XYRATEX LTD
Form 6-K
July 16, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 UNDER
THE SECURITIES EXCHANGE ACT OF 1934

July 16, 2007

XYRATEX LTD

(Registrant s name)

Langstone Road

Havant

P09 1SA

United Kingdom

(Address of Principal Executive Offices)

Indicate by check mark whether the registrant files annual reports under cover of Form 20-F or Form 40-F.

Form 20-F x Form 40-F o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No x

NEWS RELEASE

Havant, UK July 16, 2007 - Xyratex Ltd (Nasdaq: XRTX) today released the following financial information for the second quarter of its 2007 fiscal year, ending May 31, 2007:

- Management s Discussion and Analysis of Financial Condition and Results of Operations
- Unaudited condensed consolidated financial statements

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section contains forward-looking statements. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These risks and other factors include those listed under Risk Factors and elsewhere in our Annual Report on Form 20-F as filed with the Securities and Exchange Commission. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continue, or the negative of these terms or other comp terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

Overview

We are a leading provider of modular enterprise-class data storage subsystems 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 and Storage Infrastructure.

Our Networked Storage Solutions products are primarily storage subsystems, which we provide to OEMs and our Storage Infrastructure products consist of disk drive manufacturing process equipment, which we sell directly to manufacturers of disk drives and disk drive components. We form long-term strategic relationships with our customers and we support them through our operations in the United States, Asia and Europe. In our 2006 fiscal year, sales to our top two customers, Network Appliance and Seagate Technology accounted for 46% and 28% of our revenues respectively. In the six months ended May 31, 2007, sales to these customers accounted for 76% of our revenues. We had 49 customers which individually contributed more than $0.5 million to revenues in our 2006 fiscal year and at May 31, 2007 we had over 150 active customers. We enter into joint development projects with our key customers and suppliers in order to research and introduce new technologies and products.

On September 4, 2006, we completed the acquisition of Jastam Trading Co. Ltd. of Tokyo, a full service broker for equipment suppliers to high technology customers. The consideration for the acquisition of $1.7 million was paid in full in cash on completion and approximately represents the fair value of the tangible net assets acquired. The purchase of Jastam will enable us to better support current and potential future customers in Japan and is not expected to have a significant effect on future earnings in the short term.

We have recently completed a number of transactions to enhance the intellectual property base within our Networked Storage Solutions segment and generate income from our existing patent portfolio. These included the acquisition of a specific portfolio of patents from IBM in July 2006, a general patent cross license arrangement with IBM in December 2006 and the acquisition of certain key assets and intellectual property from Ario Data Networks Inc, also in December 2006. This represents a significant injection of intellectual property and will enable us to build more value add features and functions to the technology acquired as part of the acquisition of nStor Technologies, Inc. in September 2005. We also concluded two intellectual property licenses relating to the Xyratex portfolio of patents and filings. In March 2006 we licensed our network analysis patent portfolio and transferred the related product line to Napatech, a programmable network adapter company based in Denmark and in August 2006 we licensed our cross bar switching patent portfolio to Virtensys, a U.K. technology start up. In total these transactions resulted in us recording purchases of intangible and other assets totaling approximately $9.0 million, of which $5.0 million was recorded during the six months ended May 31, 2007. We recorded other income of $4.1 million related to our license to Napatech, of which a $0.9 million final payment was recorded during the six months ended May 31, 2007 and the remainder was recorded in our 2006 fiscal year.

Revenues

We derive revenues primarily from the sale of our Networked Storage Solutions products and our Storage Infrastructure products.

Our Networked Storage Solutions products consist primarily of storage subsystems which address three market segments through our OEM customers; Network Attached Storage or NAS, Storage Area Networks or SAN and Capacity Optimized storage. We have continued to see strong growth in each of these market segments over the past two fiscal years, particularly through Network Appliance, our main customer addressing these marketplaces. Our customers typically operate across multiple market segments. Capacity Optimized storage is a relatively new segment within the external storage systems market. It is primarily driven by magnetic tape technology being replaced by storage systems containing low cost disk drive technology in the back up and recovery processes within enterprises. The deployment of low cost disk drives is also taking place within the SAN and NAS market segments as IT departments begin to classify their data as

part of an information life cycle or corporate data management strategy. Our customers in each market segment currently use the Fibre Channel protocol to access the storage subsystem which can incorporate either high performance Fibre Channel or lower cost ATA/SATA disk drives.

Our Storage Infrastructure revenues are derived from the sale of disk drive manufacturing process equipment directly to manufacturers of disk drives and disk drive components and we have seen growth in these revenues over recent fiscal years, primarily through sales to Seagate Technology. We supply three main product lines in this segment: production test systems, servo track writers and media process technology (comprising media cleaning and media handling automation technology). Revenues from these products are subject to significant fluctuations, particularly from quarter to quarter, as they are dependent on the capital investment decisions and installation schedules of our customers.

We typically enter into arrangements with our largest customers and provide them with products based on purchase orders executed under these arrangements. These arrangements often include estimates as to future product demand but do not typically specify minimum volume purchase requirements. Due to the complexity of our products, we provide almost all of our products on a build-to-order basis. The prices of our products are generally agreed to in advance and are based on a pre-negotiated pricing model. The pricing model may specify certain product components and component costs as well as anticipated profit margins.

As described above, the unit prices we obtain from our major customers will typically vary with volumes. As products become more mature, prices will generally decline, partly reflecting reduced component costs. We also regularly introduce new products which are likely to incorporate additional features or new technology and these products will generally command a higher unit price. Average unit prices will also vary with the mix of customers and products. Our unit prices have reduced in the last two fiscal years as volumes with our major customers have increased and prices are adjusted in line with the agreed price/volume matrix. Because this is related to volume growth, this has not resulted in a reduction in our revenues and has also enabled reductions in component costs. With this exception, we have not seen an overall trend in our unit prices.

Sales of the major portion of our Storage Infrastructure products include an installation element. Revenue for these products is recognized upon installation except that, where there is objective and reliable evidence to support the fair value of installation, or where there is a separate arrangement for the installation, product revenue is recognized upon delivery. In addition, some of our sales contracts provide that a certain percentage of payments are to be made in advance of product delivery, in which case we record these payments as deferred revenue until the product is actually delivered.

We believe that both of our business segments present the opportunity for growth over the next several years. We are seeing growth in demand from our customers, which we believe relates to factors including increases in the amount of digitally stored information, increased information technology spending, growth in the specific markets which our customers address, the trend towards outsourcing and increased market share of our customers. Growth in our Storage Infrastructure revenues is also specifically affected by the growth in shipped volume and increases in the individual storage capacity of disk drives.

The acquisition of Maxtor by Seagate Technology in May 2006 represented a significant consolidation among disk drive suppliers and caused significant changes in market share. We believe these market share changes resulted in an exceptional level of purchases of our equipment in our 2006 fiscal year as our customers invested in new capacity to capture increased market share. In addition we believe Seagate intend to reutilize certain Maxtor owned equipment, which was previously planned to be replaced by Xyratex equipment. This planned reutilization of Maxtor owned equipment has impacted on our revenues during the six months ended May 31, 2007 and whilst the opportunity for growth in the longer term remains, we anticipate that for these two reasons revenues from our Storage Infrastructure products will decline in our 2007 fiscal year.

Foreign Exchange Rate Fluctuations

The functional currency for all our operations is U.S. dollars and the majority of our revenues and cost of revenues are denominated in U.S. dollars. A significant proportion (approximately $75 million in our 2006 fiscal year) of our non-U.S. dollar operating expenses relate to payroll and other expenses of our U.K. operations. To a lesser extent we are also exposed to movements in the Malaysian Ringgit relative to the U.S. dollar. We manage our exchange rate exposures through the use of forward foreign currency exchange contracts and option agreements. By using these derivative instruments, increases or decreases in our U.K. pound operating expenses resulting from changes in the U.S. dollar to U.K. pound exchange rate are partially offset by realized gains and losses on the derivative instruments.

Over our last three fiscal years there has been significant volatility in the exchange rate between the U.K. pound and the U.S. dollar. Overall in this period the U.S. dollar has fallen by approximately 14% relative to the U.K. pound. The effect of this volatility and movement is reduced because we have hedged the majority of our exposure to this exchange rate movement for approximately one year ahead. If there are no further changes to the exchange rate, our 2007 operating expenses will increase by $3.0 million from our 2006 fiscal year, the effect primarily being in the second half of the year.

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Costs of Revenues and Gross Profit

Our costs of revenues consist primarily of the costs of the materials and components used in the assembly and manufacture of our products, including disk drives, electronic cards, enclosures and power supplies. Other items included in costs of revenues include salaries, bonuses and other labor costs for employees engaged in the component procurement, assembly and testing of our products, warranty expenses, shipping costs, depreciation of manufacturing equipment and certain overhead costs. Our gross margins change primarily as a result of fluctuations in our product mix. Our gross margins also change as a result of changes to product pricing, manufacturing volumes and costs of components. The gross margins for our Networked Storage Solutions products tend to be lower than the margins of our Storage Infrastructure products and therefore our gross profit as a percentage of revenues will continue to vary with the proportions of revenues in each segment.

Research and Development

Our research and development expenses include expenses related to product development, engineering, materials costs and salaries, bonuses and other labor costs for our employees engaged in research and development. Research and development expenses include the costs incurred in designing products for our OEM customers, which often occurs prior to their commitment to purchase these products. We expense research and development costs as they are incurred.

Due to the level of competition in the markets in which we operate and the rapid changes in technology, our future revenues are heavily dependent on the improvements we make to our products and the introduction of new products. During our 2006 fiscal year our research and development expenses related to approximately 46 separate projects covering improving existing products, meeting customer specific requirements and entering new markets, such as development of the Storage Bridge Bay (SBB) compliant Application Storage System.

As of November, 2006 26% of our employees were engaged in our research and development activities. Over recent fiscal years research and development expenses have risen approximately at the level of increase in revenue and we expect this trend to continue, reflecting our continuing commitment to developing products based on advanced technologies and designs.

Selling, General and Administrative

Selling, general, and administrative expenses include expenses related to salaries, bonuses and other labor costs for senior management and sales, marketing, and administrative employees, market research and consulting fees, commissions to sales representatives, information technology costs, other marketing and sales activities and exchange gains and losses arising on the retranslation of U.K. pound denominated assets and liabilities. Our selling, general and administrative expenses have increased over recent fiscal years as we have grown our business. To the extent our business continues to grow we would expect these expenses to continue to increase approximately in line with our revenues.

Equity Compensation Expense

We record equity compensation expense using the fair value method required by Financial Accounting Standard (FAS) 123R Share Based Payment . Equity compensation expense calculated under FAS 123R for the six month periods ended May 31, 2007 and May 31, 2006 was $3.8 million and $3.3 million respectively. We anticipate recording $12.4 million in equity compensation expense over our next four fiscal years for share and option awards outstanding as of May 31, 2007. We also anticipate that this will increase as a result of the granting of additional share based awards in future periods and change as a result of changes in the assumptions on which the calculation of the equity compensation expense is based.

Provision for Income Taxes

We are subject to taxation primarily in the United Kingdom, the United States and Malaysia. Over 90% of our income before income taxes in the last two fiscal years has arisen in the United Kingdom or Malaysia. Since 1998, our Malaysian operations benefited from high-tech pioneer status which provided us with a zero tax rate on substantially all of our income arising in Malaysia. In 2006 we were granted a tax exempt status for our operations in Malaysia until 2012, provided that we meet certain requirements. As of November 30, 2006, we recorded a deferred tax asset of $8.2 million related to loss-carry forwards and other timing differences in the United Kingdom. As a result of loss carry-forwards we have not been required to make any significant U.K. tax payments in recent fiscal years. Of the remaining deferred tax balance of $9.8 million, $6.2 million related to equity compensation expense as described in the next paragraph and $3.3 million related to net operating loss carryforwards recorded in connection with our acquisition of nStor Technologies Inc. in 2005.

Following the introduction of FAS 123R in our 2006 fiscal year, we have recorded equity compensation expense using the fair value method. This has resulted in the recording of a tax benefit of $1.8 million which is included in the deferred tax asset at November 30, 2006. We also recorded a deferred tax asset of $4.4 million related to equity compensation expense calculated under the intrinsic method prior to our 2006 fiscal year. The realization of these

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elements of our deferred tax asset is dependent on future share price movements over the next four fiscal years. We anticipate recording any variation to the value of this asset as an adjustment to Additional Paid in Capital.

Tax payments in our 2006 fiscal year amounted to $1.0 million and, due to the beneficial Malaysian tax status and U.K. tax losses, these tax payments related primarily to our U.S. operations. We do not anticipate a significant change in the level of our tax payments in our 2007 fiscal year. The tax expense we recorded in our 2006 fiscal year, primarily related to a reduction in the deferred tax asset arising from the usage of U.K. operating loss carryforwards.

Results from Operations

The following table sets forth, for the periods indicated, selected operating data as a percentage of revenues.

	Three Months Ended May 31, 2007	2006	Six Months Ended May 31, 2007	2006
Revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	83.0	78.5	81.9	79.2
Gross profit	17.0	21.5	18.1	20.8
Operating expenses:				
Research and development	9.0	6.7	8.5	7.5
Selling, general and administrative	6.8	5.5	6.5	6.0
Amortization of intangible assets	0.8	0.4	0.7	0.5
Operating income	0.4	8.8	2.4	6.8
Net income	0.9	8.5	2.7	6.5
Segment gross profit as a percentage of segment revenues:				
Networked Storage Solutions	14.4	13.3	14.0	14.2
Storage Infrastructure	28.0	30.9	30.2	30.5

Three Months Ended May 31, 2007 Compared to Three Months Ended May 31, 2006

The following is a tabular presentation of our results of operations for the three months ended May 31, 2007 compared to the three months ended May 31, 2006. Following the table is a discussion and analysis of our business and results of operations for such periods.

	Three Months Ended May 31, 2007	May 31, 2006	Increase / (Decrease) Amount	%
	US dollars in thousands			
Revenues:				
Networked Storage Solutions	$ 169,155	$ 153,738	$ 15,417	10.0 %
Storage Infrastructure	43,870	135,144	(91,274)	(67.5)
Total revenues	213,025	288,882	(75,857)	(26.3)
Cost of revenues	176,804	226,853	(50,049)	(22.1)
Gross profit:				
Networked Storage Solutions	24,275	20,504	3,771	18.4
Storage Infrastructure	12,273	41,778	(29,505)	(70.6)
Equity compensation	(327)	(253)	(74)	
Total gross profit	36,221	62,029	(25,808)	(41.6)
Operating expenses:				
Research and development	19,209	19,402	(193)	(1.0)
Selling, general and administrative	14,584	15,955	(1,371)	(8.6)
Amortization of intangible assets	1,651	1,185	466	
Operating income	777	25,487	(24,710)	(97.0)
Other income		1,965	(1,965)	
Interest income, net	774	233	541	