MEDTRONIC INC
Form DEF 14A
July 20, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant þ
Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
þ Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

Medtronic, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ No fee required.
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1) Title of each class of securities to which transaction applies:

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3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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710 Medtronic Parkway
Minneapolis, Minnesota 55432
Telephone: 763-514-4000

July 20, 2007

Dear Shareholder:

Please join us for our Annual Meeting of Shareholders on Thursday, August 23, 2007, at 10:30 a.m. (Central Daylight Time) at Medtronic s World Headquarters, 710 Medtronic Parkway, Minneapolis (Fridley), Minnesota.

The enclosed Notice of Annual Meeting of Shareholders and Proxy Statement describe the business to be conducted at the meeting. We also will report on matters of current interest to our shareholders.

We invite you to join us beginning at 9:30 a.m. to view Medtronic s interactive product displays. Product specialists will be available to answer your questions before and after the Annual Meeting.

Your vote is important. Whether you own a few shares or many, it is important that your shares are represented. If you cannot attend the Annual Meeting in person, you may vote your shares by internet or by telephone, or by completing and signing the accompanying proxy card and promptly returning it in the envelope provided.

We look forward to seeing you at the Annual Meeting.

Sincerely,

Arthur D. Collins, Jr.
Chairman of the Board and Chief Executive Officer

Alleviating Pain, Restoring Health, Extending Life

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MEDTRONIC, INC.
NOTICE OF ANNUAL MEETING
OF SHAREHOLDERS

TIME	10:30 a.m. (Central Daylight Time) on Thursday, August 23, 2007.
PLACE	Medtronic World Headquarters 710 Medtronic Parkway Minneapolis (Fridley), Minnesota 55432
ITEMS OF BUSINESS	1. To elect four Class III directors for three-year terms. 2. To ratify the appointment of PricewaterhouseCoopers LLP as Medtronic s independent registered public accounting firm. 3. To amend Medtronic s restated articles of incorporation to provide for the annual election of all directors. 4. To consider such other business as may properly come before the Annual Meeting and any adjournment thereof.
RECORD DATE	You may vote at the Annual Meeting if you were a shareholder of record at the close of business on June 25, 2007.
VOTING BY PROXY	If you cannot attend the Annual Meeting, you may vote your shares over the internet or by telephone, or by completing and promptly returning the enclosed proxy card in the envelope provided. Internet and telephone voting procedures are on your proxy card.
ANNUAL REPORT	Medtronic s 2007 Annual Report accompanies this Notice of Annual Meeting of Shareholders.

By Order of the Board of Directors,

Terrance L. Carlson
Corporate Secretary

This Notice of Annual Meeting, Proxy Statement and accompanying proxy card are being distributed on or about July 20, 2007.

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710 Medtronic Parkway
Minneapolis, Minnesota 55432
Telephone: 763-514-4000

PROXY STATEMENT
Annual Meeting of Shareholders
August 23, 2007

We are providing these proxy materials in connection with the solicitation by the Board of Directors of Medtronic, Inc. (Medtronic) of proxies to be voted at Medtronic s Annual Meeting of Shareholders to be held on August 23, 2007, and at any adjournment of the meeting.

GENERAL INFORMATION ABOUT THE MEETING AND VOTING

What am I voting on?

There are three proposals scheduled to be voted on at the meeting:

- Election of four directors;
- Ratification of the appointment of PricewaterhouseCoopers LLP as Medtronic s independent registered public accounting firm for fiscal year 2008; and
- Amendment of Medtronic s restated articles of incorporation to provide for the annual election of all directors.

Who is entitled to vote?

Shareholders as of the close of business on June 25, 2007 (the Record Date), may vote at the Annual Meeting. You have one vote for each share of common stock you held on the Record Date, including shares:

- Held directly in your name as shareholder of record (also referred to as registered shareholder);
- Held for you in an account with a broker, bank or other nominee (shares held in street name). Street name holders generally cannot vote their shares directly and must instead instruct the brokerage firm, bank or nominee how to vote their shares; and
- Credited to your account in Medtronic s Employee Stock Ownership and Supplemental Retirement Plan.

What constitutes a quorum?

A majority of the outstanding shares entitled to vote, present or represented by proxy, constitutes a quorum for the Annual Meeting. Abstentions are counted as present and entitled to vote for purposes of determining a quorum. Shares represented by broker non-votes (see below) are also counted as present and entitled to vote for purposes of determining a quorum. On the Record Date, 1,139,865,406 shares of Medtronic common stock were outstanding and

entitled to vote.

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How many votes are required to approve each proposal?

The following explains how many votes are required to approve each proposal, provided that a majority of our shares is present at the Annual Meeting (in person or by proxy). The four candidates for election who receive a plurality vote in the affirmative will be elected. Ratifying PricewaterhouseCoopers LLP as Medtronic s independent registered public accounting firm for fiscal year 2008 requires the affirmative vote of a majority of the shares present. Amending our restated articles of incorporation requires the affirmative vote of not less than seventy-five percent of the votes entitled to be cast by all holders of shares of our common stock.

How are votes counted?

You may either vote FOR or WITHHOLD authority to vote for each nominee for the Board of Directors. You may vote FOR, AGAINST or ABSTAIN on the other proposals. If you abstain from voting on any of the other proposals, i has the same effect as a vote against the proposal. If you just sign and submit your proxy card without voting instructions, your shares will be voted FOR each director nominee and FOR or AGAINST the other proposals as recommended by the Board.

What is a broker non-vote?

If you hold your shares in street name and do not provide voting instructions to your broker, your shares will not be voted on any proposal on which your broker does not have discretionary authority to vote (a broker non-vote). Shares held by brokers who do not have discretionary authority to vote on a particular matter and who have not received voting instructions from their customers are counted as present for the purpose of determining whether there is a quorum at the Annual Meeting, but are not counted or deemed to be present or represented for the purpose of determining whether shareholders have approved that matter.

How does the Board recommend that I vote?

Medtronic s Board recommends that you vote your shares:

FOR each of the nominees to the Board;

FOR the ratification of the appointment of PricewaterhouseCoopers LLP as Medtronic s independent registered public accounting firm for fiscal year 2008; and

FOR amending Medtronic s restated articles of incorporation to provide for the annual election of all directors.

How do I vote my shares without attending the meeting?

If you are a shareholder of record or hold shares through a Medtronic stock plan, you may vote by granting a proxy. For shares held in street name, you may vote by submitting voting instructions to your broker or nominee. In any circumstance, you may vote:

By Internet or Telephone If you have internet or telephone access, you may submit your proxy by following the voting instructions on the proxy card. If you vote by internet or telephone, you need not return your proxy card.

By Mail You may vote by mail by signing and dating your proxy card and mailing it in the envelope provided. You should sign your name exactly as it appears on the proxy card. If you are signing in a representative

capacity (for example, as guardian, executor, trustee, custodian, attorney or officer of a corporation), you should indicate your name and title or capacity.

Internet and telephone voting facilities will close at 11:59 p.m., Eastern Daylight Time, on August 22, 2007.

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How do I vote my shares in person at the meeting?

If you are a shareholder of record and prefer to vote your shares at the meeting, bring the enclosed proxy card or proof of identification. You may vote shares held in street name only if you obtain a signed proxy from the record holder (broker or other nominee) giving you the right to vote the shares.

Even if you plan to attend the meeting, we encourage you to vote in advance by internet, telephone or mail so that your vote will be counted even if you are unable to attend the meeting.

What does it mean if I receive more than one proxy card?

It generally means you hold shares registered in more than one account. To ensure that all your shares are voted, sign and return each proxy card or, if you vote by internet or telephone, vote once for each proxy card you receive.

May I change my vote?

Yes. Whether you have voted by mail, internet or telephone, you may change your vote and revoke your proxy by:

Sending a written statement to that effect to the Corporate Secretary of Medtronic;

Voting by internet or telephone at a later time;

Submitting a properly signed proxy card with a later date; or

Voting in person at the Annual Meeting.

Can I receive future proxy materials electronically?

Yes. If you are a shareholder of record or hold shares through a Medtronic stock plan, you may elect to receive future proxy statements and annual reports online as described in the next paragraph. If you elect this feature, you will receive an email message notifying you when the materials are available, along with a web address for viewing the materials. If you received this proxy statement electronically, you do not need to do anything to continue receiving proxy materials electronically in the future.

Whether you hold shares registered directly in your name, through a Medtronic stock plan, or through a broker or bank, you can enroll for future delivery of proxy statements and annual reports by following these easy steps:

Go to our website at **www.medtronic.com**;

Under **About Medtronic**, click on **Investor Relations**;

In the **Shareholder Services** section, click on **Electronic Delivery of Proxy Materials**; and

Follow the prompts to submit your electronic consent.

Generally, brokers and banks offering this choice require that shareholders vote through the internet in order to enroll. Street name shareholders whose broker or bank is not included in this website are encouraged to contact their broker or bank and ask about the availability of electronic delivery. As with all internet usage, the user must pay all access fees and telephone charges. You may view this year s proxy materials at **www.medtronic.com/annualmeeting**.

What are the costs and benefits of electronic delivery of Annual Meeting materials?

There is no cost to you for electronic delivery. You may incur the usual expenses associated with internet access as charged by your internet service provider. Electronic delivery ensures quicker delivery, allows you to print the materials at your computer and makes it convenient to vote your shares online. Electronic delivery also saves Medtronic significant printing, postage and processing costs.

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PROPOSAL 1 ELECTION OF DIRECTORS

Directors and Nominees

The Board of Directors is divided into three classes of approximately equal size. The members of each class are elected to serve a three-year term with the term of office for each class ending in consecutive years. David L. Calhoun, Arthur D. Collins, Jr., James T. Lenehan and Kendall J. Powell are the Class III directors who have been nominated for re-election to the Board to serve until the 2010 Annual Meeting and until their successors are elected and qualified. All of the nominees are currently directors, and Mr. Collins was previously elected to the Board of Directors by the shareholders. Mr. Lenehan was elected to the Board by the Board of Directors in January 2007, and Messrs. Calhoun and Powell were elected to the Board by the Board of Directors in June 2007.

All of the nominees have consented to being named as a nominee in this Proxy Statement and have indicated a willingness to serve if elected. However, if any nominee becomes unable to serve before the election, the shares represented by proxies may be voted for a substitute designated by the Board, unless a contrary instruction is indicated on the proxy.

A plurality of votes cast is required for the election of directors. However, under the Medtronic Principles of Corporate Governance, any nominee for director in an uncontested election (i.e., an election where the only nominees are those recommended by the Board of Directors) who receives a greater number of votes withheld from his or her election than votes for such election (a Majority Withheld Vote) will, within five business days of the certification of the shareholder vote by the inspector of elections, tender a written offer to resign from the Board of Directors. The Corporate Governance Committee will promptly consider the resignation offer and recommend to the Board of Directors whether to accept it. The Corporate Governance Committee will consider all factors its members deem relevant in considering whether to recommend acceptance or rejection of the resignation offer, including, without limitation:

- the perceived reasons why shareholders withheld votes for election from the director;
- the length of service and qualifications of the director;
- the director s contributions to Medtronic;
- Medtronic s compliance with securities exchange listing standards;
- possible contractual ramifications in the event the director in question is a management director;
- the purpose and provisions of the Medtronic Principles of Corporate Governance; and
- the best interests of Medtronic and its shareholders.

If a director s resignation is accepted, the Corporate Governance Committee will recommend to the Board of Directors whether to fill the vacancy on the Board created by the resignation or reduce the size of the Board. Any director who tenders his or her offer to resign pursuant to this policy shall not participate in the Corporate Governance Committee or Board deliberations regarding whether to accept the offer of resignation. The Board will act on the Corporate Governance Committee s recommendation within 90 days following the certification of the shareholder vote, which may include, without limitation:

acceptance of the offer of resignation;

adoption of measures intended to address the perceived issues underlying the Majority Withheld Vote; or

rejection of the resignation offer.

Thereafter, the Board of Directors will disclose its decision to accept the resignation offer or the reasons for rejecting the offer, if applicable, on a Current Report on Form 8-K to be filed with the Securities and Exchange Commission within four business days of the date of the Board s final determination.

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NOMINEES FOR DIRECTOR FOR THREE-YEAR TERMS ENDING IN 2010 (CLASS III):

DAVID L. CALHOUN Director since 2007
Chairman and Chief Executive Officer age 50
The Nielsen Company

Mr. Calhoun was appointed Chairman of the Executive Board and Chief Executive Officer of The Nielsen Company on August 23, 2006. Prior to joining The Nielson Company, Mr. Calhoun served as Vice Chairman of General Electric Company and President & Chief Executive Officer, GE Infrastructure. Before that, Mr. Calhoun served as President and Chief Executive Officer of GE Aircraft Engines; President and Chief Executive Officer of Employers Reinsurance Corporation; President and Chief Executive Officer of GE Lighting; President and Chief Executive Officer of GE Transportation Systems; and Chief Executive Officer of GE Transportation.

ARTHUR D. COLLINS, Jr. Director since 1994
Chairman of the Board and Chief Executive Officer age 59
Medtronic, Inc.

Mr. Collins has been Chairman of the Board and Chief Executive Officer of Medtronic since April 2002; President and Chief Executive Officer from May 2001 to April 2002; President and Chief Operating Officer from August 1996 to April 2001; Chief Operating Officer from January 1994 to August 1996; and Executive Vice President of Medtronic and President of Medtronic International from June 1992 to January 1994. He was Corporate Vice President of Abbott Laboratories from October 1989 to May 1992 and Divisional Vice President of that company from May 1984 to October 1989. He is also a director of The Boeing Company, U.S. Bancorp and Cargill, Inc., a member of the Board of Overseers of The Wharton School at the University of Pennsylvania and a member of the board of The Institute of Health Technology Studies. At the Annual Meeting, Mr. Collins is expected to resign as Chief Executive Officer of Medtronic and continue as Chairman of the Board of Medtronic.

JAMES T. LENEHAN Director since 2007
Financial Consultant and Retired Vice Chairman and age 58
President of Johnson & Johnson

Mr. Lenehan served as President of Johnson & Johnson from 2002 until March 2004 after 28 years of service; Vice Chairman of Johnson & Johnson from August 2000 until June 2004; Worldwide Chairman of Johnson & Johnson s Medical Devices and Diagnostics Group from 1999 until he became Vice Chairman of the Board; and was previously Worldwide Chairman, Consumer Pharmaceuticals & Professional Group. Mr. Lenehan has been a financial consultant since October 2004.

KENDALL J. POWELL Director since 2007
President and Chief Operating Officer age 53
General Mills

Mr. Powell has been President and Chief Operating Officer and a director of General Mills since June 2006. Prior to that Mr. Powell was Executive Vice President and Chief Operating Officer; U.S. Retail from May 2005 to June 2006; Executive Vice President of General Mills from August 2004 to May 2005. From September 1999 to August 2004, Mr. Powell was Chief Executive Officer of Cereal Partners Worldwide. Mr. Powell joined General Mills in 1979. Mr. Powell also serves on the boards of Cereal Partners Worldwide, the Twin Cities United Way and the Minnesota Historical Society.

THE BOARD RECOMMENDS A VOTE FOR THE CLASS III NOMINEES.

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DIREC TORS CONTINUING IN OFFICE AFTER THE 2007 ANNUAL MEETING:
CLASS II DIRECTORS CONTINUING IN OFFICE UNTIL 2009

RICHARD H. ANDERSON Director since 2002
Executive Vice President age 52
UnitedHealth Group Incorporated

Mr. Anderson has been Executive Vice President of UnitedHealth Group and President, Commercial Services Group, of UnitedHealth Group Incorporated since December 2006, was Executive Vice President of UnitedHealth Group since November 2004 and was Chief Executive Officer of its Ingenix subsidiary from December 2004. Mr. Anderson was Chief Executive Officer of Northwest Airlines Corporation and its principal subsidiary, Northwest Airlines, from February 2001 to November 2004. Mr. Anderson serves on the Board of Directors of Cargill, Inc. and Delta Airlines, Inc. Northwest filed for bankruptcy in September 2005, which is within two years of Mr. Anderson serving as an executive officer of Northwest.

ROBERT C. POZEN Director since 2004
Chairman, MFS Investment Management age 60

Mr. Pozen has been Chairman of MFS Investment Management and a director of MFS Mutual Funds since February 2004 and previously was Secretary of Economic Affairs for the Commonwealth of Massachusetts from January 2003 to December 2003. Mr. Pozen was also John Olin Visiting Professor, Harvard Law School, from 2002 to 2003; Vice Chairman of Fidelity Investments from June 2000 to December 2001 and President of Fidelity Management & Research from April 1997 to December 2001. He is also a director of BCE Inc., the parent company of Bell Canada.

CLASS I DIRECTORS CONTINUING IN OFFICE UNTIL 2008

WILLIAM A. HAWKINS Director since 2007
President and Chief Operating Officer age 53
Medtronic, Inc.

Mr. Hawkins has been a Director of Medtronic since March 2007 and President and Chief Operating Officer of Medtronic since May 2004. He served as Senior Vice President and President, Medtronic Vascular, from January 2002 to May 2004. He served as President and Chief Executive Officer of Novoste Corporation from 1998 to 2002. Mr. Hawkins serves on the board of Deluxe Corporation, the board of trustees for the University of Virginia Darden School of Business and the board of visitors for the Duke University School of Engineering. At the Annual Meeting, Mr. Hawkins is expected to be named President and Chief Executive Officer of Medtronic.

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SHIRLEY ANN JACKSON, Ph.D. Director since 2002
President of Rensselaer Polytechnic Institute age 60

Dr. Jackson has been President of Rensselaer Polytechnic Institute since July 1999. She was Chair of the U.S. Nuclear Regulatory Commission from July 1995 to July 1999; and Professor of Physics at Rutgers University and consultant to AT&T Bell Laboratories from 1991 to 1995. She is a member of the National Academy of Engineering and the American Philosophical Society and is a Fellow of the American Academy of Arts and Sciences, the American Association for the Advancement of Science, and of the American Physical Society. She is a trustee of the Brookings Institution, a Life Trustee of M.I.T. and a member of the Council on Foreign Relations. She is also a director of NYSE Euronext, Federal Express Corporation, Marathon Oil Corporation, Public Service Enterprise Group, and International Business Machines Corporation.

DENISE M. O LEARY Director since 2000
Private Venture Capital Investor age 50

Ms. O Leary has been a private venture capital investor in a variety of early stage companies since 1996. Ms. O Leary is also a director of US Airways Group, Inc. She is a director of Stanford Hospitals and Clinics, where she was chair of the board from 2000 through 2005, and Lucile Packard Children s Hospital. She was a member of the Stanford University Board of Trustees from 1996 through 2006, where she chaired the Committee of the Medical Center for that period.

JEAN-PIERRE ROSSO Director since 1998
Chairman, World Economic Forum USA Inc. age 67

Mr. Rosso has been Chairman of World Economic Forum USA Inc. since April 2006. Mr. Rosso served as Chairman of CNH Global N.V. from November 1999 until his retirement in May 2004; was Chief Executive Officer of CNH Global N.V. from November 1999 to November 2000; and Chief Executive Officer of Case Corporation from April 1994 to November 1999 and Chairman from March 1996 to November 1996. He is also a director of ADC Telecommunications, Inc., Bombardier Inc., and Eurazeo.

JACK W. SCHULER Director since 1990
Chairman of the Board of Stericycle, Inc. and age 66
Ventana Medical Systems, Inc.

Mr. Schuler has been Chairman of the Board of Stericycle, Inc. since March 1990 and Chairman of the Board of Ventana Medical Systems, Inc. since November 1995; President and Chief Operating Officer of Abbott Laboratories from January 1987 to August 1989; and a director of that company from April 1985 to August 1989. Mr. Schuler is a director of Quidel Corporation.

Director Independence

Under the New York Stock Exchange Corporate Governance Rules, to be considered independent, a director must be determined to have no material relationship with Medtronic other than as a director. The Board of Directors has determined that the following directors, comprising all of our non-management directors, are independent under the New York Stock Exchange Corporate Governance Rules: Messrs. Anderson, Bonsignore, Calhoun, Lenehan, Powell, Pozen, Rosso, Schuler and Sprenger, Drs. Brody and Jackson and Ms. O Leary. In making this determination, the Board considered its Director Independence Standards, which correspond to the New York Stock Exchange standards on independence. These standards identify types of relationships that are categorically immaterial and do not, by

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themselves, preclude the directors from being independent. The types of relationships and the directors who had such relationships include:

having an immediate family member who is, or has recently been, employed by Medtronic other than as an executive officer (Messrs. Schuler and Sprenger);

being a current employee of an entity that has made payments to, or received payments from, Medtronic for property or services (Messrs. Anderson and Schuler and Drs. Brody and Jackson); and

being, or having a spouse who is, an employee of a non-profit organization to which Medtronic or The Medtronic Foundation has made contributions (Dr. Brody).

All of the relationships of the types listed above were entered into, and payments were made or received, by Medtronic in the ordinary course of business and on competitive terms. Aggregate payments to, transactions with or discretionary charitable contributions to each of the relevant organizations did not exceed the greater of $1 million or 2% of that organization s consolidated gross revenues for fiscal years 2005, 2006 or 2007, whichever is greater.

In addition, the Board considered relationships consistent with its Director Independence Standards in which the director was not an employee or executive officer, but had a further removed relationship with the relevant third party, such as being a director of a vendor to Medtronic or a purchaser of Medtronic s products. The Board of Directors determined that none of the relationships were material. All of the relationships were entered into, and payments were made or received, by Medtronic in the ordinary course of business and on competitive terms. Aggregate payments to, transactions with or discretionary charitable contributions to each of the relevant organizations did not exceed the greater of $1 million or 2% of that organization s consolidated gross revenues for fiscal years 2005, 2006 or 2007, whichever is greater.

Medtronic also has a minority investment in, and a development and license agreement with, a company that has granted Medtronic a sublicense to certain intellectual property of The John Hopkins University. In addition, one of the founders of that company is a professor at The John Hopkins University. The Board determined that this relationship is not a material relationship. There were no revenues generated relating to the development and license agreement in fiscal year 2007 and none are expected in fiscal year 2008, and Medtronic did not pay any royalties to John Hopkins University under the sublicense in fiscal year 2007 and does not expect to pay any in fiscal year 2008. John Hopkins University is not a shareholder of the company in which Medtronic has invested, and Dr. Brody did not participate in negotiations or approvals regarding the investment or agreement.

Mr. Pozen is Chairman of MFS Investment Management, which manages money for MFS mutual funds and other accounts, and which may from time to time buy or sell Medtronic stock. The Board determined that this relationship is not material. Mr. Pozen has no involvement with these transactions and there is an informational barrier between him and the rest of MFS with regard to Medtronic stock.

The Board noted that a number of lawsuits had been filed on behalf of third party payers asserting that Medtronic should pay certain costs related to Medtronic s voluntary field action involving certain of its Marquis and Maximo ICDs and InSync and Marquis CRT-D devices, and that such suits purport to include UnitedHealth Group (UHG) in the plaintiff class. UHG s Ingenix subsidiary has corresponded with the plaintiffs counsel in these actions regarding, among other things, UHG s intention to opt out of the putative class action cases. In July 2006, Medtronic and UHG entered into a tolling agreement pursuant to which UHG has agreed not to commence legal action against Medtronic for any claim relating to any medical device manufactured by Medtronic until 30 days following final disposition (by judicial resolution or settlement) of any individual patient litigation matter or matters against Medtronic for which UHG may have a right of subrogation. Either party may terminate the tolling period upon 145 days written notice.

Mr. Anderson has informed Medtronic that there is an informational barrier between him and UHG with respect to these potential claims. Also, Mr. Anderson does not receive from Medtronic any material, nonpublic information relating to the potential claims. As a result, the Board determined that the potential claims of UHG do not create a material relationship between Mr. Anderson and Medtronic at this time.

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Certain Relationships and Related Transactions

In January 2007, the Board of Directors of Medtronic adopted written related party transaction policies and procedures. The policies require that all interested transactions (as defined below) between Medtronic and related parties (as defined below) are subject to approval or ratification by the Corporate Governance Committee. In determining whether to approve or ratify such transactions, the Corporate Governance Committee will take into account, among other factors it deems appropriate, whether the interested transaction is on terms no less favorable than terms generally available to an unaffiliated third-party under the same or similar circumstances and the extent of the related person s interest in the transaction. In addition, the Corporate Governance Committee has reviewed a list of interested transactions and deemed them to be pre-approved or ratified. Also, the Board of Directors has delegated to the chair of the Corporate Governance Committee the authority to pre-approve or ratify any interested transaction in which the aggregate amount is expected to be less than $1 million. Finally, the policies provide that no director shall participate in any discussion or approval of an interested transaction for which he or she is a related party, except that the director shall provide all material information concerning the interested transaction to the Corporate Governance Committee.

Under the policies, an interested transaction is defined as any transaction, arrangement or relationship or series of similar transactions, arrangements or relationships (including any indebtedness or any guarantee of indebtedness) in which:

- the aggregate amount involved will or may be expected to exceed $100,000 in any fiscal year;
- Medtronic is a participant; and
- any related party has or will have a direct or indirect interest (other than solely as a result of being a director or a less than ten percent beneficial owner of another entity).

A related party is defined as any:

- person who is or was (since the beginning of the last fiscal year for which Medtronic has filed a Form 10-K and proxy statement, even if they do not presently serve in that role) an executive officer, director or nominee for election as a director;
- greater than five percent beneficial owner of Medtronic s common stock; or
- immediate family member of any of the foregoing.

During fiscal year 2007, Tino Schuler, a son of director Jack W. Schuler, was employed by Medtronic as a director of marketing in the Medtronic Xomed business. Mr. Tino Schuler worked for Xomed beginning in August 1993, and Xomed was acquired by Medtronic in 1999. Mr. Tino Schuler was paid an aggregate salary and bonus of $206,774 for his services during fiscal year 2007. Director Gordon M. Sprenger s son, Michael G. Sprenger, also worked as a director of marketing for Medtronic during fiscal year 2007, receiving an aggregate salary and bonus of $182,262. Mr. Michael Sprenger has been a Medtronic employee since May 1989, prior to his father s initial election to Medtronic s Board in September 1991. Both Mr. Tino Schuler and Mr. Michael Sprenger received in fiscal year 2007, in addition to their salaries and bonuses, the standard benefits provided to other Medtronic employees. Neither Mr. Tino Schuler nor Mr. Michael Sprenger is an executive officer of Medtronic, and these transactions are deemed under the Board of Directors written related party transaction policies as being pre-approved.

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GOVERNANCE OF MEDTRONIC

Our Corporate Governance Principles

The Board of Directors first adopted Principles of Corporate Governance (the Governance Principles) in fiscal 1996 and has revised these Governance Principals from time to time, including to comply with New York Stock Exchange Corporate Governance Rules. The Governance Principles describe Medtronic s corporate governance practices and policies, and provide a framework for the governance of Medtronic. Among other things, the Governance Principles provide that:

A majority of the members of the Board must be independent directors and no more than three directors may be Medtronic employees. Currently two directors, Medtronic s Chairman and Chief Executive Officer and its President and Chief Operating Officer, are not independent.

Medtronic maintains Audit, Compensation, Corporate Governance and Technology and Quality Committees, which consist entirely of independent directors.

The Corporate Governance Committee, which consists of all the independent directors on the Board, oversees an annual evaluation of the Board and its committees. The Nominating Subcommittee of the Corporate Governance Committee evaluates the performance of each director whose term is expiring based on criteria set forth in the Governance Principles.

Our Governance Principles, the charters of our Audit, Compensation, Corporate Governance and Technology and Quality Committees and our codes of conduct are published on our website at **www.medtronic.com** under the **Corporate Governance** caption. These materials are available in print to any shareholder upon request. From time to time the Board reviews and updates these documents as it deems necessary and appropriate.

Lead Director; Executive Sessions

The Chair of our Corporate Governance Committee, Mr. Rosso, is our designated Lead Director and presides as the chair at meetings of the independent directors. Six regular meetings of our Board are held each year and at each Board meeting our independent directors meet in executive session with no company management present.

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Committees of the Board and Meetings

Our four standing Board committees Audit, Compensation, Corporate Governance and Technology and Quality consist solely of independent directors, as defined in the New York Stock Exchange Corporate Governance Rules. Each director attended 75% or more of the total meetings of the Board and Board committees on which the director served in fiscal year 2007. The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The following table summarizes the current membership of the Board and each of its standing committees and the number of times each standing committee met during fiscal year 2007.

	Board	Audit	Compensation	Corporate Governance	Technology and Quality
Mr. Anderson	X		Chair	X	
Mr. Bonsignore	X	Chair	X	X	
Dr. Brody	X			X*	Chair
Mr. Calhoun	X	X		X	X
Mr. Collins	Chair				
Mr. Hawkins	X				
Dr. Jackson	X			X*	X
Mr. Lenehan	X			X	X
Ms. O Leary	X	X		X*	
Mr. Powell	X		X	X	X
Mr. Pozen	X	X		X	X
Mr. Rosso	X	X	X	Chair*	
Mr. Schuler	X	X	X	X*	
Mr. Sprenger	X		X	X	X
Number of fiscal year 2007 meetings	7	13	3	5	3

* Denotes member of Nominating Subcommittee, which met five times in fiscal year 2007.

Effective August 23, 2007, Ms. O Leary will serve as chair of the Audit Committee and Dr. Jackson will serve as chair of the Technology and Quality Committee. Messrs. Bonsignore and Sprenger and Dr. Brody are expected to retire at the 2007 Annual Meeting.

The Board has four standing committees, the Audit Committee, the Compensation Committee, the Corporate Governance Committee, and the Technology and Quality Committee, with each of their principal functions described below.

Audit Committee

Oversees the integrity of Medtronic s financial reporting

Oversees the independence, qualifications and performance of Medtronic s independent registered public accounting firm and the performance of Medtronic s internal auditors

Oversees Medtronic s compliance with legal and regulatory requirements

Reviews annual financial statements with management and Medtronic s independent registered public accounting firm and recommends to the Board whether the financial statements should be included in our Annual Report on Form 10-K

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Reviews and discusses with management and Medtronic s independent registered public accounting firm quarterly financial statements and discusses with management Medtronic s earnings press releases

Reviews major changes to Medtronic s accounting and auditing principles and practices

Hires the firm to be appointed as Medtronic s independent registered public accounting firm that reports directly to the Audit Committee

Pre-approves all audit and permitted non-audit services to be provided by the independent registered public accounting firm

Reviews the scope of the annual audit and internal audit programs and the results of the annual audit examination

Reviews, at least annually, a report by the independent registered public accounting firm describing its internal quality-control procedures and any issues raised by the most recent internal quality-control review

Meets periodically with management to review Medtronic s major financial and business risk exposures and steps taken to monitor and control these exposures

Considers at least annually the independence of the independent registered public accounting firm

Reviews the adequacy and effectiveness of Medtronic s internal controls and disclosure controls and procedures

Establishes procedures concerning the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters

Meets privately in separate executive sessions periodically with management, internal audit and the independent registered public accounting firm

Audit Committee Independence and Financial Experts

In accordance with NYSE requirements and SEC Rule 10A-3, all members of the Audit Committee meet the additional independence standards applicable to its members. In addition, all of our current Audit Committee members are audit committee financial experts, as that term is defined in SEC rules.

Audit Committee Pre-Approval Policies

Rules adopted by the SEC in order to implement requirements of the Sarbanes-Oxley Act of 2002 require public company audit committees to pre-approve audit and non-audit services provided by a company s independent registered public accounting firm. Our Audit Committee has adopted detailed pre-approval policies and procedures pursuant to which audit, and audit-related, tax and other permissible non-audit services, are pre-approved by category of service. The fees are budgeted, and actual fees versus the budget are monitored throughout the year. During the year, circumstances may arise when it may become necessary to engage the independent registered public accounting firm for additional services not contemplated in the original pre-approval. In those instances, we obtain the pre-approval of the Audit Committee before engaging the independent registered public accounting firm. The policies require the Audit Committee to be informed of each service, and the policies do not include any delegation of the Audit Committee s responsibilities to management. The Audit Committee may delegate pre-approval authority to one

or more of its members. The member to whom such authority is delegated will report any pre-approval decisions to the Audit Committee at its next scheduled meeting.

Compensation Committee

Reviews compensation philosophy and major compensation programs

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Annually reviews executive compensation programs, annually reviews and approves corporate goals and objectives relevant to the compensation of the Chief Executive Officer and, based on its own evaluation of performance in light of those goals and objectives as well as input from the Corporate Governance Committee, establishes and approves compensation of the Chief Executive Officer, Chief Financial Officer and other three highest paid executives

Administers and makes recommendations to the Board with respect to incentive compensation plans and equity-based compensation plans and approves stock option and other stock incentive awards for senior executive officers

Reviews new compensation arrangements and reviews and recommends to the Board employment agreements and severance arrangements for senior executive officers

Reviews and discusses with management the Compensation Discussion and Analysis required by the rules of the Securities and Exchange Commission and recommends to the Board a Compensation Discussion and Analysis for inclusion in the Company s annual proxy statement

Establishes compensation for directors and recommends changes to the full Board

You should refer to the Compensation Discussion and Analysis on page 21 for additional discussion of the Compensation Committee s processes and procedures relating to compensation.

Compensation Committee Interlocks and Insider Participation

None of the members of the Compensation Committee during fiscal year 2007 was an officer or employee of Medtronic, and no executive officer of Medtronic during fiscal year 2007 served on the compensation committee or board of any company that employed any member of Medtronic s Compensation Committee or Board.

Corporate Governance Committee

Recommends to the Board corporate governance guidelines

Leads the Board in its annual review of the Board s performance

Adopts, monitors and recommends to the Board changes to the Governance Principles

Recommends to the Board the selection and replacement, if necessary, of the Chief Executive Officer, oversees the evaluation of senior management and periodically provides input to the Compensation Committee regarding the performance of the Chief Executive Officer in light of goals and objectives set by the Compensation Committee

Reviews and determines the philosophy underlying directors compensation and remains apprised of the Compensation Committee s actions in approving executive compensation and the underlying philosophy for it

Maintains a Nominating Subcommittee which recommends to the full Corporate Governance Committee criteria for selecting new directors, nominees for Board membership and the positions of Chairman, Chief Executive Officer and Chair of the Corporate Governance Committee and whether a director should be nominated to stand for re-election

The Corporate Governance Committee considers candidates for Board membership, including those suggested by shareholders, applying the same criteria to all candidates. Any shareholder who wishes to recommend a prospective nominee for the Board for consideration by the Corporate Governance Committee must notify the Corporate Secretary in writing at Medtronic s offices at 710 Medtronic Parkway, Minneapolis, MN 55432 no later than March 22, 2008. Any such recommendations should provide whatever supporting material the shareholder considers appropriate, but should at a minimum include such background and biographical material as will enable the Corporate Governance Committee to make

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an initial determination as to whether the nominee satisfies the criteria for directors set out in the Governance Principles.

If the Corporate Governance Committee identifies a need to replace a current member of the Board, to fill a vacancy in the Board or to expand the size of the Board, the Nominating Subcommittee considers candidates from a variety of sources. The process followed to identify and evaluate candidates includes meetings to evaluate biographical information and background material relating to candidates and interviews of selected candidates by members of the Board. Recommendations of candidates for inclusion in the Board slate of director nominees are based upon the criteria set forth in the Governance Principles. These criteria include business experience and skills, independence, distinction in their activities, judgment, integrity, the ability to commit sufficient time and attention to Board activities and the absence of potential conflicts with Medtronic s interests. The Corporate Governance Committee also considers any other relevant factors that it may from time to time deem appropriate, including the current composition of the Board, the balance of management and independent directors, the need for Audit Committee and other expertise and the evaluation of all prospective nominees.

After completing interviews and the evaluation process, the Corporate Governance Committee makes a recommendation to the full Board as to persons who should be nominated by the Board. The Board determines the nominees after considering the recommendations and report of the Corporate Governance Committee and making such other evaluation as it deems appropriate.

Alternatively, shareholders intending to appear at the Annual Meeting to nominate a candidate for election by the shareholders at the meeting (in cases where the Board does not intend to nominate the candidate or where the Corporate Governance Committee was not requested to consider his or her candidacy) must comply with the procedures in Medtronic s restated articles of incorporation, which are described under Other Information Shareholder Proposals and Director Nominations below.

Technology and Quality Committee

Provides assistance to the Board concerning the allocation of Medtronic s resources to those scientific and technological efforts that offer the greatest potential growth within the framework of Medtronic s corporate objectives

Provides assistance concerning the adequacy and relevancy of Medtronic s scientific and technical direction and Medtronic s efforts, policies and practices in development and quality programs to meet Medtronic s objectives and requirements for growth

Reviews policies, practices, processes and quality programs concerning technological and product research

Reviews the results of and evaluates the effectiveness of Medtronic s scientific and technological efforts and investments in developing new products and businesses

Annually reviews the progress on major scientific and technological programs

Evaluates Medtronic s technological education, recognition and motivational programs and activities

Special Committee

In November 2005, the Board convened a Special Committee, comprised of Jack W. Schuler (Chair), Robert C. Pozen and Jean-Pierre Rosso, to oversee Medtronic s response to a subpoena received from the Office of the United States

Attorney for the District of Massachusetts relating to the fraud and abuse and federal Anti-Kickback statutes. For more information about this matter, please see Note 15 to Medtronic s consolidated financial statements included in Medtronic s Annual Report for fiscal year 2007.

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Annual Meeting of the Shareholders

It is has been the longstanding practice of Medtronic for all directors to attend the Annual Meeting of Shareholders. All directors attended the last Annual Meeting.

Director Compensation

The Director Compensation table reflects all compensation awarded to, earned by or paid to the Company s non-employee directors during fiscal year 2007. No additional compensation was provided to Messrs. Collins or Hawkins for their service as directors on the Board. Messrs. Calhoun and Powell were not members of the Board during fiscal year 2007 and, therefore, neither received nor earned fees, stock awards or option awards during fiscal year 2007.

Name	Fees Earned or Paid in Cash	Stock Awards	Option Awards	Total
Mr. Anderson	$ 82,500	$ 70,000	$ 18,244	$ 170,744
Mr. Bonsignore	76,667	70,000	18,244	164,911
Dr. Brody	80,000	70,000	18,244	168,244
Dr. Gotto[1]	23,333	70,000		93,333
Dr. Jackson	70,000	70,000	18,244	158,244
Mr. Lenehan[2]	26,667		47,045	73,712
Ms. O Leary	70,000	70,000	18,244	158,244
Mr. Pozen	80,000	70,000	52,682	202,682
Mr. Rosso	92,500	70,000	18,244	180,744
Mr. Schuler	85,833	70,000	18,244	174,077
Mr. Sprenger	70,000	70,000	18,244	158,244

(1) Dr. Gotto retired from the Board and committees of the Board on which he served at the 2006 annual meeting. The fees shown for Dr. Gotto are fees earned and are prorated based upon his retirement from the Board in August 2006.

(2) The fees shown for Mr. Lenehan are fees earned and are prorated based upon his appointment to the Board in January 2007. Mr. Lenehan did not receive a stock award in fiscal year 2007 since he was newly elected to the Board on January 18, 2007.

Fees Earned or Paid in Cash. The fees earned or paid in cash column represents the amount of annual retainer and annual cash stipend for Board and committee service. The annual cash retainer for each director is $70,000. In addition, the Chairs of each of the Audit, Compensation, Technology and Quality, and Corporate Governance Committees receive an annual cash stipend of $10,000. The annual cash retainer and annual cash stipend are paid in two installments in the middle and at the end of the plan year, which is September 1 to August 31. Members of the Special Committees are paid a cash fee of $2,500 at the end of each fiscal quarter. The annual cash retainer and annual cash stipend are reduced by 25% if a non-employee director does not attend at least 75% of the total meetings of the Board and Board committees on which such director served during the relevant plan year. The table on page 11 of this

proxy statement under the section entitled Committees of the Board and Meetings shows on which committees the individual directors serve.

Stock Awards. Directors are granted deferred stock units at the end of the plan year on August 31 in an amount equal to the annual retainer earned during that plan year divided by the average closing price of a share of Medtronic common stock for the last 20 trading days during the plan year. Dividends paid on Medtronic common stock are credited to a director s stock unit account in the form of additional stock units. The balance in a director s stock unit account will be distributed to the director in the form of shares of Medtronic common stock upon resignation or retirement from the Board in a single distribution or, at the director s option, in five equal annual distributions. Amounts in the stock awards column show 100% of the

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grant date fair value of stock awards granted to each director in fiscal year 2007, which is recognized in the year of grant and equals the share-based compensation expense recognized in fiscal year 2007 for financial statement reporting purposes in accordance with Financial Accounting Standards Board Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)) (disregarding forfeiture assumptions). For a discussion of the assumptions we use in calculating the amount recognized, see Note 11 to our consolidated financial statements in our annual report for fiscal year 2007 accompanying this proxy statement.

Option Awards. Directors are granted stock options at the beginning of the director plan year on September 1 equal to the amount of the annual retainer, $70,000, divided by the fair market value of a share of Medtronic common stock on the date of grant (which will also be the exercise price of the option). These options expire at the earlier of the tenth anniversary of the date of grant or five years after the holder ceases to be a Medtronic director. On the date he or she first becomes a director, each new non-employee director receives (1) a one-time initial stock option grant for a number of shares of Medtronic common stock equal to two times the amount of the annual retainer, or $140,000, divided by the fair market value of a share of Medtronic common stock on the date of grant (which will also be the exercise price of such option); and (2) a pro-rated stock option grant for a number of shares of Medtronic common stock equal to his or her annual retainer (pro-rated based on the number of days remaining in the plan year) divided by the fair market value of a share of Medtronic common stock on the date of grant (which will also be the exercise price of the option). Amounts in the option awards column represent the share-based compensation expense recognized in fiscal year 2007 for financial statement reporting purposes in accordance with SFAS No. 123(R) (disregarding forfeiture assumptions). For a discussion of the assumptions used in calculating the dollar amount recognized, see Note 11 to our consolidated financial statements in our annual report for fiscal year 2007 accompanying this proxy statement.

Directors received the following stock option grants during fiscal year 2007:

Name	# of Shares	Grant Date Fair Value
Mr. Anderson	1,493	$ 18,244
Mr. Bonsignore	1,493	18,244
Dr. Brody	1,493	18,244
Dr. Gotto		
Dr. Jackson	1,493	18,244
Mr. Lenehan	2,586	35,920
	801	11,126
Ms. O Leary	1,493	18,244
Mr. Pozen	1,493	18,244
Mr. Rosso	1,493	18,244
Mr. Schuler	1,493	18,244
Mr. Sprenger	1,493	18,244

All non-employee director stock options described above vest and are exercisable in full on the date of grant, except that a director initially appointed by the Board will not be entitled to exercise any stock option until the director has been elected to the Board by Medtronic s shareholders. Amounts in the grant date fair value column represent the share-based compensation expense recognized in fiscal year 2007 for those stock option grants made during fiscal year 2007 for financial statement reporting purposes in accordance with SFAS No. 123(R) (disregarding forfeiture assumptions).

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Stock Holdings. Non-employee directors held the following restricted stock, stock options, and deferred stock units as of April 27, 2007:

Non-Employee Director	Restricted Stock	Stock Options	Deferred Stock Units
Mr. Anderson		20,476	4,785
Mr. Bonsignore		46,103	7,320
Dr. Brody		56,272	8,281
Dr. Jackson		16,797	5,460
Mr. Lenehan		3,387	
Ms. O Leary		36,399	6,520
Mr. Pozen		10,480	2,662
Mr. Rosso		50,952	7,691
Mr. Schuler	14,702	65,345	8,976
Mr. Sprenger	11,790	61,753	8,736

To more closely align their interests with those of shareholders generally, directors are encouraged to own stock of Medtronic in an amount equal to five times the annual Board retainer fees. In addition, each director must retain, for a period of three years, 75% of the net after-tax profit shares realized from option exercises or share issuances resulting from grants made on or after April 26, 2003. For stock options, net after-tax profit shares are those shares remaining after payment of the option s exercise price and income taxes. For share issuances, net gain shares are those remaining after payment of income taxes. Shares retained may be sold after three years. In the case of retirement or termination, the shares may be sold after the shorter of the remaining retention period or one year following retirement or termination, as applicable.

Change in Plan Year. Effective September 1, 2007, Medtronic will transition its director compensation program to correspond with its fiscal year, with a shortened year for the September 1, 2007 to April 25, 2008 period.

Deferrals. Directors may defer all or a portion of their compensation through participation in Medtronic s Capital Accumulation Plan, a nonqualified deferred compensation plan designed to allow participants to make contributions of their compensation before taxes are withheld and to earn returns or incur losses on those contributions based upon allocations of their balances to one or more investment alternatives, which are also investment alternatives that Medtronic offers its employees through its 401(k) supplemental retirement plan.

Charitable Giving. As part of its overall program to promote charitable giving, The Medtronic Foundation matches gifts by Medtronic employees and directors to qualified educational institutions up to $7,000 per fiscal year. In addition, any individual who became a director prior to July 1, 1998 and who has served as a director for five or more years may recommend charitable institutions to which Medtronic will make a total contribution of $1 million at the time of the director s death.

Complaint Procedure; Communications with Directors

The Sarbanes-Oxley Act of 2002 requires companies to maintain procedures to receive, retain and treat complaints received regarding accounting, internal accounting controls or auditing matters and to allow for the confidential and anonymous submission by employees of concerns regarding questionable accounting or auditing matters. We currently have such procedures in place. Our 24-hour, toll-free confidential compliance line is available for the submission of concerns regarding accounting, internal controls or auditing matters. Our independent directors may

also be contacted via e-mail at **independentdirectors@medtronic.com**. Our Lead Director may be contacted via e-mail at **leaddirector@medtronic.com**. Communications received from shareholders may be forwarded directly to Board members as part of the materials sent before the next regularly scheduled Board meeting, although the Board has authorized management, in its discretion, to forward

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communications on a more expedited basis if circumstances warrant or to exclude a communication if it is illegal, unduly hostile or threatening or otherwise inappropriate. Advertisements, solicitations for periodical or other subscriptions and other similar communications generally will not be forwarded to the directors.

Our Codes of Conduct

All Medtronic employees, including our Chief Executive Officer and other senior executives, are required to comply with our long-standing Code of Conduct to help ensure that our business is conducted in accordance with the highest standards of moral and ethical behavior. Our Code of Conduct covers all areas of professional conduct, including customer relationships, conflicts of interest, insider trading, intellectual property and confidential information, as well as requiring strict adherence to all laws and regulations applicable to our business. Employees are required to bring any violations and suspected violations of the Code of Conduct to the attention of Medtronic, through management or our legal counsel or by using Medtronic s confidential compliance line. Our Code of Ethics for Senior Financial Officers, which is a part of the Code of Conduct, includes certain specific policies applicable to our Chief Executive Officer, Chief Financial Officer, Treasurer and Controller and to other senior financial officers designated from time to time by our Chief Executive Officer. These policies relate to internal controls, the public disclosures of Medtronic, violations of the securities or other laws, rules or regulations and conflicts of interest. In 2004, the Board of Directors adopted a Code of Business Conduct and Ethics for members of the Board relating to director responsibilities, conflicts of interest, strict adherence to applicable laws and regulations and promotion of ethical behavior.

Our codes of conduct are published on our website, at **www.medtronic.com** under the **Corporate Governance** caption. We intend to disclose future amendments to, or waivers for directors and executive officers of, our codes of conduct on our website promptly following the date of such amendment or waiver.

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SHARE OWNERSHIP INFORMATION

Significant Shareholders. The following table shows information as of June 25, 2007, concerning each person who is known by us to beneficially own more than 5% of our common stock.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Of Shares Beneficially Owned, Amount that May Be Acquired Within 60 Days	Percent of Class
Capital Research and Management Company 333 South Hope Street Los Angeles, CA 90071(1)	119,062,290	N/A	10.4%
Wellington Management Company, LLP 75 State Street Boston, MA 02109(2)	77,686,054	N/A	6.8%

(1) The information for security ownership of this beneficial owner is based on amendment no. 1 to a Schedule 13G filed by Capital Research and Management Company on February 12, 2007. The shares reported are as a result of Capital Research and Management Company acting as investment adviser to various investment companies. Based upon 1,139,865,406 shares outstanding as of June 25, 2007 (in addition to 1,246,421 shares resulting from the assumed conversion of $69,900,000 principal amount of Medtronic s 1.50% Convertible Senior Notes due April 2011 and 811,333 shares resulting from the assumed conversion of $45,500,000 principal amount of Medtronic s 1.625% Convertible Senior Note due April 2013, which are included in both the denominator and numerator for beneficial ownership calculations), the shareholder beneficially owns approximately 10.4% of our shares outstanding.

(2) The information for security ownership of this beneficial owner is based on a Schedule 13G filed by Wellington Management Company, LLP on February 14, 2007. The shares reported are as a result of Wellington Management Company, LLP acting as investment advisor to various investment companies. Based upon 1,139,865,406 shares outstanding as of June 25, 2007, the shareholder beneficially owns approximately 6.8% of our shares outstanding.

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Beneficial Ownership of Management. The following table shows information as of June 25, 2007 concerning beneficial ownership of Medtronic s directors, named executive officers identified in the Summary Compensation Table below, and all directors and executive officers as a group.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership[6]	Of Shares Beneficially Owned, Amount that May Be Acquired Within 60 Days
Richard H. Anderson[1]	27,766	25,261
Michael R. Bonsignore	67,357	53,423
William R. Brody, M.D., Ph.D	76,750	64,553
David L. Calhoun	13,327	2,977
Arthur D. Collins, Jr.[2]	2,848,752	2,271,974
Michael F. DeMane	214,756	205,968
Gary L. Ellis	291,823	258,801
William A. Hawkins	329,621	298,452
Shirley Ann Jackson, Ph.D	22,457	22,257
James T. Lenehan	13,387	3,387
Stephen H. Mahle	852,537	620,838
Denise M. O Leary	42,919	42,919
Kendall J. Powell	3,527	2,977
Robert C. Pozen[3]	37,842	13,142
Jean-Pierre Rosso	59,643	58,643
Jack W. Schuler[4]	245,376	74,321
Gordon M. Sprenger	138,070	70,489
Directors and executive officers as a group (29 persons)[5]	7,162,599	5,701,550

(1) Mr. Anderson disclaims beneficial ownership of 25 shares that are owned by his minor son.

(2) Mr. Collins disclaims beneficial ownership of 20,000 shares that are held by The Collins Family Foundation, a charitable trust of which he is one of the trustees.

(3) Includes 24,700 shares owned jointly with Mr. Pozen s spouse.

(4) 127,553 of these shares are pledged to a financial institution as collateral for a line of credit.

(5) As of June 25, 2007, no director or executive officer beneficially owns more than 1% of the shares outstanding. Medtronic s directors and executive officers as a group beneficially own approximately .63% of the shares outstanding.

(6) Amounts include the shares shown in the last column, which are not currently outstanding but are deemed beneficially owned because of the right to acquire shares pursuant to options exercisable within 60 days (on or before August 24, 2007) and the right to receive shares for deferred stock units issued under the Medtronic, Inc. 1998 Outside Director Stock Compensation Plan within 60 days (on or before August 24, 2007) of a director s

resignation.

Section 16(a) Beneficial Ownership Reporting Compliance. Based upon a review of reports and written representations furnished to it, Medtronic believes that during fiscal year 2007 all filings with the SEC by its executive officers and directors complied with requirements for reporting ownership and changes in ownership of Medtronic s common stock pursuant to Section 16(a) of the Securities Exchange Act of 1934 (the Exchange Act), except as follows: Michael F. DeMane, Senior Vice President, failed to timely file a report for a sale of shares on November 21, 2006, due to Medtronic s administrative oversight; Scott R. Ward, Senior Vice President and President, CardioVascular, failed to timely file a report for a sale of shares by his spouse on February 28, 2007, and a gift of shares to his spouse on January 6, 2004, due to an oversight by Mr. Ward s advisors; and Mr. Bonsignore failed to timely file a report for a transfer of funds

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out of the Medtronic stock-based fund in Medtronic s Capital Accumulation Plan on December 8, 2006, due to an administrative oversight. The reports were promptly filed when the errors were discovered.

COMPENSATION DISCUSSION AND ANALYSIS

Overview

The compensation discussion and analysis describes all material elements of our compensation programs for our named executive officers during fiscal year 2007. The accompanying Summary Compensation Table and additional tabular disclosures complement and give substance to the information in the discussion and analysis.

The Compensation Committee of the Board of Directors has the primary authority and is the decision-making body on all matters of compensation related to our named executive officers. The Compensation Committee establishes the compensation philosophy and approves all aspects of the executive compensation program including plan design and administration. For more information on the Compensation Committee, its members and its duties as identified in its charter, you should refer to the section entitled Committees of the Board and Meetings beginning on page 11 of this proxy statement.

Compensation Program Objectives and Philosophy

The goal of our compensation program for named executive officers is to support and enhance the Medtronic Mission. Our Mission has been in place since 1960, and it drives every aspect of our business. Its principles, in a condensed version below, speak to:

- Contributing to human welfare by application of biomedical engineering to develop instruments that alleviate pain, restore health and extend life;
- Directing growth in the biomedical engineering field;
- Striving without reserve for the greatest possible reliability and quality in our products and to be the unsurpassed standard of comparison and to be recognized as a company of dedication, honesty, integrity and service;
- Making a fair profit to meet our obligations, sustain our growth and reach our goals;
- Recognizing the personal worth of employees by providing an employment framework that allows personal satisfaction in work accomplished, security, advancement opportunities and means to share in the company s success; and
- Maintaining good citizenship as a company.

Our Mission lays the foundation for our unyielding standards for ethical and legal conduct and the utmost integrity in all of our activities. Our compensation program for named executive officers is aligned with these principles, and its objectives are established for this purpose. It is designed to:

- Emphasize performance-based compensation;
- Encourage strong financial performance by establishing challenging goals and leveraged incentive programs; and

Encourage executive stock ownership and alignment with shareholder interests by linking a meaningful portion of compensation to the value of Medtronic common stock.

Our philosophy is to position total compensation at a level that is commensurate with Medtronic s size and performance relative to other leading medical device and pharmaceutical companies, as well as limited number of general industry companies. To do this, the Compensation Committee annually reviews the total compensation levels and mix of elements using public information from the peer group s proxy statements and survey information from credible general industry surveys. The variable components of the

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program are designed to allow for market median pay for target performance, above-market median pay when performance is above target performance and below-market median pay when performance is below target performance. In addition, the equity components of the program align our executives with the interests of our shareholders and ensure that their total compensation will increase or decrease in direct correlation to the movement of our stock price.

Independent Compensation Consultant

The Compensation Committee has engaged Frederic W. Cook & Co., Inc., an independent outside compensation consulting firm, to advise the Compensation Committee on all matters related to executive officer and director compensation. Specifically, Frederic W. Cook & Co. conducts an annual proxy review of total compensation for named executive officers. Frederic W. Cook & Co. also provides to the Compensation Committee relevant market data, updates on compensation trends, advice on program design and advice on specific compensation decisions for the Chief Executive Officer as well for other executives. Frederic W. Cook & Co. does not advise our management and only works with management with the express permission of the Compensation Committee. The consultant attended all of the Compensation Committee meetings in fiscal year 2007, as is Medtronic s long-standing practice. The consultant also meets in executive session as requested at each meeting.

Role of Chief Executive Officer in Compensation Decisions

The chairman of the Compensation Committee, management and the independent compensation consultant retained by the Compensation Committee hold pre-meeting preparation telephone conferences prior to the three regularly scheduled committee meetings. In making their decisions, the Compensation Committee solicits views of our Chief Executive Officer on compensation matters as they relate to the compensation of members of senior management reporting to the Chief Executive Officer or the Chief Operating Officer.

Peer Companies

For fiscal year 2007, our peer group of fifteen companies included both direct and indirect competitors in the medical device and pharmaceutical field as well as other leading companies. This peer group was selected based on discussions and recommendations from our independent compensation consultant. Regularly, a comprehensive review takes place that includes an assessment of companies in the peer group as well as the size, performance and industry of companies outside the group. The peer group was selected such that Medtronic is at approximately the median in terms of several size measures such as revenues and market capitalization. The fiscal year 2007 peer group included:

Peer Companies

3M	Becton Dickinson	Johnson & Johnson
Abbott Laboratories	Biomet	Lilly (Eli)
Amgen	Boston Scientific	St. Jude Medical
Bard (C.R.)	Bristol-Meyers Squibb	Stryker
Baxter International	Genentech	Wyeth

In fiscal year 2007, there were no changes made to the peer group from the prior year. For fiscal year 2008, the peer group will change because at least one of the peers has been acquired by a private group of investors. In addition, in fiscal year 2008 the Compensation Committee intends to conduct one of its periodic comprehensive reviews of the peer group.

Elements of Compensation

The principal elements of the program consist of the following components:

Base salary;

Annual performance-based incentives; and

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Long-term compensation in the form of stock options, performance-based restricted stock and restricted stock units, a cash-based long-term performance plan, and time-based restricted stock units.

In addition to the elements above, the following indirect elements are part of a company-wide benefits program:

Qualified retirement plans, supplemental retirement plans, and a nonqualified deferred compensation plan;

Business allowance in lieu of perquisites; and

Change of control agreements.

Each element is reviewed individually and considered collectively with other elements of our compensation program to ensure that it is consistent with the goals and objectives of that particular element of compensation as well as our overall compensation program.

Compensation Mix

The table below illustrates how the primary components of executive compensation (base salary, annual performance-based incentives and long-term compensation) for our named executive officers were allocated in fiscal year 2007. Comparisons are made between:

Annual vs. long-term compensation;

Performance-based vs. non-performance-based compensation; and

Equity-based vs. cash-based compensation.

Name	Annual Compensation	Long-Term Compensation	Performance-Based Compensation	Not Performance-Based Compensation	Equity-Based Compensation	Cash-Based Compensation
Arthur D. Collins, Jr.	27%	73%	88%	12%	49%	51%
Gary L. Ellis	36	64	80	20	43	57
William A. Hawkins	36	64	82	18	43	57
Michael F. DeMane	34	66	81	19	44	56
Stephen H. Mahle	32	68	82	18	45	55

The information in the chart above demonstrates our pay philosophy, which emphasizes performance-based pay and sustained financial performance by focusing on long-term financial measures and stock performance. In doing so, we establish a strong link between our named executive officers and our shareholders. The percentages above are calculated based on total direct compensation (base salary, annual incentives and long-term incentives) excluding special time-based restricted stock awards and excluding compensation related to relocation or expatriate duties.

Base Salaries

With respect to base salaries, our objective is to establish salaries within a competitive range based on the market median base salary for our industry peer group. Establishing market competitive base salaries aids in the attraction and retention of top talent and allows us to develop a pay mix that appropriately reflects the market mix of fixed versus variable pay. The salary increases for named executives for fiscal year 2007 were based on a number of factors including:

Individual performance during the fiscal year;

Current salary relative to the market;

Past salary treatment;

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The level of responsibility;

Business strategy;

Total compensation strategy; and

The scope and complexity of the position.

The Compensation Committee reviews and approves base salaries for named executives annually at its meeting in April following a review of the above criteria.

Base salary percentage increases for fiscal year 2007 and for fiscal year 2008 (to date) are shown below:

Name	Fiscal Year 2006	Fiscal Year 2007	Percent Increase	Fiscal Year 2008	Percent Increase
Arthur D. Collins, Jr.	$ 1,175,000	$ 1,275,000	8.5	$ 1,275,000	
Gary L. Ellis	475,000	525,000	10.5	600,000	14.3
William A. Hawkins	735,000	775,000	5.4	806,000	4.0
Michael F. DeMane	490,209	530,000	8.1	557,000	5.1
Stephen H. Mahle	572,000	595,000	4.0	620,000	4.2

The base salary increases in fiscal year 2007 were based on market data as provided through internal surveys as well as recommendations from the Compensation Committee s external independent compensation consultant. Mr. Ellis received the highest base salary increase due to his recent promotion as Chief Financial Officer to align his base salary according to competitive market data. Mr. Collins base salary increase was determined for the period through the 2007 Annual Meeting, rather than for fiscal year 2007, so his annualized percentage increase was approximately 6.4%. Mr. DeMane s base salary was increased to $500,000 in the middle of fiscal year 2006 upon his promotion to Senior Vice President and President, Europe, Canada, Latin America and Emerging Markets. The increase at the beginning of fiscal year 2007 from $500,000 to $530,000 was an increase of 6%. This and other fiscal year 2007 increases of 4% to 6% are within a range of general market movement for these positions and were made to bring the salaries in line with the competitive market median of the industry peer group.

Annual Performance-Based Incentives

We deliver annual performance-based incentives to our named executive officers though our Medtronic Incentive Plan (MIP). Our objective is to establish MIP award targets within a competitive range based on the market median annual incentives for our industry peer group. However, we establish an award range that allows above-market pay for above-market performance and below-market pay for below-market performance. It is important to note that our MIP award targets are set at competitive levels to allow us to attract and retain employees and offer a pay mix that is similar to that in the market in which we compete for talent.

Award Targets. The Compensation Committee reviews, discusses and approves MIP award targets for named executive officers in June. Attainment of MIP award targets is approved on a preliminary basis by the Compensation Committee each April based on year-end forecasts and ratified again in June by the chairman of the Compensation Committee just prior to payout.

Our MIP award targets are established as a percentage of base salary earned during the fiscal year. No incentives are earned unless a minimum (threshold) Earning Per Share target is met. Minimum awards (at the threshold level of performance) are 50% of the target amount and maximum payouts for named

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executive officers are either 220% or 225% of the target amount. The chart below shows, as a percent of base salary, the minimum, target, and maximum awards under this plan.

	MIP Awards as Percent of Base Salary		
Name	**Threshold Performance**	**Target Performance**	**Maximum Performance**
Arthur D. Collins, Jr.	60	120	264
Gary L. Ellis	38	75	165
William A. Hawkins	48	95	209
Michael F. DeMane	38	75	169
Stephen H. Mahle	40	80	180

Establishing market competitive cash incentives helps attract and retain high caliber talent, motivate and focus that talent on achieving aggressive financial performance objectives and reward that talent for achieving or exceeding our annual operating plan goals.

Performance Measures. MIP award measures are reviewed and approved annually at the Compensation Committee s June meeting. Financial measures are selected based on how effectively they impact, independently and together, the overall success of Medtronic.

The current financial measures for the portion of our plan based on corporate performance are Earnings Per Share, Revenue Growth and Return on Net Assets, with weights of 50%, 30%, and 20%, respectively. Earnings Per Share is an aggregate measure that focuses on growth and equity management, and reflects how well we deliver value to our shareholders from our business operations. Revenue growth is a reflection of our ability to successfully bring new products to market, gain market share and expand the many markets that we serve. Return on Net Assets measures our success at generating profits relative to our assets that is, our ability to leverage our assets to create sustained growth. Target payouts for corporate measures for fiscal year 2007 were based on performance targets with the following ranges: 11% to 23% growth in Earnings Per Share, 10% to 15% revenue growth, and 16% to 20% return on net assets. These are reasonably aggressive goals as compared to our peer group of companies and, as such, fully support our compensation philosophy. In addition, an Earnings Per Share threshold equal to 90% of target was used and was set at the prior year s actual results so any drop in Earnings Per Share would result in no payouts under this plan.

All of Mr. Collins MIP is based on these corporate performance measures. The remaining named executive officers have a portion of their MIP based on corporate measures and a portion based on individual performance as evaluated by our Chief Executive Officer or Chief Operating Officer a category that takes into account all aspects of their job and includes non-financial areas such as talent management, quality and regulatory successes, and strategic initiatives. The chart below shows the apportionment of MIP for the named executive officers among the various performance measures for fiscal year 2007:

Name	**Corporate Performance**	**Individual Performance**	**Europe, Canada, Latin America & Emerging Markets Performance**	**CRDM Performance**

Arthur D. Collins, Jr.	100%			
Gary L. Ellis	75	25%		
William A. Hawkins	75	25		
Michael F. DeMane	25	25	50%	
Stephen H. Mahle	25	25		50%

Mr. Mahle and Mr. DeMane have a portion of their MIP based on the performance of the business units they lead. For fiscal year 2007, those business unit measures included Revenue Growth, Earnings before Interest and Taxes, Market Share (for Mr. Mahle only), Days Sales Outstanding (for Mr. DeMane only), and Weeks of Inventory. The latter two measures reflect how well we are managing specific assets accounts

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receivable and inventory. Earnings Before Interest and Taxes is what we use as one broad measure of business unit results; similar to the Earnings Per Share measure used on a corporate-wide basis.

In establishing our performance measure targets, we consider a number of factors, including prior performance, forecast performance, and industry expectations. We look to our annual operating plan and to the level of performance required to meet our stated objectives. We take into account current platforms and timeline for the approval and introduction of new products. Finally, we look to the competitive market and estimate regulatory and legal influences, as well as economic trends.

Fiscal Year 2007 Award Payments. For fiscal year 2007, corporate Earnings Per Share and Revenue Growth performance were below target. Corporate Earnings Per Share exceeded the minimum threshold amount required for an award. Return on Net Assets was above target, resulting in overall corporate performance at 67% of target. Cardiac Rhythm Disease Management performance was at 9% of target and Europe, Canada, Latin America and Emerging Markets group performance was 183% of target. Individual performance for all named executive officers (excluding Mr. Collins, who does not have this measure) was between 67% and 100% of target.

Award payments to named executive officers are highlighted below:

Name	Award Payments	Percentage of Target
Arthur D. Collins, Jr.	$ 1,020,000	67
Gary L. Ellis	295,313	75
William A. Hawkins	490,963	67
Michael F. DeMane	529,470	133
Stephen H. Mahle	219,793	46

Long-Term Compensation

Long-term compensation allows us to provide incentives and rewards to those employees who are responsible for the strategic and long-term success of the company. Our objective is to align the actions of our named executive officers with the interests of shareholders, link a significant portion of their compensation to sustained financial results and growth in stock price, provide a competitive total compensation package, and aid in the attraction and retention of top talent. We provide our named executives with four types of long-term compensation:

Stock options;

Performance-based restricted stock or restricted stock units;

A cash-based long-term performance plan; and

Time-based restricted stock units.

A goal of our program is to establish aggregate long-term compensation pay targets within a competitive range based on the median long-term incentives of our industry peer group of companies. We establish a pay range that allows aggregate payouts that are above market median pay for above target performance and below market median pay for below target performance.

Another goal of our long term compensation program is to provide a balance among the individual program components. Our program delivers a mix of rewards with differing leverage and delivery methods to appropriately capture the unique benefits of these different programs. Our goals are to achieve an equal balance among the three primary components of the program (stock options, performance-based restricted stock or restricted stock units, and performance-based cash) and to use time-based restricted stock in more limited circumstances for special recognition and retention purposes. This mix of long-term incentives, introduced in fiscal year 2007, is similar to the mix of our peer group. By maintaining an equal balance of the three primary components, we underscore the importance of all of them. This supports our overall compensation philosophy and objectives to reinforce alignment with shareholder interests,

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encourage strong financial performance through aggressive goals and highly leveraged programs, and emphasize performance-based compensation.

Award Targets. The Compensation Committee reviews, discusses and approves all long-term compensation pay targets for named executives in June after discussing and reviewing a comprehensive annual proxy executive compensation study provided by our external independent consultant. Once the market median long-term incentive compensation of the peer group of companies is determined for each named executive officer, that amount is allocated equally among the three primary components to establish the award targets for stock options, performance-based restricted stock, and the long-term performance plan.

Stock Options. Stock options provide value only when the price of the stock appreciates over the grant price. This helps ensure a strong link between our executives and our shareholders.

As discussed above, stock option grant guidelines are approved by the Compensation Committee in June following a review of competitive market data. Once the target grant guidelines are established, the Compensation Committee approves a range that allows for an award amount of 50% to 200% of that target guideline amount. Our annual stock option grants to named executive officers are made at the beginning of our third quarter and may be above or below the target amounts based on individual performance. All stock option grants have an exercise price that is equal to the closing market price of our shares on the date of grant, have a term of ten years and generally vest in equal increments of 25% each year beginning one year after the date of grant.

For fiscal year 2007, stock options awards were granted at target grant guideline amounts to all of the named executive officers and accounted for approximately 24% of total compensation for our Chief Executive Officer and approximately 22% to 23% of total compensation for the remaining named executive officers.

Performance-Based Restricted Stock/Restricted Stock Units. Performance-based restricted stock or restricted stock units are used to focus executives on a key financial goal, diluted earnings per share, align them with shareholder interests, and aid in the attraction and retention of top talent.

As discussed above, performance-based restricted stock and restricted stock unit grant targets for named executive officers are approved by the Compensation Committee in June following a review of our peer companies. Actual grants are made at the beginning of our third quarter and are equal to the grant targets (unlike stock options, there is no grant range provided). All performance-based restricted stock/restricted stock unit grants are made at a price equal to the closing market price of our shares on the date of grant and cliff vest 100% three years after the date of grant if the applicable performance goal is achieved. Performance-based restricted stock was first introduced in fiscal year 2007 to replace a portion of named executive officer stock option awards using an exchange factor of one performance-based restricted share for every four stock options.

The performance goal that must be achieved for the fiscal year 2007 performance-based restricted stock/restricted stock unit grants to vest is cumulative diluted earnings per share growth of 9% each year over three years. Diluted earnings per share is an appropriate measure of overall financial well being. Performance is measured over the three consecutive fiscal years beginning with the fiscal year during which the grant is made. If the performance goal is achieved, the stock will cliff vest 100% on the third anniversary of the date of grant. If the performance goal is not met, none of the awards vest.

The determination as to whether a named executive officer receives a grant of performance-based restricted stock versus restricted stock units is made based on the country of origin and country of residence of the named executive officers and related tax consequences. Named executive officers who receive performance-based restricted stock also receive dividends on those awards, while those receiving performance-based restricted stock units receive dividend

credits that vest and are distributed along with the vesting of the original award. In addition, named executive officers with performance-based restricted stock have voting rights on those shares during the vesting period while those with performance-based restricted stock units do not. The two forms of award are similar in other respects.

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For fiscal year 2007, performance-based restricted stock/restricted stock unit awards were delivered at target grant amounts to all of the named executive officers and accounted for approximately 24% of total compensation for Art Collins and approximately 21% to 23% of total compensation for the remaining named executive officers. Mr. DeMane was the only named executive officer to receive performance-based restricted stock units rather than performance-based restricted stock, and this was due to his status as a Swiss-based executive in fiscal year 2007 and the related tax consequences of performance-based restricted stock

Cash-Based Long-Term Performance Plan. Our objective with our Long-Term Performance Plan (LTPP) is to maintain the alignment of our named executive officers goals with our long-term financial performance goals. We feel this approach focuses our executives on sustained achievement of financial targets that are critical to our long-term success.

As discussed above, our LTPP grant targets for named executive officers are approved annually by the Compensation Committee in June following a review of our peer groups. Grants are made annually for overlapping three-year performance periods. Calculations of final awards are reviewed by the Compensation Committee each April based on year-end forecasts and confirmed in June by the Chairman of the Compensation Committee just prior to payout. For the 2007-2009 phase of the LTPP, no incentives are earned unless two thresholds of Earnings Per Share and Return on Net Assets are met. Minimum payouts (at the threshold level of performance) are 20% of the target amount and maximum payouts are 180% of the target amount. The minimum, target and maximum payouts to our named executive officers can be found in the Grants of Plan-Based Awards table on page 36 of this proxy statement.

The LTPP performance measures are the same performance measures as those described in the section entitled Performance Measures on page 25 of this proxy statement except the LTPP performance is measured over three fiscal years. For the LTPP, performance measure targets are set at or close to the same level as our long-term financial objectives. Target payouts for the fiscal year 2007 to fiscal year 2009 period are based on performance targets with the following ranges: average growth in Diluted Earnings Per Share of 9% to 17% per year over three years, average revenue growth of 8% to 16% per year over three years, and average return on net assets of 12% to 20% over three years. In setting our performance measure targets, we consider a number of items the most important of which is our strategic plan, which takes into account our current product lines and our timeline for the approval and introduction of new products.

For fiscal year 2007, Long-Term Performance Plan awards were granted at target amounts to all of the named executive officers and accounted for approximately 24% of total compensation for our Chief Executive Officer and approximately 21% to 23% of total compensation for the remaining named executive officers.

Fiscal year 2007 was also the final year of the 3-year performance period for the fiscal year 2005 through fiscal year 2007 phase of the Performance Share Plan, the predecessor to the LTPP. This predecessor plan was similar in design to the current LTPP except the plan was denominated in performance shares and the payout was 50% in cash and 50% in Medtronic stock. The dollar value of the final awards to named executive officers for the fiscal year 2005 to fiscal year 2007 phase of the Performance Share Plan were as follows:

Name	Cash Award	Stock Award	Total Award
Arthur D. Collins, Jr.	$ 703,565	$ 703,565	$ 1,407,130
Gary L. Ellis	105,665	105,665	211,330
William A. Hawkins	328,344	328,344	656,688
Michael F. DeMane	163,252	163,252	326,504
Stephen H. Mahle	206,397	206,397	412,794

The Stock Awards Column in the Summary Compensation Table includes the share-based compensation expense recognized in accordance with FAS 123(R) in fiscal year 2007 rather than the amounts shown in the table above.

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Time-Based Restricted Stock Units. Grants of time-based restricted stock units are periodically made to named executive officers for strategic reasons such as attraction, promotion, succession planning, special recognition and retention. While vesting on these awards is generally three- to five-year cliff vesting, specific circumstances will dictate the terms of these grants. All time-based restricted stock unit grants are made at a price equal to the closing market price of our shares on the date of grant.

During fiscal year 2007, our named executive officers received the following grants of time-based restricted stock units:

Name	Face Value of Grant	Number of Units	Vesting Provisions	Dividend Treatment
Gary L. Ellis	$ 1,000,043	19,795	100% on fourth anniversary of grant date	Receives dividend credits
William A. Hawkins	2,000,014	40,775	100% on third anniversary of grant date	Receives dividend credits
Michael F. DeMane	2,000,014	40,775	100% on third anniversary of grant date	Receives dividend credits

These grants were made for strong leadership and/or retention related to succession planning.

Adjustments for Special Charges

Medtronic s performance-based plans require that when special charges (such as certain litigation, restructuring charges and in-process research and development charges) significantly impact operating income, this impact be reviewed and evaluated by the Compensation Committee and potentially excluded in determining financial performance. The plans define significant as an impact in the general amount of 5% of the operating income in the year incurred. The intent of this standard is to allow decisions of material strategic importance to be made by Management without undue concern for impact on compensation.

In accordance with Medtronic s policy, for fiscal year 2007 a number of items were excluded from Medtronic s results for the purposes of calculating performance on short-term and long-term incentive programs and the Medtronic, Inc. s Savings and Investment Plan. These exclusions had no net impact on payments made under these programs.

Qualified Retirement Plans

Medtronic has three types of pension plans. Our original pension plan is a defined benefit, tax qualified retirement plan covering most U.S. employees who began employment with Medtronic prior to May 1, 2005. Recently, we implemented two new alternative plans for employees hired on or after May 1, 2005, a defined benefit plan, the Personal Pension Account, and a defined contribution plan, the Personal Investment Account. Additional details regarding the pension plans are provided on page 42 of this proxy statement.

Supplemental Retirement Plans

Medtronic provides a Supplemental Executive Retirement Plan benefit. This plan is a nonqualified plan which is designed to provide all eligible employees, including the named executive officers, with benefits which supplement those provided under certain of the tax qualified plans maintained by Medtronic. Designed to provide a consistent level of benefit as a percentage of covered compensation for all employees, the Supplemental Executive Retirement Plan restores benefits lost under the Personal Pension Account, Personal Investment Account or the Medtronic Retirement Plan due to covered compensation limits established by the IRS. The Plan also restores benefits for otherwise eligible compensation deferred into the Medtronic, Inc. Capital Accumulation Plan Deferral Program (the Capital Accumulation Plan). The Capital Accumulation Plan uses the same benefit formula as the qualified plan and includes the same elements of compensation included in the qualified plan in addition to compensation deferred into our Capital Accumulation Plan. As such, the plan provides employees with no greater benefit than they would have received under the qualified plan were it not for the covered compensation

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limits and deferrals into our Capital Accumulation Plan. Lost 401(k) benefits are not restored under this plan.

Nonqualified Deferred Compensation Plan

Our objective is to provide all eligible employees, including our named executive officers, with a market competitive nonqualified deferred compensation program through the Capital Accumulation Plan. Our plan allows named executive officers to make voluntary deferrals from their income. There is no company contribution other than a credit of gain/loss related to the investment allocation choices made by the participants. For fiscal year 2007, the Capital Accumulation Plan is summarized below. Named Executive Officers can defer compensation according to the following guidelines:

Eligible Compensation	Named Executive Officers can defer from Base Salary (up to 50)% Annual Incentive (specific dollar amount up to 100)% Long-Term Incentive (Long-Term Performance Plan specific dollar amount up to 100)%
Deferral Commitment	Separate deferral commitment for each calendar year and each category of compensation.
Account Distribution	Separate distribution elections are made for each deferral commitment. Named executive officers may elect Distribution on a specific date (as long as that date is at least 5 years beyond the period of the deferral) Distribution at retirement, in the form of a lump sum distribution or installments over 5, 10, or 15 years All CAP distributions are made in cash
Interest Crediting Method	Named executive officers choose how to direct their deferrals among 11 investment alternatives all of which are offered in the Medtronic Supplemental Retirement Plan available to all eligible Medtronic U.S. employees.

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Business Allowance and Perquisites

We provide our named executive officers with a market competitive business allowance rather than perquisites such as an automobile program, financial and tax planning, and country club memberships. In addition, we pay up to $2,000 for the cost of an annual executive physical that exceeds coverage provided by the executive s medical plans. We offer these opportunities to aid in the attraction and retention of top talent. For named executive officers on expatriate assignments, rather than providing a business allowance, we pay for certain housing and related living costs. These amounts are sometimes a significant part of an expatriate s total compensation. Additional items included in the all other compensation column of our summary compensation table are explained in greater detail following that table. For fiscal year 2007, we provided the following business allowances and expatriate benefits for our named executive officers:

Name	Business Allowance and Perquisites (or Expatriate Benefits)	
Arthur D. Collins, Jr.	Business Allowance: $	40,000
Gary L. Ellis	Business Allowance: $	24,000
William A. Hawkins	Business Allowance: $	30,000
Michael F. DeMane	Expatriate Benefits: $	862,075(1)
Stephen H. Mahle	Business Allowance: $	24,000

(1) Additional details on the expatriate benefits for Mr. DeMane are shown following the Summary Compensation Table on page 34 of this proxy statement.

Change of Control Agreements

The principal reasons for providing compensation in a change of control situation are two-fold: (1) To protect the compensation already earned by executives and to ensure that they will be treated fairly in the event of a change of control; and (2) To help ensure the retention and dedicated attention of key executives critical to the ongoing operation of the company. Our change of control provisions support these principles. We believe that the interests of shareholders will be best served if the interests of our executive officers are aligned with them, and providing change of control benefits should eliminate, or at least reduce, the reluctance of senior management to pursue potential mergers or transactions that may be in the best interest of shareholders.

For fiscal year 2007, our change of control agreements for our named executive officers provided the following:

Agreement Provision	Description
Severance Triggers	Termination by Medtronic other than for Cause or Disability Termination by the Executive for Good Reason Termination by the Executive for any reason during 30-day period following first anniversary of change of

	control
Severance Benefits	3X base and bonus (2X if voluntary termination during 30-day period following the first anniversary of the change of control) Accrued salary, annual and long-term incentives (pro-rata payout on incentives) Continuation of certain insurance and welfare plan benefits for a period of time not exceeding three (or in certain cases two) years Full excise tax gross up, if applicable

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Our change of control agreements are discussed in more detail in the Employment and Change of Control Arrangements section below. We do not have employment contracts other than those associated with a change of control.

Stock Retention Requirements

The Compensation Committee has approved the implementation of stock retention requirements. The Chief Executive Officer must retain, for a period of three years, 75% of the net after-tax profit shares realized from option exercises and 75% of the net gain shares relating to share issuances resulting from grants made on or after April 26, 2003. Other named executive officers must retain, for a period of three years, 50% of the net after-tax profit shares realized from option exercises or 50% of the net gain shares relating to share issuances resulting from grants made on or after April 26, 2003. For stock options, net after-tax profit shares are those shares remaining after payment of the option s exercise price and applicable taxes. For share issuances, net gain shares are those shares remaining after payment of income taxes. Shares retained may be sold after three years. In the case of retirement or termination, the shares may be sold after the shorter of the remaining retention period or one year following retirement/termination.

Modified stock retention guidelines apply to shares awarded to Mr. DeMane in fiscal year 2007 because he was a Swiss-based executive at this time. The modified guidelines allow Mr. DeMane to satisfy holding requirements by demonstrating ownership of an equivalent number of shares rather than holding shares from specific awards, which due to Swiss tax regulations would result in severe tax consequences.

As of April 27, 2007, all executive officers were in compliance with the stock retention requirements.

Tax and Accounting Implications

As part of its role, the Compensation Committee reviews and considers the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code of 1986, as amended, which provides that the Company may not deduct compensation of more than $1 million that is paid to certain individuals. In carrying out its duties, the Compensation Committee makes all reasonable attempts to comply with the $1 million deduction limitation for executive compensation, unless the Compensation Committee determines that such compliance in given circumstances would not be in the best interests of Medtronic and its shareholders. Mr. Collins defers the portion of his base salary that is over $1 million. Other major components of his fiscal year 2007 total direct compensation are performance-based and therefore not subject to the $1 million limit under Section 162(m) of the Internal Revenue Code of 1986.

Beginning in the first quarter of fiscal year 2007, the Company began accounting for stock-based awards in accordance with the requirements of FASB Statement 123(R) by using the modified prospective method of application. Under the modified prospective method, compensation cost is recognized prospectively for both new grants issued subsequent to the date of adoption, and all unvested awards outstanding at the date of adoption.

The nonqualified deferred compensation plan described above is a plan that qualified under section 409A of the Internal Revenue Code.

Medtronic Stock Grant Policy and Practice

All employee stock awards, which include restricted stock grants, restricted stock units and stock options, are approved either by the Compensation Committee of the Board or the internal stock committee (the ISC). The Compensation Committee approves all stock awards to its executive officers as well as all awards which cannot be delegated to the ISC due to the size of the award. The ISC, which includes the Chief Executive Officer, the Chief

Operating Officer and the Senior Vice President of Human Resources, approves all other stock awards.

In the past, Medtronic s stock grants were effective on the date of the approval (either the date of the Compensation Committee meeting or the date the ISC resolutions are signed). However, in some cases,

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such as those contingent on a future date of employment, grants were made on a future effective date that was specifically identified in the resolutions at the time of approval.

Beginning in fiscal year 2007, Medtronic adopted a policy of making stock and option grants only four times each year. Grants are to be made on the first business day of each fiscal quarter for all grants approved by the Compensation Committee or the ISC during the preceding quarter.

The fair market value or exercise price on all Medtronic stock awards is established in the Medtronic, Inc. 2003 Long-Term Incentive Plan as the closing sale price of shares on the New York Stock Exchange on the date of grant. Medtronic has priced stock awards consistent with the plan and no backdating of stock options has occurred.

COMPENSATION COMMITTEE REPORT

The Compensation Committee of the Company has reviewed and discussed the section of this proxy statement entitled Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management. Based on such review and discussions, the Compensation Committee recommended to the Board that the section entitled Compensation Discussion and Analysis be included in this proxy statement.

COMPENSATION COMMITTEE:

Richard H. Anderson, Chair
Michael R. Bonsignore
Jean-Pierre Rosso
Jack W. Schuler
Gordon M. Sprenger

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EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

The following table summarizes all compensation awarded to, earned by or paid to the Company s chief executive officer, chief financial officer and three other most highly compensated executive officers (collectively, the named executive officers) during fiscal year 2007. You should refer to the section entitled Compensation Discussion and Analysis beginning on page 21 of this proxy statement to understand the elements used in setting the compensation for our named executive officers. A narrative description of the material factors necessary to understand the information in the table is provided below.

d Principal Position[1]	Year	Salary	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	To
. Collins, Jr. n and Chief Executive	2007	$ 1,275,000	$ 2,322,420	$ 5,985,461	$ 1,020,000	$ 849,071	$ 48,678	$ 11,
Ellis ice President and Chief Officer	2007	525,000	462,861	534,401	295,313	167,499	33,184	2,
A. Hawkins and Chief Operating	2007	775,000	1,726,476	1,261,157	490,963	119,907	38,809	4,
F. DeMane ice President	2007	530,000	1,680,638	878,660	529,470	92,371	870,752	4,
H. Mahle e Vice President & , Cardiac Rhythm	2007	595,000	880,465	1,645,264	219,793	562,898	33,290	3,

ment

(1) At the Annual Meeting, Mr. Collins is expected to resign as Chief Executive Officer of Medtronic, Mr. Hawkins is expected to be named President and Chief Executive Officer of Medtronic and Mr. DeMane is expected to be named Chief Operating Officer of Medtronic.

Salary. The salary column represents the base salary earned by the named executive officer during fiscal year 2007. This column includes any amounts that the officer may have deferred under the Capital Accumulation Plan, which is included in the nonqualified deferred compensation table on page 43. Each of the named executive officers also contributed a portion of his salary to the Medtronic, Inc. Savings and Investment Plan.

Stock Awards. The stock awards column represents the dollar amount of share-based compensation expense recognized in fiscal year 2007 for restricted stock and restricted stock units (including performance-based restricted stock and performance-based restricted stock units) (collectively, restricted stock awards) granted to each of the named executive officers and share-based compensation recognized in fiscal year 2007 relating to the equity-based portions of our long-term performance plan (formerly our performance share plan), which includes long-term incentive compensation for the fiscal year 2005 to fiscal year 2007 and fiscal year 2006 to fiscal year 2008 periods. This compensation was recognized for financial statement reporting purposes in accordance with SFAS No. 123(R) (disregarding forfeiture assumptions). For a discussion of the assumptions used in calculating the dollar amount recognized, see Note 11 to our consolidated financial statements in our annual report for fiscal year 2007 accompanying this proxy statement.

Option Awards. The option awards column represents the dollar amount of share-based compensation expense recognized in fiscal year 2007 for stock option awards granted to each of the named

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executive officers for financial statement reporting purposes in accordance with SFAS No. 123(R) (disregarding forfeiture assumptions). For a discussion of the assumptions used in calculating the dollar amount recognized, see Note 11 to our consolidated financial statements in our annual report for fiscal year 2007 accompanying this proxy statement.

Non-Equity Incentive Plan Compensation. This column reflects the full Medtronic, Inc. incentive plan cash payment earned by the named executive officers during fiscal year 2007 and payable in June 2007. This column includes any amounts that the officer may have deferred under the Capital Accumulation Plan. These deferrals are not included in the nonqualified deferred compensation table on page 43 of this proxy statement because the payment was made after the end of fiscal year 2007.

Change in Pension Value and Nonqualified Deferred Compensation Earnings. This column includes the estimated aggregate increase in the accrued pension benefit under Medtronic s defined benefit pension plan. Assumptions are described in Note 13 to our consolidated financial statements in our annual report for fiscal year 2007 accompanying this proxy statement.

Also included is $1,473 in above-market earnings on Mr. Mahle s deferred compensation earnings.

All Other Compensation. The all other compensation column includes the following:

$8,580 contributed by Medtronic to match named executive officer contributions to their Medtronic s 401(k) supplemental retirement plan;

a business allowance, paid in lieu of perquisites, in the amounts of $40,000 to Mr. Collins, $30,000 to Mr. Hawkins, and $24,000 to Messrs. Ellis and Mahle;

payments to Mr. DeMane in the amount of $862,075 related to his expatriate assignment in Europe (including tax gross-ups for the payment of taxes); and

up to $2,000 in reimbursement for an annual physical examination.

No named executive officers other than Mr. DeMane received perquisites having a value of $10,000 or more. Of the $862,075 relating to Mr. DeMane s expatriate assignment in Europe, $377,961 was for foreign-income tax payments, $199,365 was in the form of a host housing allowance and for interim living expenses, $79,103 was for family education expenses and $23,024 was related to tax gross-up payments for Mr. DeMane. Additional categories of expatriation expense are a cost of living differential, an automobile allowance, payments for home leave and a family allowance, payments for storage, financial planning payments and miscellaneous assignment-related expenses. All incremental costs were calculated by reference to the actual amount paid by Medtronic for fiscal year 2007. Medtronic pays Mr. DeMane portions of his compensation in Swiss Francs, which is converted based on published market exchange rates as determined on a quarterly basis.

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GRANTS OF PLAN-BASED AWARDS

The following table summarizes all plan-based award grants to each of the named executive officers during fiscal year 2007. You should refer to the Compensation Discussion and Analysis sections entitled Annual Performance-Based Incentives on page 24 and Long-Term Compensation beginning on page 26 to understand how plan-based awards are determined. A narrative description of the material factors necessary to understand the information in the table is provided below.

		Estimated Possible Payouts Under Non-Equity Incentive Plan Awards		
Name	**Award Type**	**Threshold ($)**	**Target ($)**	**Maximum ($)**
Arthur D. Collins, Jr.	MIP	765,000	1,530,000	3,000,000
	LTPP	500,000	2,500,000	4,500,000
Gary L. Ellis	MIP	196,875	393,750	866,250
	LTPP	110,000	550,000	990,000
William A. Hawkins	MIP	368,125	736,250	1,619,750
	LTPP	180,000	900,000	1,620,000
Michael F. DeMane	MIP	198,750	397,500	894,375
	LTPP	120,000	600,000	1,080,000
Stephen H. Mahle	MIP	238,000	476,000	1,071,000
	LTPP	150,000	750,000	1,350,000

Name	**Award Type**	**Grant Date**	**Approve Date**	**Estimated Future Payouts Under Equity Incentive Plan Awards Target (#)**	**All Other Stock Awards: Number of Shares of Stock or Units (#)**	**All Other Option Awards: Number of Securities Underlying Options (#)**	**Exercise or Base Price of Option Awards ($/Sh)**	**Grant Date Fair Value of Stock and Option Awards**
Arthur D. Collins, Jr.	OPT	10/30/06	10/18/06			184,805	48.70	2,263,861
	PBRSA	10/30/06	10/18/06	51,335				2,500,015
Gary L. Ellis	OPT	10/30/06	10/18/06			41,068	48.70	503,083
	PBRSA	10/30/06	10/18/06	11,294				550,018
	RSU	07/31/06	06/22/06		19,795			1,000,043
William A. Hawkins	OPT	10/30/06	10/18/06			67,762	48.70	830,085

	PBRSA	10/30/06	10/18/06	18,481				900,025
	RSU	05/15/06	05/02/06		40,775			2,000,014
Michael F. DeMane	OPT	10/30/06	10/18/06			45,175	48.70	553,394
	PBRSU	10/30/06	10/18/06	12,321				600,033
	RSU	05/15/06	05/02/06		40,775			2,000,014
Stephen H. Mahle	OPT	10/30/06	10/18/06			55,442	48.70	679,165
	PBRSA	10/30/06	10/18/06	15,401				750,029

MIP = Annual performance-based plan award granted under the Medtronic, Inc. Executive Incentive Plan
LTPP = Long-term performance plan award granted under the Medtronic, Inc. 2003 Long-Term Incentive Plan
OPT = Nonqualified stock options granted under the Medtronic, Inc. 2003 Long-Term Incentive Plan
PBRSA = Performance-based restricted stock granted under the Medtronic, Inc. 2003 Long-Term Incentive Plan
PBRSU = Performance-based restricted stock units granted under the Medtronic, Inc. 2003 Long-Term Incentive Plan
RSA = Restricted stock awards granted under the Medtronic, Inc. 2003 Long-Term Incentive Plan
RSU = Restricted stock units granted under the Medtronic, Inc. 2003 Long-Term Incentive Plan

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Estimated Future Payouts Under Non-Equity Incentive Plan Awards. Amounts in these columns represent future cash payments under the 2007-2009 Long-Term Performance Plan and cash payments made in June 2007 under the annual performance-based plan for fiscal year 2007 at threshold, target and maximum performance. The Long-Term Performance Plan provides for annual grants that are earned over a three-year period. Upon meeting a minimum performance threshold, awards under the Long-Term Performance Plan can range from 20% to 180% of the original grant based on company performance relative to the following metrics: three-year cumulative diluted earnings per share, three-year average annual revenue growth and three-year average after-tax return on net assets. Similarly, the Medtronic Incentive Plan provides for annual grants based upon meeting a minimum performance threshold. Awards under the Medtronic Incentive Plan can range from 50% to 225% of the original determination based on both company performance relative to diluted earnings per share, average annual revenue growth and average after-tax return on net assets in fiscal year 2007 and, for all named executive officers except for the chief executive officer, on individual performance as evaluated by our chief executive officer and/or chief operating officer. The maximum award under the Plan is $3,000,000.

Estimated Future Payouts Under Equity Incentive Plan Awards. Amounts in this column represent grants of performance-based restricted stock, all of which have an October 30, 2006 grant date. Performance-based restricted stock grants vest 100% on the third anniversary of the date of grant assuming that Medtronic achieves a minimum three-year cumulative diluted earnings per share threshold.

All Other Stock Awards. Amounts in the all other stock awards column represents grants of restricted stock or restricted stock units.

All Other Option Awards/Exercise or Base Price of Option Awards. The exercise or base price of all option awards is the closing market price of Medtronic common stock on the date of grant. Option awards vest 25% on each anniversary of the date of grant over a four year period.

Grant Date Fair Value of Stock and Option Awards. This column represents the grant date fair value of each equity award granted in fiscal year 2007 computed in accordance with SFAS No. 123(R). For a discussion of the assumptions we use in calculating the amount recognized, see Note 11 to our consolidated financial statements in our annual report for fiscal year 2007 accompanying this proxy statement.

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OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END

The table below reflects all outstanding equity awards made to each of the named executive officers that are outstanding at the end of fiscal year 2007. The market or payout value of unearned shares, units or other rights that have not vested equals $53.60, which was the closing price of Medtronic s common stock on the NYSE on April 27, 2007 and for performance-based restricted stock and for performance share plan awards presumes that the target performance goals are met.

Option Awards					Stock Awards				Equity Incen Plan Award Unearned Sha Units or Oth Rights That H Not Veste Ma or P
	Number of Securities Underlying Unexercised Options(#)					Shares or Units of Stock That Have Not Vested			
Option Grant Date	Exer-cisable	Unexer cisable	Option Exercise Price	Option Expiration Date	Grant Date	Number	Market Value	Number	Va
08/11/1997	500,000		$ 23.36	08/11/2007	10/24/2002	44,574	$ 2,389,166		
10/29/1997	69,566		21.56	10/29/2007	10/23/2003	43,469	2,329,938		
05/01/1998	30,190		26.50	05/01/2008	10/21/2004	40,000	2,144,000		
10/28/1998	70,520		31.91	10/28/2008	10/19/2005	35,249	1,889,346		
04/28/1999	10,656		37.59	04/28/2009	04/30/2005			14,240	$ 7
05/01/1999	99,204		35.97	05/01/2009	10/30/2006			51,335	2,7
10/27/1999	120,755		33.13	10/27/2009					
04/30/2000	100,658		51.94	04/30/2010					
10/26/2000	116,223		51.63	10/26/2010					
04/27/2001	61,589		44.25	04/27/2011					
10/25/2001	298,851		43.50	10/25/2011					
04/26/2002	27,821		43.81	04/26/2012					
10/24/2002	289,726		44.87	10/24/2012					
04/25/2003	34,098		48.08	04/25/2013					
10/23/2003	211,911	70,637	46.01	10/23/2013					
04/30/2004	42,927		50.46	04/30/2014					
10/21/2004	130,000	130,000	50.00	10/21/2014					
10/19/2005	57,279	171,837	56.74	10/19/2015					
10/30/2006		184,805	48.70	10/30/2016					
10/29/1997	18,552		21.56	10/29/2007	06/24/2005	9,485	508,396		
05/01/1998	4,530		26.50	05/01/2008	07/31/2006	19,795	1,061,012		
10/28/1998	12,538		31.91	10/28/2008	04/30/2005			3,454	
04/28/1999		2,618	37.59	04/28/2009	10/30/2006			11,294	6

05/01/1999	13,328		35.97	05/01/2009
10/27/1999	19,623		33.13	10/27/2009
04/30/2000	23,590		51.94	04/30/2010
10/26/2000	17,434		51.63	10/26/2010
04/27/2001	15,579		44.25	04/27/2011
10/25/2001	32,184		43.50	10/25/2011
04/26/2002	5,257		43.81	04/26/2012
10/24/2002	33,430		44.87	10/24/2012
04/25/2003	7,189		48.08	04/25/2013
10/23/2003	24,451	8,151	46.01	10/23/2013
04/30/2004	4,246		50.46	04/30/2014
10/21/2004	15,000	15,000	50.00	10/21/2014
10/19/2005	9,252	27,759	56.74	10/19/2015
10/30/2006		41,068	48.70	10/30/2016

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	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options(#)					Shares or Units of Stock That Have Not Vested		Equity Incent Plan Awards Unearned Sha Units or Oth Rights That H Not Vested	
Option Grant Date	Exer-cisable	Unexer cisable	Option Exercise Price	Option Expiration Date	Grant Date	Number	Market Value	Number	Ma or Pa Va
01/07/2002	82,305		48.60	01/07/2012	08/28/2003	30,334	1,625,902		
01/07/2002	36,214		48.60	01/07/2012	05/15/2006	40,775	2,185,540		
10/24/2002	49,031		44.87	10/24/2012	04/30/2005			6,770	36
10/23/2003	48,903	16,301	46.01	10/23/2013	10/30/2006			18,481	99
10/21/2004	50,000	50,000	50.00	10/21/2014					
04/29/2005	7,591		52.70	04/29/2015					
04/29/2005	5,462		52.70	04/29/2015					
10/19/2005	18,946	56,839	56.74	10/19/2015					
10/30/2006		67,762	48.70	10/30/2016					
03/17/2000	5,694		$ 52.69	03/17/2010	08/28/2003	60,668	$ 3,251,805		
08/09/2000	8,889		56.25	08/09/2010	05/15/2006	40,775	2,185,540		
10/26/2000	19,371		51.63	10/26/2010	04/30/2005			3,636	$ 19
10/25/2001	32,184		43.50	10/25/2011	10/30/2006			12,321	66
10/24/2002	49,031		44.87	10/24/2012					
10/23/2003	48,903	16,301	46.01	10/23/2013					
10/21/2004	30,000	30,000	50.00	10/21/2014					
10/19/2005	11,896	35,690	56.74	10/19/2015					
10/30/2006		45,175	48.70	10/30/2016					
08/11/1997	20,000		23.36	08/11/2007	08/28/2003	30,334	1,625,902		
10/29/1997	11,596		21.56	10/29/2007	04/30/2005			4,160	22
05/01/1998	3,774		26.50	05/01/2008	10/30/2006			15,401	82
05/01/1998	31,062		26.50	05/01/2008					
10/28/1998	20,374		31.91	10/28/2008					
04/28/1999	4,496		37.59	04/28/2009					
05/01/1999	39,826		35.97	05/01/2009					
10/27/1999	51,321		33.13	10/27/2009					
04/30/2000	34,581		51.94	04/30/2010					
10/26/2000	48,427		51.63	10/26/2010					
04/27/2001	27,226		44.25	04/27/2011					
06/28/2001	31,381		47.80	06/28/2011					
10/25/2001	80,460		43.50	10/25/2011					

04/26/2002	10,841		43.81	04/26/2012
10/24/2002	78,004		44.87	10/24/2012
04/25/2003	14,054		48.08	04/25/2013
10/23/2003	57,053	19,018	46.01	10/23/2013
04/30/2004	8,144		50.46	04/30/2014
10/21/2004	35,000	35,000	50.00	10/21/2014
10/19/2005	13,218	39,655	56.74	10/19/2015
10/30/2006		55,442	48.70	10/30/2016

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The table below shows the vesting schedule for all unexercisable options. All options vest on the anniversary of the grant date in the year indicated.

		Vesting Schedule for Unexercisable Options			
Name	**Grant Date**	**2007**	**2008**	**2009**	**2010**
Arthur D. Collins, Jr.	10/23/2003	70,637			
	10/21/2004	65,000	65,000		
	10/19/2005	57,279	57,279	57,279	
	10/30/2006	46,201	46,201	46,201	46,202
Gary L. Ellis	04/28/1999	2,618			
	10/23/2003	8,151			
	10/21/2004	7,500	7,500		
	10/19/2005	9,253	9,253	9,253	
	10/30/2006	10,267	10,267	10,267	10,267
William A. Hawkins	10/23/2003	16,301			
	10/21/2004	25,000	25,000		
	10/19/2005	18,946	18,946	18,947	
	10/30/2006	16,940	16,941	16,940	16,941
Michael F. DeMane	10/23/2003	16,301			
	10/21/2004	15,000	15,000		
	10/19/2005	11,897	11,896	11,897	
	10/30/2006	11,293	11,294	11,294	11,294
Stephen H. Mahle	10/23/2003	19,018			
	10/21/2004	17,500	17,500		
	10/19/2005	13,218	13,218	13,219	
	10/30/2006	13,860	13,861	13,860	13,861

The amounts shown in the column entitled Number of Shares or Units of Stock That Have Not Vested of the Outstanding Equity Awards at Fiscal Year-End table are of restricted stock and restricted stock units that have not yet vested. The table below shows the vesting schedules for all outstanding restricted stock and restricted stock unit grants.

		Vesting Schedule for Unvested Restricted Stock and RSUs			
Name	**Grant Date**	**2007**	**2008**	**2009**	**2010**
Arthur D. Collins, Jr. (1)	10/24/2002	44,574			
	10/23/2003		43,469		
	10/21/2004			40,000	
	10/19/2005				35,249
Gary L. Ellis	06/24/2005			9,485	
	07/31/2006				19,795
William A. Hawkins	08/28/2003	30,334			
	05/15/2006			40,775	
Michael F. DeMane	08/28/2003		60,668		
	05/15/2006			40,775	

Stephen H. Mahle	08/28/2003	30,334

(1) Mr. Collins 2003, 2004 and 2005 grants vest immediately in the event of death, disability or retirement (so long as, with respect to his 2003 grants, such event occurs following the fourth anniversary of the date of grant).

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The amounts shown in the column entitled Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested of the Outstanding Equity Awards at Fiscal Year-End table that correspond to an April 30, 2005 grant date reflect outstanding equity awards under the 2008 Performance Share Plan, which vest on the last day of fiscal year 2008, and amounts that correspond to an October 30, 2006 grant date reflect performance-based restricted stock awards that vest on the third anniversary of the date of grant.

Messrs. Collins, Hawkins and Mahle also own 306,575, 51,792 and 31,148 restricted/deferred stock units, respectively, that are fully vested and will be distributed following their retirement.

OPTION EXERCISES AND STOCK VESTED

The table below includes information related to options exercised by each of the named executive officers and their restricted stock awards that have vested during fiscal year 2007. The table also includes the value realized for such options and restricted stock awards. For options, the value realized on exercise is equal to the difference between the market price of the underlying shares at exercise and the exercise price of the options. For stock awards, the value realized on vesting is equal to the market price of the underlying shares at vesting.

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise	Value Realized on Exercise	Number of Shares Acquired on Vesting (1)	Value Realized on Vesting
Arthur D. Collins, Jr.	75,760	$ 2,393,174	27,526	$ 1,407,129
Gary L. Ellis			4,134	211,330
William A. Hawkins			64,269	3,153,981
Michael F. DeMane	72,729	1,490,749	27,476	1,424,185
Stephen H. Mahle	54,628	1,676,977	38,409	1,812,405

(1) Includes shares received pursuant to the Performance Share Plan for the fiscal year 2005 to fiscal year 2007 grant cycle by each named executive officer in June of 2006.

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PENSION BENEFITS

The table below includes information with respect to Medtronic s pension plan for each of the named executive officers as at the end of fiscal year 2007. A narrative description of the material factors necessary to understand the information in the table is provided below.

Name	Plan Name	Number of Years Credited Service	Present Value of Accumulated Benefit	Payments During Last Fiscal Year
Arthur D. Collins, Jr.	Medtronic, Inc. Retirement Plan	14.9	$ 413,318	
	Medtronic, Inc. SERP		3,178,250	
Gary L. Ellis	Medtronic, Inc. Retirement Plan	17.4	207,404	
	Medtronic, Inc. SERP		364,884	
William A. Hawkins	Medtronic, Inc. Retirement Plan	5.3	60,383	
	Medtronic, Inc. SERP		288,113	
Michael F. DeMane	Medtronic, Inc. Retirement Plan	7.9	81,668	
	Medtronic, Inc. SERP		289,697	
Stephen H. Mahle	Medtronic, Inc. Retirement Plan	34.8	1,256,653	
	Medtronic, Inc. SERP		1,847,015	

The Medtronic, Inc. Retirement Plan (the Plan) is a funded, tax-qualified, noncontributory defined-benefit pension plan that covers all eligible employees employed with the Company prior to April 30, 2005, including the Named Executive Officers. Effective May 1, 2005 the Company froze the Plan to new entrants and provided all eligible employees the option of continuing to accrue retirement benefits under the Plan or participate in one of two new options being offered. All Named Executive Officers elected to continue participation in the Plan. Benefits under the Plan are based upon the employee s years of credited service and the average of the employee s highest five consecutive years of covered compensation during the employee s career while covered under the Plan. Employees have the option of providing for a survivorship benefit upon the employee s death by making the appropriate election at the time of retirement. Covered compensation includes base salary, formula bonus and incentive plan payments, sales commissions, salary reduction contributions (such as a cafeteria plan or medical plan), salary continuation payments for short-term disability, but excludes compensation paid under the Company s Long Term Performance Plan or the Performance Share Plan. In addition, the IRS limits the amount of Covered Compensation that can be used in the benefit calculation. For the Plan year ended April 30, 2007, that limit is $220,000. Normal retirement age under the plan is age 65. Eligible employees may retire upon reaching age 55 with at least ten years of service or upon reaching age 62 without regard to years of service. Messrs. Collins and Mahle were eligible for early retirement at the end of fiscal year 2007. Any retirement prior to normal retirement age is considered early retirement.

Benefits under the Plan are calculated as a monthly annuity by taking 40% of the final average covered compensation less a social security allowance (which varies by individual based upon year of birth) and multiplying this difference

by years of credited service under the Plan. That result is then divided by 30 to yield the benefit at normal retirement age, with an early retirement factor applied to calculate the early retirement benefit.

The Plan currently limits pensions paid under the Plan to an annual maximum of $175,000, payable at age 65 in accordance with IRS requirements. The Company also has an unfunded Medtronic, Inc. Supplemental Executive Retirement Plan (the SERP) that provides out of the general assets of the Company an amount substantially equal to the difference between the amount that would have been payable to the executive under the Plan in the absence of legislation limiting pension benefits and earnings that may be considered in calculating pension benefits and the amount actually payable under the Plan.

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Compensation used in the calculation of the SERP benefit includes eligible compensation in excess of the IRS limitation and amounts deferred to the Capital Accumulation Plan. Upon retirement or termination of employment the amount of retirement benefits earned under the SERP are calculated and if the lump sum value is less than $100,000, it is paid out as a lump sum six months after retirement or termination. If the lump sum value exceeds $100,000, the value is paid out over a fifteen year period in the form of a monthly annuity commencing six months after retirement or termination. In the event of the employee s death prior to the completion of the fifteen year payment cycle, any remaining benefits from the SERP are payable per the beneficiary designation on record. If a beneficiary is not named the benefit is payable to the employee s surviving spouse, if there is no surviving spouse, to the children or if no survivors, the estate.

NONQUALIFIED DEFERRED COMPENSATION

The table below includes information with respect to the deferral of compensation on a basis that is not tax-qualified for each of the named executive officers for fiscal year 2007. A narrative description of the material factors necessary to understand the information in the table is provided below.

Name	Executive Contributions in Last FY	Aggregate Earnings in Last FY	Aggregate Balance at Last FYE
Arthur D. Collins, Jr.	$ 326,154	$ 1,685,591	$ 25,620,191
Gary L. Ellis			
William A. Hawkins	2,502,553	273,498	2,776,051
Michael F. DeMane	9,231	18,993	392,479
Stephen H. Mahle	1,428,033	301,509	2,823,181

Executive Contributions in Last Fiscal Year. This column includes the following amounts that were reported in the Summary Compensation Table for the most recent fiscal year as shown on page 34 of this proxy statement: Mr. Collins base salary in the amount of $326,154; Mr. Hawkins $533,342 of stock compensation expense recognized in fiscal year 2007 relating to restricted stock unit deferrals, Mr. DeMane base salary in the amount of $9,231 and Mr. Mahle $333,334 of stock compensation expense recognized in fiscal year 2007 relating to restricted stock unit deferrals. Fiscal year 2007 annual incentive deferral amounts of $200,000 and $529,470 for Mr. Hawkins and Mr. DeMane, respectively, were made in June 2007 (which is in fiscal year 2008) and are not reflected in this column.

The Capital Accumulation Plan allows U.S. executives of Medtronic to defer:

Up to 50% of their base salary;

Up to 100% of their annual incentive plan payments; and

Up to 100% of their cash long-term incentive plan payments,

subject to a minimum floor of $10,000. Medtronic does not make any contributions to the deferral plan the aggregate balances shown above represent amounts that the named executive officers earned but elected to defer, plus earnings (or losses).

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Participants receive credits of gains or losses daily based on funds that are indexed to eleven investment alternatives, which are all also available under the Medtronic supplemental retirement plan 401(k). Investment returns for these investment alternatives are shown below:

	Return on Funds April 28, 2006 to April 27, 2007			
Medtronic Stock	8.37%			
$4,520				
Cost of Sales	2,305	-	1,664 a	3,969
Gross Profit	2,215	-	(1,664)	551
Product research and development	1,048	91	367 b	1,506
Sales and marketing	1,053	48	263 c	1,364
General and administrative	795	34	-	829
Total operating expense	2,967	173	630	3,699
Operating income loss	(752)	(173)	(2,294)	(3,148)
Interest income (expense)	(3)	-	-	(3)
Net loss before income taxes	(755)	(173)	(2,294)	(3,151)
Provision for income taxes	5	-	-	5
Net loss	$ (760)	$ (173)	$ (2,294)	$ (3,156)
Basic loss per share	$ (0.15)	$	$	$ (0.31)
Diluted loss per share	$ (0.15)	$	$	$ (0.31)
Basic - shares used in per share computations	5,175		5,136 d	10,311
Diluted - shares used in per share computations	5,175		5,136 d	10,311

Footnotes to the Unaudited Pro Forma Condensed Combined Statement of Operations for the six months ended April 30, 2005 for the Company and March 31, 2005 for PyX:

(a) The intellectual property acquired in the PyX acquisition is amortized to expense over 36 months. This $1,664,000 adjustment reflects six months of amortization of intellectual property originally valued at $9,987,000 acquired in the PyX acquisition.

(b) Adjustment to reflect the difference between the current salaries plus benefits of the PyX engineering employees and the expected salaries plus benefits of the PyX engineering employees when they are hired by the Company.

Included in this adjustment is $141,000 of amortization expense related to six-months of amortization of deferred compensation related to the issuance of options to purchase the Company's common stock awarded to the engineering employees of PyX as part of the purchase price of PyX. The deferred compensation related to the purchase price of PyX totals $1,876,000 and will be amortized to product research and development and sales and marketing expense over the 4-year vesting period of the options. This adjustment is for the six-month period from November 1, 2004 through April 30, 2005.

(c) Adjustment to reflect the difference between the current salaries plus benefits of the PyX sales employees and the expected salaries plus benefits of the PyX sales employees when they are hired by the Company. Included in this adjustment is $94,000 of amortization expense related to six-months of amortization of deferred compensation related to the issuance of options to purchase the Company's common stock awarded to the sales and marketing employees of PyX as part of the purchase price of PyX. The deferred compensation related to the purchase price of PyX totals $1,876,000 and will be amortized to product research and development and sales and marketing expense over the 4-year vesting period of the options. This adjustment is for the six-month period from November 1, 2004 through April 30, 2005.

(d) Combined pro forma shares include 2,561,050 shares of the Company's common stock that the Company will be issuing to the shareholders of PyX, at an assumed price of $3.09 per share based on the average closing price for the Company's common stock over the period beginning five trading days prior to and ending five trading days after the date the merger agreement was signed, March 28, 2005, plus 2,575,000 shares of the Company's common stock in the private placement equity transaction at an assumed price of $2.00 per share, which is based on the lowest unit price at which the Company is obligated to complete the private placement. The following securities were not included in the computation of pro forma number of shares because to do so would have been antidilutive for the periods presented:

SBE outstanding employee stock options	2,307,627
Warrants to purchase SBE common stock	140,000
PyX outstanding employee stock options to be assumed by SBE	2,038,950
Warrants to purchase SBE common stock issued in conjunction with the private placement transaction	1,287,500
Total securities not included in pro forma number of shares	5,774,077

SBE, Inc.
Unaudited Pro Forma Condensed Combined State of Operations

	for the year ended October 31, 2004 Historical SBE	December 31, 2004 Historical PyX	Adjustments	Combined Companies
		(in thousands, except for per share amounts)		
Net Sales	$ 11,066	$ -	$	$ 11,066
Cost of Sales	6,646	-	3,329 a	9,975
Gross Profit	4,420	-	3,329	1,092
Product research and development	2,411	143	735 b	3,289
Sales and marketing	2,177	125	525 c	2,827
General and administrative	1,755	-		1,755
Loan reserve	(239)	-		(239)
Total operating expense	6,104	268	1,260	7,632
Operating loss	(1,684)	(268)	(4,589)	(6,541)
Interest income (expense)	5	-		5
Net loss before income taxes	(1,679)	(268)	(4,589)	(6,536)
Benefit for income taxes	-	-		
Net loss	$ (1,679)	$ (268)	$ (4,589)	$ (6,536)
Basic loss per share	$ (0.33)	$	$	$ (0.64)
Diluted loss per share	$ (0.33)	$	$	$ (0.64)
Basic - shares used in per share computations	5,022		5,136 d	10,158
Diluted - shares used in per share computations	5,022		5,136 d	10,158

Footnotes to the Unaudited Pro Forma Condensed Combined Statement of Operations for the year ended October 31, 2004 for the Company and December 31, 2004 for PyX:

(a) The intellectual property acquired in the PyX acquisition is amortized to expense over 36 months. This $3,329,000 adjustment reflects twelve months amortization of intellectual property originally valued at $9,987,000 acquired in the PyX acquisition.

(b) Adjustment to reflect the difference between the current salaries plus benefits of the PyX engineering employees and the expected salaries plus benefits of the PyX engineering employees when they are hired by the Company. Included in this adjustment is $281,000 of amortization expense related to twelve-months of amortization of deferred compensation related to the issuance of options to purchase the Company's common stock awarded to

the engineering employees of PyX as part of the purchase price of PyX. The deferred compensation related to the purchase price of PyX totals $1,876,000 and will be amortized to product research and development and sales and marketing expense over the 4-year vesting period of the options. This adjustment is for the twelve-month period from November 1, 2003 through October 31, 2004.

(c) Adjustment to reflect the difference between the current salaries plus benefits of the PyX sales employees and the expected salaries plus benefits of the PyX sales employees when they are hired by the Company. Included in this adjustment is $188,000 of amortization expense related to twelve-months of amortization of deferred compensation related to the issuance of options to purchase the Company's common stock awarded to the sales and marketing employees of PyX as part of the purchase price of PyX. The deferred compensation related to the purchase price of PyX totals $1,876,000 and will be amortized to product research and development and sales and marketing expense over the 4-year vesting period of the options. This adjustment is for the twelve-month period from November 1, 2003 through October 31, 2004.

(d) Combined pro forma shares include 2,561,050 shares of the Company's common stock that the Company will be issuing to the shareholders of PyX, at an assumed price of $3.09 per share is based on the average closing price for the Company's common stock over the period beginning five trading days prior to and ending five trading days after the date the merger agreement was signed, March 28, 2005, plus 2,575,000 shares of the Company's common stock that the Company will be selling to the purchasers in the private placement equity transaction at an assumed price of $2.00 per share, which is based on the lowest unit price at which the Company is obligated to complete the private placement. The following securities were not included in the computation of pro forma number of shares because to do so would have been antidilutive for the periods presented:

SBE outstanding employee stock options	2,307,627
Warrants to purchase SBE common stock	140,000
PyX outstanding employee stock options to be assumed by SBE	2,038,950
Warrants to purchase SBE common stock issued in conjunction with the private placement transaction	1,287,500
Total securities not included in pro forma number of shares	5,774,077

SELECTED FINANCIAL DATA OF PYX

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations of PyX" and the financial statements and the notes thereto included elsewhere in this proxy statement. PyX was incorporated on November 26, 2002. The selected statements of operations data for the quarters ended March 31, 2005 and 2004 and the fiscal years ended December 31, 2002, 2003 and 2004 and the selected balance sheet data as of March 31, 2005 and December 31, 2003 and 2004 are derived from the audited financial statements that are included elsewhere in this proxy statement and represent the financial data of PyX since its inception

	January 1, 2005 to March 31, 2005	January 1, 2004 to March 31, 2004	January 1, 2004 to December 31,2004	Period from Inception to December 31, 2003
Statements of Operations Data:				
Total revenues	$ -	$ -	$ -	$ 5,000
Total operating expenses	466,255	6,579	267,432	26,696
Operating loss	(466,255)	(6,579)	(267,432)	(21,696)
Net loss	(467,255)	(6,579)	(268,463)	(22,510)

	March 31, 2005	2004	December 31, 2003
Balance Sheet Data:			
Total current assets	$ 93,897	$4,869	$ 392
Total assets	198,864	41,449	11,982
Total current liabilities	207,187	219,922	1,992
Total liabilities	207,187	219,922	1,992
Total shareholders' equity (deficit)	$ (8,323)	$(178,473)	$ 9,990

DESCRIPTION OF PYX'S BUSINESS

The following description of PyX's business contains forward-looking statements that involve risks and uncertainties. Words such as "believes,""anticipates,""expects,""intends" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Readers are cautioned that the forward-looking statements reflect PyX's analysis only as of the date hereof, and PyX assumes no obligation to update these statements. Actual events or results may differ materially from the results discussed in or implied by the forward-looking statements. The following description should be read in conjunction with PyX's consolidated financial statements for the years ended December 31, 2003 and 2004 [AND Q1?] and the related notes included in this proxy statement.

Overview

PyX Technologies, Inc., or PyX, is a technology company that was incorporated under the laws of the State of California on November 26, 2002. Since inception, PyX's efforts have been devoted to the development of software products for the Internet Small Computer System Interface, or iSCSI, enterprise storage market and raising capital. PyX has not received any significant revenues from the sale of its products or services. Accordingly, through the date of this proxy statement, PyX is considered to be in the development stage and the accompanying financial statements on page [___] represent those of a development stage enterprise.

PyX's goal is to develop a complete software-based, scalable storage solution via an iSCSI Initiator and Target driver set for the NetBSD or LINUX OS. PyX believes that its iSCSI software provides an efficient alternative for all environments seeking interoperability in a software-based enterprise storage solution. A Storage Area Network, or SAN, infrastructure with iSCSI capabilities can continue to operate during the constant network changes and updates facing network operators today.

PyX currently has two products that have been completed, an iSCSI Initiator and an iSCSI Target running on Linux. All PyX products conform to the iSCSI standard as ratified by the Internet Engineering Task Force ("IETF"). PyX believes that it is the first and only company in the world to complete development of a universal iSCSI protocol that meets and exceeds the IETF standard for Error Recovery Level Two (ERL2) with full Sync and Steering.

Strategy

PyX expects its principal markets to be with the manufacturers, developers and systems integrators of small- and medium-sized companies for whom the costs of other high-performance storage transport technology, and in particular fibre channel architectures, may be prohibitively expensive. As companies see the number of servers and databases grow on their networks, they are experiencing increasing storage-management complexity that can result in inefficient storage utilization and increased cost of ownership. When the expense and scarcity of qualified IT support staff are factored in, these issues can be compounded significantly.

For small- and medium-sized companies, iSCSI may be their best solution as it utilizes the same IP infrastructure as network attached storage, but features the block input/output protocol inherent in storage area networks, or SANs. PyX believes that the adaptability of iSCSI to varied storage approaches likewise increases the market potential for iSCSI software solutions. The bulk of PyX's iSCSI revenues for 2005 and 2006 are expected to come from sales in the SAN market as described above. PyX also anticipates being able to market to the developing consumer and military/government markets. Specifically, iSCSI applications are expected to include Secure Mobile Computing, in the military/government market, and the Global Personal SAN, in the consumer market. While these markets will take longer to develop, they are expected to be a part of PyX's long-term strategy for growth and expansion beyond the traditional SAN market.

Products

PyX's product development initiative for 2005 is expected to include several iSCSI software products, two of which have been completed, the iSCSI Initiator and the iSCSI Target software running on Linux. The iSCSI Initiator, the Linux version of which is currently being shipped, is a product that resides on a client's computer, server or device that is connected to a network. PyX's technology allows the iSCSI Initiator to regard the target storage device as another local disk, whether it is in a server in a nearby location or in another country. The iSCSI Target is a product that resides on a storage server and is the destination of the iSCSI Initiator. Recently, a graphical user interface was added to the management features of this stack to enhance the ease-of-use experience and broaden the appeal to a larger market.

All of PyX's current and planned products conform to the iSCSI standard as ratified by the Internet Engineering Task Force, IETF. PyX believes that it is the first and only company in the world to complete development of a universal iSCSI protocol that meets, and exceeds, the IETF standard for Error Recovery Level Two, or ERL2, with full Sync and Steering. At present, PyX is not aware of any other iSCSI vendors that are offering both Initiator and Target solutions that provide full error-recovery features.

This advance in PyX's technology offers enterprise level, multi-path migration with error recovery previously available only in more expensive fibre channel architectures. PyX believes that its software will enable original equipment manufacturers, value-added resellers and independent software vendors to deliver on iSCSI's promise of providing multi-path linked enterprise data storage with error recovery and failover at significantly less than the cost of fibre channel.

PyX's roadmap for the further development of its iSCSI software products is expected to include a number of initiatives in 2005 and 2006. The chart below presents the current plan and an estimated timeline for projects that have been approved or are being considered by PyX.

Intellectual Property

PyX does not hold and has not applied for or registered any patents or trademarks.

Customers

As of the date hereof, PyX is dependent on one customer, a leading video surveillance company, for 100% of its revenue. PyX expects to execute agreements with additional customers in 2005.

Employees

PyX currently has five employees: Greg Yamamoto, its Chief Executive Officer; Andre Hedrick, its President and Chief Technical Officer; Leo Fang, its Chief Operating Officer); Nicholas Bellinger its Chief Software Architect; and Chris Short its Vice President of North American Sales.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Words such as "believes,""anticipates,""expects,""intends" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Readers are cautioned that the forward-looking statements reflect our analysis only as of the date hereof, and neither we nor PyX assume any obligation to update these statements. Actual events or results may differ materially from the results discussed in or implied by the forward-looking statements. The following discussion should be read in conjunction with PyX's consolidated financial statements for the quarters ended March 31, 2005 and 2004 and the years ended December 31, 2003 and 2004 and the related notes included in this proxy statement.

Overview

PyX Technologies, Inc., or PyX, is a technology company that was incorporated under the laws of the State of California on November 26, 2002. Since inception, PyX's efforts have been devoted to the development of software products for the Internet Small Computer System Interface, or iSCSI, enterprise storage market and raising capital. PyX has not received any significant revenues from the sale of its products or services. Accordingly, through the date of this proxy statement, PyX is considered to be in the development stage and the accompanying financial statements on page ___ represent those of a development stage enterprise.

PyX's revenues are derived primarily from the sale of iSCSI software licenses and related consulting services associated with customer product development. Currently, PyX has licensed its iSCSI Initiator and Target software to a single customer. Revenues are recognized upon satisfying all generally accepted accounting principles related to software revenue recognition. Cash received in advance of revenue recognition is included in deferred revenue.

PyX's operating expenses consist primarily of research and development costs and selling and marketing expenses. PyX's research and development expenses consist primarily of salaries of personnel, consulting expenses associated with new technology development and testing costs. PyX's selling and marketing expenses consist primarily of sales personnel and public relations expenses**.**

PyX's general and administrative expenses consist primarily of salaries of personnel engaged in corporate administration, finance and accounting, human resources, and operations. General and administrative expenses also include professional fees and other general corporate expenses.

Critical Accounting Policies And Use Of Estimates

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires PyX to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Results of Operations

The following table sets forth our results of operations:

	Quarter Ended March 31, 2005	Quarter Ended March 31, 2005	January 1, 2004 to December 31, 2004	Period from Inception to December 31, 2003
Total revenue	$ -	$ -	$ -	$ 5,000
Total operating expenses	466,255	6,579	267,442	26,696
Operating loss	(466,255)	(6,579)	(267,442)	(21,696)
Interest expense	200		200	-
Income (loss) before income taxes	(466,455)	(6,579)	(267,642)	(21,696)
Income tax expense	800	-	831	814
Net loss	$ (467,255)	$ (6,579)	$ (268,473)	$ (22,510)

Comparison of Quarters Ended March 31, 2005 and 2004

Revenues

There was no revenue for either period. PyX defers all revenue in accordance with generally accepted accounting principles related to software revenue recognition. PyX had $19,500 in deferred revenue for the quarter ended March 31, 2005 compared to none in the same period in 2004.

Operating Expenses

Operating expenses for the quarter ended March 31, 2005 increased to $466,255 from $6,579 for the period in 2004. The increase in operating expenses was primarily due to an increase in salary payments during the later part of 2004 along with increased travel, accounting and advertising expenses. Include in the March 31, 2005 operating expense is $303,150 of non-cash salary expense related to warrants to purchase common stock granted to three employees of the Company in lieu of a cash salary and $82,105 in non-cash compensation expense related to vested stock options granted to employees of the Company.

Interest Expense

Interest expense for the quarter ended March 31, 2005 increased to $200 from no interest expense for the same period in 2004. The increase was due to the interest related to a $10,000 loan financed in the fourth quarter of 2004.

Net Loss

Net loss for the quarter ended March 31, 2005 increased to $467,255 from $6,579 for the period from the same period in 2004. The increased loss in 2005 primarily resulted from increased research and development spending on the iSCSI software products and an increase in cash and non-cash salary expense during the quarter ended March 31, 2005. In the quarter ended March 31, 2004, none of the Company’s employees were paid a salary.

Stock-based Compensation

On February 28, 2005, the Company granted three employees warrants to purchase a total of 215,000 shares of the Company's common stock for $0.01 per share in lieu of cash salary. The difference between the $0.01 exercise price per share and the estimated fair market value on the grant date of $1.42 is included in the general and administrative expense as compensation expense. The Company also adopted an employee stock option plan on February 28, 2005 and granted 4,432,500 stock options on February 28, 2005 to its employees. The stock options vest over four years and have an exercise price of $1.00 per share.

Comparison of Years Ended December 31, 2004 and 2003

Revenues

Total revenues for the year ended December 31, 2004 decreased to $0 from $5,000 for the period from inception to December 31, 2003. The decrease in revenues in 2004 resulted primarily from deferral to 2005 of all of PyX's revenue for 2004 in accordance with generally accepted accounting principles related to software revenue recognition. PyX had $82,500 in deferred revenue for 2004.

Operating Expenses

Operating expenses for the year ended December 31, 2004 increased to $267,442 from $26,696 for the period from inception to December 31, 2003. The increase in operating expenses was primarily due to an increase in salary payments during 2004.

Interest Expense

Interest expense for the year ended December 31, 2004 increased to US $200 from no interest expense for the period from inception to December 31, 2003. The increase was primarily due to the interest related to a $10,000 loan financed in the fourth quarter of 2004.

Net Loss

Net loss for the year ended December 31, 2004 increased to $268,000 from $23,000 for the period from inception to December 31, 2003. The increased loss in 2004 primarily resulted from increased research and development spending on the iSCSI software products and an increase in salary payments during 2004.

Stock-based Compensation

From its inception to December 31, 2004, PyX did not have any stock based compensation.

Liquidity and Capital Resources

Since its inception, PyX has financed its operations through sales of stock and a small loan and, more recently, minimal amounts of internally generated cash flow from operations. PyX's cash and cash equivalents increased to $78,846 at March 31, 2005. The increase was primarily a result of an investment round of $250,000 in January 2005, offset by $65,900 for retaining legal counsel, pre-paying future commission expenses and fixed asset costs. PyX's net cash and cash equivalents provided by financing activities during the first quarter of 2005 totaled $250,000.

At December 31, 2004, PyX had cash of $4,869. This represented a $4,477 increase in cash from $392 at December 31, 2003. The increase in cash resulted primarily from $90,000 in cash received from financing activities, most

notably $80,000 from the sale of stock and $10,000 from a related party loan. The cash received from financing activities was partially offset by losses from operations and purchases of computer equipment.

In January of 2003, PyX sold 5,000,000 shares of PyX common stock for a per share price of $0.002 with aggregate proceeds to PyX of $10,000. In June and August of 2003, PyX sold 22,500 shares of PyX common stock for a per share price of $1.00. In March and April of 2004, PyX sold 80,000 shares of PyX common stock for a per share price of $1.00. In January 2005, PyX sold 250,000 shares of PyX common stock for a per share price of $1.00.

PyX's cash expenditures have been primarily related to operating expense, such as payroll, marketing and travel, in addition to purchases of computer and development equipment.

If the proposed acquisition of the Company by SBE does not materialize the Company will need to raise additional capital through the issuance of debt or equity securities. In addition, the Company's projected revenue growth will provide sufficient capital to continue operations. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of our common stock, and debt covenants could impose restrictions on our operations. The sale of equity or debt could result in additional dilution to current stockholders, and such financing may not be available to us on acceptable terms, if at all.

Recent Accounting Pronouncements

PyX derives revenues from the following sources: (1) software, which includes new iSCSI Target and Initiator software licenses and (2) services, which includes consulting.

New software license revenues represent all fees earned from granting customers licenses to use PyX's iSCSI software. While the basis for software license revenue recognition is substantially governed by the provisions of Statement of Position No. 97-2, Software Revenue Recognition, or SOP 97-2, issued by the American Institute of Certified Public Accountants, PyX exercises judgment and uses estimates in connection with the determination of the amount of software and services revenues to be recognized in each accounting period.

For software license arrangements that do not require significant modification or customization of the underlying software, PyX recognizes new software license revenue when: (1) it enters into a legally binding arrangement with a customer for the license of software; (2) it delivers the products; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured. Substantially all of PyX's new software license revenue is recognized in this manner. No software license revenue has been recognized to date.

Certain of PyX's software arrangements include consulting implementation services sold separately under consulting engagement contracts. Consulting revenues from these arrangements are generally accounted for separately from new software license revenues because the arrangements qualify as service transactions as defined in SOP 97-2. The more significant factors considered in determining whether the revenue should be accounted for separately include the nature of services (i.e., consideration of whether the services are essential to the functionality of the licensed product), degree of risk, availability of services from other vendors, timing of payments and impact of milestones or acceptance criteria on the realizability of the software license fee. Revenues for consulting services are generally recognized as the services are performed. If there is a significant uncertainty about the project completion or receipt of payment for the consulting services, revenue is deferred until the uncertainty is sufficiently resolved. Service revenues of $0 and $5,000 were recognized in the year ended December 31, 2004 and the period from inception (November 26, 2002) to December 31, 2003, respectively.

INDEX TO PyX TECHNOLOGIES, INC.
FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

Board of Directors
PyX Technologies, Inc.
San Ramon, California

We have audited the accompanying balance sheets of PyX Technologies, Inc. (the “Company”) as of December 31, 2004 and 2003 and the related statements of operations, stockholders’ equity (deficit), and cash flows for the year ended December 31, 2004, the period from inception (November 26, 2002) through December 31, 2003, and the period from inception (November 26, 2002) through December 31, 2004. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of PyX Technologies, Inc. as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the year ended December 31, 2004, the period from inception (November 26, 2002) through December 31, 2003, and the period from inception (November 26, 2002) through December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Seidman, LLP

March 3, 2005, except for Note 5, which is as of March 28, 2005
San Francisco, California

PYX TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
BALANCE SHEETS

	(unaudited) March 31, 2005	December 31, 2004	2003
Assets			
Current Assets			
Cash	$ 78,847	$ 4,869	$ 392
Accounts receivable	15,050	-	-
Total current assets	93,897	4,869	392
Property and equipment, net	20,467	12,580	11,982
Other assets	84,500	24,000	-
Total Assets	$ 198,864	$ 41,449	$ 11,982
Liabilities and Shareholders' Equity			
Current Liabilities			
Loans	$ 10,400	$ 10,200	$ -
Accounts payable	68,608	82,870	1,992
Accrued payroll and employee benefits	26,179	44,352	-
Deferred revenues	102,000	82,500	-
Total current liabilities	207,187	219,922	1,992
Total liabilities	207,187	219,922	1,992
Commitments and contingencies			
Stockholders' equity (deficit)			
Common stock			
($0.001 par value); authorized 10,000,000, 10,000,000 and 200,000 shares; issued and outstanding 5,567,500, 5,102,500 and 100,450	1,549	1,084	1,004
Additional paid-in capital	4,607,271	111,416	31,496
Deferred compensation	(3,858,915)	---	---
Deficit accumulated during the development stage	(758,228)	(290,973)	(22,510)
Total shareholders' equity (deficit)	(8,323)	(178,473)	9,990
Total liabilities and shareholders' equity (deficit)	**$ 198,864**	$ 41,449	$ 11,982

The accompanying notes are an integral part of these financial statements.

PYX TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
STATEMENTS OF OPERATIONS

	(unaudited) January 1, 2005 to March 31, 2005	**(unaudited)** January 1, 2004 to March 31, 2004	January 1, 2004 to December 31, 2004	Period from Inception to December 31, 2003	Cumulative from Inception to March, 31 2005
Service contract revenues	$ -	$ -	$ -	$ 5,000	$ 5,000
Total revenues	-	-	-	5,000	5,000
Costs and expenses					
Product research and development	46,732	3,379	142,625	13,808	203,165
Selling, general and administrative	419,523	3,200	124,807	12,888	557,218
Total operating expenses	466,255	6,579	267,432	26,696	760,383
Operating loss	(466,255)	(6,579)	(267,432)	(21,696)	(755,383)
Interest expense	200	-	200	-	400
Loss before income taxes	(466,455)	(6,579)	(267,632)	(21,696)	(755,783)
Income tax expense	800	-	831	814	2,445
Net loss	$ (467,255)	$ (6,579)	$ (268,463)	$ (22,510)	$ (758,228)

The accompanying notes are an integral part of these financial statements.

PYX TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)

	Common Stock and Additional Paid-in Capital					
	Shares	Par Value	Additional Paid-in Capital	Deferred Compensation	Accumulated Deficit	Total
Balance, November 26, 2002	$ ---	$ ---	$ ---	$ ---	$ ---	$ ---
Stock issued to founders	5,000,000	1,000	9,000	---	---	10,000
Stock issued in connection with private placement	22,500	4	22,496	---	---	22,500
Net loss	---	---	---	---	(22,510)	(22,510)
Balance, December 31, 2003	5,022,500	1,004	31,496	---	(22,510)	9,990
Stock issued in connection with private placement	80,000	80	79,920	---	---	80,000
Net loss	--	---	--	---	(268,463)	(268,463)
Balance, December 31, 2004	5,102,500	1,084	111,416	---	(290,973)	(178,473)
Stock issued in connection with private placement	250,000	250	249,750	---	---	250,000
Warrants to purchase stock issued in connection with employment	215,000	215	305,085	---	---	305,300
Deferred compensation included in common stock			3,941,020	---		3,941,020
Deferred compensation				(3,858,915)		(3,858,915)
Net loss	--	---	--	---	(467,255)	(467,255)
Balance, March 31, 2005 (unaudited)	5,567,500	$ 1,549	$ 4,607,271	$ (3,858,915)	$ (758,228)	$ (8,323)

The accompanying notes are an integral part of these financial statements.

PYX TECHNOLOGIES, INC.
(A DEVELOPMENT STAGE COMPANY)
STATEMENTS OF CASH FLOWS

	(unaudited) Quarter Ended March 31, 2005	(unaudited) Quarter Ended March 31, 2004	Year Ended December 31, 2004	Period from Inception (November 26, 2002) through December 31, 2003	Period from Inception (November 26, 2002) through March 31, 2005
Cash flows from operating activities:					
Net loss	(467,255)	(6,579)	(268,463)	(22,510)	(758,228)
Adjustments to reconcile net loss to net cash used in operating activities:					
Depreciation	2,125	1,116	5,447	1,812	9,384
Stock based compensation expense	385,255	-	-		385,255
Changes in operating assets and liabilities:					
Account receivable	(15,050)	-	-	-	(15,050)
Other assets	(60,500)	-	(24,000)	---	(84,500)
Accounts payable	(14,062)	-	80,879	1,992	68,608
Accrued payroll and commissions	(18,173)	-	44,351	---	26,179
Deferred revenues	19,500	5,000	82,500	---	102,000
Net cash used in operating activities	(168,160)	(463)	(79,286)	(18,706)	(266,352)
Cash flows from investing activities:					
Purchases of property and equipment	(10,012)	(734)	(6,437)	(13,402)	(29,851)
Net cash used in investing activities	(10,012)	(734)	(6,437)	(13,402)	(29,851)
Cash flows from financing activities:					
Loan	-	-	10,200	---	10,400
Proceeds from issuance of common stock	252,150	30,000	80,000	32,500	364,650
Net cash provided by financing activities	252,150	30,000	90,200	32,500	375,050
Net increase in cash and cash equivalents	73,978	28,803	4,477	392	79,847

Cash at beginning of year	4,869	392	392	---	-
Cash at end of year	78,847	29,195	4,869	392	78,847
Interest paid	-	-	-	-	-
Income tax paid	-	-	800	-	800

The accompanying notes are an integral part of these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company and Basis of Presentation:

PyX Technologies, Inc. (the Company) is a technology company incorporated under the laws of the State of California on November 26, 2002 (inception). The Company is in the research and development stage of software products for the Internet Small Computer System Interface (“iSCSI”) Enterprise Storage market.

Since inception, the Company's efforts have been devoted to the development of iSCSI software and raising capital. The Company has not received any significant revenues from the sale of its products or services since inception. Accordingly, through the date of these financial statements, the Company is considered to be in the development stage and the accompanying financial statements represent those of a development stage enterprise.

The financial statements present the results of operations for the period from inception to March 31, 2005. While the Company was incorporated on November 26, 2002, it had no operations during the period November 26, 2002 to December 31, 2002.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash:

Substantially all of the Company’s cash is held with one large financial institution and may at times be above insured limits.

Property and Equipment:

Property and equipment are carried at cost. The Company records depreciation charges on a straight-line basis over the assets' estimated useful lives of three years for computers and related equipment used to develop its software products.

When assets are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss on sale or disposal is recognized in operations. Maintenance, repairs and minor renewals are charged to expense as incurred.

The Company reviews property and equipment for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. In performing the review for recoverability, The Company estimates the future gross cash flows expected to result from the use of the asset and its eventual disposition. If such gross cash flows are less than the carrying amount of the asset, the asset is considered impaired. The amount of the impairment loss, if any, would then be calculated based on the excess of the carrying amount of the asset over its fair value.

Revenue Recognition:

The Company will derive revenues from the following sources: (1) software, which includes new iSCSI Target and Initiator software licenses and (2) services, which include consulting.

When the Company exits the development stage, new software license revenues will represent all fees earned from granting customers licenses to use the Company's iSCSI software. While the basis for software license revenue recognition is substantially governed by the provisions of Statement of Position No. 97-2, Software Revenue Recognition, issued by the American Institute of Certified Public Accountants, the Company exercises judgment and uses estimates in connection with the determination of the amount of software and services revenues to be recognized in each accounting period.

For software license arrangements that do not require significant modification or customization of the underlying software, the Company will recognize new software license revenue when: (1) it enters into a legally binding arrangement with a customer for the license of software; (2) it delivers the products; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured. Substantially all of the Company's new software license revenue is recognized in this manner. No software license revenue has been recognized to date.

Certain of the Company's software arrangements include consulting implementation services sold separately under consulting engagement contracts. Consulting revenues from these arrangements are generally accounted for separately from new software license revenues because the arrangements qualify as service transactions as defined in SOP 97-2. The more significant factors considered in determining whether the revenue should be accounted for separately include the nature of services (i.e., consideration of whether the services are essential to the functionality of the licensed product), degree of risk, availability of services from other vendors, timing of payments and impact of milestones or acceptance criteria on the realizability of the software license fee. Revenues for consulting services are generally recognized as the services are performed. If there is a significant uncertainty about the project completion or receipt of payment for the consulting services, revenue is deferred until the uncertainty is sufficiently resolved. Service revenues of $0 and $5,000 were recognized in the year ended December 31, 2004 and the period from inception (November 26, 2002) to December 31, 2003, respectively.

Product Research and Development Expenditures:

Research and development costs are expensed as incurred.

Stock-based Compensation

On February 28, 2005, the Company granted three employees warrants to purchase a total of 215,000 shares of the Company's common stock for $0.01 per share in lieu of cash salary. The difference between the $0.01 exercise price and the estimated fair market value on the grant date of $1.00 is included in the general and administrative expense as compensation expense.

Income Taxes:

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes.* SFAS No. 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of items that have been included in the financial statements or tax returns. Deferred income taxes represent the future net tax effects resulting from temporary differences between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are recorded against net deferred tax assets where, in our opinion, realization is uncertain. The provision for income taxes represents the net change in deferred tax amounts, plus income taxes payable for the current period.

As of December 31, 2004 the Company had net operating loss (NOL) carryforwards of approximately $99,000 and $2,000 for federal and state income tax purposes expiring in varying amounts from 2023 through 2024. Because management could not determine it was more likely than not that deferred tax assets, primarily relating to the NOLs, would be realized, a valuation allowance has been provided to eliminate all of the deferred tax assets of approximately $40,000 at December 31, 2004. The Company did pay the required California state minimum income taxes in 2003 and 2004.

Pursuant to the provision of the Tax Reform Act of 1986, utilization of the NOL carryforwards may also be subject to an annual limitation if a greater than 50% change in the ownership of the Company occurs within a three-year period.

2. PROPERTY AND EQUIPMENT

Property and equipment are comprised of the following:

	March 31, 2005	December 31, 2004	December 31, 2003
Computer hardware	$ 29,851	$ 19,839	$ 13,402
Less accumulated depreciation and amortization	(9,384)	(7,259)	(1,812)
	$ 20,467	$ 12,580	$ 11,590

Depreciation expense totaled $2,125, $5,447 and $1,812 for the three months ended March 31, 2005 and years ended December 31, 2004 and 2003, respectively.

3. SHAREHOLDERS' EQUITY

In January 1, 2003, the Company sold 100,000 shares to the Company’s founders in exchange for the assignment to the Company of certain technology and related rights owned by the purchasers valued at $10,000. In July 2003, 450 shares of common stock were sold to investors for $50.00 per share. On November 30, 2003, the Company increased its authorized number of shares of common stock from 200,000 to 10,000,000 and simultaneously declared a 50 to 1 stock split of its common stock. In March 2004, 80,000 shares of the Company’s Common Stock have been sold to investors for $1.00 per share. On January 20, 2005, the Company issued $250,000 of preferred stock for $250,000 cash. The preferred stock has a liquidation preference to the Company’s common stock holders. The preferred stock is convertible into common stock simultaneously with the sale of the Company to SBE. The Company also entered into an employment agreement with two of the holders of the preferred stock. The employees will receive 175,000 shares of the Company’s preferred stock vested monthly over the period January 2005 though July 2005 in lieu of cash compensation. For financial statement reporting, all shares and par value amounts have been adjusted to reflect such stock split.

4. LOANS

On September 27, 2004, the Company entered into a loan agreement with a relative of one of the founders for $10,000 at an annual interest rate of 8% due October 31, 2005. As of March 31, 2005, the outstanding principal and interest totaled $10,400.

5. SUBSEQUENT EVENTS

On March 28, 2005, the Company entered into a definite agreement to be acquired by SBE, Inc (“SBE”), a Delaware corporation listed on the Nasdaq SmallCap Market under symbol SBEI. In the acquisition, the Company will be merged with and into a wholly-owned subsidiary of SBE and each outstanding share of the Company’s Common Stock will be automatically converted into 0.46 shares of SBE Common Stock . The closing of the merger is subject to

certain closing conditions including approval by SBE's stockholders, SBE entering into a definitive agreement for raising at least $5 million in cash from investors (with the closing being subject only to the closing of the merger), amendment of the Company's agreement with Pelco and customary closing conditions. The merger is expected to close in SBE's third fiscal quarter, ending July 31, 2005. An officer of SBE, Inc. is also a shareholder of the Company.

PROPOSAL 2
APPROVAL OF THE UNIT SUBSCRIPTION AGREEMENT
AND THE ISSUANCE OF SHARES OF SERIES A
PREFERRED STOCK IN THE PRIVATE PLACEMENT

General

The unit subscription agreement provides that, subject to satisfaction of certain conditions, and assuming a price per share of $2.00, we will issue to the purchasers:

- 2,575,000 shares of our common stock, or approximately 24.8% of the outstanding shares of our common stock after the closing of the merger and the private placement, assuming no further issuances of shares of our common stock and no exercise of outstanding stock options or warrants, based on the number of shares outstanding on April 29, 2005; and

- warrants to purchase up to an additional 1,287,500 shares of our common stock, or approximately 12.4% of the outstanding shares of our common stock after the closing of the merger and the private placement, assuming no further issuances of shares of our common stock and not exercise of outstanding stock options or warrants, based on the number of shares outstanding on April 29, 2005.

We refer to the shares of our common stock and the warrants to purchase shares of our common stock in this proxy statement as units. Each unit consists of one share of our common stock and a warrant to purchase one-half of a share of our common stock.

The aggregate proceeds we will receive from the issuance of the units to the purchasers in the private placement is $5,150,000.

We entered into unit subscription agreements, each dated as of March 4, 2005, with each of the purchasers set forth below. Together, these investors are referred to as the purchasers. The purchasers have agreed to purchase units representing aggregate gross proceeds to us of $5.0 million in the following amounts:

Name	Investment
Herschel Berkowitz	$150,000.00
Paul Packer	50,000.00
Globis Capital Partners	500,000.00
Globis Overseas Fund Ltd.	200,000.00
Richard Grossman	50,000.00
Joshua Hirsch	50,000.00
James Kardon	17,000.00
AIGH Investment Partners LLC	825,000.00
Ellis International LLC	100,000.00
Jack Dodick	200,000.00
Stephen Spira	100,000.00
Fame Associates	100,000.00
Cam Co	350,000.00
Anfel Trading Limited	650,000.00
Ganot Corporation	350,000.00
LaPlace Group, LLC	300,000.00
F. Lyon Polk	60,000.00
Paul Tramontano	50,000.00
Hilary Edson	60,000.00

Kevin McCaffrey	100,000.00
William Heinzerling	100,000.00
John A. Moore	100,000.00
Mark Giordano	30,000.00
Jeffrey Schwartz	8,000.00
Norman Pessin	250,000.00
Greg Yamamoto	200,000.00
Tzu-Wang Pan	50,000.00
Kurt Miyatake	50,000.00
Greg Yamamoto, as UTMA custodian for Melanie Yamamoto	50,000.00
Greg Yamamoto, as UTMA custodian for Nicholas Yamamoto	50,000.00
Total	**$5,150,000.00**

The form of unit subscription agreement is attached to this proxy statement as Annex C. You should read the unit subscription agreement carefully. It is the agreement that governs the terms of the private placement. The following information summarizes the terms related to the private placement and the unit subscription agreements.

Per Unit Purchase Price

Each unit will be issued at a price equal to the lowest of:

- $2.50;

- 92% of the average closing sale price per share of our common stock, as reported on the Nasdaq SmallCap Market, for each of the five consecutive trading days on which our common stock trades ending on the date immediately prior to the closing date of the private placement; and

- 95% of the closing sale price per share of our common stock, as reported on the Nasdaq SmallCap Market, on the trading day on which our common stock trades that immediately precedes the closing date of the private placement.

The private placement will be significantly dilutive to current stockholders and the PyX stockholders. We have the right to terminate the unit subscription agreement and not close the transaction if the price per unit is less than $2.00.

Closing of the Private Placement

The unit subscription agreements provide that the closing of the private placement will take place as soon as practicable after the last condition precedent to closing has been satisfied or waived and no later than 60 days after the date the unit subscription agreements were entered into. However, if the SEC determines to review this proxy statement, then the closing of the private placement must take place no later than July 31, 2005, or such later date as the purchasers of a majority of the units determine.

Closing of the private placement could be delayed if there is a delay in satisfying the closing conditions to the private placement. There can be no assurances as to whether, and on what date, the conditions will be satisfied or that the parties will complete the private placement at all. If the private placement is not completed on or before 60 days after the unit subscription units were entered into or July 31, 2005, as applicable, and the purchasers of a majority of the units are unwilling to extend the closing date, the unit subscription agreements will terminate.

Representations and Warranties

The unit subscription agreements contain customary representations and warranties made by us to the purchasers and by the purchasers to us for purposes of allocating the risks associated with the private placement. The assertions embodied in the representations and warranties made by us are qualified by information set forth in a confidential disclosure letter that was delivered in connection with the execution of the unit subscription agreements. While we do not believe that the disclosure letter contains information that securities laws require us to publicly disclose, other than information that is being disclosed in this proxy statement, the disclosure schedule may contain information that modifies, qualifies and creates exceptions to the representations and warranties set forth in the unit subscription agreements. Accordingly, you should not rely on any of these representations and warranties as characterizations of the actual state of facts, since they may be modified in important respects by the underlying disclosure letter. Our disclosure letter contains information that in some cases has been included in our general prior public disclosures, and also may contain additional non-public information. Moreover, information concerning the subject matter of the representations and warranties may have changed since the date of the unit subscription agreements, which subsequent information may or may not be fully reflected in the disclosure letter we delivered to the purchasers at signing and which may not be delivered by us until the closing date of the private placement.

The representations and warranties in the unit subscription agreements include, among other things:

- the purchasers and our authority to enter into, and carry out the obligations under, the unit subscription agreements and the enforceability of the unit subscription agreements; and
- retention of brokers or finders in connection with the private placement.

In addition, the unit subscription agreements contain additional representations and warranties by us as to certain other matters, including:

- our organization, qualification, corporate power and good standing;
- the organization, qualification and good standing of each of our subsidiaries, including, for purposes of the unit subscription agreements, of PyX;
- capitalization;
- this proxy statement and the special meeting;
- the authorization of shares of common stock and the warrants to purchase shares of common stock to be issued pursuant to the unit subscription agreements;
- the exemption of the units from the registration requirements of the Securities Act of 1933, as amended;
- the absence of certain conflicts;
- receipt of all necessary governmental authorizations required in connection with the private placement;
- compliance with applicable legal requirements and material agreements;
- the accuracy of certain of our SEC filings and our financial statements;
- litigation matters;

- the absence of certain changes since January 31, 2005;
- our intellectual property;
- adverse business developments;

- outstanding registration rights;
- the accuracy of our charter documents as provided to the purchasers; and
- our use of the proceeds from the private placement.

All of the representations and warranties set forth in the unit subscription agreements survive for a period of one year following the closing of the private placement.

Certain Covenants

We have agreed to cooperate with the purchasers in connection with their filings with the SEC with respect to the units. Additionally, we have agreed to deliver to the purchasers any reports that we deliver to our stockholders generally and to reserve for issuance that number shares of our common stock issuable upon exercise of the warrants issued to the purchasers in connection with the private placement.

Indemnification

We have agreed to indemnify the purchasers with respect to breaches of representations, warranties and covenants contained in the unit purchase agreements. However, our liability for such breaches is limited to the aggregate purchase price paid by the purchasers in connection with the private placement. Further, the purchasers are not entitled to recover any damages with respect to an indemnification claim until the total damages incurred under the unit subscription agreements exceed $25,000, after which they are entitled to be indemnified for the full amount of the damages, subject to the cap mentioned above.

Conditions Precedent

The completion of the private placement depends on the satisfaction of a number of conditions, including, among others, conditions relating to:

- execution and delivery of the investor rights agreement;
- accuracy of the representations and warranties of the parties and compliance by the parties with their respective covenants;
- the approval of Proposals 1 and 2;
- our listing status on the Nasdaq SmallCap Market;
- completion of the merger; and
- entry by PyX into a reseller agreement with LSI Logic.

Warrants

The warrants issued in connection with the private placement have a term of five years and are exercisable at a per share price equal to 133% of the unit price described above under “Per Unit Purchase Price” subject to proportional adjustments for stock splits, stock dividends, recapitalizations and the like. In addition, the shares of our common stock issuable upon exercise of the warrants are subject to adjustment in the event we issue shares of our common stock at a price less than the then applicable purchase price of the warrants, subject to certain customary exceptions,

including, among other things, issuances to employees, officers and directors under our equity compensation plans. If not exercised after five years, the right to purchase shares of our common stock pursuant to the warrants will terminate. The warrants contain a cashless exercise feature. The common stock underlying the warrants are entitled to the benefits and subject to the terms of the Registration Rights described below.

The form of warrant is attached to this proxy statement as Annex E. You should read the warrant carefully. It is the agreement that governs the terms of the warrant. The following information summarizes the terms related to the private placement and the unit subscription agreements.

Investor Rights Agreement

We entered an investor rights agreement, dated as of May 5, 2005, with the purchasers in the private placement. The investor rights agreement is attached to this proxy statement as Annex F. You should read the investor rights agreement carefully. It is the agreement that governs the terms under which we have agreed to register for resale the sale of the shares of common stock and the shares of common stock to be issued upon exercise of the warrants that will be issued to the purchasers in the private placement. The following summarizes the terms of the registration rights agreement.

Registration Rights

We have agreed to file a registration statement with the SEC within 60 days after the closing date of the private placement registering the resale of such shares of common stock, including the shares underlying the warrants, from time to time by these purchasers, and to use our best efforts to cause the registration statement to become effective as within 90 days after filing the registration statement. Once effective, the registration statement will permit the purchasers to sell their shares of common stock in the open market from time to time using the methods of distribution to be described in the registration statement. Our obligation to maintain the effectiveness of the registration statement terminates on the earlier of (i) two years after closing and (ii) the date that all of the shares of our common stock issued to the purchasers, including any shares purchased by the purchasers upon exercise of the preemptive rights described below under “Preemptive Rights,” (a) have been sold or (iii) can be sold under Rule 144(k) of the Securities Act of 1933, as amended. We have also agreed not to grant any other registration rights senior to the rights granted to the purchasers. We expect to register such shares for resale concurrently with those issued in the merger. We have also agreed to certain customary obligations and indemnity provisions relating to the registration process and to pay the expenses incurred in connection with the registration of these shares.

Rights of Participation

Each purchaser in the private placement will have the right to participate in any future private placements of our equity for a period of two years following the closing of the private placement. These rights are subject to certain customary exceptions, including, among other things, issuances to employees, officers and directors under our equity compensation plans. These rights are intended to enable the purchasers to maintain their pro rata interest in us according to their then-current ownership interest at the time of the applicable issuances.

The Voting Agreement

Certain members of our management are party to a voting agreement, dated May 4, 2005, pursuant to which they have agreed, subject to the terms and conditions of the voting agreement, to vote all of their shares of common stock in favor of proposals 1 and 2 and any other matter necessary to effect the transactions. The form of voting agreement is attached to this proxy statement as Annex D. You should read the voting agreement carefully. It is the agreement that governs the terms under which our management team has agreed to vote in favor of the transactions. The shares subject to the voting agreement represent approximately 3.2% of the outstanding shares of our common stock, based on the number of shares outstanding on June 9, 2005.

Recommendation of our Board of Directors

Our board of directors recommends that our stockholders vote FOR the unit subscription agreement and the issuance of units consisting of one share of our common stock and a warrant to purchase an additional one-half share of our

common stock, for aggregate gross proceeds to us of $5,150,000, to the purchasers in the private placement.

OTHER MATTERS

Incorporation By Reference Of Annual Report On Form 10-K

Concurrently with this proxy statement, we are sending you a copy of our annual report on Form 10-K for the year ended October 31, 2004 and our quarterly report on Form 10-Q for the quarter ended April 30, 2005. This proxy statement incorporates by reference Items 7, 7A, 8 and 9 of the Form 10-K, which contains important information about us and our financial condition that is not included in this proxy statement. A copy of the Form 10-K has also been filed with the SEC and may be accessed from the SEC's homepage (www.sec.gov).

Accountants

Representatives of BDO Seidman, LLP are expected to be present at the Special Meeting will have an opportunity to make a statement if they so desire and will not be available to respond to appropriate questions.

By Order of the Board of Directors,

/s/ David W. Brunton

David W. Brunton
Secretary

San Ramon, California
June ----, 2005

ANNEX A

HOULIHAN LOKEY HOWARD & ZUKIN FINANCIAL ADVISORS, INC. OPINION

Annex A

ANNEX B

AGREEMENT AND PLAN OF MERGER

Annex B

ANNEX C

SBE, INC.

UNIT SUBSCRIPTION AGREEMENT
COMMON STOCK
AND WARRANTS

Unit Subscription Agreement (this "Agreement") dated as of May 4, 2005 among SBE, Inc., a Delaware corporation (the "Company"), and the persons who execute this Agreement as investors (the "Investors").

Background: The Company desires to sell to the Investors, and the Investors desire to purchase, an aggregate of shares of Common Stock of the Company (the "Shares") in Units with 5-year warrants, in substantially the form attached hereto as Exhibit 1, exercisable to purchase shares of Common Stock of the Company (the "Warrant Shares") at the Exercise Price (as defined below) (the "Warrants"), all for an aggregate price of $5,150,000. The proceeds are necessary for development and continuance of the business of the Company and each of its Subsidiaries and the development and continuance of the business of PyX Technologies, Inc. ("PyX"), which the Company proposes to acquire in the Acquisition (as defined below). Concurrently with the execution of this Agreement, each of the executive officers and directors of the Company has entered into a Voting Agreement in the form attached as Exhibit 2 providing that he or she will vote his shares of Common Stock of the Company in favor of the Proposal at the Stockholders Meeting (the "Voting Agreement").

Certain Definitions:

"Acquisition" shall mean the acquisition by the Company of PyX substantially in accordance with the terms set forth in the Agreement and Plan of Merger and Reorganization, dated March 28, 2005, filed by the Company with the SEC on Form 8-K on such date (the "Acquisition Agreement").

"Action" has the meaning set forth in Section 2.10.

"AIGH" means AIGH Investment Partners, LLC, a Delaware limited liability company.

"Agreement" has the meaning set forth in the Preamble to the Agreement.

"Blue Sky Laws" has the meaning set forth in Section 2.7(b).

"Certificate of Incorporation" has the meaning set forth in Section 2.2(a).

"Closing" and "Closing Date" have the meanings set forth in Section 1.2.

"Closing Certificate" has the meaning set forth in Section 1.3(m).

"Closing Sale Price" means the closing sale price per share of the Company's Common Stock as quoted on The Nasdaq SmallCap Market on the trading day on which the Common Stock trades immediately preceding the Closing Date.

"Common Stock" shall mean stock of the Company of any class (however designated) whether now or hereafter authorized, which generally has the right to participate in the voting and in the distribution of earnings and assets of the Company without limit as to amount or percentage. As of the date of this Agreement, Common Stock means the Company's Common Stock, $0.001 par value per share.

"Company" includes the Company and any corporation or other entity that shall succeed to or assume, directly or indirectly, the obligations of the Company hereunder. The term "corporation" shall include an association, joint stock company, business trust, limited liability company or other similar organization.

"Company Disclosure Letter" means the disclosure letter delivered to the Investors prior to the execution of this Agreement, which letter is incorporated in this Agreement by reference. The disclosure schedule delivered by PyX to the Company pursuant to the Acquisition Agreement shall be attached to, and is hereby incorporated by reference into, the Company Disclosure Letter.

"Contemplated Transactions" has the meaning set forth in Section 2.1(b).

"Exchange Act" has the meaning set forth in Section 2.7(b).

"Exercise Price" means 133% of the Unit Price.

"Financial Statements" has the meaning set forth in Section 2.9(f).

"Form 10-K Financial Statements" has the meaning set forth in Section 2.9(d).

"Governmental Body" has the meaning set forth in Section 2.7(b).

"Investor Rights Agreement" has the meaning set forth in Section 1.3(a).

"Investors" has the meaning set forth in the Preamble to the Agreement.

"January 31 Form 10-Q Financial Statements" has the meaning set forth in Section 2.9(e).

"Legal Fee" has the meaning set forth in Section 6.9.

"Legal Requirement" has the meaning set forth in Section 2.8.

"Loss" has the meaning set forth in Section 5.2(b).

"Majority Investors" has the meaning set forth in Section 1.2.

"Market Price" means the average closing sale price per share of the Company's Common Stock as quoted on the NASDAQ SmallCap Market for the five preceding consecutive trading days on which the Common Stock trades ending on the date immediately before the Closing Date.

"Material Adverse Change" and "Material Adverse Effect" shall mean a material adverse change in the business, financial condition, results of operation, properties or operations of the Company and its Subsidiaries taken as a whole; provided, however, that "Material Adverse Change" and "Material Adverse Effect" shall not include any such changes that result from (a) general economic, business or industry conditions, (b) the taking of any action permitted or required by this Agreement, (c) the announcement or pendency of this Agreement, the Contemplated Transactions, the Acquisition Agreement, the Acquisition or the other transactions contemplated by the Acquisition Agreement; and provided, further, that a decline in the Company's stock price shall not, in and of itself, constitute a "Material Adverse Change" or "Material Adverse Effect."

"Material Agreement" means any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Company or any of its Subsidiaries is a party or by which the Company or of any of its Subsidiaries or any property or asset of the Company or of any of its Subsidiaries is bound or affected that is material to the Company and its Subsidiaries, taken as a whole.

"NASD" means the National Association of Securities Dealers, Inc.

"Ordinary Course of Business" has the meaning set forth in Section 2.11.

"Person" means any individual, sole proprietorship, partnership, corporation, limited liability company, business trust, unincorporated association, joint stock corporation, trust, joint venture or other entity, any university or similar institution, or any government or any agency or instrumentality or political subdivision thereof.

"Price Termination" has the meaning set forth in Section 1.1.

"Proposal" has the meaning set forth in Section 2.2(b)(i).

"Proprietary Assets" has the meaning set forth in Section 2.12.

"Proxy Statement" has the meaning set forth in Section 2.2(b)(i).

"PyX" has the meaning set forth in the Background to the Agreement.

"PyX Financial Statements" has the meaning set forth in Section 2.9(f).

"Required Stockholder Approval" has the meaning set forth in Section 2.2(b)(i).

"Review Date" has the meaning set forth in Section 1.2.

"SEC" means the Securities and Exchange Commission.

"SEC Documents" has the meaning set forth in Section 2.9(a).

"Securities" means the Shares and Warrants.

"Securities Act" has the meaning set forth in Section 2.5.

"Shares" has the meaning set forth in the Background to the Agreement.

"Stockholders Meeting" has the meaning set forth in Section 2.2(b)(i).

"Subsidiary" shall mean, immediately prior to the Closing, any corporation of which stock or other interest having ordinary power to elect a majority of the Board of Directors (or other governing body) of such entity (regardless of whether or not at the time stock or interests of any other class or classes of such corporation shall have or may have voting power by reason of the happening of any contingency) is, immediately prior to the Closing, directly or indirectly owned by the Company or by one or more Subsidiaries. For purposes of clarity, the definition of Subsidiary shall include PyX.

"Transaction Documents" means the Agreement, the Voting Agreement, the Warrants and the Investor Rights Agreement.

"Transfer Agent" has the meaning set forth in Section 1.2(b).

"Unit" shall mean (i) one (1) Share and (ii) one Warrant to purchase one half (0.5) of a Warrant Share.

"Unit Price" shall mean the lowest of (i) $2.50, (ii) 92% of the Market Price and (iii) 95% of the Closing Sale Price.

"Warrants" has the meaning set forth in the Background to the Agreement.

"Warrant Share" has the meaning set forth in the Background to the Agreement, and includes any shares of Common Stock issued or from time to time issuable upon exercise of the Warrants.

"Voting Agreement" has the meaning set forth in the Background to the Agreement.

In consideration of the mutual covenants contained herein, the parties agree as follows:

1. Purchase and Sale of Stock.

1.1. Sale and Issuance of Securities. (a) The Company shall sell to the Investors and the Investors shall purchase from the Company, that number of Units equal to $5,150,000 divided by the Unit Price, at a price per Unit equal to the Unit Price; provided, however, that the Company shall have the right not to sell the Units under this Agreement and to terminate this Agreement without penalty (except as provided in Section 6.9) if the Unit Price as of the Closing Date is less than $2.00 ("Price Termination").

(b) The purchase price of the Units to be purchased by each Investor from the Company is set forth on Schedule 1.1(b) hereto, subject to acceptance, in whole or in part, by the Company.

1.2. Closing. The closing (the "Closing") of the purchase and sale of the Securities hereunder shall take place as soon as practicable after the conditions for Closing set forth in this Agreement are met (other than closing conditions that, by their nature, are satisfied at the Closing) but no later than (i) a date that is within 60 days of the date of this Agreement if the SEC determines not to review the Proxy Statement or (ii) July 31, 2005 (the "Review Date") if the SEC determines to review the Proxy Statement; provided, that the Company, AIGH and other Investors who together with AIGH have subscribed for an aggregate of at least 50% of the Units (the "Majority Investors") may extend such date. The Company shall notify the Investors promptly after the conditions set forth in Section 1.3 (other than those that, by their nature, are satisfied at the Closing) have been met, and the Closing shall take place within three business days after such notice is given (the "Closing Date"). The Closing shall take place at the offices of Hahn & Hessen LLP, the Investors' counsel, in New York, New York, or at such other location as is mutually acceptable to the Majority Investors and the Company, subject to fulfillment of the conditions of closing set forth in the Agreement. At the Closing:

(a) each Investor purchasing Securities at the Closing shall deliver to the Company or its designees by wire transfer or such other method of payment as the Company shall approve, an amount equal to the purchase price of the Securities purchased by such Investor hereunder, as set forth opposite such Investor's name on the signature pages hereof;

(b) the Company shall authorize its transfer agent (the "Transfer Agent") to arrange delivery to each Investor of one or more stock certificates registered in the name of the Investor, or in such nominee name(s) as designated by the Investor in writing, representing the number of Shares obtaining by dividing the dollar amount set forth opposite such Investor's name on Schedule 1.1(b) by the Unit Price; and

(c) the Company shall issue and deliver to each Investor the number of Warrants obtained by dividing one-half of the dollar amount set forth opposite such Investor's name on Schedule 1.1(b) by the Unit Price.

1.3. Investors' Conditions of Closing. The obligation of the Investors to complete the purchase of the Securities at the Closing is subject to fulfillment (or waiver by the Majority Investors) of the following conditions:

(a) the Company shall execute and deliver an Investor Rights Agreement, dated the Closing Date, in the form attached as Exhibit 3, with respect to the Shares and the Warrant Shares (the "Investor Rights Agreement");

(b) the Company shall cause to be delivered to the Investors an Opinion of Counsel, dated the Closing Date and reasonably satisfactory to counsel for the Investors, with respect to the matters set forth on Exhibit 4;

(c) the representation and warranties of the Company set forth in this Agreement shall be true and correct in all respects as of the date of this Agreement and (to the extent such representations and warranties speak as of a later date) as of such later date as though made on and as of the Closing Date, except for such inaccuracies as have not resulted and would not reasonably be expected to result in a Material Adverse Change, and the Company shall have performed in all material respects all covenants and other obligations required to be performed by it under this Agreement at or prior to the Closing Date;

(d) the absence of a Material Adverse Change from the date of this Agreement up to, and including, the Closing Date;

(e) the Company shall pay the Investors' expenses to the extent set forth in Section 6.9 hereof;

(f) the Company shall deliver to the Investors a certified copy of its Certificate of Incorporation, as amended, and Bylaws and a Certificate of Good Standing from the Secretary of State of the State of Delaware;

(g) the Required Stockholder Approval shall have been obtained;

(h) the Company shall not be subject to delisting with The Nasdaq SmallCap Market, or obliged to apply for relisting, under Rule 4330(f) of the NASD or otherwise as a consequence of the Acquisition and the Contemplated Transactions;

(i) the Acquisition shall have been completed;

(j) the Investors shall have received a certificate signed on behalf of the Company by the President and Secretary of the Company, in such capacities, to the effect that the condition set forth in Section 1.3(c) shall have been satisfied (the "Closing Certificate");

(k) PyX shall have entered into a definitive reseller agreement with LSI Logic; and

(l) All Securities delivered at the Closing shall have any necessary stock transfer tax stamps (purchased at the expense of the Company) affixed.

1.4. Company's Conditions of Closing. The obligation of the Company to complete the sale of the Securities at the Closing is subject to fulfillment (or waiver by the Company) of the following conditions:

(a) the Investors shall execute and deliver the Investor Rights Agreement;

(b) The NASDAQ SmallCap Market shall have granted its approval to the Acquisition and to the Contemplated Transactions;

(c) the representation and warranties of the Investors set forth in this Agreement shall be true and correct in all respects as of the date of this Agreement and on the Closing Date;

(d) the Required Stockholder Approval shall have been obtained;

(e) the Company shall not be subject to delisting with The Nasdaq SmallCap Market, or obliged to apply for relisting, under Rule 4330(f) of the NASD or otherwise as a consequence of the Acquisition and the Contemplated Transactions; and

(f) the Acquisition shall have been completed.

2. Representations, Warranties and Covenants of the Company. The Company hereby represents and warrants to, and covenants with, each of the Investors as follows:

2.1. Corporate Organization; Authority; Due Authorization.

(a) The Company (i) is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation, (ii) has the corporate power and authority to own or lease its properties as and in the places where such business is conducted and to carry on its business as conducted and (iii) is duly qualified as a foreign corporation authorized to do business in every jurisdiction where the failure to so qualify, individually or in the aggregate, would result in a Material Adverse Effect. Set forth in the Company Disclosure Letter is a complete and correct list of all Subsidiaries. Each Subsidiary is duly incorporated or organized, validly existing and in good standing under the laws of its jurisdiction of incorporation or organization and is qualified to do business as a foreign corporation or limited liability company in each jurisdiction in which the failure to so qualify, individually or in the aggregate, would result in a Material Adverse Change.

(b) The Company (i) has the requisite corporate power and authority to execute, deliver and perform this Agreement and the other Transaction Documents to which it is a party and to incur the obligations herein and therein and (ii) has been authorized by all necessary corporate action to execute, deliver and perform this Agreement and the other Transaction Documents to which it is a party and to consummate the transactions contemplated hereby and thereby (the "Contemplated Transactions"). Each of this Agreement and the other Transaction Documents is a valid and binding obligation of the Company enforceable in accordance with its terms except as limited by applicable bankruptcy, reorganization, insolvency, moratorium or similar laws affecting the enforcement of creditors' rights and the availability of equitable remedies (regardless of whether such enforceability is considered in a proceeding at law or equity). To the Company's knowledge, the Voting Agreement is a valid and binding obligation of the parties thereto other than the Company, enforceable in accordance with its terms.

2.2. Capitalization; Authorization of Additional Shares of Common Stock.

(a) Current Capitalization. As of the date hereof, the authorized capital stock of the Company consists of (i) 25,000,000 shares of Common Stock, $0.001 par value, of which 5,243,483 shares of Common Stock are outstanding and (ii) 2,000,000 shares of Preferred Stock, $0.001 par value, of which no shares are outstanding. All outstanding shares were issued in compliance with all applicable Federal and state securities laws, and the issuance of such shares was duly authorized. Except as contemplated by this Agreement or as set forth in the Company Disclosure Letter, there are (i) no outstanding subscriptions, warrants, options, conversion privileges or other rights or agreements obligating the Company to purchase or otherwise acquire or issue any shares of capital stock of the Company (or shares reserved for such purpose), (ii) no preemptive rights contained in the Company's Certificate of Incorporation, as amended (the "Certificate of Incorporation"), Bylaws of the Company or contracts to which the Company is a party or rights of first refusal with respect to the issuance of additional shares of capital stock of the Company (other than as set forth in the Investor Rights Agreement, including without limitation the Securities and the Warrant Shares), and (iii) no commitments or understandings (oral or written) of the Company to issue any shares, warrants, options or other rights other than option grants that may be committed to potential employees of the Company in the Ordinary Course of Business. Except as set forth in the Company Disclosure Letter, to the Company's knowledge, none of the shares of Common Stock is subject to any stockholders' agreement, voting trust agreement or similar arrangement or understanding. Except as set forth in the Company Disclosure Letter, the Company has no outstanding bonds, debentures, notes or other obligations the holders of which have the right to vote (or which are convertible into or exercisable for securities having the right to vote) with the stockholders of the Company on any matter. With respect to each Subsidiary other than PyX, and to the Company's knowledge with respect to PyX, (x) all the issued and outstanding shares of the Subsidiary's capital stock or equity interests have been duly authorized and validly issued, are fully paid and nonassessable, have been issued in compliance with applicable federal and state securities laws, were not issued in violation of or subject to any preemptive rights or other rights to subscribe for or purchase securities, and (y) except as disclosed in the Company Disclosure Letter, there are no outstanding options to purchase, or any preemptive rights or other rights to subscribe for or to purchase, any securities or obligations convertible into, or any contracts or commitments to issue or sell, shares of the Subsidiary's capital stock or any such options, rights, convertible securities or obligations. Except as disclosed in the Company Disclosure Letter, the Company owns 100% of the outstanding equity of each Subsidiary other than PyX. At the closing of the Acquisition, PyX will be merged with and into another Subsidiary of the Company and will cease to exist as a separate corporation or Subsidiary.

(b) Proxy Statement; Stockholders Meeting.

(i) As promptly as possible, the Company shall take all action necessary to call a meeting of its stockholders (together with any adjournments or postponements thereof, the "Stockholders Meeting") for the purpose of seeking the requisite stockholder approval (the "Required Stockholder Approval") of (x) the Acquisition, (y) the Contemplated Transactions to the extent necessary to comply with Rule 4350(i) of the NASD, and (z) all matters to be voted upon incident thereto (collectively, the "Proposal"). In connection therewith, the Company will promptly prepare and file with the SEC proxy materials (including one or more proxy statements (as amended or supplemented, the "Proxy Statement") and form of proxy) for use at the Stockholders Meeting and, after receiving and promptly responding to any comments of the SEC thereon and obtaining SEC approval of the mailing of the Proxy Statement and proxy to the Company's stockholders, shall promptly mail such proxy materials to the stockholders of the Company. The Company will comply with Section 14(a) of the Exchange Act and the rules promulgated thereunder in relation to the Proxy Statement and form of proxy to be sent to the stockholders of the Company in connection with the Stockholders Meeting, and the Proxy Statement shall not, on the date the Proxy Statement (or any amendment thereof or supplement thereto) is first mailed to stockholders or at the time of the Stockholders Meeting, contain any statement that, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or omit to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the Stockholders Meeting or the subject matter thereof which has become false or misleading. If the Company should discover at any time prior to the Closing Date any event relating to the Company or any of its Subsidiaries or any of their respective affiliates, officers or directors that is required to be set forth in a supplement or amendment to the Proxy Statement, in addition to the Company's obligations under the Exchange Act, the Company will promptly inform its stockholders thereof. The Company shall give prompt notice to AIGH and the Investors' counsel of any determination by the SEC to review or not to review the Proxy Statement.

(ii) Subject to its fiduciary obligations under applicable law (as determined in good faith by the Company's Board of Directors, after having taken into account the written advice of the Company's outside counsel), the Company's Board of Directors shall recommend to the Company's stockholders (and not revoke or amend such recommendation) that the stockholders vote in favor of the Proposal and shall cause the Company to take all commercially reasonable action to solicit the Required Stockholder Approval. Whether or not the Company's Board of Directors determines at any time after the date hereof that, due to its fiduciary duties, it must revoke or amend its recommendation to the Company's stockholders, the Company is required to, and will take, in accordance with applicable law and its Certificate of Incorporation and Bylaws, all action necessary to convene the Stockholders Meeting as promptly as practicable to consider and vote upon the approval of the Proposal.

(iii) In the event that (x) the Company does not file the Proxy Statement within 20 business days following the date of this Agreement, (y) the Company fails to use its best efforts to cause the Stockholders Meeting to take place within 90 days following the date of this Agreement, or (z) the Company's Board of Directors has withdrawn or modified its recommendation to its stockholders pursuant to the provisions of Section 2.2(b)(ii), the Company will pay to each Investor, at the earlier to occur of (a) the Closing and (b) the business day after the latest permitted date for Closing, as set forth in Section 1.2, if the Closing has not occurred by such latest permitted date, a cash fee equal to 25% of such Investor's investment set forth on Schedule 1.1(b); provided, however, that, with respect to clause (y) above, no such penalty shall apply in the event that a delay beyond the Review Date arises out of review by the SEC as long as the Company continues to use its best efforts to cause the Stockholders Meeting to take place as soon as practicable.

2.3. Validity of Securities. The issuance of the Securities has been duly authorized by all necessary corporate action on the part of the Company other than the Required Stockholder Approval and, when issued to, delivered to, and paid for by the Investors in accordance with this Agreement, the Shares will be validly issued, fully paid and non-assessable.

2.4. Warrant Shares. The issuance of the Warrant Shares upon exercise of the Warrants has been duly authorized by the Company's Board of Directors. At all times between the Closing Date and prior to such exercise, the Warrant Shares will have been duly reserved for issuance upon such exercise and, when so issued, will be validly issued, fully paid and non-assessable.

2.5. Private Offering. Neither the Company nor, to the Company's knowledge, anyone acting on its behalf has within the last 12 months issued, sold or offered any security of the Company (including, without limitation, any Common Stock or warrants of similar tenor to the Warrants) to any Person under circumstances that would cause the issuance and sale of the Securities, as contemplated by this Agreement, to be subject to the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"). The Company agrees that neither the Company nor anyone acting on its behalf will offer the Securities or any part thereof or any similar securities for issuance or sale to, or solicit any offer to acquire any of the same from, anyone so as to make the issuance and sale of the Securities subject to the registration requirements of Section 5 of the Securities Act.

2.6. Brokers and Finders. Except as set forth in the Company Disclosure Letter, neither the Company nor any of its officers, directors, employees or stockholders, has employed any broker or finder with respect to the Contemplated Transactions.

2.7. No Conflict; Required Filings and Consents.

(a) The execution, delivery and performance of this Agreement and the other Transaction Documents by the Company do not, and the consummation by the Company of the Contemplated Transactions will not, (i) conflict with or violate the Certificate of Incorporation or Bylaws of the Company or the charter documents of its Subsidiaries, (ii) conflict with or violate any law, rule, regulation, order, judgment or decree applicable to the Company or its Subsidiaries or by which any property or asset of the Company or its Subsidiaries is bound or affected or (iii) result in any breach of or constitute a default (or an event which with notice or lapse of time or both would become a default) under, result in the loss of a material benefit under, or give to others any right of purchase or sale, or any right of termination, amendment, acceleration, increased payments or cancellation of, or result in the creation of a lien or other encumbrance on any property or asset of the Company or of any of its Subsidiaries pursuant to, any Material Agreement; except, in the case of clauses (ii) and (iii) above, for any such conflicts, violations, breaches, defaults or other occurrences that would not prevent or delay consummation of any of the Contemplated Transactions in any material respect or otherwise prevent the Company from performing its obligations under this Agreement or any of the other Transaction Documents in any material respect, and would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect.

(b) The execution and delivery of this Agreement and the other Transaction Documents by the Company do not, and the performance of this Agreement and the other Transaction Documents and the consummation by the Company of the Contemplated Transactions will not, require any consent, approval, authorization or permit of, or filing with or notification to, any Governmental Body (as hereinafter defined) except for the filing of a Form D with the Securities and Exchange Commission and the filing of the Proxy Statement and the filing of a Form 8-K and other applicable requirements, if any, of the Securities Exchange Act of 1934, as amended (the "Exchange Act") or any state securities or "blue sky" laws ("Blue Sky Laws"), any approval required by applicable rules of the markets in which the Company's securities are traded and any required filing of the Voting Agreement with the appropriate Governmental Body. For purposes of this Agreement, "Governmental Body" shall mean any: (a) nation, state, commonwealth, province, territory, county, municipality, district or other jurisdiction of any nature; (b) federal, state, local, municipal, foreign or other government; or (c) governmental or quasi-governmental authority of any nature (including any governmental division, department, agency, commission, instrumentality, official, organization, unit, body or entity and any court or other tribunal). Without limitation on the foregoing, the consummation of the Contemplated Transactions and the Acquisition do not require the approval of the stockholders of the Company other than the Required Stockholder Approval and the approval of the Nasdaq SmallCap Market, both of which will be obtained prior to the Closing.

2.8. Compliance. Except as set forth in the Company Disclosure Letter, neither the Company nor any Subsidiary is in conflict with, or in default or violation of (i) any law, rule, regulation, order, judgment or decree applicable to the Company or such Subsidiary or by which any property or asset of the Company or such Subsidiary is bound or affected ("Legal Requirement") or (ii) any Material Agreement, in each case except for any such conflicts, defaults or violations that would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect. Since November 1, 2001, neither the Company nor any Subsidiary has received any written notice or communication from any Governmental Body regarding any actual or possible violation of, or failure to comply with, any Legal Requirement.

2.9. SEC Documents; Financial Statements.

(a) The information contained in the following documents did not, as of the date of the applicable document, include any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances in which they were made, not misleading, as of their respective filing dates or, if amended, as so amended (the following documents, together with any other filings made by the Company with the SEC after the date of this Agreement prior to the Closing Date, collectively, the "SEC Documents"), provided that the representation in this sentence shall not apply to any misstatement or omission in any SEC Document filed prior to the date of this Agreement which will have been superseded by a subsequent SEC Document filed prior to the Closing Date:

(i) the Company's Annual Report on Form 10-K for the year ended October 31, 2004;

(ii) the Company's definitive Proxy Statement with respect to its 2005 Annual Meeting of Stockholders, filed with the SEC on February 10, 2005;

(iii) the Company's Quarterly Report on Form 10-Q for the quarter ended January 31, 2005; and

(iv) the Company's Current Reports on Form 8-K, filed with the SEC on October 14, 2004, December 15, 2004, January 4, 2005, February 23, 2005 and March 28, 2005, and on Form 8-K/A, filed with the SEC on February 28, 2005.

(b) In addition, as of the date of this Agreement and as of the Closing Date, the Company Disclosure Letter, when read together with the representations and warranties contained in this Agreement, does not include any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances in which they were made and the time period about which they were made, not misleading.

(c) The Company has filed all forms, reports and documents required to be filed by it with the SEC since October 31, 2001, including, without limitation, the SEC Documents. As of their respective dates, the SEC Documents have complied, and will have complied, as to form in all material respects with the applicable requirements of the Securities Act, the Exchange Act and the rules and regulations thereunder.

(d) The Company's Annual Report on Form 10-K for the year ended October 31, 2004 includes (i) consolidated balance sheets as of October 31, 2003 and 2004 and (ii) consolidated statements of operations and consolidated statements of cash flows for the three one-year periods then ended (collectively, the "Form 10-K Financial Statements").

(e) The Company's Quarterly Report on Form 10-Q for the quarter ended January 31, 2005, includes (i) consolidated balance sheets as of January 31, 2005 and October 31, 2004 and (ii) consolidated statements of operations and consolidated statements of cash flows for the quarters ended January 31, 2004 and 2005 (the "January 31 Form 10-Q Financial Statements).

(f) PyX's balance sheets as of December 31, 2004 and 2003 and related statements of operations, stockholders' equity (deficit), and cash flows for the year ended December 31, 2004, the period from inception (November 26, 2002) through December 31, 2003, and the period from inception (November 26, 2002) through December 31, 2004 are referred to herein as the "PyX Financial Statements" and, together with the Form 10-K Financial Statements and the January 31 Form 10-Q Financial Statements, are referred to as the "Financial Statements."

(g) The Form 10-K Financial Statements and the January 31 Form 10-Q Financial Statements (including the related notes and schedules thereto and all other financial information included in the SEC Documents) fairly present in all material respects the consolidated financial position, results of operations or cash flows, as the case may be, of the Company and its Subsidiaries other than PyX for the periods set forth therein (subject, in the case of unaudited statements, to normal year-end audit adjustments that would not be material in amount or effect), in each case in accordance with generally accepted accounting principles consistently applied during the periods involved, except as may be noted therein. The PyX Financial Statements fairly present in all material respects the consolidated financial position, results of operations or cash flows, as the case may be, of PyX for the periods set forth therein, in each case in accordance with generally accepted accounting principles consistently applied during the periods involved, except as may be noted therein.

(h) Any SEC Documents filed after the date of this Agreement and prior to the Closing Date will not, as of the date of the applicable document, include any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances in which they were made, not misleading, as of their respective filing dates or, if amended, as so amended.

2.10. Litigation. Except as set forth in the SEC Documents or the Company Disclosure Letter, there are no claims, actions, suits, investigations, inquiries or proceedings (each, an "Action") pending against the Company or any of its Subsidiaries or, to the knowledge of the Company, threatened against the Company or any of its Subsidiaries, at law or in equity, or before or by any court, tribunal, arbitrator, mediator or any federal or state commission, board, bureau, agency or instrumentality, that, individually or in the aggregate, would reasonably be expected to have a Material Adverse Effect. Neither the Company nor any of its Subsidiaries is a party to or subject to the provisions of any order, writ, injunction, judgment or decree of any court or government agency or instrumentality.

2.11. Absence of Certain Changes. Except (i) as specifically contemplated by this Agreement or the Acquisition Agreement and related agreements and the transactions contemplated thereby, or (ii) as set forth in the Company Disclosure Letter, the SEC Documents or the Financial Statements, since January 31, 2005, there has not been (a) any Material Adverse Change; (b) any return of any capital or other distribution of assets to stockholders of the Company (except to the Company); (c) except for the Acquisition, any acquisition (by merger, consolidation, acquisition of stock and/or assets or otherwise) of any Person; or (d) any transactions, other than in the ordinary course of business, consistent with past practices and reasonable business operations ("Ordinary Course of Business"), with any of its officers, directors, principal stockholders or employees or any Person affiliated with any of such persons.

2.12. Proprietary Assets.

(a) For purposes of this Agreement, "Proprietary Assets" shall mean all right, title and interest of the Company and the Subsidiaries in and to the following items or types of property: (i) every patent, patent application, trademark (whether registered or unregistered), trademark application, trade name, fictitious business name, service mark (whether registered or unregistered), service mark application, copyright (whether registered or unregistered), copyright application, maskwork, maskwork application, trade secret, know-how, customer list, franchise, system, computer software, computer program, invention, design, blueprint, engineering drawing, proprietary product, technology, proprietary right or other intellectual property right or intangible asset other than goodwill; and (ii) all licenses and other rights to use or exploit any of the foregoing.

(b) Except as set forth in the Company Disclosure Letter, each of the Company or its Subsidiaries: has good, valid and marketable title to each of the Proprietary Assets owned by it, free and clear of all liens and other encumbrances; has a valid right to use all Proprietary Assets owned by third parties; and is not obligated to make any payment to any Person for the use of any Proprietary Asset except as set forth in the applicable license agreement. Except as set forth in the Company Disclosure Letter, neither the Company nor any of its Subsidiaries has developed jointly with any other Person any material Proprietary Asset with respect to which such other Person has any rights.

(c) Each of the Company and its Subsidiaries has taken commercially reasonable and customary measures and precautions to protect and maintain the confidentiality and secrecy of all Proprietary Assets of the Company and its Subsidiaries (except Proprietary Assets whose value would be unimpaired by public disclosure) and otherwise to maintain and protect the value of all Proprietary Assets of the Company and its Subsidiaries. Except as set forth in the Company Disclosure Letter, neither the Company nor any of its Subsidiaries has (other than pursuant to license agreements identified in the Company Disclosure Letter) disclosed or delivered to any Person, or permitted the disclosure or delivery to any Person of, (i) the source code, or any portion or aspect of the source code, of any Proprietary Asset, (ii) the object code, or any portion or aspect of the object code, of any Proprietary Asset of the Company and its Subsidiaries, except in the ordinary course of its business or (iii) any patent applications (except as required by law).

(d) To the knowledge of the Company, (i) none of the Proprietary Assets of the Company and its Subsidiaries infringes or conflicts with any Proprietary Asset owned or used by any other Person; (ii) neither the Company nor any Subsidiary is infringing, misappropriating or making any unlawful use of any Proprietary Asset owned or used by any other Person; and (iii) no other Person is infringing, misappropriating or making any unlawful use of, and no Proprietary Asset owned or used by any other Person infringes or conflicts with, any Proprietary Asset of the Company or any of its Subsidiaries.

(e) Except as set forth in the Company Disclosure Letter, excluding warranty claims received by Company or any of its Subsidiaries in the ordinary course of business, there has not been any claim by any customer or other Person alleging that any Proprietary Asset of the Company or any of its Subsidiaries (including each version thereof that has ever been licensed or otherwise made available by the Company to any Person) does not conform in all material respects with any specification, documentation, performance standard, representation or statement made or provided by or on behalf of the Company.

(f) To the knowledge of the Company, the Proprietary Assets of the Company and its Subsidiaries constitute all the Proprietary Assets necessary to enable the Company and its Subsidiaries to conduct their respective businesses in the manner in which such businesses have been and are being conducted. Except as set forth in the Company Disclosure Letter, (i) neither the Company nor any Subsidiary has licensed any of its Proprietary Assets to any Person on an exclusive, semi-exclusive or royalty-free basis and (ii) neither the Company nor any Subsidiary has entered into any covenant not to compete or contract limiting such entity’s ability to exploit fully any of such entity’s material Proprietary Assets or to transact business in any material market or geographical area or with any Person.

(g) Except as set forth in the Company Disclosure Letter, neither the Company nor any of its Subsidiaries has at any time received any notice or other communication (in writing or otherwise) of any actual, alleged, possible or potential infringement, misappropriation or unlawful use of, any Proprietary Asset owned or used by any other Person.

2.13. Adverse Business Developments. Except as set forth in the Company Disclosure Letter, there is no existing, pending or, to the knowledge of the Company, threatened termination, cancellation, limitation, modification or change in the business relationship of the Company or any of its Subsidiaries, with any supplier, customer or other Person, except as such as would not reasonably be expected, individually or in the aggregate, to have a Material Adverse Effect.

2.14. Registration Rights. Except as set forth in the Investor Rights Agreement, the Shareholder Agreement attached as an exhibit to the Acquisition Agreement, the SEC Documents, or in the Company Disclosure Letter, the Company is not under any obligation to register under the Securities Act any of its currently outstanding securities or any securities issuable upon exercise or conversion of its currently outstanding securities nor is the Company obligated to register or qualify any such securities under any state securities or Blue Sky Laws.

2.15. Corporate Documents. The Company's Certificate of Incorporation and Bylaws, each as amended to date and prior to the Closing Date, which have been requested and previously provided to the Investors, are true, correct and complete and contain all amendments thereto.

2.16. Disclosure. The Company shall file a Current Report on Form 8-K, by the time required by the SEC, describing the material terms of the transactions contemplated by this Agreement, and disclosing such portions of the Transaction Documents as contain material nonpublic information with respect to the Company that has not previously been publicly disclosed by the Company, and attaching as an exhibit to such Form 8-K a form of this Agreement. Except for information that may be provided to the Investors pursuant to this Agreement or pursuant to the request of any Investor or counsel to the Investors, the Company shall not, and shall use commercially reasonable efforts to cause each of its officers, directors, employees and agents not to, provide any Investor with any material nonpublic information regarding the Company from and after the filing of such Form 8-K without the express prior consent of such Investor.

2.17. Use of Proceeds. The net proceeds received by the Company from the sale of the Securities shall be used by the Company for working capital and general corporate purposes, including without limitation to support the operations, if any, of each of the Subsidiaries and PyX.

3. Representations and Warranties of the Investors. Each Investor represents and warrants to the Company as follows:

3.1. Authorization. Such Investor (a) has full power and authority to execute, deliver and perform this Agreement and the other Transaction Documents to which it is a party and to incur the obligations herein and therein and (b) if applicable has been authorized by all necessary corporate or equivalent action to execute, deliver and perform this Agreement and the other Transaction Documents and to consummate the Contemplated Transactions. Each of this Agreement and the other Transaction Documents is a valid and binding obligation of such Investor enforceable in accordance with its terms, except as limited by applicable bankruptcy, reorganization, insolvency, moratorium or similar laws affecting the enforcement of creditors' rights and the availability of equitable remedies (regardless of whether such enforceability is considered in a proceeding at law or equity).

3.2. Brokers and Finders. Such Investor has not retained any investment banker, broker or finder in connection with the Contemplated Transactions.

4. Securities Laws.

4.1. Securities Laws Representations and Covenants of Investors.

(a) This Agreement is made with each Investor in reliance upon such Investor's representation to the Company, which by such Investor's execution of this Agreement such Investor hereby confirms, that the Securities to be received by such Investor will be acquired for investment for such Investor's own account, not as a nominee or agent, and not with a view to the resale or distribution of any part thereof such that such Investors would constitute an "underwriter" under the Securities Act; provided that this representation and warranty shall not limit the Investor's right to sell the Shares or the Warrant Shares pursuant to the Investor Rights Agreement or in compliance with an exemption from registration under the Securities Act or the Investor's right to indemnification under this Agreement or the Investor Rights Agreement.

(b) Each Investor understands and acknowledges that the offering of the Securities pursuant to this Agreement will not be registered under the Securities Act or qualified under any Blue Sky Laws, on the grounds that the offering and sale of the Securities are exempt from registration and qualification, respectively, under the Securities Act and the Blue Sky Laws.

(c) Each Investor covenants that, unless the Shares, the Warrants, the Warrant Shares or any other shares of capital stock of the Company received in respect of the foregoing have been registered pursuant to the Investor Rights Agreement being entered into among the Company and the Investors, such Investor will not dispose of such securities unless and until such Investor shall have notified the Company of the proposed disposition and shall have furnished the Company with an opinion of counsel reasonably satisfactory in form and substance to the Company to the effect that (i) such disposition will not require registration under the Securities Act and (ii) appropriate action necessary for compliance with the Securities Act and any applicable state, local or foreign law has been taken; provided, however, that an investor may dispose of such securities without providing the opinion referred to above if the Company has been provided with adequate assurance that such disposition has been made in compliance with Rule 144 under the Securities Act (or any similar rule).

(d) Each Investor represents that: (i) such Investor has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of such Investor's prospective investment in the Securities; (ii) such Investor has the ability to bear the economic risks of such Investor's prospective investment and can afford the complete loss of such investment; (iii) such Investor has been furnished with and has had access to such information as is in the Company Disclosure Letter together with the opportunity to obtain such additional information as it requested to verify the accuracy of the information supplied; and (iv) such Investor has had access to officers of the Company and an opportunity to ask questions of and receive answers from such officers and has had all questions that have been asked by such Investor satisfactorily answered by the Company.

(e) Each Investor further represents by execution of this Agreement that such Investor qualifies as an "accredited investor" as such term is defined under Rule 501 promulgated under the Securities Act. Any Investor that is a corporation, a partnership, a limited liability company, a trust or other business entity further represents by execution of this Agreement that it has not been organized for the purpose of purchasing the Securities.

(f) By acceptance hereof, each Investor agrees that the Shares, the Warrants, the Warrant Shares and any shares of capital stock of the Company received in respect of the foregoing held by it may not be sold by such Investor without registration under the Securities Act or an exemption therefrom, and therefore such Investor may be required to hold such securities for an indeterminate period.

4.2. Legends. All certificates for the Shares, the Warrants and the Warrant Shares, and each certificate representing any shares of capital stock of the Company received in respect of the foregoing, whether by reason of a stock split or share reclassification thereof, a stock dividend thereon or otherwise and each certificate for any such securities issued to subsequent transferees of any such certificate (unless otherwise permitted herein) shall bear the following legend:

"THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE BEEN ACQUIRED FOR INVESTMENT AND HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. SUCH SECURITIES MAY NOT BE SOLD OR TRANSFERRED IN THE ABSENCE OF REGISTRATION OR AN EXEMPTION THEREFROM UNDER SAID ACT."

5. Additional Covenants of the Company.

5.1. Reports, Information, Authorization of Sufficient Shares.

(a) The Company shall cooperate with each Investor in supplying such information as may be reasonably requested by such Investor to complete and file any information reporting forms presently or hereafter required by the SEC as a condition to the availability of an exemption, presently existing or hereafter adopted, from the Securities Act for the sale of any of the Shares, the Warrants, the Warrant Shares and shares of capital stock of the Company received in respect of the foregoing.

(b) For so long as an Investor (or the successor or assign of such Investor) holds either Securities or Warrant Shares, the Company shall deliver to such Investor (or the successor or assign of such Investor), contemporaneously with delivery to other holders of Common Stock, a copy of each report of the Company delivered to holders of Common Stock.

(c) At the Closing and at every time thereafter, the Company shall keep reserved for issuance a sufficient number of authorized but unissued shares of Common Stock (or other securities for which the Warrants are then exercisable) so that the Warrants that remain unexercised at such time may be exercised to purchase Common Stock (or such other securities).

5.2. Expenses; Indemnification.

(a) The Company agrees to pay on the Closing Date and hold the Investors harmless against liability for the payment of (1) any stamp or similar taxes (including interest and penalties, if any) that may be determined to be payable in respect of the execution and delivery of this Agreement and the issue and sale of any Securities and Warrant Shares, (2) the expense of preparing and issuing the Securities and Warrant Shares, and (3) the cost of delivering the Securities and Warrant Shares of each Investor to such Investor's address, insured in accordance with customary practice. Each Investor shall be responsible for its out-of-pocket expenses arising in connection with the Contemplated Transactions, except that, at the Closing, the Company shall pay fees and disbursements of counsel to the Investors as set forth in Section 6.9.

(b) The Company hereby agrees and acknowledges that the Investors have been induced to enter into this Agreement and to purchase the Securities hereunder, in part, based upon the representations, warranties and covenants of the Company contained herein. The Company hereby agrees to pay, indemnify and hold harmless the Investors and any director, officer, partner, member, employee or other affiliate of any Investor against all claims, losses and damages resulting from any and all legal or administrative proceedings against one or more Investors, including without limitation, reasonable attorneys' fees and expenses incurred in connection therewith (collectively, "Loss"), resulting from a breach by the Company of any representation or warranty of the Company contained herein or the failure of the Company to perform any covenant made herein; provided that the Company's liability under this Section 5.2(b) shall be limited to the aggregate purchase price actually paid for the Securities and that the Company shall not be obligated to indemnify the Investors for Losses until the total amount of Losses accrued aggregates $25,000, at which point the Company will be obligated to indemnify the Investors for such amount to the first dollar.

(c) As soon as reasonably practicable after receipt by an Investor of notice of any Loss in respect of which the Company may be liable under this Section 5.2, the Investor shall give notice thereof to the Company. Each Investor may, at its option, claim indemnity under this Section 5.2 as soon as a claim has been threatened by a third party, regardless of whether an actual Loss has been suffered, so long as counsel for such Investor shall in good faith determine that such claim is not frivolous and that such Investor may be liable or otherwise incur a Loss as a result thereof and shall give notice of such determination to the Company. Each Investor shall permit the Company, at the Company's option and expense, to assume the defense of any such claim by counsel mutually and reasonably satisfactory to the Company and the Investors who are subject to such claim, and to settle or otherwise dispose of the same; provided, however, that each Investor may at all times participate in such defense at such Investor's expense; and provided, further, that the Company shall not, in defense of any such claim, except with the prior written consent of a majority in interest of the Investors subject to such claim, consent to the entry of any judgment or any settlement of such claim that does not include as an unconditional term thereof the giving by the claimant or plaintiff in question to each Investor and its affiliates of a release of all liabilities in respect of such claims. If the Company does not promptly assume the defense of such claim irrespective of whether such inability is due to the inability of the afore-described Investors and the Company to mutually agree as to the choice of counsel, or if any such counsel is unable to represent one or more of the Investors due to a conflict or potential conflict of interest, then an Investor may assume such defense and be entitled to indemnification and prompt reimbursement from the Company for such Investor's costs and expenses incurred in connection therewith, including without limitation, reasonable attorneys' fees and expenses. Such fees and expenses shall be reimbursed to the Investors as soon as practicable after submission of invoices to the Company.

(d) The Company shall maintain the effectiveness of the Registration Statement (as defined in the Investor Rights Agreement) under the Securities Act for as long as is required under the Investor Rights Agreement.

6. Miscellaneous.

6.1. Entire Agreement; Successors and Assigns. This Agreement and the other Transaction Documents constitute the entire contract between the parties relative to the subject matter hereof and thereof, and no party shall be liable or bound to the other in any manner by any warranties, representations or covenants except as specifically set forth herein or therein. This Agreement and the other Transaction Documents supersede any previous agreement among the parties with respect to the Securities. The terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective executors, administrators, heirs, successors and assigns of the parties. Except as expressly provided herein, nothing in this Agreement, expressed or implied, is intended to confer upon any party, other than the parties hereto, any rights, remedies, obligations or liabilities under or by reason of this Agreement.

6.2. Survival of Representations and Warranties. Notwithstanding any right of the Investors fully to investigate the affairs of the Company and notwithstanding any knowledge of facts determined or determinable by any Investor pursuant to such right of investigation, each Investor has the right to rely fully upon the representations, warranties, covenants and agreements of the Company contained in this Agreement or in any documents delivered pursuant to this Agreement. All such representations and warranties of the Company shall survive the execution and delivery of this Agreement and the Closing hereunder and shall continue in full force and effect for one year after the Closing. The covenants of the Company set forth in Section 5 shall remain in effect as set forth therein.

6.3. Governing Law; Jurisdiction. This Agreement shall be governed by and construed in accordance with the laws of the State of New York without regard to principles of conflicts of law. Each party hereby irrevocably consents and submits to the jurisdiction of any New York State or United States Federal Court sitting in the State of New York, County of New York, over any action or proceeding arising out of or relating to this Agreement and irrevocably consents to the service of any and all process in any such action or proceeding by registered mail addressed to such party at its address specified in Section 6.6 (or as otherwise noticed to the other party). Each party further waives any objection to venue in New York and any objection to an action or proceeding in such state and county on the basis of *forum non conveniens*. Each party also waives any right to trial by jury.

6.4. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

6.5. Headings. The headings of the sections of this Agreement are for convenience and shall not by themselves determine the interpretation of this Agreement.

6.6. Notices. Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given upon (a) personal delivery, (b) delivery by fax (with answer back confirmed), or (c) two business days after mailing by recognized overnight courier (such as Federal Express), addressed to a party at its address or sent to the fax number shown below or at such other address or fax number as such party may designate by three days' advance notice to the other party.

Any notice to the Investors shall be sent to the addresses set forth on the signature pages hereof, with a copy to:

Hahn & Hessen LLP
488 Madison Avenue
New York, New York 10022
Attention: James Kardon
Fax Number: (212) 478-7400

Any notice to the Company shall be sent to:

SBE, Inc.
2305 Camino Ramon, Suite 200,
San Ramon, California 94583
Attention: David Brunton
Fax Number: (925) 355-2041

with a copy to:

Cooley Godward LLP
One Maritime Plaza, 20th Floor
San Francisco, CA 94111-3580
Attention: Jodie Bourdet
Fax Number: (415) 951-3699

6.7. Rights of Transferees. Except as may be set forth in the Investor Rights Agreement, any and all rights and obligations of each of the Investors herein incident to the ownership of Securities or the Warrant Shares shall pass successively to all subsequent transferees of such securities until extinguished pursuant to the terms hereof.

6.8. Severability. Whenever possible, each provision of this Agreement shall be interpreted in such a manner as to be effective and valid under applicable law, but if any provision of this Agreement shall be deemed prohibited or invalid under such applicable law, such provision shall be ineffective to the extent of such prohibition or invalidity, and such prohibition or invalidity shall not invalidate the remainder of such provision or any other provision of this Agreement.

6.9. Expenses. Irrespective of whether any Closing is effected, the Company shall pay all costs and expenses that it incurs with respect to the negotiation, execution, delivery and performance of this Agreement. Each Investor shall be responsible for all costs incurred by such Investor in connection with the negotiation, execution, delivery and performance of this Agreement including, but not limited to, legal fees and expenses, except that the Company shall pay at the Closing or upon Price Termination the reasonable legal fees and expenses of Hahn & Hessen LLP (the "Legal Fee"), as counsel to the Investors, up to a maximum aggregate amount of $50,000. AIGH may, at its option, deduct the Legal Fee from the purchase price paid to the Company for its Securities for payment to Hahn & Hessen LLP. After the Closing, the Company shall pay Hahn & Hessen LLP's reasonable legal fees and expenses associated with the transactions contemplated by the Investor Rights Agreement, provided that the Company will not be obligated to pay any such amount after the total amount paid to Hahn & Hessen LLP by the Company, including the amount paid at the Closing, equals $50,000.

6.10. Amendments and Waivers. Unless a particular provision or section of this Agreement requires otherwise explicitly in a particular instance, any provision of this Agreement may be amended and the observance of any provision of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of (a) the Company and (b) the holders of 75% of the Shares (not including for this purpose any Shares that have been sold to the public pursuant to a registration statement under the Securities Act or an exemption therefrom) (it being understood that any amendment effected prior to the Closing shall require the consent of Investors investing 75% of the total amount set forth on Schedule 1.1(b)). Any amendment or waiver effected in accordance with this Section 6.10 shall be binding upon each holder of any Securities at the time outstanding (including securities into which such Securities are convertible), each future holder of all such Securities, and the Company.

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SIGNATURE PAGE
TO
SBE, INC.
SUBSCRIPTION AGREEMENT
Dated May 4, 2005

IF the PURCHASER is an INDIVIDUAL, please complete the following:

IN WITNESS WHEREOF, the undersigned has executed this Agreement this 4th day of May, 2005.

Amount of Subscription:
$_____

_____
Print Name

_____
Signature of Investor

_____
Social Security Number

_____
Address and Fax Number

_____
E-mail Address

ACCEPTED AND AGREED:

SBE, INC.

By:_____
Name:_____
Title:_____
Dated:_____

SIGNATURE PAGE
TO
SBE, INC.
SUBSCRIPTION AGREEMENT
Dated May 4, 2005

IF the INTERESTS will be held as JOINT TENANTS, as TENANTS IN COMMON, or as COMMUNITY PROPERTY, please complete the following:

IN WITNESS WHEREOF, the undersigned has executed this Agreement this 4th day of May, 2005.

Amount of Subscription:
$_____

_____
Print Name of Purchaser

_____
Signature of a Purchaser

_____
Social Security Number

_____
Print Name of Spouse or Other Purchaser

_____
Signature of Spouse or Other Purchaser

_____
Social Security Number

_____
Address

_____
Fax Number

_____
E-mail Address

ACCEPTED AND AGREED:

SBE, INC.

By:_____
Name:_____
Title:_____
Dated:_____

SIGNATURE PAGE
TO
SBE, INC.
SUBSCRIPTION AGREEMENT
Dated May 4, 2005

IF the PURCHASER is a PARTNERSHIP, CORPORATION, LIMITED LIABILITY COMPANY, TRUST or OTHER ENTITY, please complete the following:

IN WITNESS WHEREOF, the undersigned has executed this Agreement this 4th day of May, 2005.

Amount of Subscription:
$_____

_____
Print Full Legal Name of Partnership,
Company, Limited Liability Company, Trust or Other
Entity

By: _____
(Authorized Signatory)
Name: _____
Title: _____
Address and Fax Number: _____

_____

Taxpayer Identification Number: _____
Date and State of Organization:_____
Date on which Taxable Year Ends:_____
E-mail Address: _____

ACCEPTED AND AGREED:

SBE, INC.

By:_____
Name:_____
Title:_____
Dated:_____

Schedule 1.1(b)

INVESTORS

Name	Total Purchase Price
Herschel Berkowitz	$150,000.00
Paul Packer	50,000.00
Globis Capital Partners	500,000.00
Globis Overseas Fund Ltd.	200,000.00
Richard Grossman	50,000.00
Joshua Hirsch	50,000.00
James Kardon	17,000.00
AIGH Investment Partners LLC	825,000.00
Ellis International LLC	100,000.00
Jack Dodick	200,000.00
Stephen Spira	100,000.00
Fame Associates	100,000.00
Cam Co	350,000.00
Anfel Trading Limited	650,000.00
Ganot Corporation	350,000.00
LaPlace Group, LLC	300,000.00
F. Lyon Polk	60,000.00
Paul Tramontano	50,000.00
Hilary Edson	60,000.00
Kevin McCaffrey	100,000.00
William Heinzerling	100,000.00

John A. Moore	100,000.00
Mark Giordano	30,000.00
Jeffrey Schwartz	8,000.00
Norman Pessin	250,000.00
Greg Yamamoto	200,000.00
Tzu-Wang Pan	50,000.00
Kurt Miyatake	50,000.00
Greg Yamamoto, as UTMA custodian for Melanie Yamamoto	50,000.00
Greg Yamamoto, as UTMA custodian for Nicholas Yamamoto	50,000.00
TOTAL	$5,150,000.00

EXHIBITS AND SCHEDULES TO THE UNIT SUBSCRIPTION AGREEMENT

Schedule 1.1(b)	Investors
Exhibit 1:	Form of Warrants
Exhibit 2:	Voting Agreement
Exhibit 3:	Form of Investor Rights Agreement
Exhibit 4:	Matters Covered by Legal Opinion

ANNEX D

VOTING AGREEMENT

Annex D

ANNEX E

FORM OF WARRANT

Annex E

ANNEX F

SBE, INC.

INVESTOR RIGHTS AGREEMENT

INVESTOR RIGHTS AGREEMENT (this "**Agreement**") is entered into as of _____, 2005 by and among SBE, Inc., a Delaware corporation (the "**Company**") and the investors listed on Exhibit A hereto (collectively the **"Investors"**).

WHEREAS, the Company desires to sell to the Investors, and the Investors desire to purchase, _____ shares of Common Stock of the Company (the **"Shares"**) and 5-year warrants (the "**Warrants**"), exercisable to purchase _____ shares of Common Stock of the Company (the "**Warrant Shares**"), upon the terms and conditions set forth in that certain Unit Subscription Agreement, dated as of May 4, 2005, between the Company and the Investors (the **"Unit Subscription Agreement"**);

WHEREAS, the terms of the Unit Subscription Agreement provide that it shall be a condition precedent to the closing of the transactions thereunder for the Company and the Investors to execute and deliver this Agreement; and

WHEREAS, capitalized terms used herein and not otherwise defined are defined in the Unit Subscription Agreement.

NOW, THEREFORE, in consideration of the premises and mutual covenants contained herein, the parties hereto hereby agree as follows:

1. **Definitions**. The following terms shall have the meanings provided below:

"Additional Shares" shall mean any additional shares of Common Stock which may be issued or become issuable from time to time upon a distribution with respect to, or in exchange for, or in replacement of, Shares, a Warrant or Warrant Shares, as a result of anti-dilution provisions of a Warrant or otherwise.

"**Additional Share Notice**" shall have the meaning assigned thereto in Section 10 hereof.

"Blue Sky" shall have the meaning assigned thereto in Section 4(c) hereof.

"Board of Directors" shall mean the board of directors of the Company.

"Convertible Securities"means (i) options to purchase or rights to subscribe for Common Stock, (ii) securities by their terms convertible into or exchangeable for Common Stock or (iii) options to purchase or rights to subscribe for such convertible or exchangeable securities.

"correspondence" shall have the meaning assigned thereto in Section 14(d) hereof.

"**Difference**" shall have the meaning assigned thereto in Section 7(b) hereof.

"Exchange Act" shall mean the Securities Exchange Act of 1934, as amended, and all of the rules and regulations promulgated thereunder.

"Excluded Stock" shall mean (i) all shares of Common Stock issued or issuable to employees, directors or consultants pursuant to any equity compensation plan that is in effect on the date of this Agreement, (ii) all shares of Common Stock issued or issuable to employees or directors pursuant to any equity compensation plan approved by the stockholders of the Company after the date of this Agreement, (iii) all shares of Common Stock issued or issuable to employees, directors or consultants as bona fide compensation for business services rendered, not compensation for fundraising activities, (iv) all shares of Common Stock issued or issuable to bona fide leasing companies, strategic partners, or major lenders, (v) all shares of Common Stock issued or issuable as the purchase price in a bona fide acquisition or merger (including reasonable fees paid in connection therewith) or (vi) all Warrant Shares, Additional Shares and shares issued upon conversion or exercise of other Convertible Securities outstanding on the date hereof.

"Holder"shall mean the Investors or any transferee of the Warrants or Registrable Shares that were held by Investors.

"Majority Holders"shall mean, at the relevant time of reference thereto, those Holders holding more than fifty percent (50%) of the Registrable Shares Owned by all of the Holders.

"**Mandatory Registration**" shall have the meaning assigned thereto in Section 3(a) hereof.

"Mandatory Registration Termination Date"shall have the meaning assigned thereto in Section 3(c) hereof.

"Own"shall mean to own beneficially, as that term is defined in the rules and regulations of the SEC.

"**Proportionate Percentage**" shall have the meaning assigned thereto in Section 10 hereof.

"**Purchase Notice**" shall have the meaning assigned thereto in Section 10 hereof.

"Registrable Shares" shall mean the Shares, the Warrant Shares and any Additional Shares.

"Registration Statement"shall have the meaning assigned thereto in Section 3(a) hereof.

"Rule 144" shall mean Rule 144 promulgated under the Securities Act and any successor or substitute rule, law or provision.

"SEC" shall mean the Securities and Exchange Commission.

"Securities Act" shall mean the Securities Act of 1933, as amended, and all of the rules and regulations promulgated thereunder.

"Selling Expenses" shall mean all underwriting discounts, brokerage and selling commissions applicable to the sale of Registrable Shares, including standard underwriters' cutbacks.

"Shares" shall have the meaning assigned thereto in the Preamble to this Agreement.

"Suspension" shall have the meaning assigned thereto in Section 9(b) hereof.

"Unit Subscription Agreement" shall have the meaning assigned thereto in the Preamble to this Agreement.

"Warrants" shall have the meaning assigned thereto in the Preamble to this Agreement.

"Warrant Shares" shall have the meaning assigned thereto in the Preamble to this Agreement.

2. **Effectiveness**. This Agreement shall become effective upon the Closing.

3. **Mandatory Registration**. (a) No later than sixty (60) days after the Closing, the Company will prepare and file with the SEC a registration statement on Form S-3 for the purpose of registering (such registration, the "**Mandatory Registration**") under the Securities Act all of the Registrable Shares for resale by, and for the account of, the Investors as selling stockholders thereunder (the **"Registration Statement"**). The Registration Statement shall permit the Investors to offer and sell, on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, any or all of the Registrable Shares. Such Registration Statement also shall cover, to the extent allowable under the Securities Act and the rules promulgated thereunder (including Rule 416), such indeterminate number of additional shares of Common Stock resulting from stock splits, stock dividends or similar transactions with respect to the Registrable Shares.

(b) The Company agrees to use its best efforts to cause the Registration Statement to become effective within ninety (90) days after filing.

(c) The Company shall be required to keep the Registration Statement, as amended, effective until such date that is the earlier of (i) two years after the Closing, (ii) the date when all of the Registrable Shares registered thereunder shall have been sold or (iii) such time as all the Registrable Shares held by the Investors can be sold pursuant to Rule 144(k) and without compliance with the registration requirements of the Securities Act (such date is referred to herein as the **"Mandatory Registration Termination Date"**). Thereafter, the Company shall be entitled to withdraw the Registration Statement and the Investors shall have no further right to offer or sell any of the Registrable Shares pursuant to the Registration Statement (or any prospectus relating thereto).

(d) The Company shall not grant any registration rights that are senior to the registration rights of the Investors under this Agreement if such registration rights would adversely affect the Investors' ability to sell Registrable Shares pursuant to the Registration Statement. The Company represents that no stockholders other than the Investors have the right to sell any Common Stock or other securities of the Company pursuant to the Registration Statement other than rights granted pursuant to the transactions contemplated by the Acquisition Agreement.

4. **Obligations of the Company**. In connection with the Company's obligations under Section 3 hereof to file the Registration Statement with the SEC and to use its reasonable efforts to cause the Registration Statement to become effective as soon as practicable after filing, the Company shall, as expeditiously as reasonably possible, subject to Section 9 hereof:

(a) prepare and file with the SEC such amendments and supplements to the Registration Statement and the prospectus used in connection therewith as may be necessary in order to keep the Registration Statement effective until the Mandatory Registration Termination Date;

(b) furnish to the selling Holders such reasonable number of copies of the Registration Statement and a final prospectus, in conformity with the requirements of the Securities Act, and such other documents (including, without limitation, prospectus amendments and supplements as are prepared by the Company in accordance with Section 4(a) above) as the selling Holders may reasonably request, in order to facilitate the public or other disposition of such selling Holders' Registrable Shares;

(c) use reasonable efforts to register and qualify the Registrable Shares covered by the Registration Statement under such other securities laws or blue sky (**"Blue Sky"**) laws of all states requiring such securities or Blue Sky registration or qualification, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions; and

(d) use reasonable efforts to cause all such Registrable Shares registered hereunder to be listed on each securities exchange (including without limitation The Nasdaq SmallCap Market) on which securities of the same class issued by the Company are then listed.

5. **Furnish Information**. (a) It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Agreement that the selling Holders shall furnish to the Company such information regarding them and the securities held by them as the Company shall reasonably request and as shall be required in order to effect any registration by the Company pursuant to this Agreement.

(b) The Registration Statement will provide for a plan of distribution with respect to the Registrable Shares substantially as follows: The Registrable Shares may be sold from time to time by the Holders, or by pledgees, donees, transferees or other successors in interest. Such sales may be made on one or more exchanges or in the over-the-counter market, or otherwise at prices and at terms then prevailing or at prices related to the then-current market price, or in negotiated transactions. The Registrable Shares may be sold by one or more of the following: (i) a block trade in which the broker or dealer so engaged will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction; (ii) purchases by a broker or dealer as principal and resale by such broker or dealer for its account pursuant to the resale registration statement; (iii) an exchange distribution in accordance with the rules of such exchange; (iv) one or more underwritten offerings on a firm commitment or best efforts basis; (v) ordinary brokerage transactions and transactions in which the broker solicits purchasers; and (vi) transactions between sellers and purchasers without a broker/dealer. In addition, any securities covered by the Registration Statement that qualify for sale pursuant to Rule 144 may be sold under Rule 144 rather than pursuant to the Registration Statement. From time to time the selling Holders may engage in short sales, short sales versus the box, puts and calls and other transactions in securities of the issuer or derivatives thereof, and may sell and deliver the shares in connection therewith. For so long as a Holder owns any Registrable Shares, such Holder shall not maintain a Net Short Position. For purposes of this Section, a "**Net Short Position**" by a person means a position

whereby such person has executed one or more sales of Common Stock that is marked as a short sale and that is executed at a time when such Holder has no equivalent offsetting long position in the Common Stock. For purposes of determining whether a Holder has an equivalent offsetting long position in the Common Stock, all Common Stock that is beneficially owned by such Holder shall be deemed to be held long by such Holder. The Holders may also distribute the shares to their partners, members, stockholders or shareholders to the extent such distributions are effected in full compliance with applicable securities laws and provided that the distributing Holders and the distributees provide the Company with such documents and other information as reasonably requested by the Company. In effecting sales, brokers or dealers engaged by the selling Holders may arrange for other brokers or dealers to participate. Brokers or dealers will receive commissions or discounts from selling Holders in amounts to be negotiated immediately prior to the sale.

6. **Expenses of Registration**. All expenses incurred in connection with the registration of the Registrable Shares pursuant to this Agreement, including without limitation all registration and qualification and filing fees, printing expenses, fees and disbursements of counsel for the Company, and the reasonable fees and disbursements of one counsel for the selling Holders selected by the selling Holders, shall be borne by the Company; provided, however, that the reasonable fees and disbursements of such counsel shall be subject to the limitation on the Legal Fee set forth in Section 6.9 of the Unit Subscription Agreement. All Selling Expenses shall be borne by the Holders of the Registrable Shares so registered and sold, pro rata on the basis of the number of their Registrable Shares so registered and sold.

7. **Indemnification.**

(a) To the extent permitted by law, the Company will indemnify and hold harmless each selling Holder (including the partners or officers, directors and stockholders of such Holder), and each person, if any, who controls such selling Holder within the meaning of the Securities Act, against any losses, claims, damages or liabilities, joint or several, to which they may become subject under the Securities Act, the Exchange Act, and other federal or state securities laws, or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) (i) arise out of or are based upon any untrue or alleged untrue statement of any material fact contained in the Registration Statement, in any preliminary prospectus or final prospectus relating thereto or in any amendments or supplements to the Registration Statement or any such preliminary prospectus or final prospectus, (ii) arise out of or are based upon the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading or (iii) arise out of any violation or alleged violation by the Company of the Securities Act, the Exchange Act, any other federal or state securities law or any rule or regulation promulgated under the Securities Act, the Exchange Act or any other federal or state securities law; and will reimburse such selling Holder, or such officer, director or controlling person for any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the indemnity agreement contained in this Section 7(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld or delayed), nor shall the Company be liable in any such case for any such loss, damage, liability or action, to the extent that it arises out of or is based upon an untrue statement or alleged untrue statement or omission made in connection with the Registration Statement, any preliminary prospectus or final prospectus relating thereto or any amendments or supplements to the Registration Statement or any such preliminary prospectus or final prospectus, in reliance upon and in conformity with written information furnished expressly for use in connection with the Registration Statement or any such preliminary prospectus or final prospectus by the selling Holders, any broker/dealer acting on their behalf or controlling person with respect to them.

(b) To the extent permitted by law, each selling Holder will severally and not jointly indemnify and hold harmless the Company, each of its directors, each of its officers who have signed the Registration Statement, each person, if any, who controls the Company within the meaning of the Securities Act, or any selling Holders, and all other selling Holders against any losses, claims, damages or liabilities to which the Company or any such director, officer, controlling person or such other selling Holder may become subject to, under the Securities Act or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereto) arise out of or are based upon any untrue or alleged untrue statement of any material fact contained in the Registration Statement or any preliminary prospectus or final prospectus, relating thereto or in any amendments or supplements to the Registration Statement or any such preliminary prospectus or final prospectus, or arise out of or are based upon the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, in each case to the extent and only to the extent that such untrue statement or alleged untrue statement or omission or alleged omission was made in the Registration Statement, in any preliminary prospectus or final prospectus relating thereto or in any amendments or supplements to the Registration Statement or any such preliminary prospectus or final prospectus, in reliance upon and in conformity with written information furnished by the selling Holder expressly for use in connection with the Registration Statement, or any preliminary prospectus or final prospectus; and such selling Holder will reimburse any legal or other expenses reasonably incurred by the Company or any such director, officer, controlling person, or other selling Holder in connection with investigating or defending any such loss, claim, damage, liability or action, provided, however, that the liability of each selling Holder hereunder (when aggregated with amounts contributed, if any, pursuant to Section 7(d)) shall be limited to the difference (the "**Difference**") between (a) the amount received by such Holder from the sale of the Registrable Shares pursuant to the Registration Statement and (b) the amount paid by such Holder to the Company for such Registrable Shares pursuant to the Unit Subscription Agreement, and provided further, however, that the indemnity agreement contained in this Section 7(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of those selling Holder(s) against which the request for indemnity is being made (which consent shall not be unreasonably withheld or delayed).

(c) Promptly after receipt by an indemnified party under this Section 7 of notice of the commencement of any action, such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 7, notify the indemnifying party in writing of the commencement thereof and the indemnifying party shall have the right to participate in and, to the extent the indemnifying party desires, jointly with any other indemnifying party similarly noticed, to assume at its expense the defense thereof with counsel mutually satisfactory to the indemnifying parties with the consent of the indemnified party, which consent will not be unreasonably withheld, conditioned or delayed. In the event that the indemnifying party assumes any such defense, the indemnified party may participate in such defense with its own counsel and at its own expense, provided, however, that the counsel for the indemnifying party shall act as lead counsel in all matters pertaining to such defense or settlement of such claim and the indemnifying party shall only pay for such indemnified party's reasonable legal fees and expenses for the period prior to the date of its participation in such defense, and provided further, however, that the indemnified party (together with all indemnified parties which may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the reasonable fees and expenses of such separate counsel to be paid by the indemnifying party, if the representation of the indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between the indemnified party and any other party represented by such counsel in such proceeding. Notwithstanding the foregoing, the indemnifying party shall not be obligated to pay the fees of more than one separate counsel. The failure to notify an indemnifying party of the commencement of any such action will not relieve such indemnifying party of any liability to the indemnified party under this Section 7 (except to the extent that such failure materially and adversely affects the indemnifying party's ability to defend such action), nor shall the omission so to notify an indemnifying party relieve such indemnifying party of any liability which it may have to any indemnified party otherwise other than under this Section 7. No indemnifying party shall, without the consent of the indemnified party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such indemnified party of a release from all liability in respect to such claim or litigation and otherwise in form and substance reasonably satisfactory to the indemnified party.

(d) If the indemnification provided in this Section 7 is held by a court of competent jurisdiction to be unavailable to an indemnified party with respect to any loss, liability, claim, damage or expense referred to herein, then the indemnifying party, in lieu of indemnifying such indemnified party hereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage or expense in such proportion as is appropriate to reflect the relative fault of the indemnifying party on the one hand and of the indemnified party on the other in connection with the statements or omissions that shall have resulted in such loss, liability, claim, damage or expense, as well as any other relevant equitable considerations; provided that in no event shall any contribution by an Holder under this Section 7(d), when aggregated with amounts paid, if any, pursuant to Section 7(b), exceed the Difference. The relative fault of the indemnifying party and of the indemnified party shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission to state a material fact relates to information supplied by the indemnifying party or by the indemnified party and the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent such statement or omission.

(e) The obligations of the Company and Holders under this Section 7 shall survive the completion of any offering of Registrable Shares in a Registration Statement under Section 3 and otherwise.

8. **Reports Under the Exchange Act**. With a view to making available to the Holders the benefits of Rule 144 and any other rule or regulation of the SEC that may at any time permit the Holders to sell the Registrable Shares to the public without registration, the Company agrees to use reasonable efforts: (a) to make and keep public information available, as those terms are understood and defined in Rule 144, (b) to file with the SEC in a timely manner all reports and other documents required to be filed by an issuer of securities registered under the Securities Act or the Exchange Act and (c) undertake any additional actions reasonably necessary to maintain the availability of the Registration Statement or the use of Rule 144.

9. **Selling Procedures**. Any sale of Registrable Shares pursuant to a registration statement filed in accordance with Section 3 hereof shall be subject to the following conditions and procedures:

(a) Updating the Prospectus.

(i) If the Company informs the selling Holder that the Registration Statement or final prospectus then on file with the SEC is not current or otherwise does not comply with the Securities Act, the Company shall use its commercially reasonable efforts to provide to the selling Holder a current prospectus that complies with the Securities Act as soon as practicable, but in no event later than three (3) business days after delivery of such notice.

(ii) If the Company requires more than three (3) business days to update the prospectus under Section 9(a)(i) above, the Company shall have the right to delay the preparation of a current prospectus that complies with the Securities Act without explanation to such Holder, subject to the limitations set forth in Section 9(b) below, for a total of not more than two periods of thirty (30) days each during any twelve-month period.

(b) General. Notwithstanding the foregoing, upon receipt of any notice from the Company of (i) any request by the SEC or any other federal or state governmental authority during the period of effectiveness of the Registration Statement for amendments or supplements to the Registration Statement or related prospectus or for additional information relating to the Registration Statement, (ii) the issuance by the SEC or any other federal or state governmental authority of any stop order suspending the effectiveness of the Registration Statement or the initiation of any proceedings for that purpose, (iii) the receipt by the Company of any notification with respect to the suspension of the qualification or exemption from qualification of any of the Registrable Shares for sale in any jurisdiction or the initiation or threatening of any proceeding for such purpose, (iv) the happening of any event which makes any statement made in the Registration Statement or related prospectus or any document incorporated or deemed to be incorporated therein by reference untrue in any material respect or which requires the making of any changes in the Registration Statement or prospectus so that, in the case of the Registration Statement, it will not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading, and that in the case of the prospectus, it will not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading or (v) that, in the judgment of the Board of Directors, it is advisable to suspend use of the prospectus for a discrete period of time due to pending corporate developments, public filings with the SEC or that there exists material nonpublic information about the Company that the Board of Directors, acting in good faith, determines not to disclose in a registration statement, then the Company may suspend use of the prospectus (each a **"Suspension"**), in which case the Company shall promptly so notify each Holder and each Holder shall not dispose of Registrable Shares covered by the Registration Statement or prospectus until copies of a supplemented or amended prospectus are distributed to the Holders or until the Holders are advised in writing by the Company that the use of the applicable prospectus may be resumed; provided, however, that, notwithstanding the foregoing, the Company may suspend use of the prospectus pursuant to Sections 9(a)(ii), 9(b)(iv) and 9(b)(v), and an Holder may be prohibited from selling or otherwise disposing of the Registrable Shares covered by the Registration Statement or prospectus, for no more than two periods of thirty (30) days during any such twelve-month period. The Company shall use its best efforts to ensure the use of the prospectus may be resumed as soon as practicable. The Company shall use its best efforts to obtain the withdrawal of any order suspending the effectiveness of the Registration Statement, or the lifting of any suspension of the qualification (or exemption from qualification) of any of the securities for sale in any jurisdiction, at the earliest practicable moment. The Company shall, upon the occurrence of any event contemplated by clause (iv), prepare a supplement or post-effective amendment to the Registration Statement or a supplement to the related prospectus or any document incorporated therein by reference or file any other required document so that, as thereafter delivered to the purchasers of the Registrable Shares being sold thereunder, such prospectus will not contain an untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

10. **Preemptive Rights**. In the event that at any time after the date hereof until the date that is two (2) years after the Closing Date, the Company proposes to issue additional shares of Common Stock or Convertible Securities, other than Excluded Stock, pursuant to a private offering not registered with the SEC, the Company shall send a notice (an "**Additional Share Notice**") to the Holder setting forth the terms of such proposed issuance. The Holder shall be entitled to purchase the proposed number of shares of Common Stock or Convertible Securities, proposed to be issued in proportion to the Holder's Proportionate Percentage (as hereafter defined) on substantially the same terms set forth in the Additional Share Notice by (a) notice to the Company (the "**Purchase Notice**") within 10 days of the date of the Additional Share Notice and (b) payment of the price for such shares of Common Stock or Convertible Securities, by wire transfer of immediately available funds or such other method of payment as the Company may approve, within 10 days after delivery to the Company of the Purchase Notice. The "**Proportionate Percentage**" of the Holder means the percentage obtained by dividing (x) the aggregate number shares of Common Stock Owned by the Holder by (y) the aggregate number of shares of Common Stock of the Company issued and outstanding immediately prior to the proposed new issuance.

11. **Issuance of Certain Securities.** Until all Registrable Shares have been resold publicly pursuant to a registration statement or under Rule 144, the Company shall not issue any (a) Convertible Securities or similar securities that contain a provision that provides for any change or determination of the applicable conversion price, conversion rate, or exercise price (or a similar provision which might have a similar effect) based on any determination of the market price or other value of the Company's securities or any other market based or contingent standard, such as so-called "toxic" or "death spiral" convertible securities; provided, however, that this prohibition shall not include Convertible Securities or similar securities the conversion or exercise price or conversion rate of which is (i) fixed on the date of issuance, (ii) subject to adjustment as a result of or in connection with a business combination or similar transaction or (iii) subject to adjustment based upon the issuance by the Company of additional securities, including without limitation, standard anti-dilution adjustment provisions which are not based on calculations of market price or other variable valuations; and provided, further, that in no event shall this provision be deemed to prohibit the transactions contemplated in the Unit Subscription Agreement; (b) any preferred stock, debt instruments or similar securities or investment instruments providing for (i) preferences or other payments substantially in excess of the original investment by purchasers thereof or (ii) dividends, interest or similar payments other than dividends, interest or similar payments computed on an annual basis and not in excess, directly or indirectly, of the lesser of a rate equal to (A) twice the interest rate on 10 year US Treasury Notes and (B) 20%.

12. **Assignment**. This Agreement shall be binding upon and inure to the benefit of and be enforceable by the parties hereto and their respective successors and assigns. In addition, and whether or not any express assignment shall have been made, the provisions of this Agreement which are for the benefit of the Holders shall also be for the benefit of and enforceable by any subsequent holder of any Registrable Shares who has executed a copy of this Agreement or otherwise indicated its agreement to be bound hereby. Without limitation on the Holders' rights to transfer Registrable Shares, the Company acknowledges that any Holder may, at any time, transfer any of the Registrable Shares which it may own, beneficially or of record, to (a) its affiliates or (b) its partner(s), investor(s), security holder(s) or beneficial holder(s) pursuant to its organization documents or other agreements, and that, upon the consummation of any such transfer, the provisions of this Agreement shall be binding upon and inure to the benefit of each transferee of such Registrable Shares.

13. **Entire Agreement**. This Agreement (including the exhibits hereto), the Unit Subscription Agreement and the Warrants constitute and contain the entire agreement and understanding of the parties with respect to the subject matter hereof, and such agreements also supersede any and all prior negotiations, correspondence, agreements or understandings with respect to the subject matter hereof.

14. **Miscellaneous**.

(a) Amendments. This Agreement may not be amended, modified or terminated, and no rights or provisions may be waived, except with the written consent of the Majority Holders and the Company.

(b) Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of New York. Each party hereby irrevocably consents and submits to the jurisdiction of any New York State or United States Federal Court sitting in the State of New York, County of New York, over any action or proceeding arising out of or relating to this Agreement and irrevocably consents to the service of any and all process in any such action or proceeding by registered mail addressed to such party at its address specified herein (or as otherwise noticed to the other party). Each party further waives any objection to venue in New York and any objection to an action or proceeding in such state and county on the basis of *forum non conveniens*. Each party also waives any right to trial by jury.

(c) Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, personal representatives, successors or assigns. This Agreement shall also be binding upon and inure to the benefit of any transferee of any of the Registrable Shares. Notwithstanding anything in this Agreement to the contrary, if at any time any Holder shall cease to own any Registrable Shares, all of such Holder's rights under this Agreement shall immediately terminate.

(d) Notices.

(i) Any notices, reports or other correspondence (hereinafter collectively referred to as **"correspondence"**) required or permitted to be given hereunder shall be given in writing and shall be deemed effectively given upon (a) personal delivery, (b) delivery by fax (with answer back confirmed), or (c) two business days after mailing by recognized overnight courier (such as Federal Express), addressed to a party at its address or sent to the fax number provided below or at such other address or fax number as such party may designate by three days' advance notice to the other party.

(ii) All correspondence to the Company shall be addressed as follows:

SBE, Inc.
2305 Camino Ramon, Suite 200,
San Ramon, California 94583
Attention: David Brunton
Fax Number: (925) 355-2041

with a copy to:

Cooley Godward LLP
One Maritime Plaza, 20th Floor
San Francisco, CA 94111-3580
Attention: Jodie Bourdet
Fax Number: (415) 951-3699

(iii) All correspondence to any Holder shall be sent to the most recent address furnished by the Holder to the Company.

(iv) Any Holder may change the address to which correspondence to it is to be addressed by notification as provided for herein.

(e) Injunctive Relief. The parties acknowledge and agree that in the event of any breach of this Agreement, remedies at law may be inadequate, and each of the parties hereto shall be entitled to seek specific performance of the obligations of the other parties hereto and such appropriate injunctive relief as may be granted by a court of competent jurisdiction.

(f) Attorney's Fees. If any action at law or in equity is necessary to enforce or interpret any of the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

(g) Severability. If any provision of this Agreement is held by a court of competent jurisdiction to be unenforceable under applicable law, such provision shall be replaced with a provision that accomplishes, to the extent possible, the original business purpose of such provision in a valid and enforceable manner, and the balance of the Agreement shall be interpreted as if such provision were so modified and shall be enforceable in accordance with its terms.

(h) Aggregation of Shares. Registrable Shares held or acquired by affiliated entities or persons shall be aggregated for the purpose of determining the availability of any rights under this Agreement.

(i) Counterparts. This Agreement may be executed in a number of counterparts, any of which together shall for all purposes constitute one Agreement, binding on all the parties hereto notwithstanding that all such parties have not signed the same counterpart.

SIGNATURE PAGE TO SBE, INC. INVESTOR RIGHTS AGREEMENT

IN WITNESS WHEREOF, the parties hereto have executed this Investor Rights Agreement as of the date and year first above written.

SBE, INC.

By: /s/

Name:
Title:

INVESTORS:

Name:

[ ]
By: /s/

Name:
Title:

Exhibit A

SCHEDULE OF INVESTORS

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