, making them excellent platforms to address the requirements of the healthcare, video, IP storage, data deduplication and cloud storage markets.

Our storage subsystems are internally managed by a range of firmware modules and features. These firmware modules can monitor the internal performance of the subsystem, create high-availability internal environments, communicate independently with remote service, support organizations, and integrate seamlessly with our customers' controlling software and management technology through industry standard interfaces. Increasingly we can provide this firmware both integrated within the product or independently to tightly integrate with OEM customers' own hardware and software.

We also provide RAID technology to protect users from failure of disk drives, ensuring they have 24×7 access to data. Our RAID technology provides cost effective solutions with high performance and a range of features including RAID 6 (the ability to deliver data even with two concurrent disk drive faults). Current products include our F6500 SBB-based RAID controller which supports our OneStor family of products. These products are complete SAN 'solutions' particularly suited to sell to vertical-focused OEMs who do not have their own RAID data protected controllers.

A cornerstone of our manufacturing process is our Integrated Storage Test Process (ISTP) and overall knowledge and HDD expertise. Within our overall test process, Xyratex incorporates a certification test (CERT), which has been internally developed leveraging our SI division test knowledge and has continually evolved to integrate the latest available HDDs. The process is undertaken on all our storage system products and provides a simulation of how the storage system and its HDDs will perform over an extended period of time. This ISTP process which includes unit test, functional test, CERT, and ORT has been shown to dramatically reduce early life failure rates and potential field returns for our OEM customers.

As an OEM supplier we extend our overall offering beyond the specific product and view the provision of an industry leading manufacturing, supply and delivery process as an essential element of our overall competitive strength.

Our manufacturing operations based in the United States, United Kingdom, and Malaysia are tightly integrated with key suppliers located primarily in lower cost regions, delivering both volume and product mix flexibility and efficiency. The modular manufacturing lines can be easily replicated in the most efficient worldwide location and provide a quality and reliability of finished goods which we believe to be unsurpassed in the industry.

Flexibility in supply has enabled us to support our customers' growth. For some customers we provide both standard products and highly customized products integrating hardware and software components developed by our customers. We can provide products as component elements or as complete packaged solutions directly shipping to freight consolidators.

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SI Products

We believe we are a leading global provider of HDD production test equipment, media write equipment, media cleaning systems and media automation. Over the past few years, we have provided production equipment to leading disk drive manufacturers and their component suppliers, including Western Digital, Seagate Technology, and Hitachi GST. Our SI products include the following:

Disk Drive Production Test and Qualification Technologies. We design and manufacture large and fully automated process test systems that incorporate mechanical and electronic hardware and firmware for controlling the HDD operating environment during final qualification and testing. This test process isolates any magnetic defects within each disk drive during an extensive period of testing that can exceed 100 hours for current generation high capacity HDDs. Our test systems can be configured to meet the specific requirements of individual customers and are capable of testing a full range of HDD protocols (high-speed FC, low-cost SATA, ATA and SAS) and form factors. These test systems can be configured to perform the following processes: drive formatting and qualification, interface electronics verification, and complete servo pattern writing outside a cleanroom environment. Xyratex has delivered over 2.2 million test cells, which we estimate have qualified over 1.3 billion HDDs. While the SI division makes equipment to test large numbers of HDDs individually, the NSS division tests them both individually and as parts of storage systems. This unique in-house feedback on HDD testing issues and trends allows the SI division to understand customer needs and adapt its products accordingly.

Media Write Technologies. We design and manufacture complete servo track writers and their key subassemblies using a modular approach. Servo track writers are required in the production of all the current HDDs to write digitally generated magnetic reference patterns on the surface of the disks at a very high speed. These reference patterns are used to precisely define the position of data on the disk. Our products enable the two most significant methods of servo track writing: media writing and self-servo writing. Media writing is a process, conducted within a clean room environment, in which a stack of disks are written with servo patterns and then individually assembled into a number of disk drives. In self-servo writing, the pattern is written on the disk within the drive, without using specialized external hardware.

Cleaning and Contamination Control Technologies. Our range of precision media cleaning systems represents the latest in cleaning technology and performance for the HDD industry. These systems can be customized to various media process requirements by integrating specific IP blocks developed by Xyratex. Our systems achieve very high throughputs (up to 2,000 dph, or disks per hour) while meeting demanding contamination specifications.

Optical Inspection Technologies. Our line of substrate inspection systems represents a unique modular design that combines high sensitivity, integrated, defect detection optics with proven high speed automation. These systems can be configured to meet a wide range of process applications by optimizing automation and optical tester selections to meet throughput and sensitivity requirements for critical defect detection making them ideal for high volume production environment focused on time-to-market.

Head and Media Tester. Our Head and Media Test Systems can be used in all areas of the HDD industry from research to high volume component testing. The systems can be configured for the appropriate environment with a common software and measurement base.

Automation and Factory Control Technologies. Our automation solutions are included in all major stages of substrate, media and final HDD processing requirements, including disk handling and tracking, cassette transport with intelligent routing, disk stacking, and process management firmware. We work closely with our customers to ensure that our solutions are designed to integrate tightly with specific production environments, yet remain modular and flexible enough to grow as needs change.

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Sales, Marketing, and Distribution

We market and sell our products primarily to leading OEMs and disk drive manufacturers, and also to a small number of other companies. We believe that we have a strong sales and marketing model that allows us to develop strategic relationships based on our technical expertise. As part of our sales and marketing activities, we attend industry trade shows and participate in industry associations and customer-sponsored events. As of November 30, 2009, we had 213 employees involved in sales, marketing and customer support activities.

Our sales and marketing efforts focus on acquiring and deepening our relationships with new and existing customers. Our relationships with new customers frequently begin with supplying key technology components and develop into arrangements for the provision of more comprehensive technology solutions. Our sales cycle is typically long; in some cases, it can take up to 18 months for new customers to evaluate our technology and business.

Our customers are primarily U.S. companies with global operations. We ship to their operations in North America, Asia and Europe. The following table sets forth the percentage of our revenues generated from sales to customers in North America, Asia, and Europe for the past three fiscal years.

	Year Ended November 30,	
	2009	**2008**