DOT HILL SYSTEMS CORP
Form 10-K
March 16, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2009

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition Period From to

Commission file number 1-13317

DOT HILL SYSTEMS CORP.

(Exact name of registrant as specified in its charter)

Delaware	**13-3460176**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**

1351 S. Sunset Street,

Longmont, CO	**80501**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code:

(303) 845-3200

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common stock, $0.001 par value	**The Nasdaq Stock Market**

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ

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 þ No ¨

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 ¨ No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act:

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company þ
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of June 30, 2009 was $37,967,112.

The number of shares of the registrant s common stock outstanding as of March 8, 2010 was 54,367,653.

Documents Incorporated by Reference

Portions of the registrant s definitive proxy statement for its 2010 annual meeting of stockholders are incorporated by reference into Part III of this Form 10-K.

Table of Contents

DOT HILL SYSTEMS CORP.

INDEX TO ANNUAL REPORT ON FORM 10-K

FOR THE YEAR ENDED DECEMBER 31, 2009

		Page
	PART I	
Item 1.	Business	1
Item 1A.	Risk Factors	22
Item 1B.	Unresolved Staff Comments	34
Item 2.	Properties	34
Item 3.	Legal Proceedings	35
Item 4.	(Removed and Reserved)	36
	PART II	
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	37
Item 6.	Selected Financial Data	39
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	41
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	59
Item 8.	Financial Statements and Supplementary Data	59
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	59
Item 9A.	Controls and Procedures	59
Item 9B.	Other Information	62
	PART III	
Item 10.	Directors, Executive Officers and Corporate Governance	62
Item 11.	Executive Compensation	62
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	62
Item 13.	Certain Relationships and Related Transactions, and Director Independence	63
Item 14.	Principal Accounting Fees and Services	63
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	64

Table of Contents

Forward-Looking Statements

Certain statements contained in this annual report on Form 10-K, including, but not limited to, statements regarding the development, growth and expansion of our business, our intent, belief or current expectations, primarily with respect to our future operating performance and the products we expect to offer, and other statements regarding matters that are not historical facts, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and are subject to the safe harbor created by these sections. Future filings with the Securities and Exchange Commission, or SEC, future press releases and future oral or written statements made by us or with our approval, which are not statements of historical fact, may also contain forward-looking statements. Because such statements include risks and uncertainties, many of which are beyond our control, actual results may differ materially from those expressed or implied by such forward-looking statements. Some of the factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements are set forth in the section entitled Risk Factors and in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere throughout this annual report on Form 10-K.

Readers are cautioned not to place undue reliance on these forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and, except as required by applicable law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

In this annual report on Form 10-K, Dot Hill, Dot Hill Systems Corp., we, us and our refer to Dot Hill Systems Corporation, and our wholly owned subsidiaries on a consolidated basis, unless the context otherwise provides.

PART I

Item 1. *Business*

We are a provider of entry-level and midrange storage systems and enterprise server software for organizations requiring high reliability, high performance networked storage and data management solutions in an open systems architecture. Our storage solutions consist of integrated hardware, firmware and software products employing a modular system that allows end-users to add various capacity or data protection schemes as needed. Our broad range of products, from medium capacity stand-alone storage units to complete multi-terabyte storage area networks, or SANs, provide end-users with a cost-effective means of addressing increasing storage demands without sacrificing performance. Our current product family based on our Rapid Evolution, or R/Evolution, architecture provides high performance and large disk array capacities for a broad variety of environments, employing Fibre Channel, or FC, Internet Small Computer Systems Interface, or iSCSI or Serial Attached SCSI, or SAS, interconnects to switches and/or hosts. In addition, our Assured family of data protection software products provides additional layers of data protection options to complement our line of storage disk arrays. Our current mainstream 2000 series of entry-level storage products and Just a Bunch of Disks, or JBOD, arrays have significantly increased in market share during 2009 and are targeted primarily at mainstream enterprise and small-to-medium business, or SMB, applications. Our new replacement products for the legacy SANnet II products, the 2000 series, have been distinguished by certification as Network Equipment Building System, or NEBS, Level 3 (a telecommunications standard for equipment used in central offices) and are MIL-STD-810F (a military standard created by the U.S. government) compliant based on their ruggedness and reliability. In January 2009, we launched a new line of products to address the growing need for smaller form factor, highly dense storage utilizing SAS or serial ATA, or SATA, disks, as well as the newest generation of solid state disks, or SSDs.

As a result of our ongoing strategic development, planning and evaluation, we have identified some potential higher margin business that we believe will complement our current product offerings. Accordingly, we have decided to expand our software offerings. We plan to leverage our current products and technology to

Table of Contents

pursue selling through distributors and open storage partners, or OSPs. Our investment in software will require significant investment and development on our part, which will impact our cash and operating results until we generate sufficient revenues to recover our investment.

In September 2008, we acquired certain assets, namely RAIDCore and Network Attached Storage, or NAS, from Ciprico Inc., or Ciprico. We believe this acquisition will open up new markets for us in the enterprise server and workstation markets for data protection internal to the servers and workstations. In particular, the RAIDCore acquisition will allow us to broaden our product portfolio in the redundant array of independent disks, or RAID, market while allowing us to sell into the Band 1 market, and to pursue opportunities at current and target OEM customers. The Ciprico acquisition also provided us with a team of software development professionals located in Minneapolis, Minnesota. We signed our first customer agreement relating to RAIDCore products in May 2009 and began selling to this customer during the third quarter of 2009. Sales in 2009 were not significant. Additionally, we do not anticipate significant sales in 2010.

In December 2009 we announced that TYAN, an industry-leading server platform provider which is part of Mitac International Corporation had selected our RAIDCore Virtual RAID Adapter technology to be featured in its newest server platforms. Also in December 2009, we announced that Advanced Micro Devices or AMD will embed our RAIDCore Virtual RAID Adapter technology into select platforms based on the recently announced AMD SR5690/SP5100 server chipset.

In January 2010, we acquired Cloverleaf Communications Inc., or Cloverleaf, a privately held software company focused on heterogeneous storage virtualization and unified storage technologies. The acquisition of Cloverleaf could broaden our market opportunities and help accelerate our transition from a provider of storage arrays to a provider of storage solutions and software. The Cloverleaf acquisition also provided us with a new team of software developers and other professionals located in Israel. The Cloverleaf Intelligent Storage Networking System, or iSN , is an intelligent, network resident, storage network management system that provides a combination of benefits, features and capabilities qualified to meet the demands of mid to large-sized data centers. The iSN incorporates architecture that delivers linear scalability, strong fault tolerance and high levels of availability. The iSN s open software is integrated with off the shelf hardware components and provides interoperability and networking technology flexibility.

We have decided to expand our routes to market beyond our focus on OEMs, and in October of 2009, we launched a Dot Hill channel program targeted at selling through distributors and OSPs. We believe this will provide Dot Hill with additional sales channels for all of our products.

Our agreements with our customers do not contain any minimum purchase commitments and may be terminated at any time upon notice from the applicable customer. Our ability to achieve profitability will depend on, among other things, the level and mix of orders we actually receive from such customers, the actual amounts we spend on marketing support, the actual amounts we spend for inventory support and incremental internal investment, our ability to reduce product cost, our product lead time, our ability to meet delivery schedules required by our customers and the economic environment.

Our products and services are sold worldwide to facilitate server and SAN storage implementations, primarily through original equipment manufacturers, or OEMs, and supplemented by system integrators, or SIs, distributors and value added resellers, or VARs. Our OEM channel partners currently include, among others, Hewlett-Packard, or HP, NetApp, Inc., or NetApp, Motorola, Inc., or Motorola, General Dynamics Government Systems Corporation, or General Dynamics, Lockheed Martin Corporation, or Lockheed Martin, Fujitsu Technology Solutions GmbH, or FTS, and Sun Microsystems, or Sun. Although our products and services are sold worldwide, the majority of our net revenue is derived from our U.S. operations. See Note 14 of the Notes to Consolidated Financial Statements for a breakout of our net revenue by geographical regions.

We began shipping products to HP in the fourth quarter of 2007. In January 2008, we amended our agreement with HP to allow for sales to additional divisions within HP. Our products are primarily sold within HP s MSA 2000 product family. Sales to HP increased significantly during 2008 and increased again in 2009

Table of Contents

primarily as a result of the successful launch and market acceptance of the HP MSA 2000 product in 2008 as well as the successful launch of follow-on products in 2009. The agreement with HP does not contain any minimum purchase commitments and the term of the agreement was extended from one to five years. Net revenue from HP approximated 51% of our total net revenue in 2009.

Pursuant to our Development and OEM Supply Agreement with NetApp, we are designing and developing general purpose disk arrays for a variety of products to be sold under private label by NetApp. We began shipping products to NetApp under the agreement for general availability in the third quarter of 2007, and net revenue from NetApp increased significantly during 2008. Net revenue from NetApp decreased slightly in 2009 primarily as a result of general economic conditions. Net revenue from NetApp approximated 25% of our total net revenue in 2009.

We have experienced a decline in net revenue from Sun primarily due to the products nearing the end of their lifecycle. Net revenue from Sun approximated 4% of our total net revenue in 2009. We do not expect to generate significant net revenue from Sun in future periods.

We have also experienced a decline in net revenue from FTS as a result of its decision to internally source the products we sell to them. Net revenue from FTS approximated 5% of our total net revenues in 2009. We expect net revenue from FTS to continue to decline in future periods as a result of this transition.

In addition, the demand for our products has been affected in the past, and may continue to be affected in the future, by various factors, including, but not limited to, the following:

- general economic and political conditions and specific conditions in the markets we address, including the continuing volatility in the technology sector, current general economic volatility and trends in the data storage markets in various geographic regions;

- the inability of certain of our customers who depend on credit to have access to their traditional sources of credit to finance the purchase of products from us, particularly in the current global economic environment, which may lead them to reduce their level of purchases or to seek credit or other accommodations from us; and

- the timing, rescheduling or cancellation of significant customer orders and our ability, as well as the ability of our customers, to manage inventory.

For these and other reasons, our net revenue and results of operations in 2009 and prior periods may not necessarily be indicative of future net revenue and results of operations.

Our strategy includes outsourcing substantially all of our manufacturing to third-party manufacturers in order to reduce sales cycle times and manufacturing infrastructure, enhance working capital and improve margins by taking advantage of the third parties manufacturing and procurement economies of scale. We have historically outsourced substantially all of our manufacturing operations to Flextronics International Limited, or Flextronics. In February 2007, we entered into a manufacturing agreement with MiTAC International Corporation, or MiTAC, a leading provider of contract manufacturing and original design manufacturing services, and SYNNEX Corporation, or SYNNEX, a leading global information technology, or IT, supply chain services company. We began shipping products for general availability under the MiTAC and SYNNEX agreement in 2007.

In September 2008, we entered into a manufacturing agreement with Foxconn Technology Group, or Foxconn. Under the terms of the agreement, Foxconn supplies us with manufacturing, assembly and test services from its facilities in China and final integration services including final assembly, testing and configure-to-order services, through its worldwide facilities. The agreement provides for an initial three-year term that is automatically renewed at the end of such three-year term for additional one-year terms unless and until the agreement is terminated by either party. Foxconn began manufacturing products for us in July 2009 and we began shipping products for general availability under the Foxconn agreement during the second half of 2009. We expect Foxconn to manufacture a larger percentage of our products in 2010.

Table of Contents

In December 2008, our management approved, committed to, and initiated plans to restructure and improve efficiencies in our operations. The restructuring was due to a combination of factors, primarily driven by the economic downturn, but also driven by our plan to consolidate our facilities in Carlsbad, California into the Longmont, Colorado facility. The consolidation is currently in process and we anticipate it will be completed by June 30, 2010.

We were formed in 1999 by the combination of Box Hill Systems Corp., or Box Hill, and Artecon, Inc., or Artecon. We reincorporated in Delaware in 2001. Our website address is http://www.dothill.com. Information contained on our website does not constitute a part of this annual report on Form 10-K. Our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and all amendments to those reports that we file with the SEC are currently available free of charge to the general public through our website promptly after being filed with the SEC and are also accessible through the SEC s website which may be found at http://www.sec.gov. In addition, you may read and copy the materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

Industry Background

Growth of Data Storage

The efficient generation, storage, management and retrieval of digital data and content has become increasingly strategic and mission-critical to organizations. The volume of this data continues to grow rapidly, driven by several factors, including, among others:

- the proliferation of different types of data and data forms such as digital graphics, video, text and audio;
- the emergence of Internet-based communication protocols which enable users to rapidly duplicate, change and re-communicate data;
- new regulations and corporate policies requiring additional storage requirements imposed on healthcare companies and evolving regulatory requirements for financial services companies;
- the implementation of enterprise-wide databases containing business management information;
- gains in network bandwidth and the technology for managing and classifying large volumes of data; and
- the development of the information lifecycle management and the growing use of RAID systems in the backup market in place of, or in addition to, automated tape libraries, due to new applications of technologies that offer improved alternatives in the trade-off between performance and cost of ownership.

While visibility of worldwide external disk storage systems shipped was poor throughout 2009, the industry continued to report an overall capacity growth in 2009 despite economic conditions. A further trend that is expected to benefit us is a shift in spending toward the entry-level storage market as IT budgets are adjusted downwards. We expect this trend to continue well into 2010 and potentially beyond as entry level storage starts to offer an increasing number of traditional mid-range level features.

Traditionally, storage vendors have designed products for markets differentiated by capacity, performance, price and feature set. These storage markets are typically identified as:

- *Entry-level.* Entry-level storage products are designed for lower capacity, stand-alone data storage needs. OEMs and server companies address this market primarily through an indirect sales channel approach employing distributors, retailers and VARs that assist IT managers in identifying, purchasing and installing the product.

4

Table of Contents

Midrange. Midrange or departmental/workgroup 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. In this market, storage providers, OEMs and server companies primarily sell their products to local IT managers either direct or through distributors, VARs and regional SIs.

High-end. High-end or data center 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. In this market, storage providers, OEMs and server companies sell their products with a combination of a direct sales force and indirect channels, including OEMs, large SIs, VARs and managed services providers.

In addition to dramatic increases in the overall volume of data, the storage market has been influenced by the following major trends:

Migration to Networked, Clustered Computing and Unified Storage. Computing processes and architectures have evolved from mainframe computing systems toward a centrally managed network computing environment characterized by multiple operating systems and server platforms that must share information both locally and remotely. In addition, virtual server environments enabled by vendors such as VMware and Microsoft/s Hyper-V have led to a marked increase in the trend toward Unified Storage solutions that offer both NAS and SAN attach capabilities in a single storage solution. Organizations require large-scale data storage solutions offering, among other things:

increased connectivity capabilities;

greater capacity;

higher performance;

the ability to share data among different platforms;

greater reliability; and

greater protection.

Organizations have responded by implementing tailored networks, optimized for data storage functions that facilitate data access and protection.

Increasing Focus on Total Cost of Ownership and Return on Investment. IT managers are increasingly focused on lowering the total cost of ownership and increasing their return on investment on each technology purchase. IT managers evaluate total cost of ownership and return on investment based upon several metrics, including initial purchase price, ease of provisioning, scalability, reliability and redundancy, ease of management, IT staff productivity, operating costs and after-sale service and support.

Storage Area Networks

End users require storage systems that enable them to capture, protect, manage and archive data across a variety of storage platforms and applications without sacrificing performance or reliability. Historically, SCSI was the primary method of connecting storage to servers, based on a direct attached storage, or DAS, model. SAS has been adopted to replace parallel SCSI. Subsequently, the FC protocol was developed, which enables storage devices to connect to servers over a networked architecture, allowing end-users to connect multiple storage devices with high bandwidth throughput over long distances and centrally manage their storage environment. More recently, the iSCSI protocol has emerged in entry-level and midrange systems for storage connected via standard local area networks, or LANs, and wide area networks, or WANs, and leverages the significant investments and existing deployments of Ethernet technology. On-going developments in the industry

Table of Contents

have also led to preliminary proposed standards for FC over Ethernet, or FCoE, which are expected to deploy in 2010. Centrally managed network storage systems are designed to provide connectivity across multiple operating systems and devices and may be based on either open or proprietary technology standards.

SANs, whether FC or iSCSI based, apply the benefits of a networked approach to data storage applications, allowing large blocks of data to move efficiently and reliably between multiple storage devices and servers without interrupting normal network traffic. SANs provide high scalability, connectivity and fault-tolerance, which permit IT managers to create and manage centralized pools of storage and backup devices with redundant data paths. With the addition of file-sharing software, SANs also allow multiple hosts to share consolidated data, dramatically reducing the need to duplicate, move and manage multiple files in a wide variety of data-intensive applications. SANs primarily employ FC technology, although more recently iSCSI is increasingly being employed to provide storage access over Internet Protocol, or IP SANs.

Direct Attached Storage

A significant portion of storage systems that do not require the benefits of a scalable networked storage infrastructure are based on a DAS architecture attached directly to a server. Such storage is typically used to create a large data storage attached to a single server that is then shared or accessed over a general purpose LAN as opposed to a dedicated storage network. Newer clustered file systems for example are often based on large arrays of networked servers that each have a local set of disks, or a RAID disk set, as their local data storage. These local DAS RAID arrays can range from several disks housed inside the server housing and controlled by a local RAID controller adapter installed inside the server, up to larger RAID arrays connected to the server via a local high speed dedicated storage link. RAID arrays inside the servers typically require a dedicated RAID host bus adapter that interfaces multiple disk drives to the host computer bus to provide a high performance disk array with RAID level data protection. More recent server implementations are commonly replacing the dedicated RAID host bus adapter with a lower cost built in disk input/output, or I/O, controller function built into the server motherboard, and implementing the RAID software on the host server operating system. This same RAID controller or software is also capable of connecting to external JBOD or SAS RAID arrays via an external SAS cable to provide extremely cost effective, local storage for servers. We intend to serve this market with our acquired RAIDCore product.

Demand for High Performance, Affordable Network Storage Solutions

Customers increasingly demand higher performing, affordable solutions to address expanding storage requirements, interoperability across disparate systems, the need for improved connectivity and rising data management costs. Customers are also demanding open standards architecture and modular systems that allow them to add capacity as needed. These demands have created significant opportunities for network storage system solutions that are affordable and provide high performance. In general, features that were historically only available in high-end storage systems are increasingly required in entry-level and midrange systems.

Reliability

One of the most important requirements for many customers is that their stored data is available, and that the systems upon which they are stored be reliable. For example, Internet-related customers can lose significant revenue for every minute their sites are inoperable and users cannot access data from the website. Similarly, the operations of corporate customers can grind to a halt if important data is lost or unavailable. For these reasons, a storage system s reliability is often a very critical factor in making a choice among storage systems.

Our Solutions

Hardware Based Storage Solutions

We offer a flexible broad line of networked data storage solutions composed of standards-based hardware and embedded software for open systems environments including SAS, FC and iSCSI storage markets. We

Table of Contents

incorporate many of the performance attributes and other features demanded by high-end/data center end-users into our products, at prices that are suitable for the entry-level or midrange markets. Our end-users consist of entry-level and midrange users, requiring cost-effective, easily managed, high-performance, reliable storage systems. Our product lines range from approximately 146 gigabyte, or GB, to complete 108 terabyte, or TB, storage systems. These offerings allow our products to be integrated in a modular building block fashion or configured into a complete storage solution, increasing OEM flexibility in creating differentiated products. Modular products also allow our OEM partners to customize solutions, bundling our products with value-added hardware, software and services.

These products and services are intended to provide users with the following benefits:

Low Total Cost of Ownership and High Return on Investment. Our products combine reliability, flexibility, scalability and manageability into one of the smallest form factors in today s market. Our product set provides end-users with a low total cost of ownership due to our products high reliability, the simplicity of our plug-and-play technology, decreased service and support costs and modular system approach that allow end-users to add capacity as needed. The modular nature of our products addresses our end-users desire for a storage solution that does not require a large, upfront investment in a monolithic structure with unused capacity. In addition, we believe that our R/Evolution and SANnet II storage systems are among the most space-efficient in the storage industry, maximizing the utilization of our customers limited space and significantly reducing their costs. By extending and leveraging our customers installed storage system and architecture, we are able to provide solutions that offer both a lower total cost of ownership and a higher return on investment.

Modular Scalability. Our products are designed using a single cohesive modular architecture that allows customers to size and configure storage systems to meet their specific requirements or storage network type. This modular architecture also allows customers to easily expand and, in some cases, reconfigure a system as their needs change, permitting them to extend the useful life of, and better utilize, their existing systems.

Reliability. We believe that high reliability is essential to our customers due to the critical nature of the data being stored. We offer high reliability in our product lines and integrate the latest in technological advances to meet expanding market opportunities. We design redundancy, high reliability, high performance and ruggedness into our R/Evolution and SANnet II storage systems. Redundant components have the ability to be replaced while the system is online without interrupting network activity. All of our SANnet II and 5730 disk array products currently offered are certified to operate under extreme climatic and other harsh operating conditions without degradation in reliability or performance, as attested to with the NEBS Level 3 and MIL-STD-810F certifications. Our R/Evolution product family is targeted at the general purpose market without compromising our high reliability standards.

High-end performance attributes and features. Our R/Evolution products are enclosed in a compact two unit high chassis which accommodates up to 12 3.5 disk drives or 24 2.5 disk drives in the array. Arrays can be configured from 876 GB for entry-level Series 2000 products to 108 TB for the Series 5000 midrange products. Customers can intermix SAS and SATA II drives in the same enclosure offering a multitude of configuration options that provide greater flexibility to end users that wish to store different performance profiles of data in the same physical array. Additionally, our R/Evolution products currently feature the industry s only unified product architecture which utilizes a common RAID controller architecture from the entry-level to the midrange.

Open Systems, Multi-Platform Support. As an independent provider of storage products, we are well positioned to provide storage solutions on a variety of platforms and operating systems, including Linux, HP-UX, Solaris and Windows. Our product lines support access to data by multiple servers using different operating systems simultaneously. This multi-platform compatibility allows customers to standardize on a single storage system that can readily be reconfigured and redeployed at minimal cost as the customer s storage architecture changes.

Table of Contents

Manageability. The ability to manage storage systems, particularly through software, is a key differentiator among storage vendors. RAIDar (TM) and SANscape(R), our storage management software for R/Evolution and SANnet II products, respectively, enable customers to more easily manage and configure their storage systems and respond to their changing system requirements.

Data Management Software. We introduced our AssuredFamily of data management services, or DMS, in 2007 in conjunction with the launch of our R/Evolution product family. As part of our AssuredFamily, AssuredSnap(TM) enables point in time snapshots of data for usage in realtime backups, data mining and disaster avoidance. AssuredCopy(TM) enables users to create a clone copy of data at any point in time. We expect to continue to expand our portfolio of DMS available for our R/Evolution based products.

Stand Alone Storage Software

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

Through our acquisition of Cloverleaf Communications, we believe we will be able to address some substantial storage management issues facing systems administrators in corporations and governments worldwide. The Cloverleaf family of Intelligent Storage Networking (iSN) products deliver the following:

Simplified Heterogeneous Storage Management. The iSN provides complete storage ecosystem management using a unified set of management tools so IT personnel can do more with the same resources.

Business Continuity. The iSN delivers data protection through snapshots, virtual replicas and mirroring. Our long-haul communications layer supports policy-based Recovery Point Objective (RPO) and Recovery Time Objective (RTO) quality of service at the globally distributed geographical scale.

Scaling and Maximizing Assets. The iSN offers virtualization and thin provisioning, any-to-any, non-disruptive data migration and tiered storage.

Ultimately, we believe the iSN can simplify data center management, eliminate downtime and cut storage costs, enabling companies to work faster, smarter and more cost effectively.

Our Strategy

Our first objective is to return to profitability through our core business of selling entry and mid level storage arrays through OEMs and more recently through OSPs. Second, we want to scale this core storage hardware business, taking advantage of the operating leverage it affords as a lot of the cost structure is relatively fixed, and capture an increasing share of the open systems storage solution market while maintaining reasonable profit margins. Third, we want to leverage the foundation and customer and channel relationships provided by this core storage hardware business and build a higher margin software business. Our strategy for the storage hardware business includes the following:

Utilize indirect sales channels. We have adopted an indirect sales model to access end-user markets primarily through our OEM, OSP, VAR and SI partners. This allows us to benefit from our channel partners extensive direct and indirect distribution networks, installed customer bases and greater sales, marketing and global service and support infrastructures. The costs associated with a direct worldwide sales force are extensive. By leveraging the sales networks of our partners, we can manage our sales and marketing costs at much lower levels. In addition, we encourage our partners to provide direct support and service to end-users.

Table of Contents

Outsource manufacturing and service operations. We outsource substantially all of our manufacturing operations, which we believe allows us to reduce our manufacturing infrastructure, enhance working capital and improve margins.

Focus on existing customers and develop new customer relationships. We have entered into OEM agreements with HP, NetApp, Motorola, General Dynamics, Lockheed Martin, FTS, Sun, NEC, Sepaton, Inc., or Sepaton, and Stratus Technologies, or Stratus. We intend to focus on expanding our relationships with our existing channel partners and to continue seeking additional OEM relationships with other industry leaders to sell current products and expand the number of products offered to existing OEM partners to enable them to address new markets.

Grow and extend technology leadership. We view our core competencies as the research, design and engineering of modular open storage systems and data protection for enterprise servers. We believe that focused research and development on advanced, cost effective storage technologies is critical to our ongoing success. We intend to continue to develop and integrate high-end features into our products in order to offer more complete storage solutions and enhance our existing products to benefit our channel partners efforts to increase sales.

Leverage our R/Evolution architecture. We developed our R/Evolution architecture as a foundational element of our R/Evolution modular storage arrays. This modular architecture allows us to quickly develop and bring to market new products based on this foundation. We intend to focus and unify our development efforts on this approach, which we believe offers a competitive time to market advantage to us. In particular, we intend to utilize R/Evolution to continually extend the feature sets of both our entry-level and midrange solutions and build a comprehensive set of software based features that offer our customers increased levels of value and differentiation.

Quickly adopt new standards. We strive to introduce products that are first to market. For example, in January 2009 we introduced the first two unit high, 24 drive 2.5 small form factor disk RAID array that supported mainstream SAS, SATA and SSD drives. We believe our highly modular architecture will allow us to quickly adopt newer standards such as 8G FC, 10G iSCSI and FCoE. In addition, our RAIDCore enterprise RAID stack for Windows and Linux servers allow us to quickly adopt and migrate to next generation Intel and AMD class server architectures due to its highly modular architecture and approach.

Pursue strategic alliances, partnerships and acquisitions. We plan to continue to evaluate and selectively pursue strategic acquisitions, alliances and partnerships and other strategic alternatives that are complementary to our business. We believe that growth of the network storage market will create additional opportunities to expand our business. In some cases, we believe the most efficient pursuit of these opportunities may be through partnerships and relationships that allow us to leverage our existing products, core competencies and channels while capitalizing on products, technologies and channels that may be available through potential strategic partners.

Our storage software business is in its nascent phase. Our strategy includes the following:

Expand our total available market. With our acquisitions of both RAIDCore and NAS assets in September 2008 and Cloverleaf in 2010, we intend to expand our available market by extending our reach into server internal storage and entry-level NAS, as well as storage software opportunities. We expect the recent acquisition of Cloverleaf could significantly increase our target market.

Leverage existing customer relationships and sales channels described above. We plan to sell our standalone software solutions through the same channels as we do our hardware storage products e.g. OEMs and OSPs.

Introduce heterogeneous storage virtualization features currently available for very large and complex environments to less complex operating environments. The iSN product purchased through the acquisition of Cloverleaf currently has a robust set of features that includes thin provisioning, automated tiered provisioning and extensive data replication capabilities including snapshots, volume

Table of Contents

copy, split mirroring, continuous data protection as well as asynchronous and synchronous replication. We believe that we can introduce many of these software features to entry-level and mid-market customers and compete effectively on a feature and total cost of ownership basis with our competitors in this market.

Our Products

We design our family of open systems storage hardware and software products with the reliability, flexibility and performance necessary to meet IT managers needs for easily scalable cost effective solutions. We currently offer storage systems in FC, SCSI, iSCSI, SAS and SATA technologies with DAS and SAN configurations. We also offer enterprise class RAID software for industry standard Windows and Linux servers, as well as storage management applications, which can manage any one or all of our storage system configurations. In addition, performance enhancing and DMS software is sold bundled with our storage systems or licensed separately to OEM customers, including AssuredSnap and AssuredCopy.

Our 5730 product is NEBS Level 3 certified and meets carrier class standards for telecommunications equipment, including storage products. There are three levels of NEBS specifications. The most rugged and reliable equipment is rated carrier-class NEBS Level 3. The NEBS standards mandate a battery of tests designed to simulate the extreme conditions resulting from natural or man-made disasters and cover a range of product requirements for operational continuity. MIL-STD-810F is a military standard created by the United States Government. It involves a range of tests used to measure the reliability of equipment in extreme conditions, including physical impact, moisture, vibration and high and low temperatures. These standards address system ruggedness and reliability, which are important requirements for end-users, particularly those in these telecommunications and government sectors.

Our primary products include the following:

Storage Systems Hardware

Product Line	Description	General Availability	Capacity	Target Market	Features
2730	2 unit high, 12-56 SAS or SATA drives, 4 Gb FC DAS and SAN storage	3Q06	Up to 56 TB using 1 TB SATA drives	Entry-level	Complete SAN solution in a single enclosure, scalable performance and capacity for general purpose applications.
2730T	2 unit high, 12-56 SAS or SATA drives, 4 Gb FC DAS and SAN storage	2Q07	Up to 56 TB using 1 TB SATA drives	Entry-level	Complete SAN solution with enhanced performance in a single enclosure, scalable performance and capacity for general purpose applications.
2722	2 unit high, 24-96 SAS, SATA or SSD drives, 4 Gb FC DAS and SAN storage	1Q09	Up to 48TB using 500 GB drives	Enhanced entry-level small form factor storage	Complete SAN solution in a single enclosure, scalable performance and capacity for high density and low power applications.
2732	2 unit high, 12-96	3Q09	Up to 192TB using 2TB SATA drives	Enhanced entry-level	Complete SAN solution in a single enclosure, scalable performance and

SAS, SATA or SSD drives,	capacity for high density and low power applications.
4 Gb FC DAS and	
SAN storage	

Table of Contents

Product Line	Description	General Availability	Capacity	Target Market	Features
2530	2 unit high, 12-56 SAS or SATA drives, 3 Gb SAS DAS and SAN storage	3Q08	Up to 56 TB using 1 TB SATA drives	Entry-level	Complete DAS solution with enhanced performance in a single enclosure, scalable performance and capacity for general purpose applications.
2522	2 unit high, 24-96 SAS or SSD drives, 3 Gb SAS DAS storage	1Q09	Up to 48GB using 500GB drives	Entry-level small form factor storage	Complete DAS solution in a single enclosure, scalable performance and capacity for high density and low power applications.
2532	2 unit high, 24-96 SAS, SATA or SSD drives, 3 Gb SAS DAS storage	3Q09	Up to 192TB using 2TB drives	Enhanced entry-level	Complete DAS solution in a single enclosure, scalable performance and capacity for high density and low power applications.
2330	2 unit high, 12-56 SAS or SATA drives, 1 Gb iSCSI SAN storage	4Q07	Up to 56 TB using 1 TB SATA drives	Entry-level storage	Complete SAN solution in a single enclosure, scalable performance and capacity for general purpose applications.
2322	2 unit high, 24-96 SAS or SSD drives, 3 Gb SAS DAS storage	3Q09	Up to 48GB using 500GB Drives	Entry-level storage	Complete SAN solution in a single enclosure, scalable performance and capacity for high density and low power applications.
2332	2 unit high, 24 SAS, SATA or SSD drives, 1 Gb iSCSI SAN storage	3Q09	Up to 192TB using 2TB drives	Enhanced entry-level	SAS expansion unit for 2722 or 2522.
2122	2 unit high, 24 SAS, SATA or SSD drives, 3 Gb SAS JBOD interface	1Q09	Up to 48TB using 500GB drives	Entry-level small form factor storage	SAS expansion unit for 2722 or 2522.
2130	2 unit high, 12 SAS, or SATA drives, 3 Gb SAS JBOD interface	1Q09	Up to 192TB using 2 TB SATA drives	Entry-level small form factor storage	SAS expansion unit for 2330, 2332, 2530, 2532, 2730, 2730T and 2732.
5730	2 unit high, 12-108 SAS or SATA drives, 4 Gb FC DAS and SAN storage	4Q07	Up to 108 TB using 1 TB SATA drives	Midrange storage	Complete SAN solution in a single enclosure, scalable performance and capacity for general purpose applications.
3720	2 unit high, 24-144	1Q10	Up to 72TB using 500GB drives	Entry-level small form	Complete SAN solution in a single enclosure, scalable performance supporting

SAS or SSD drives,		factor storage	rapid data access and replication.
8 Gb FC SAN storage			

Table of Contents

Product Line	Description	General Availability	Capacity	Target Market	Features
3730	2 unit high, 12-144 SAS, SATA or SSD drives, 8 Gb FC SAN storage	1Q10	Up to 288TB using 2TB drives	Enhanced entry-level	Complete SAN solution in a single enclosure, scalable performance supporting rapid data access and replication.
3920	2 unit high, 24-144 SAS or SSD drives, 8 Gb FC plus 1Gb iSCSI Hybrid SAN storage	1Q10	Up to 72TB using 500GB drives	Entry-level small form factor storage	Complete SAN solution in a single enclosure, scalable performance supporting rapid data access and offsite replication.
3930	2 unit high, 24-144 SAS or SSD drives, 8 Gb FC plus 1Gb iSCSI Hybrid SAN storage	1Q10	Up to 288TB using 2TB drives	Enhanced entry-level	Complete SAN solution in a single enclosure, scalable performance supporting rapid data access and offsite replication.
3120	2 unit high, 24 SAS, or SSD drives, 6 Gb SAS JBOD interface	1Q10	Up to 72TB using 500GB drives	Entry-level small form factor storage	SAS expansion unit for the 3720 and 3920.
3130	2 unit high, 12 SAS, SATA, or SSD drives, 6 Gb SAS JBOD interface	1Q10	Up to 288TB using 2TB drives	Enhanced entry-level	SAS expansion unit for the 3730 and 3930.

Storage Software

Product Line	Description	General Availability	Capacity	Target Market	Features
Embedded Software and Tools					
AssuredSnap	DMS	3Q06	N/A	Entry-level and midrange storage	Snapshot technology for backup, data mining and disaster recovery.
AssuredCopy	DMS	3Q06	N/A	Entry-level and midrange storage	Create volume copies or backups of disk volumes to prevent data loss or corruption.
AssuredRemote	DMS	1Q10	N/A	Entry-level	Array-based remote replication software for data protection and disaster recovery.
RAIDar	Storage management software	1Q00	N/A	Entry-level and midrange storage	Graphical and command line consoles with diagnostics, monitoring and reporting.

RAIDar 2.0	Enhanced Storage management software	1Q09	N/A	Entry-level and midrange storage	Enhanced wizard based graphical and command line consoles with diagnostics, monitoring and reporting.

Table of Contents

Product Line	Description	General Availability	Capacity	Target Market	Features
Standalone Software					
RAIDCore	Enterprise server RAID software stack	1Q09	N/A	Entry level and midrange servers	Enterprise class host RAID stack for Windows and Linux.
iSN	Enterprise heterogeneous storage virtualization software	1Q10	N/A	Enterprise	Heterogeneous storage virtualization platform which provides management of up to 2PB of storage using advanced data migration, thin provisioning and tiered storage capabilities.

R/Evolution Modular Storage Architecture. This family of new offerings focuses on the incorporation of SAS/SATA drive technology with a variety of front-end host interfaces. These products are focused on the general purpose market initially and introduce several technological advancements including EcoStor (elimination of batteries in a RAID cache management system) and SimulCache (high-speed mirrored cache coherency). We believe we were the first RAID vendor to offer mixed SAS, SATA or SSD disk drives in the same two unit high, 12 (2U/12) drive enclosure in a highly reliable storage system. With the introduction of the new 24 drive small form factor drive products (2U/24), we believe we are also the first to offer such systems with full embedded RAID and data protection capability.

2730. Our 2730 product, our first R/Evolution architecture product, is a general purpose high performance 2U/12 storage array offering up to four 4 Gb FC ports host connectivity and any combination of up to 56 SAS and SATA disk drives. It can be deployed in both a SAN and DAS environment.

2730T. Our 2730 Turbo product, based on our R/Evolution architecture, is a general purpose high performance 2U/12 storage array offering up to four 4 Gb FC ports host connectivity and any combination of up to 56 SAS and SATA disk drives. It can be deployed in both a SAN and DAS environment.

2722. Our 2722 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/24 storage array offering up to four 4 Gb FC ports host connectivity and any combination of up to 96 SAS and SATA disk drives. It can be deployed in both a SAN and DAS environment.

2732. Our 2732 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 storage array offering up to four 4 Gb FC ports host connectivity and any combination of up to 96 SAS, SATA and SSD disk drives. It can be deployed in both a SAN and DAS environment.

2530. Our 2530 product, based on our R/Evolution architecture product, is a general purpose high performance storage array offering up to four 3 Gb SAS ports host connectivity and any combination of up to 56 SAS and SATA disk drives. It can be deployed in a DAS environment.

2522. Our 2522 product, based on our R/Evolution architecture product, is a general purpose high performance storage array offering up to four 3 Gb SAS ports host connectivity and any combination of up to 96 SAS and SATA disk drives. It can be deployed in a DAS environment.

2532. Our 2532 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 storage array offering up to four 3 Gb SAS ports host connectivity and any combination of up to 96 SAS, SATA and SSD disk drives. It can be

deployed in a DAS environment.

Table of Contents

2332. Our 2332 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 storage array offering up to four 1 Gb iSCSI ports host connectivity and any combination of up to 96 SAS, SATA and SSD disk drives. It can be deployed in IP SAN environments.

2112. Our 2122 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/24 JBOD expansion array which can connect via 3 Gb SAS cables to the 2522 or 2722 RAID arrays.

2330. Our 2330 product, based on our R/Evolution architecture product, is a general purpose high performance storage array offering up to four 1 Gb iSCSI ports host connectivity and any combination of up to 56 SAS and SATA disk drives. It can be deployed in IP SAN environments.

2332. Our 2332 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 storage array offering up to four 1 Gb iSCSI ports host connectivity and any combination of up to 96 SAS, SATA and SSD disk drives. It can be deployed in IP SAN environments.

2130. Our 2130 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 JBOD expansion array which can connect via 3 Gb SAS cables to the 2330, 2332, 2530, 2532, 2730,2 730T or 2732 RAID arrays.

3720. Our 3720 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/24 storage array offering up to four 4 Gb fibre channel ports host connectivity and any combination of up to 144 SAS and SSD disk drives. It can be deployed in both a SAN and DAS environment.

3730. Our 3730 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 storage array offering up to four 4 Gb fibre channel ports host connectivity and any combination of up to 144 SAS, SATA and SSD disk drives. It can be deployed in IP SAN environment.

3920. Our 3920 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/24 storage array offering up to four 4 Gb fibre channel and an additional 4 iSCSI ports for flexible host connectivity and any combination of up to 144 SAS and SSD disk drives. It can be deployed in both a SAN and DAS environment.

3930. Our 3930 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 storage array offering up to four 4 Gb fibre channel and an additional 4 iSCSI ports for flexible host connectivity and any combination of up to 144 SAS, SATA and SSD disk drives. It can be deployed in both a SAN and DAS environment.

3120. Our 3120 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/24 JBOD expansion array which can connect via 6Gb SAS cables to the 3720 or 3920 RAID arrays.

3130. Our 3130 product, based on our R/Evolution architecture product, is a general purpose high performance 2U/12 JBOD expansion array which can connect via 6Gb SAS cables to the 3730 or 3930 RAID arrays.

5730. Our 5730 product, our first midrange based R/Evolution architecture product, is a general purpose high performance storage array offering up to eight 4 Gb FC ports host connectivity and any combination of up to 108 SAS and SATA disk drives. It can be deployed in both a SAN and DAS environment.

14

Table of Contents

Software. We develop application software technologies and products that are complementary to our overall storage solutions. Our software supports widely used open systems platforms, including Linux, Unix and Windows. We also offer a web-based graphical user interface, or GUI, (RAIDar) for our R/Evolution modular storage products for array management for our Series 2000 and 5000 products. AssuredSnap and AssuredCopy are data management services offerings providing rollback and roll forward manipulation of point in time data snapshots and volume clone or copy of data, respectively.

AssuredSnap. AssuredSnap is our DMS software that introduces point in time snapshot technology into the R/Evolution product family. AssuredSnap provides the ability to create point-in-time copies or backups of disk volumes with instant restoration of data to any captured point in time snapshot. Since AssuredSnap only copies data that has changed to disk it can virtually eliminate backup windows. The AssuredSnap implementation is not only fast, but also reduces the size of snapshots by storing only a single instance of changed blocks. This technology is unique in the market and allows IT managers increased backup efficiency and flexibility.

AssuredCopy. AssuredCopy is our DMS software that introduces data cloning or volume copy services into the R/Evolution product family. AssuredCopy leverages snapshot technology to create complete, physically independent copies of master or snapshot volumes. Once complete, volume copies can be mounted to any host system for read-only or read-write access. As both a data protection and a data management technology, AssuredCopy can be used to support applications such as backup and data recovery, data mining, decision support, data distribution and migration, application development and test. AssuredCopy protects against accidental or malicious loss or corruption of data, and provides additional protection against complete volume failure.

AssuredRemote. AssuredRemote is our DMS software that introduces remote replication into the R/Evolution product family. AssuredRemote leverages snapshot technology and then transfers them to a paired array over either Fiber Channel or Ethernet to for enhanced data protection and disaster recovery.

RAIDar. RAIDar is a GUI used for configuring, monitoring, error reporting and running diagnostics for our 2730 RAID systems. Our OEM customers have the option of customizing their own GUI with the purchase of a customization tool kit. This tool kit enables our OEM customers to private label the GUI quickly and cost efficiently. RAIDar 2.0 adds greater end user ease of use capability in the form of simple configuration wizards.

RAIDCore. RAIDCore is a high performance, feature rich, host based RAID stack for Windows and Linux based enterprise servers. Our OEM and SI customers typically integrate RAIDCore as an ingredient of their entry-level Intel or AMD based server products. It has the ability to replace a dedicated hardware RAID adapter in many applications by utilizing the built in disk I/O ports built into modern server hardware. In most instances, RAIDCore is private labeled and branded with the OEM s own brand.

iSN . iSN is a heterogeneous storage virtualization product that provides a multi-vendor storage solution for growing enterprise and high performance computing needs. Providing both unified storage and advanced storage virtualization features, up to 2PB of storage can be managed and protected both locally and remotely, supporting both network attach server file and SAN under one integrated storage management interface.

Sales and Marketing

Our products and services are sold worldwide to facilitate server and SAN storage implementations, primarily through OEMs and supplemented by SIs, distributors and OSPs. We rely on multiple channels to reach end-user customers that range in size from small businesses to government agencies and large multinational corporations. We maintain a sales and marketing organization operating out of our office in Longmont, Colorado, with regional offices in Germany, Japan and the United Kingdom as well as several smaller localized field sales offices throughout North America. Generally, our customers have no minimum purchase requirements and have certain rights to extend, delay or cancel shipment of their orders without penalty.

15

Table of Contents

OEMs

Our primary distribution channel is through OEMs. We have several OEM relationships and are actively developing new ones. Currently our significant OEM partners include, among others, HP, NetApp and Sun. OEMs generally resell our products under their own brand name and typically assume responsibility for marketing, sales, service and support. Our OEM relationships allow us to sell into geographic or vertical markets where each OEM has significant presence. For the years ended December 31, 2007, 2008 and 2009 OEM sales represented 86.9%, 90.6% and 89.3% of our net revenue, respectively. Sales to HP accounted for 0.8%, 32.6% and 51.4% of our net revenue for the years ended December 31, 2007, 2008 and 2009, respectively. Sales to NetApp accounted for 12.5%, 23.2% and 24.7% of our net revenue for the years ended December 31, 2007, 2008 and 2009, respectively. Sales to Sun accounted for 63.2%, 24.6% and 4.4% of our net revenue for the years ended December 31, 2007, 2008 and 2009, respectively. We do not expect to generate a significant amount of net revenue from Sun in future periods.

Indirect Channels

Most of our non-customized products are sold in conjunction with smaller OEMs, distributors, VARs and SIs, who work closely with our sales force to sell our products to end-users. Our indirect channel partners resell our products either under the Dot Hill brand or under their own or generic R/Evolution brand name, and share responsibility with us for marketing, sales, service and support. We believe indirect channel sales represent an attractive growth opportunity and intend to expand the scope of our indirect channel sales efforts by continuing to actively pursue additional indirect channel partners, both domestically and internationally.

Marketing

We support our OEM and other indirect channels with a broad array of marketing programs designed to promote our products and technology leadership, attract additional channel partners and generate end-user demand. Our product marketing team focuses on product strategy, product development roadmaps, the new product introduction process, product lifecycle management, demand assessment and competitive analysis. The product marketing team also ensures that product development activities, product launches, channel marketing program activities and ongoing demand and supply planning occur on a well-managed, timely basis in coordination with our development, manufacturing and sales groups, as well as our sales channel partners. The groups work closely with our sales and research and development groups to align our product development roadmap to meet key customer and channel technology requirements.

Our Relationships with Key OEMs

Our OEM channel partners currently include, among others, HP, NetApp, Motorola, Lockheed Martin, FTS, Sun, NEC, Sepaton and Stratus. We believe that our product sales through these market leaders strengthen our credibility in the marketplace, validate our technology and enable us to sell our products to a much broader customer base. In addition to expanding and enhancing our relationships with certain of our OEM customers and other channel partners, we intend to seek additional OEM customers as a part of our overall strategy.

In January 2008, we amended our agreement with HP to allow for sales to additional divisions within HP. Our products are primarily sold within HP s MSA 2000 product family. Sales to HP increased significantly during 2008 and increased again in 2009 primarily as a result of the successful launch and market acceptance of the HP MSA 2000 product in 2008 as well as the successful launch of follow-on products in 2009. The agreement with HP does not contain any minimum purchase commitments and the term of the agreement was extended from one to five years.

Pursuant to our Development and OEM Supply Agreement with NetApp, we are designing and developing general purpose disk arrays for a variety of products to be sold under private label by NetApp. The initial term of the agreement is three years after first general availability customer shipment and after this initial period the

Table of Contents

agreement renews automatically for a subsequent 12 months unless terminated by either party. We started shipping products for general availability to NetApp in September 2007 and net revenue from NetApp increased significantly during 2008. Net revenues from NetApp decreased slightly in 2009 primarily as a result of economic conditions.

In 2002, we entered into a three-year OEM agreement with an annual renewal to provide our SANnet II and SANscape products for private label sales by Sun. This agreement was extended until January 2011. Sun has announced that the products we sell to them will no longer be available after specific periods in 2009. Consequently, we experienced a significant decline in sales to Sun in 2009 and we do not expect to generate significant net revenue from Sun in future periods.

In 2006, we entered into a Master Purchase Agreement with FTS. Under the agreement, we co-develop storage solutions utilizing key components and patented technologies from Dot Hill. The initial agreement term is five years and does not include a minimum purchase requirement. We have experienced a decline in net revenue from FTS as a result of its decision to internally source the products we sell to them. Net revenues from FTS approximated 5% of our total net revenues in 2009. We expect net revenue from FTS to continue to decline in future periods as a result of this transition.

Our agreements with our OEM partners do not contain any minimum purchase commitments, do not obligate our OEM partners to purchase their storage solutions exclusively from us and may be terminated at any time upon notice from the applicable partner.

Customer Service and Support

We recognize that providing comprehensive, proactive and responsive support is essential to maintaining and growing customer satisfaction, fostering customer loyalty and securing repeat business. We provide comprehensive 24 hours a day, seven days a week, 365 days a year global customer service and support, either directly or through third-party service providers, aimed at simplifying installation, minimizing usage problems, maximizing system availability and streamlining administration. Through direct and third-party service providers, we maintain a global network of professional engineers and technicians who provide telephonic technical support in various languages from strategically located global response centers on a 24-hour, seven-day basis. In addition, we have the ability to provide four hour on-site service response as required on a global basis. We also offer all of our customers access to SANsolve, our web-hosted interactive support knowledge base that gives our customers the ability to find answers to technical questions through our Customer Resource Center as well as initiate and track all support requests.

We have also taken steps to better align our service and support structure with our indirect sales model, including the following:

- Encouraged OEMs to provide support and service directly to end-users. For example, HP, Sun, FTS and NetApp provide all but the final level of support and service to their end-users.

- Identified key areas for further development such as product certification/recertification training for our partners. In addition, we offered expanded array support services for a fee through our professional services offering.

- Established authorized service providers.

We plan to expand our service offerings, including onsite support contracts and professional services. These services will be performed either directly by us, or through the increased use of third-party service providers. We also are capitalizing on a growing population of product whose initial warranty expired by providing cost effective extended warranty and out-of-warranty repair services.

Table of Contents

Research and Development

Our research and development team has been focused on developing innovative storage products, storage management software, storage management application software for the open systems market and the integration of our storage controller technology into our designed storage systems. In addition we have been working on the integration of our newly acquired software RAIDCore technology in open system servers to allow us to address segments of the market that we did not previously have access to. We have a history of industry firsts, including the first successfully commercialized hot-swappable SCSI disk array and RAID storage system for the UNIX environment and the first NEBS Level 3 certified and MIL-STD-810F tested line of storage systems. We were first to market and have patented SimulCache which increases the write performance in a dual controller array. We were first to market and have patented EcoStor into our R/Evolution products, which eliminate batteries in the storage system, hence decreasing service costs while ensuring permanent data integrity in the event of power failure. We also believe that we were one of the first in the industry to be able to reliably intermix SAS and SATA drives in the same storage system without caveat. This has enabled us to build products that can optimize capacity and performance applications within the same storage array. We recently launched the first external RAID product using 24 2.5 drives in a two unit high chassis form factor. We are focused on continuously developing products that meet changing customer needs and anticipating and proactively responding to highly evolving technology in a timely and cost-effective manner. We also generally design and develop our products to have a modular architecture that can be scaled to meet customer needs and modified to respond to technological developments in the open systems computing environment across product lines. We are actively working on next generation technologies in both storage hardware protocols and storage software applications.

Our areas of expertise include Linux, Unix and Windows driver and system software design, SAN storage resource management software design, storage system design and integration, RAID controller design and technology, RAID firmware development, data management software development, storage enclosure design and high-speed data interface design. We are currently focusing development efforts on our next-generation family of storage systems and on our software products. Projects include the launch of additional members of the R/Evolution family of systems, improvements to our storage software offerings and next generation high-speed solutions that will take advantage of the latest transports and technologies.

Our research and development activities are directed by individuals with significant expertise and industry experience. Our total research and development expenses were $22.6 million, $28.7 million and $28.1 million for the years ended December 31, 2007, 2008 and 2009, respectively. We have five worldwide technology development centers located in Longmont, Colorado, Minneapolis, Minnesota, Carlsbad, California, Hyderabad, India, and Petach Tiqwa, Israel due to our recent acquisition of Cloverleaf in 2010. The Minneapolis development center focuses on RAIDCore development and the Petach Tiqwa development center focuses on iSN .

Manufacturing and Suppliers

We outsource substantially all of our manufacturing to third-party manufacturers in order to reduce sales cycle times and manufacturing infrastructure, enhance working capital and improve margins by taking advantage of the third parties manufacturing and procurement economies of scale. We have historically outsourced substantially all of our manufacturing operations to Flextronics International Limited, or Flextronics. In February 2007, we entered into a manufacturing agreement with MiTAC, a leading provider of contract manufacturing and original design manufacturing services, and SYNNEX, a leading global IT supply chain services company. Under the terms of the agreement, MiTAC supplies us with manufacturing, assembly and test services from its facilities in China and SYNNEX provides us with final assembly, testing and configure-to-order services through its facilities in Fremont, California. We believe that the agreement with MiTAC and SYNNEX facilitates our strategic product initiatives, helps to expand our global capabilities and reduces our manufacturing costs. We began shipping products under the MiTAC and SYNNEX agreement in 2007. All of our Series 2000 and Series 5000 R/Evolution products are shipping from these manufacturing partners.

Table of Contents

In September 2008, we entered into a manufacturing agreement with Foxconn. Under the terms of the agreement, Foxconn supplies us with manufacturing, assembly and test services from its facilities in China and final integration services including final assembly, testing and configure-to-order services, through its worldwide facilities. The agreement provides for an initial three-year term that is automatically renewed at the end of such three-year term for additional one-year terms unless and until the agreement is terminated by either party. Foxconn began manufacturing products for us in July 2009 and we began shipping products for general availability under the Foxconn agreement during the second half of 2009. We expect Foxconn to manufacture a larger percentage of our products in 2010.

Intellectual Property

Our success depends significantly upon our proprietary technology. We have received registered trademark protection for the marks SANnet(R), SANpath(R), SANscape(R), Stratis(R), Dot Hill(R), Dot Hill Systems(R) and the Dot Hill logo. We have attempted to protect our intellectual property rights primarily through copyrights, trade secrets, employee and third party nondisclosure agreements and other measures. We have registered trademarks and will continue to evaluate the registration of additional trademarks as appropriate. We claim common law protection for, and may seek to register, other trademarks. In addition, we generally enter into confidentiality agreements with our employees and with key vendors and suppliers.

As of December 31, 2009, we had been awarded a total of 57 United States patents, 16 of which were awarded in 2009. 49 of these patents generally cover RAID controller and SAM-related technology. In addition, as of December 31, 2009 we had four allowed United States patents, and 37 filed United States patent applications. The patents covering our core technologies expire from 2010 to 2030. If we are unable to protect our intellectual property or infringe intellectual property of a third party, our operating results could be harmed.

In June 2006, we entered into a settlement and license agreement with Crossroads Systems Inc., or Crossroads, which was amended in October 2006 and settled the patent action brought by Crossroads against us and licensed to us the family of patents from which it stemmed. We concurrently entered into an agreement with Infortrend Technology Inc., or Infortrend, under which Infortrend paid for most of the settlement charges as well as most of the royalties on products that we ship that incorporate Crossroads controller technology. On products that do not incorporate Infortrend s controller technology we are solely responsible for payment of royalties to Crossroads.

Competition

The storage market is intensely competitive and is characterized by rapidly changing technology. For storage hardware solutions, we compete primarily against independent storage system suppliers, including EMC Corp., or EMC, Hitachi Data Systems Corp., or Hitachi, Engenio Information Technologies, Inc., a subsidiary of LSI Logic Corp., or LSI, Infortrend, and Xyratex Ltd., or Xyratex. We also compete with traditional suppliers of computer systems, including IBM, Sun and HP, which market storage systems as well as other computer products. For our RAIDCore product we compete primarily with LSI and Adaptec Inc., or Adaptec, and for our iSN products we compete primarily with Falconstor Software Inc., or Falconstor, Compellent Technologies Inc., or Compellent, and LSI.

Many of our existing and potential competitors have longer operating histories, greater name recognition and substantially greater financial, technical, sales, marketing and other resources. As a result, they may have more advanced technology, larger distribution channels, stronger brand names, better customer service and access to more customers than we do. Other large companies with significant resources could become direct competitors, either through acquiring a competitor or through internal efforts. Additionally, a number of public and privately held companies are currently attempting to enter the storage market, some of which may become significant competitors in the future. In the future, it is conceivable that we could compete with some of the original design manufacturers, one of whom is our manufacturing partner today as they develop expertise in chassis design and power and cooling technologies.

Table of Contents

We believe the principal competitive factors in the hardware storage systems and software storage solutions markets are:

- product performance, features, scalability and reliability;
- price;
- product breadth;
- timeliness of new product introductions;
- interoperability and ease of management; and
- responsiveness to OEMs and customer support.

We believe that we compete favorably in several of these categories. To remain competitive, we believe we must invest significant resources in developing new products, enhancing our current products and maintaining high quality standards and customer satisfaction.

Employees

As of December 31, 2009, we had 285 full-time employees, of whom 46 were engaged in sales and marketing, 137 in research and development, 50 in manufacturing, 35 in general management and administration and 17 in customer service and support. We have not had a work stoppage among our employees and none of our employees are represented under collective bargaining agreements. We consider our relations with our employees to be good.

Named Executive Officers and Key Employees of the Registrant

Name	Age	Position	Officer or Key Employee Since
Dana W. Kammersgard(2)	54	Chief Executive Officer and President	August 1984(1)
Hanif I. Jamal(2)	49	Senior Vice President, Chief Financial Officer, Treasurer and Corporate Secretary	July 2006
James Kuenzel(3)	56	Senior Vice President of Engineering	February 2006
Ernest Hafersat(3)	60	Senior Vice President of Worldwide Manufacturing, Operations and Supply Base Management	March 2008

(1) In 1999, Artecon and Box Hill merged to form Dot Hill. Artecon was founded in 1984 and Mr. Kammersgard was an officer of Artecon from its inception until the merger, and has been an officer of Dot Hill since that date.

(2) Named Executive Officers.

(3) Key employees.

All officers are elected by our board of directors and serve at the pleasure of our board of directors as provided in our bylaws.

Dana W. Kammersgard has served as our President since August 2004. In March 2006, Mr. Kammersgard was appointed as our Chief Executive Officer and President. From August 1999 to August 2004, Mr. Kammersgard served as our Chief Technical Officer. Mr. Kammersgard was a founder of Artecon and served as a director from its inception in 1984 until the merger of Box Hill and Artecon in August 1999. At Artecon, Mr. Kammersgard served in various positions since 1984, including Secretary and Senior Vice

Table of Contents

President of Engineering from March 1998 until August 1999 and as Vice President of Sales and Marketing from March 1997 until March 1998. Prior to co-founding Artecon, Mr. Kammersgard was the director of software development at CALMA, a division of General Electric Company. Mr. Kammersgard holds a B.A. in Chemistry from the University of California, San Diego.

Hanif I. Jamal has served as our Senior Vice President, Chief Financial Officer and Corporate Secretary since July 2006. Prior to joining Dot Hill, Mr. Jamal served as Vice President and Corporate Treasurer for Gateway Inc. from 2004 to 2006. Prior to joining Gateway in 2002, Mr. Jamal served in a number of leadership positions over 17 years within Hewlett- Packard Company in the customer financing division, HP Technology Finance. Mr. Jamal led HP s customer financing operations in North America, Latin America and Europe and was also Vice President and General Manager for HP s Commercial and Consumer Financing Division. In 1998, he established Hewlett-Packard International Bank in Dublin, Ireland, and served as Managing Director through 2000. Jamal holds an MBA from Stanford Graduate School of Business and a Bachelor of Science degree, with Honors, in Management Sciences from the University of Manchester Institute of Science and Technology in the United Kingdom.

James Kuenzel has served as our Senior Vice President of Engineering since February 2006. Mr. Kuenzel joined Dot Hill after leaving Maranti Networks Inc. where he began his tenure in 2002 as Vice President of Engineering and then was appointed to President and Chief Operating Officer. Kuenzel has also held Vice President of Engineering positions at McData Corporation, Cabletron Systems, Inc. and Digital Equipment Corporation. Mr. Kuenzel attended Georgetown University Extension, University of Wisconsin Extension, and holds an A.A. in Electronics from Philco Ford Technical Institute.

Ernest Hafersat has served as our Senior Vice President of Worldwide Manufacturing, Operations and Supply Base Management since November 2008 and previously served as our Vice President of Worldwide Manufacturing Operations and Supply Base Management since March 31, 2008. Mr. Hafersat joined Dot Hill after leaving Western Digital Corporation where he held senior level positions in operations and engineering from 2005 to 2008. Prior to Western Digital, Mr. Hafersat was Vice President, Manufacturing Operations & Program Management for Carrier Access Corp. Previous positions include Vice President, Operations for Vari-l Corp., Vice President/ GM at Read-Rite Corp.-Philippines, Senior Director, Engineering/ NPI at Maxtor Corp. and Director of Engineering at Hyundai Semiconductor-Korea. Mr. Hafersat has overseen operations, supply base management, global supplier quality and engineering for both domestic and international multi-site facilities. His international experience includes China, Pacific Rim countries, Mexico and Costa Rica. Mr. Hafersat has a BSIE/BSEE from Waterbury State Technical University, and attended University of Hartford and Rennsslaer Polytechnic Institute with credits toward an MBA.

Table of Contents

Item 1A. ***Risk Factors***

The following sets forth risk factors that may affect our future results. Our business, results of operations and financial condition may be materially and adversely affected due to any of the following risks. We face risks described but not limited to those detailed below. Additional risks we are not presently aware of or that we currently believe are immaterial may also impair our business operations. The trading price of our common stock could decline due to any of these risks. In assessing these risks, you should also refer to the other information contained or incorporated by reference in this annual report on Form 10-K, including our financial statements and related notes.

Recent turmoil in the global economy, credit markets and the financial services industry may negatively impact our revenues, access to capital, our customers access to capital and ability to pay for their purchases in a timely manner, and our suppliers access to capital and ability to provide us with goods and timely delivery, or willingness to provide credit terms to us.

The current global economic condition could reduce the demand for our products and negatively impact net revenues and operating profit. We are unable to predict changes in general macroeconomic conditions and when, or if, global IT spending rates will be affected and to what degree they will be impacted. Furthermore, even if IT spending rates increase, we cannot be certain that the market for external storage solutions will be positively impacted. If there are future reductions in either domestic or international IT spending rates, or if IT spending rates do not increase, our net revenues, operating results and financial condition may be adversely affected. In addition, the recent economic crisis could also adversely impact our customers, and/or their customers, ability to finance the purchase of storage systems from us or our suppliers ability to provide us with product, any of which may negatively impact our business, financial condition and results of operations.

Our smaller OEM customers may not be as well capitalized as, nor do they have the financial resources of, our larger customers. In addition, our sales to all our customers are typically made on credit without collateral. There is a risk that customers will not pay, or that payment may be delayed, because of their liquidity constraints, or because they are awaiting payment from their customers, or other factors beyond our control, which could increase our exposure to losses from bad debts, or increase accounts receivable, and thus reduce cash.

Our third-party manufacturers rely on other third parties to supply key components of our storage products. Some of these components are available only from one or limited sources in the quantities and quality we require. Should any of the component suppliers cease to operate due to the current economic conditions or otherwise, we would have to qualify and locate alternative suppliers. We estimate that replacing key components we currently use in our products with those of another supplier could involve several months of hardware and software modification, which could significantly harm our ability to meet our customers orders for our products, damage our customer relationships and result in a loss of sales.

Our manufacturing suppliers provide us with credit terms that have in some cases been negotiated and documented in our manufacturing agreements. The credit terms we receive from these suppliers vary amongst our manufacturing partners but they all provide for adequate credit limits and credit terms. Should any of our manufacturing partners reduce our credit limits or shorten payment terms, due to their inability to purchase credit insurance or due to uncertainty regarding our financial position, our cash resources and working capital could be significantly impacted.

We are dependent on sales to a relatively small number of customers and a disruption in sales to any one of these customers could materially harm our financial results.

Our business is highly dependent on a limited number of OEM customers. For example, sales to HP accounted for 32.6% and 51.4% of our net revenues for the years ended December 31, 2008 and 2009, respectively. In addition, sales to NetApp accounted for 23.2% and 24.7% of our net revenues for the years ended December 31, 2008 and 2009, respectively. Furthermore, sales to Sun accounted for 24.6% and 4.4% of net revenues for the years ended December 31, 2008 and 2009, respectively. We expect HP and NetApp will each

Table of Contents

represent greater than 10% of our overall revenues for the year ending December 31, 2010. If our relationships with HP and NetApp or certain of our other OEM customers were disrupted or significantly cut back, we would lose a significant portion of our anticipated net revenue and our business could be materially harmed. We cannot guarantee that our relationship with HP, NetApp or our other OEM customers will expand or not otherwise be disrupted. Factors that could influence our relationship with our significant OEM customers, including HP and NetApp, include:

- our ability to maintain our products at prices that are competitive with those of other hardware storage system suppliers;
- our ability to maintain quality levels for our products sufficient to meet the expectations of our OEM customers;
- our ability to produce, ship and deliver a sufficient quantity of our hardware products in a timely manner to meet the needs of our OEM customers;
- our ability to continue to develop and launch new products that our OEM customers feel meet their needs and requirements, with respect to cost, timeliness, features, performance and other factors;
- our ability to provide timely, responsive and accurate customer support to our OEM customers; and
- the ability of our OEM customers to effectively launch, ramp, ship, sell and market their own solutions based on our products.

Our contracts with our OEM customers do not include minimum purchase requirements and are not exclusive, and we cannot assure you that our relationship with these major customers will not be terminated or will generate significant sales.

None of our contracts with our existing customers, including HP and NetApp, contain any minimum purchasing commitments and our customers may cancel purchase orders at any time, cease making purchases or elect not to renew the applicable contract upon the expiration of the current term. Consequently, our customers generally order only through written purchase orders. Further, we do not expect that future contracts with customers, if any, will include any minimum purchase commitments. Changes in the timing, or volume of purchases by our major customers, could result in lower net revenue. For example, we cannot be certain that our sales to any of our OEM customers will continue at historical levels or will ramp to expected levels. In addition, our existing contracts do not require our OEM customers to purchase our products exclusively or on a preferential basis over the products of any of our competitors. Consequently, to the extent they are not sole sourced, our OEM customers may sell the products of our competitors. The decision by any of our OEM customers to cancel purchase orders, cease making purchases or terminate their respective contracts could cause our net revenues to decline substantially, and our business, financial condition and results of operations could be significantly harmed.

We sell on a purchase order basis, making us subject to uncertainties and variability in demand by our customers, and our component suppliers may make obsolete certain components we incorporate into our products, either of which could decrease revenue and adversely affect our operating results.

We sell to our customers on a purchase order basis rather than pursuant to long-term contracts or contracts with minimum purchase requirements. Consequently, our sales are subject to demand variability by our customers. The level and timing of orders placed by our customers vary for a variety of reasons, including seasonal buying by end-users, the introduction of new technologies and general economic conditions. Customers submitting a purchase order may cancel, reduce or delay their orders. If we are unable to anticipate and respond to the demands of our customers, we may lose customers because we have an inadequate supply of products, or we may have excess inventory, either of which may harm our business, financial position and operating results.

In addition, there are occasions when some of our component suppliers make obsolete certain components that we incorporate into our products. In these situations we may be required to purchase such components on a last time buy basis, based on our forecasts of customer demand. If we incorrectly forecast customer demand or

23

Table of Contents

if our OEMs over or under forecast demand, we may have an inadequate supply of products, or we may have excess inventory which may have to be sold in the open market at a deep discount, if at all possible, either of which may harm our business, financial position and operating results.

Our sales cycle varies substantially from customer to customer and future net revenue in any period may be lower than our historical revenues or forecasts.

Our sales are difficult to forecast because the open systems storage market is rapidly evolving and our sales cycle varies substantially from customer to customer. Customer orders for our products can range in value from a few thousand dollars to over a million dollars. The length of time between initial contact with a potential customer and the sale of our product may last from 6 to 36 months. This is particularly true during times of economic slowdown for sales to OEM customers and for the sale and installation of complex solutions.

Additional factors that may extend our sales cycle, particularly orders for new products, include:

- the amount of time needed for technical evaluations by customers;
- customers budget constraints and changes to customers budgets during the course of the sales cycle;
- customers internal review and testing procedures;
- our engineering work necessary to integrate a storage solution with a customer s system;
- the complexity of technical challenges that need to be overcome during the development, testing and/or qualification process for new products and/or new customers;
- meeting unique customer specifications and requirements; and
- difficulties by our customers in integrating our products and technologies into their own products.

Our net revenue is difficult for us to predict since it is directly affected by the timing of large orders. We may ship products representing a significant portion of our net sales for a quarter during the last month of that quarter. In addition, our expense levels are based, in part, on our expectations as to future sales. As a result, if sales levels are below expectations, our operating results may be disproportionately affected. We cannot assure you that our sales will not decline in future periods.

Our recent acquisition of Cloverleaf may not be successfully integrated or produce the results we anticipate.

In January 2010, we acquired Cloverleaf, a privately held software company. The Cloverleaf acquisition also provided us with a new team of software development and other professionals, primarily based primarily in Israel. Cloverleaf was our first acquisition involving significant international operations. We expect that the integration of Cloverleaf s operations with our own will be a complex, time-consuming and costly process involving typical acquisition risks and related challenges, some of which are discussed below:

- operating as a larger combined company with operations in Israel, where we have limited operational experience;

managing geographically dispersed personnel with diverse cultural backgrounds and organizational structures;

the greater cash management, exchange rate, legal and income taxation risks associated with the combined company s new multinational character and the movement of cash between Dot Hill and its domestic and foreign subsidiaries;

assessing and maintaining the combined company s internal control over financial reporting and disclosure controls and procedures as required by U.S. securities laws;

diversion of management s attention from normal daily operations of our business;

potential incompatibility of business cultures and/or loss of key personnel;

Table of Contents

- difficulties in integrating the personnel, operations, technology or products and service offerings of Cloverleaf;
- products derived from this acquisition may not meet the needs of customers or their expectations with respect to reliability;
- insufficient net revenues to offset increased expenses associated with the Cloverleaf acquisition;
- increased professional advisor fees related to the new profile of the combined company;
- the costs and effects of the purchase accounting associated with this acquisition;
- the possibility that we may incur unanticipated expenses in connection with this transaction or be required to expend material sums on potential contingent intellectual property, tax, environmental or other liabilities associated with Cloverleaf s prior operations or facilities; and
- increased difficulty in financial forecasting due to our limited familiarity with Cloverleaf s operations, customers and markets or their impact on the overall results of operations of the combined company.

In addition, the accounting treatment for the Cloverleaf acquisition may result in significant amortizable intangible assets, which when amortized will negatively affect our consolidated results of operations. The accounting treatment for the Cloverleaf acquisition may also result in significant goodwill, which, if impaired, will negatively affect our consolidated results of operations.

Failure to successfully address one or more of the above risks may result in unanticipated liabilities and cash outlays, lower than expected net revenue, losses from operations, failure to realize any of the expected benefits of the acquisition, and related declines in our stock price.

Our inability to further develop and increase sales from our RAIDCore software may significantly impact our ability to increase net revenue, gross margin and operating income.

In September 2008, we bought certain assets from Cirprico including RAIDCore. While we have agreements with several technology partners to market or integrate RAIDCore into their solutions, we cannot be certain that revenue from these customer relationships will exceed the costs of developing, manufacturing and marketing these products. The initial license fees from these software products are low. We intend to grow RAIDCore revenue by selling products with increased functionality to end user customers. If customers are unwilling to pay enough for these additional features to cover our development costs or if we are unable to generate incremental revenue from these newly developed features to cover development and marketing costs, our financial results may be negatively impacted.

The common stock we issued in the acquisition of Cloverleaf in 2010 and charges associated with this acquisition may negatively impact our earnings per share.

Based on the increase in our number of common shares outstanding in connection with our Cloverleaf acquisition, projected amortization charges and the potential for additional costs associated with integrating the company, the acquisition may result in lower earnings per share than would have been earned by us in the absence of the transaction. We expect that over time this acquisition will yield benefits to the combined company such that it will ultimately be accretive to earnings per share. However, there can be no assurance that an increase in earnings per share will be achieved. In order to achieve increases in earnings per share as a result of this acquisition, management will, among other things, need to successfully manage the combined company s operations, increase revenue and compete effectively in its end-markets. Failure to achieve any of these objectives could cause our stock price to decline.

Table of Contents

The open systems storage market is rapidly changing and we may be unable to keep pace with or properly prepare for the effects of those changes. In addition, if we fail to develop and market new software and hardware products that meet customer requirements, our business will be harmed.

The open systems data storage market in which we operate is characterized by rapid technological change, frequent new product introductions, new interface protocol, evolving industry standards and consolidation among our competitors, suppliers and customers. Customer preferences in this market are difficult to predict and changes in those preferences and the introduction of new products by our competitors or us could render our existing products obsolete or uncompetitive. Our success will depend upon our ability to address the increasingly sophisticated needs of customers, to enhance existing products, and to develop and introduce on a timely basis, new competitive products, including new software and hardware, and enhancements to existing software and hardware that keep pace with technological developments and emerging industry standards. If we cannot successfully identify, manage, develop, manufacture or market product enhancements or new products, our business will be harmed. In addition, consolidation among our competitors, suppliers and customers may harm our business by increasing the resources of our competitors, reducing the number of suppliers available to us for our product components and increasing competition for customers by reducing the number of customer-purchasing decisions.

We believe that to remain competitive, we will need to continue to develop new hardware and software products, which will require a significant investment in new product development. Our competitors may be developing alternative technologies, which may adversely affect the market acceptance of our products. If alternative technologies and interface protocols are adopted by the industry that we have not incorporated into our products, we may become uncompetitive and not have product offerings for select market segments. Even if our new products are developed on time, we may not be able to manufacture them at competitive prices or in sufficient volumes.

The market for storage products is intensely competitive and subject to substantial pricing pressure that may harm our net revenues, gross margins and operating results.

The storage market is intensely competitive and is characterized by rapidly changing technology. We compete primarily against independent storage system suppliers, including EMC, NetApp, Hitachi, LSI, Infortrend and Xyratex, but also against server companies such as HP, IBM and Sun, some of whom are our customers. We also compete with smaller storage software and hardware companies such as Nexsan Corporation, or Nexsan, Compellent and Falconstor. The server companies and independent storage systems suppliers are also potential customers as well and as indicated we have established a relationship with HP and NetApp. Future competitors could include original design manufacturers and contract manufacturers, some of whom we partner with today.

Many of our existing and potential competitors have longer operating histories, greater name recognition and substantially greater financial, technical, sales, marketing and other resources than us. As a result, they may have more advanced technology, larger distribution channels, stronger brand names, better customer service and access to more customers than we do. Other large companies with significant resources could become direct competitors, either through acquiring a competitor or through internal efforts. Additionally, a number of new, privately held companies are currently attempting to enter the storage market, some of which may become significant competitors in the future. Any of these existing or potential competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements, devote greater resources to the development, promotion and sale of products or deliver competitive products at lower prices than us.

We could also lose current or future business to certain of our suppliers or manufacturers, some of which directly and indirectly compete with us. Currently, we leverage our supply and manufacturing relationships to provide a significant share of our products. Our suppliers and manufacturers are very familiar with the specific attributes of our products and may be able to provide our customers with similar products.

Table of Contents

We also expect that competition will increase as a result of industry consolidation and the creation of companies with new, innovative product offerings. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address the needs of our prospective customers.

Accordingly, it is possible that new competitors, or alliances among competitors, may emerge and rapidly acquire significant market share. Increased competition is likely to result in price reductions, and may reduce operating margins and create a potential loss of market share, any of which could harm our business. We believe that the principal competitive factors affecting the storage systems market include: performance, features, scalability and reliability; price; product breadth; product availability and quality; timeliness of new product introductions; and interoperability and ease of management.

We cannot assure you that we will be able to successfully incorporate these factors into our products and compete against current or future competitors or that competitive pressures we face will not harm our business. If we are unable to cost effectively develop and market products to compete with the products of competitors, our business will be materially and adversely affected. In addition, if major OEM customers who are also competitors cease purchasing our products in order to concentrate on sales of their own products, our business will be harmed.

Additional pricing pressures are due, in part, to continuing decreases in component prices, such as those of disks, memory, semiconductors and RAID controllers. Decreases in component prices are typically passed on to customers by storage companies through a continuing decrease in the price of storage hardware systems.

Pricing pressures could also result when we cannot pass increased material costs onto our customers. For example, if fuel prices were to increase significantly again, this could result in higher steel and freight costs which we may not be able to pass onto our customers.

Pricing pressures also exist from our significant OEM customers that may attempt to change the terms, including pricing and payment terms of their agreements, with us. As our OEM customers are pressured to reduce prices as a result of competitive factors, we may be required to contractually, or otherwise, commit to price reductions for our products prior to determining if we can implement corresponding cost reductions. If we are unable to achieve such cost reductions, or are unable to pass along cost increases to our customers, and have to reduce the pricing of our products, our gross margins may be negatively impacted which could have a material adverse effect on our business, financial condition and results of operations.

Our inability to lower product costs or changes in the mix of products we sell may significantly impact our gross margins and results of operations.

Our gross margins are determined in large part based on our manufacturing costs, our component costs, our timing and magnitude of product cost reductions, and our ability to include RAID controllers and value added features into our products, such as DMS, as well as the prices at which we sell our products. The amount of revenue recognized from software and service sales and the relative mix of such sales in comparison to sales of our other products will also impact our gross margins, as the gross margin on sales of software and services is higher than that of our other products. If we are unable to lower production costs to be consistent with our projections or any decline in selling prices, our gross margins and results of operations may suffer. Several of the new products we are currently shipping or expect to begin shipping are in the early stages of their lifecycle. Our historical experience indicates that gross margins on new products are low initially and increase over time as a result of maturing manufacturing processes, component cost reductions and re-engineering the products to reduce costs. If we fail to achieve these improvements, our gross margins will be negatively impacted and our business, financial condition and results of operations could be significantly harmed.

In addition, we typically plan our production and inventory levels based on internal forecasts of customer demand, which is highly unpredictable and can fluctuate substantially. Our customer s forecasts have not historically demonstrated a high degree of accuracy. From time to time, in response to anticipated long lead times

Table of Contents

to obtain inventory and materials from our outside suppliers, we may order materials in advance of anticipated customer demand. This advance ordering may result in excess inventory levels or unanticipated inventory write-downs due to expected orders that fail to materialize.

Additional factors which could adversely impact gross margin dollars and gross margin percentage include:

- changes in the mix of products we sell to our customers;
- increased price competition;
- introduction of new products by us or our competitors, including products with price performance advantages;
- our inability to reduce production or component costs;
- entry into new markets or the acquisition of new customers;
- sales discounts and marketing development funds;
- increases in material or labor costs;
- excess inventory, inventory shrinkages and losses and inventory holding charges;
- purchase price variances resulting from reductions in component costs purchased on our behalf by our contract manufacturers or owned by us in inventory versus the original cost of those components;
- increased warranty costs and costs associated with any potential future product quality and product defect issues;
- our inability to sell our higher performance Series 5000 and Series 2000 products, our DMS software and our RAIDCore software;
- component shortages which can result in expedite fees, overtime or increased use of air freight; and
- increased freight costs resulting from higher fuel prices, or from the need to expedite shipments of components to our contract manufacturer or finished goods to some of our customers and their hub locations.

Our OEM customers may have very aggressive product launch and ramp schedules and our efforts to accommodate these schedules may divert our management s attention, cause component shortages and force us to allocate products across many customers, all of which could harm our customer relations.

Our efforts to accommodate our customers aggressive launch and ramp schedules can divert management s attention from the rest of our business and force us to allocate product volumes across many customers due to component shortages, all of which could harm our relations with

customers. In addition, we could incur overtime, expedite charges, and other charges such as shipping products by air as opposed to by ocean as a result of efforts to meet such schedules. Any of these factors could result in lower net revenue and gross margin as well as increased operating expenses which could have an impact on our business, financial condition and results of operations.

Our inability to grow and manage our indirect sales channel may significantly impact our ability to increase net revenue, gross margin and operating income.

We have recently expanded our indirect sales model to access end-user markets primarily through our distributors and OSPs and are investing significant monetary and human resources in order to grow this indirect sales channel. If we cannot successfully identify, manage, develop, and generate sufficient net revenue through our indirect sales channel, our business could be harmed. In addition, even if we are able to grow our indirect sales channel, managing the interaction of our OEMs , distributors , and OSPs efforts to reach various potential customer segments for our products and services is a complex process. Moreover, since each channel method has distinct risks and gross margins, our failure to implement the most advantageous balance in the delivery model for our products and services could adversely affect our net revenue and gross margin and our profitability.

Table of Contents

Manufacturing and supplier disruptions could harm our business.

We rely on third parties to manufacture substantially all of our products. If our agreements with Foxconn, Flextronics, MiTAC or SYNNEX are terminated, or if they do not perform their obligations under our agreement, or if we otherwise determine to transition manufacturing of our products to another third party manufacturer, it could take several months to establish and qualify alternative manufacturing for our products and we may not be able to fulfill our customers orders in a timely manner. If our agreements with Foxconn, Flextronics, MiTAC or SYNNEX terminate, we cannot be certain that we will be able to identify a suitable alternative manufacturing partner that meets the requirements of our OEM customers and one that is cost competitive. Failure to identify a suitable alternative manufacturing partner could impact our customer relationships and our financial condition.

Due to our use of third-party manufacturers, our ability to control the timing of shipments could decrease. Delayed shipment could result in the deferral or cancellation of purchases of our products. Any significant deferral or cancellation of these sales would harm our results of operations in any particular quarter. Net revenue for a period may be lower than predicted if large orders forecasted for that period are delayed or are not realized, which could also impact cash flow or result in a decline in our stock price. To the extent we establish a relationship with an alternative manufacturer for our products, we may be able to partially mitigate potential disruptions to our business. We may also suffer manufacturing disruptions as we ramp up manufacturing processes for our new integrated storage systems, which could result in delays in delivery of these products to our OEM customers and adversely affect our results of operations. Additionally, production of our products could be disrupted as a result of geo-political events in Asia and other manufacturing locations.

We also generally extend to our customers the warranties provided to us by our suppliers and, accordingly, the majority of our warranty obligations to customers are covered by supplier warranties. For warranty costs not covered by our suppliers, we reserve for estimated warranty costs in the period the net revenue is recognized. There can be no assurance that our suppliers will continue to provide such warranties to us in the future, or that we have estimated these costs correctly, which could have a material adverse effect on our business, financial condition and results of operations.

Any shortage of disk drives, memory or other components could increase our costs or harm our ability to manufacture and deliver our storage products to our customers in a timely manner.

From time to time there is significant market demand for disk drives, semiconductors, memory and other components, and we may experience component shortages, selective supply allocations and increased prices of such components. In such event, we may be required to purchase our components from alternative suppliers, and we cannot be certain that alternative sources of supplies will be available at competitive terms. Even if alternative sources of supply for critical components such as disk drives and memory become available, incorporating substitute components into our products could delay our ability to deliver our products in a timely manner.

Demand for disk drives and memory has at times surpassed supply, forcing drive, memory and component suppliers, including those who supply the components that are integrated into many of our storage products, to manage allocation of their inventory. If such a shortage were prolonged, we may be forced to pay higher prices for disk drives, memory or components or may be unable to purchase sufficient quantities of these components to meet our customers demand for our storage products in a timely manner or at all. Similar circumstances could occur with respect to other necessary components.

A significant percentage of our expenses are fixed, and if we fail to generate targeted net revenues or gross margins in associated periods, our operating results will be harmed.

We have taken and may have to take further measures to reduce expenses if net revenues or gross margins decline and we experience greater operating losses or do not achieve profitable results. A number of factors could preclude us from successfully bringing costs and expenses in line with our net revenue, such as the fact that our

Table of Contents

expense levels are based in part on our expectations as to future sales, and that a significant percentage of our expenses are fixed, which limits our ability to reduce expenses quickly in response to any shortfalls in net revenue or gross margin. As a result, if net revenue, product margin or gross margin does not meet our projections, operating results may be negatively affected.

We may continue to experience losses in the future, and may have difficulty forecasting future operating results, (which could result in revenue and earnings volatility), which could cause our stock price to decline.

For the year ended December 31, 2009, we incurred a net loss of $13.6 million. For 2010, we expect our business to remain volatile as we are often unable to reliably predict net revenues from our major customers including NetApp, HP and our other customers. Our ability to reliably predict net revenues is likely to be more challenging in 2010 as a result of our recent acquisition of Cloverleaf. Net revenue levels achieved from NetApp, HP and our other customers, the mix of products sold to our customers, our ability to introduce new products as planned and our ability to reduce product costs and manage our operating expenses and manufacturing variances will affect our financial results for 2010. Consequently, we cannot assure you that we will be profitable in any future period.

Our future operating results and profitability will depend on, and could vary substantially as a result of many factors, including:

- our ability to implement and achieve targeted gross margin cost reduction objectives and;
- our ability to contain operating expenses and manufacturing variances;
- our ability to meet product delivery schedules for HP and other customers which could result in increased air freight, expedite and overtime charges;
- the extent to which we invest in new initiatives such as channel sales and software development;
- our plans to maintain and enhance our engineering, research, development and product testing programs;
- the extent to which we consolidate our facilities and relocate employees and assets;
- the success of our manufacturing strategy and the move of the manufacturing of some of our products to a newer contract manufacturing partner;
- the success of our sales and marketing efforts;
- the amount of field failures resulting in product replacements or recalls;
- the extent and terms of any development, marketing or other arrangements;
- changes in economic, regulatory or competitive conditions, including the current worldwide economic crisis;

increased intangible amortization and other costs associated with our recent acquisition of Cloverleaf;

costs of filing, prosecuting, defending and enforcing intellectual property rights; and

costs of litigating and defending law suits.

Product recalls, epidemic failures, post-manufacture repairs of our products liability claims, absence or cost of insurance, and associated costs could harm our reputation, divert resources, reduce sales and increase costs and could have a material adverse effect on our financial condition.

Our new integrated storage systems, as well as our legacy products, may contain undetected errors, or failures that become epidemic failure, which may be discovered after shipment, resulting in a loss of net revenue, or a loss or delay in market acceptance, which could harm our business. The product failure or recall could be the

Table of Contents

result of components purchased from our suppliers not meeting the required specifications, manufacturing defects or from our own design deficiencies. For example, during the first half of 2007, we experienced several product quality issues associated with our then recently introduced Series 2000 products. The cost of rectifying these issues had a negative impact on gross margins during the first half of 2007.

Even if the errors are detected before shipment, such errors could result in the halting of production, the delay of shipments, recovery costs, loss of goodwill, tarnishment of reputation and/or a substantial decrease in net revenue. Our standard warranty provides that if our systems do not function to published specifications, we will repair or replace the defective component or system without charge generally for a period of about three years. Significant warranty costs, particularly those that exceed reserves, could decrease our gross margin and negatively impact our business, financial condition and results of operations. In addition, defects in our products could result in our customers claiming property damages, consequential damages, or bodily injury, which could also result in our loss of customers and goodwill. None of our customers have thus far asserted claims, but may in the future assert claims, that our products have failed to meet agreed-to specifications or that they have sustained injuries from our products, and we may be subject to lawsuits relating to these claims. There is a risk that these claims or liabilities may exceed, or fall outside of the scope of our insurance coverage. Any such claim could distract management s attention from operating our business and, if successful, result in damage claims against us that might not be covered by our insurance.

Our success depends significantly upon our ability to protect our intellectual property and to avoid infringing the intellectual property of third parties, which has already resulted in costly, time-consuming litigation and could result in the inability to offer certain products.

We rely primarily on patents, copyrights, trademarks, trade secrets, nondisclosure agreements and common law to protect our intellectual property. Despite our efforts to protect our intellectual property, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary. In addition, the laws of foreign countries may not adequately protect our intellectual property rights. Our efforts to protect our intellectual property from third party discovery and infringement may be insufficient and third parties may independently develop technologies similar to ours, duplicate our products or design around our patents.

In addition, third parties may assert infringement claims against us, which would require us to incur substantial license fees, legal fees and other expenses, and distract management from the operations of our business. For example, in 2003, Crossroads filed a lawsuit against us alleging that our products infringe two United States patents assigned to Crossroads. In 2006, we entered into a Settlement and License Agreement with Crossroads that settled the lawsuit and licensed to us the family of patents from which it stemmed. We incurred significant legal expenses in connection with these matters. Other third parties may assert additional infringement claims against us in the future, which would similarly require us to incur substantial license fees, legal fees and other expenses, and distract management from the operations of our business.

We expect that providers of storage products will increasingly be subject to infringement claims as the number of products and competitors increases. We receive, from time to time, letters from third parties suggesting that we may require a license from such third parties to manufacture or sell our products. We evaluate all such communications to assess whether to seek a license from the patent owner. We may be required to purchase licenses that could have a material impact on our business, or, we may not be able to obtain the necessary license from a third party on commercially reasonable terms, or at all. Consequently, we could be prohibited from marketing products that incorporate the protected technology or incur substantial costs to redesign our products in a manner to avoid infringement of third party intellectual property rights.

Our success depends on our ability to attract and retain key personnel.

Our performance depends in significant part on our ability to attract and retain talented senior management and other key personnel. Our key personnel include Dana Kammersgard, our Chief Executive Officer and President, Hanif Jamal, our Senior Vice President and Chief Financial Officer, James Kuenzel, our Senior Vice

Table of Contents

President of Engineering and Ernest Hafersat, our Senior Vice President of WorldWide Manufacturing, Operations, and Supply Base Management. If any of these individuals were to terminate his employment with us, we would be required to locate and hire a suitable replacement. Competition for attracting talented employees in the technology industry can be intense. We may be unable to identify suitable replacements for any employees that we lose. In addition, even if we are successful in locating suitable replacements, the time and cost involved in recruiting, hiring, training and integrating new employees, particularly key employees responsible for significant portions of our operations, could harm our business by delaying our production schedule, our research and development efforts, our ability to execute on our business strategy and our client development and marketing efforts.

Many of our customer relationships are based on personal relationships between the customer and our executives or sales representatives. If these representatives terminate their employment with us, we may be forced to expend substantial resources to attempt to retain the customers that the sales representatives serviced. Ultimately, if we were unsuccessful in retaining these customers, our net revenue would decline.

We may face difficulties retaining key employees and attracting new employees in connection with our consolidation of operations and facilities in Longmont, Colorado.

We have decided to consolidate our Longmont, Colorado and our Carlsbad, California operations and facilities into a single facility in Longmont, Colorado. We may face difficulties retaining key employees in Carlsbad, California and Longmont, Colorado and attracting new employees in Longmont, Colorado in connection with the consolidation, which may adversely affect our operations and the transfer of knowledge and processes to the consolidated facility in a timely manner.

Protective provisions in our charter and bylaws and the existence of our stockholder rights plan could prevent a takeover which could harm our stockholders.

Our certificate of incorporation and bylaws contain a number of provisions that could impede a takeover or prevent us from being acquired, including, but not limited to, a classified board of directors, the elimination of our stockholders ability to take action by written consent and limitations on the ability of our stockholders to remove a director from office without cause. Our board of directors may issue additional shares of common stock or establish one or more classes or series of preferred stock with such designations, relative voting rights, dividend rates, liquidation and other rights, preferences and limitations as determined by our board of directors without stockholder approval. In addition, we adopted a stockholder rights plan in May 2003 that is designed to impede takeover transactions that are not supported by our board of directors. Each of these charter and bylaw provisions and the stockholder rights plan gives our board of directors, acting without stockholder approval, the ability to prevent, or render more difficult or costly, the completion of a takeover transaction that our stockholders might view as being in their best interests.

Unanticipated changes in our tax provisions or adverse outcomes resulting from examination of our income tax returns could adversely affect our results of operations.

We are subject to income taxes in the United States and various foreign jurisdictions. Our effective income tax rates have recently been and could in the future be adversely affected by changes in tax laws or interpretations of those tax laws, by changes in the mix of earnings in countries with differing statutory tax rates, by discovery of new information in the course of our tax return preparation process, or by changes in the valuation of our deferred tax assets and liabilities. Our effective income tax rates are also affected by intercompany transactions for licenses, services, funding and other items. Additionally, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities which may result in the assessment of additional income taxes. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. However, there can be no assurance that the outcomes from these continuous examinations will not have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

The exercise of outstanding warrants may result in dilution to our stockholders.

Dilution of the per share value of our common stock could result from the exercise of outstanding warrants. As of December 31, 2009 there was an outstanding warrant to purchase 1,602,489 shares of our common stock. The warrant has an exercise price of $2.40 per share, which at December 31, 2009 exceeded the trading price of our common stock. The warrant is exercisable for a period of five years from the date of issuance, or five years from January 2008. When the exercise price of the warrant is less than the trading price of our common stock, exercise of the warrant would have a dilutive effect on our stockholders. The possibility of the issuance of shares of our common stock upon exercise of the warrant could cause the trading price of our common stock to decline.

Furthermore, it is also possible that future large customers or suppliers, make our relationship with them contingent on receiving warrants to purchase shares of our common stock. The impact of potentially issuing additional warrants can have a dilutive effect on our stockholders.

Our stock price may be highly volatile and could decline substantially and unexpectedly, which can and has in some cases resulted in litigation.

The market price of our common stock has fluctuated substantially, and there can be no assurance that such volatility will not continue. Several factors could impact our stock price including, but not limited to:

differences between our actual operating results and the published expectations of analysts;

quarterly fluctuations in our operating results;

introduction of new products or changes in product pricing policies by our competitors or us;

conditions in the markets in which we operate;

changes in market projections by industry forecasters;

changes in estimates of our earnings by industry analysts;

overall market conditions for high technology equities;

rumors or dissemination of false information; and

general economic and geopolitical conditions.

It is often the case that securities class action litigation is brought against a company following periods of volatility in the market price of its securities. Securities litigation could result in the expenditure of substantial funds, divert management s attention and resources, harm our reputation in the industry and the securities markets and reduce our profitability.

Future sales of our common stock may hurt our market price.

As of December 31, 2009, 32% of our common stock was owned by five institutional stockholders. As a result, a substantial number of shares of our common stock may become available for resale. If these or other of our stockholders sell substantial amounts of our common stock in the

public market, the market price of our common stock could decline. These sales might also make it more difficult for us to sell equity securities in the future at times and prices that we deem appropriate.

Our system of internal controls may be inadequate.

We maintain a system of internal controls in order to ensure we are able to collect, process, summarize, and disclose the information required by the Securities and Exchange Commission within the time periods specified. Any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Due to these and other inherent limitations of

Table of Contents

control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Additionally, public companies in the United States are required to review their internal controls under the Sarbanes-Oxley Act of 2002. If the internal controls put in place by us are not adequate or fail to perform as anticipated, errors could occur that would not be detected, which could require us to restate our consolidated financial statements, receive an adverse audit opinion on the effectiveness of our internal controls, and/or take other actions that will divert significant financial and managerial resources, as well as be subject to fines and/or other government enforcement actions. Furthermore, the price of our stock could be adversely affected.

Environmental compliance costs could adversely affect our results of operations.

Many of our products are subject to various laws governing chemical substances in products, including those regulating the manufacture and distribution of chemical substances and those restricting the presence of certain substances in electronic products. We could incur substantial costs, or our products could be restricted from entering certain countries, if our products become non-compliant with environmental laws.

We face increasing complexity in our product design and procurement operations as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead and certain other substances that apply to specified electronic products put on the market in the European Union as of July 1, 2006 (Restriction of Hazardous Substances Directive, or RoHS). We design our products to ensure that they comply with these requirements as well as related requirements imposed by our OEM customers. We are also working with our suppliers to provide us with compliant materials, parts and components. If our products do not comply with the European substance restrictions, we could become subject to fines, civil or criminal sanctions, and contract damage claims. In addition, we could be prohibited from shipping non-compliant products into the European Union, and required to recall and replace any products already shipped, if such products were found to be non-compliant, which would disrupt our ability to ship products and result in reduced net revenue, increased obsolete or excess inventories and harm to our business and customer relationships. Various other countries and states in the United States have issued, or are in the process of issuing, other environmental regulations that may impose additional restrictions or obligations and require further changes to our products. These regulations could impose a significant cost of doing business in those countries and states.

The European Union has enacted the Waste Electrical and Electronic Equipment Directive, which makes producers of electrical goods financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for the individual member states of the European Union to enact the directive in their respective countries was August 13, 2004. Producers participating in the market became financially responsible for implementing these responsibilities beginning in August 2005. Similar legislation has been or may be enacted in other jurisdictions, including in the United States, Canada, Mexico, China and Japan, the cumulative impact of which could be significant.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our corporate headquarters currently occupy approximately 58,000 square feet that includes office and laboratory space located in Longmont, Colorado. This facility includes administration, research and development, sales and marketing and operations functions. The expiration date of the lease is January 2013.

We also lease approximately 58,500 square feet in Carlsbad, California, under a lease that expires in April 2013. This facility includes administration, research and development and operations functions. As part of our restructuring activities, we have consolidated a portion of our Carlsbad, California facility into our Longmont,

Table of Contents

Colorado facility. As of December 31, 2009, we were not utilizing approximately 76% of the Carlsbad facility. For additional information regarding our restructuring activities see Note 6 of the Notes to Consolidated Financial Statements.

We lease approximately 7,300 square feet of office space located in Plymouth, Minnesota, under a lease that expires October 2011. We use this office space as a research and development facility for our RAIDCore software.

In addition, we lease other international office space in countries such as: Israel, Germany, Japan, China, Singapore and the United Kingdom primarily for research and development and sales and marketing functions.

Our existing leased facilities are appropriate for our current needs, although additional office space may be needed in the Longmont, Colorado area in the near future. We do not own any real estate.

Item 3. ***Legal Proceedings***

Dot Hill Securities Class Actions, Derivative Suits and Direct State Securities Action

In late January and early February 2006, numerous purported class action complaints were filed against us in the United States District Court for the Southern District of California. The complaints allege violations of federal securities laws related to alleged inflation in our stock price in connection with various statements and alleged omissions to the public and to the securities markets and declines in our stock price in connection with the restatement of certain of our quarterly financial statements for fiscal year 2004, and seeking damages therefore. The complaints were consolidated into a single action, and the Court appointed as lead plaintiff a group comprised of the Detroit Police and Fire Retirement System and the General Retirement System of the City of Detroit. The consolidated complaint was filed on August 25, 2006, and we filed a motion to dismiss on October 5, 2006. The Court granted our motion to dismiss on March 15, 2007. Plaintiffs filed their Second Amended Consolidated Complaint on April 20, 2007. We filed a motion to dismiss the Second Amended Consolidated Complaint on May 1, 2008, which the Court granted on September 2, 2008. The plaintiffs subsequently filed a Third Amended Consolidated Complaint on October 10, 2008, and on November 24, 2008 we filed a motion to dismiss. On March 18, 2009, the Court dismissed the Third Amended Consolidated Complaint, but granted plaintiffs leave to amend one more time. On April 17, 2009, plaintiffs filed a Notice of Appeal regarding the Court s September 2, 2008 and March 18, 2009 orders. On May 19, 2009, the Court entered final judgment and dismissed the action with prejudice. The plaintiffs subsequently filed an Amended Notice of Appeal on June 8, 2009. On October 29, 2009, the parties filed a Stipulation of Dismissal of Appeal. On October 30, 2009, the appeal was dismissed.

In addition, three complaints purporting to be derivative actions were filed in California state court against certain of our directors and executive officers. These complaints are based on the same facts and circumstances described in the federal class action complaints and generally allege that the named directors and officers breached their fiduciary duties by failing to oversee adequately our financial reporting. Each of the complaints generally seeks an unspecified amount of damages. Our demurrers to two of those cases, in which we sought dismissal, were overruled (i.e., denied). We formed a Special Litigation Committee, or SLC, of disinterested directors to investigate the alleged wrongdoing. On January 12, 2007, another derivative action similar to the previous derivative actions with the addition of allegations regarding purported stock option backdating was served on us. In April 2007, the SLC concluded its investigation and based on its findings directed us to file a motion to dismiss the derivative matters. On July 13, 2007, all of the derivative actions were consolidated for pre-trial proceedings. We filed a motion to dismiss the consolidated matters pursuant to the SLC s directive on May 30, 2008. The hearing on this motion is set for May 14, 2010. The outcome of this action is uncertain, and no amounts have been accrued as of December 31, 2009.

The pending proceedings involve complex questions of fact and law and will require the expenditure of significant funds and the diversion of other resources to prosecute and defend. The results of legal proceedings

Table of Contents

are inherently uncertain and material adverse outcomes are possible. From time to time we may enter into confidential discussions regarding the potential settlement of pending litigation or other proceedings. However, there can be no assurance that any such discussions will occur or will result in a settlement. The settlement of any pending litigation or other proceedings could require us to incur substantial settlement payments and costs.

Other Litigation

We may be involved in certain other legal actions and claims from time to time arising in the ordinary course of business. Management believes that the outcome of such other litigation and claims will likely not have a material adverse effect on our financial condition or results of operations.

Item 4. ***(Removed and Reserved)***

Table of Contents

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Our common stock is currently included for quotation on the Nasdaq Global Market and is currently traded under the symbol HILL.

The following table sets forth for the periods indicated the per share range of the high and low sales prices of our common stock as reported on the Nasdaq Global Market.

	Low	High
Year Ended December 31, 2008		
First Quarter	$ 2.38	$ 4.05
Second Quarter	2.39	3.48
Third Quarter	1.84	2.89
Fourth Quarter	0.46	2.05
Year Ended December 31, 2009		
First Quarter	0.40	1.00
Second Quarter	0.56	1.50
Third Quarter	0.63	1.90
Fourth Quarter	1.48	2.83

On March 8, 2010 the last reported sale price for our common stock on the Nasdaq Global Market was $1.42 per share. As of March 8, 2010 there were 54,367,653 shares of our common stock outstanding held by approximately 110 holders of record. We have never paid any cash dividends on our common stock, and currently intend to retain future earnings, if any, to the extent possible to fund the development and growth of our business. We do not anticipate paying any cash dividends on our common stock in the foreseeable future.

The information required to be disclosed by item 201(d) of Regulation S-K, *Securities Authorized for Issuance Under Equity Compensation Plans,* is included under Item 12 of Part III of this annual report on Form 10-K.

Table of Contents

PERFORMANCE MEASUREMENT COMPARISON

The following graph compares the cumulative 5-year total return provided stockholders on our common stock relative to the cumulative total returns of the S&P 500 Index, the Nasdaq Composite Index and the Nasdaq Computer Index. An investment of $100 (with reinvestment of all dividends) is assumed to have been made in our common stock and in each index on December 31, 2004 and its relative performance is tracked through December 31, 2009.

COMPARISON OF CUMULATIVE TOTAL RETURN FOR

THE FIVE YEAR PERIOD ENDED DECEMBER 31, 2009

Table of Contents

Item 6. ***Selected Financial Data***

We derived the selected consolidated financial data presented below from our audited consolidated financial statements for the years ended December 31, 2007, 2008 and 2009, which are included elsewhere in this annual report on Form 10-K. Statement of operations data for the years ended December 31, 2005 and 2006 and balance sheet data as of December 31, 2005, 2006 and 2007 have been derived from our audited consolidated financial statements not included herein. All data are in thousands except per share data. You should read the selected consolidated financial data together with our consolidated financial statements and related disclosures thereto and with Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this annual report on Form 10-K.

	2005	2006	2007	2008	2009
Statement of Operations Data:					
Net revenue	$ 233,799	$ 239,217	$ 207,095	$ 272,879	$ 234,383
Cost of goods sold	180,196	202,561	180,662	242,491	196,556
Gross profit	53,603	36,656	26,433	30,388	37,827
Operating expenses:					
Sales and marketing	19,120	15,996	15,939	13,878	10,970
Research and development	23,628	36,529	22,564	28,709	28,120
General and administrative	12,933	18,119	12,606	12,779	10,139
Legal settlement		3,395		(4,036)	
Goodwill and long-lived asset impairment charge(1)(5)			40,725	5,432	
Restructuring charge(4)				813	2,430
Operating loss	(2,078)	(37,383)	(65,401)	(27,187)	(13,832)
Other income, net	3,478	5,496	4,996	1,612	167
Income tax (benefit) expense(2)	(25,197)	48,885	(177)	190	(40)
Net income (loss)	$ 26,597	$ (80,772)	$ (60,228)	$ (25,765)	$ (13,625)
Net income (loss) attributable to common stockholders	$ 26,597	$ (80,772)	$ (60,228)	$ (25,765)	$ (13,625)
Net income (loss) per share:					
Basic(3)	$ 0.61	$ (1.80)	$ (1.32)	$ (0.56)	$ (0.29)
Diluted(3)	$ 0.58	$ (1.80)	$ (1.32)	$ (0.56)	$ (0.29)
Weighted average shares outstanding:					
Basic	43,903	44,757	45,534	46,136	47,094
Diluted	45,639	44,757	45,534		