

FARO TECHNOLOGIES INC
Form 10-K
February 25, 2015

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

FORM 10-K

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

For the fiscal year ended December 31, 2014

or

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

For the transition period from _____ to _____

Commission File Number 0-23081

FARO TECHNOLOGIES, INC.

(Exact name of Registrant as Specified in Its Charter)

Florida
(State or Other Jurisdiction of
Incorporation or Organization)

59-3157093
(I.R.S. Employer
Identification Number)

250 Technology Park, Lake Mary, FL
(Address of Principal Executive Offices)

32746
(Zip Code)

Registrant's telephone number, including area code: (407) 333-9911

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

Title of each class	Name of each exchange on which registered
Common Stock, par value \$.001	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definite proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Edgar Filing: FARO TECHNOLOGIES INC - Form 10-K

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the
Act). Yes No

The aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant on June 27, 2014 (the last business day of the Registrant's most recently completed second fiscal quarter) was \$831,458,800.32 (based on the closing price of the Registrant's common stock on such date on the NASDAQ Global Select Market, and assuming solely for the purposes of this calculation that all directors and executive officers of the Registrant are affiliates.

As of February 10, 2015, there were outstanding 17,317,430 shares of the Registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's proxy statement for the 2015 Annual Meeting of Shareholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

TABLE OF CONTENTS

		Page
<u>PART I</u>		1
Item 1.	<u>Business.</u>	3
Item 1A.	<u>Risk Factors.</u>	11
Item 1B.	<u>Unresolved Staff Comments.</u>	21
Item 2.	<u>Properties.</u>	21
Item 3.	<u>Legal Proceedings.</u>	22
Item 4.	<u>Mine Safety Disclosures.</u>	22
<u>PART II</u>		22
Item 5.	<u>Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.</u>	22
Item 6.	<u>Selected Financial Data.</u>	24
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	25
Item 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk.</u>	36
Item 8.	<u>Financial Statements and Supplementary Data.</u>	37
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.</u>	63
Item 9A.	<u>Controls and Procedures.</u>	63
Item 9B.	<u>Other Information.</u>	66
<u>PART III</u>		66
Item 10.	<u>Directors, Executive Officers, and Corporate Governance.</u>	66
Item 11.	<u>Executive Compensation.</u>	66
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.</u>	66
Item 13.	<u>Certain Relationships and Related Transactions and Director Independence.</u>	66
Item 14.	<u>Principal Accounting Fees and Services.</u>	67
<u>PART IV</u>		67
Item 15.	<u>Exhibits, Financial Statement Schedules.</u>	67

PART I

CAUTIONARY STATEMENTS FOR FORWARD-LOOKING INFORMATION

Some of the statements made in this Annual Report on Form 10-K are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Statements that are not historical facts or that describe our plans, beliefs, goals, intentions, objectives, projections, expectations, assumptions, strategies, or future events are forward-looking statements. In addition, words such as may, might, would, will, will be, future, strategy, should, could, seek, expect, anticipate, intend, estimate, goal, objective, project, forecast, target, or similar words identify forward-looking statements.

Forward-looking statements are not guarantees of future performance and are subject to a number of known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. Consequently, undue reliance should not be placed on these forward-looking statements. The Company does not intend to update any forward-looking statements, whether as a result of new information, future events, or otherwise, unless otherwise required by law. Important factors that could cause actual results to differ materially from those contemplated in such forward-looking statements include, among others, the following:

economic downturn in the manufacturing industry or the domestic and international economies in the regions of the world where the Company operates;

the Company's inability to further penetrate its customer base and target markets;

development by others of new or improved products, processes or technologies that make the Company's products less competitive or obsolete;

the Company's inability to maintain its technological advantage by developing new products and enhancing its existing products;

the Company's inability to successfully identify and acquire target companies or achieve expected benefits from acquisitions that are consummated;

the cyclical nature of the industries of the Company's customers and material adverse changes in its customers' access to liquidity and capital;

change in the potential for the computer-aided measurement (CAM2) market and the potential adoption rate for the Company's products, which are difficult to quantify and predict;

the Company's inability to protect its patents and other proprietary rights in the United States and foreign countries;

fluctuations in the Company's annual and quarterly operating results and the inability to achieve its financial operating targets as a result of a number of factors including, without limitation (i) litigation and regulatory action brought against the Company, (ii) quality issues with its products, (iii) excess or obsolete inventory, shrinkage or other inventory losses due to product obsolescence, scrap or material price changes, (iv) raw material price fluctuations and other inflationary pressures, (v) expansion of the Company's manufacturing capability, (vi) the size and timing of customer orders, (vii) the amount of time that it takes to fulfill orders and ship the Company's products, (viii) the length of the Company's sales cycle to new customers and the time and expense incurred in further

penetrating its existing customer base, (ix) increases in operating expenses required for product development and new product marketing, (x) costs associated with new product introductions, such as product development, marketing, assembly line start-up costs and low introductory period production volumes, (xi) the timing and market acceptance of new products and product enhancements, (xii) customer order deferrals in anticipation of new products and product enhancements, (xiii) the Company's success in its sales and marketing programs, (xiv) start-up costs associated with opening new sales offices outside of the United States, (xv) fluctuations in revenue without proportionate adjustments in fixed costs, (xvi) the efficiencies achieved in managing inventories and fixed assets, and (xvii) compliance with government regulations including health, safety, and environmental matters;

changes in gross margins due to changing mix of products sold and the different gross margins on different products and sales channels;

the Company's inability to successfully maintain the requirements of Restriction of use of Hazardous Substances (RoHS2) and Waste Electrical and Electronic Equipment (WEEE) compliance in its products;

the inability of the Company's products to displace traditional measurement devices and attain broad market acceptance;

the impact of competitive products and pricing in the CAM2 market and the broader market for measurement and inspection devices;

the effects of increased competition as a result of consolidation in the CAM2 market;

risks associated with expanding international operations, such as fluctuations in currency exchange rates, difficulties in staffing and managing foreign operations, political and economic instability, compliance with import and export regulations, and the burdens and potential exposure of complying with a wide variety of U.S. and foreign laws and labor practices;

the loss of the Company's Chief Executive Officer or other key personnel;

difficulties in recruiting research and development engineers and application engineers;

the failure to effectively manage the effects of the Company's growth;

the impact of reductions or projected reductions in government spending, particularly in the defense sector;

variations in the Company's effective income tax rate and the difficulty in predicting the tax rate on a quarterly and annual basis;

the loss of key suppliers and the inability to find sufficient alternative suppliers in a reasonable period or on commercially reasonable terms;

the impact of disruption, delays, or deficiencies in the design or implementation of the Company's new global enterprise resource planning system;

the Company's ability to achieve and maintain profitability;

the effect of estimates and assumptions with respect to critical accounting policies and the impact of the adoption of recently issued accounting pronouncements;

the magnitude of increased warranty costs from new product introductions and enhancements to existing products;

the continuation of the Company's share repurchase program;

the sufficiency of the Company's working capital, cash flow from operations, and credit facility to fund its long-term liquidity requirements;

the impact of geographic changes in the manufacturing or sales of the Company's products on its tax rate; and

the Company's ability to comply with the requirements for favorable tax rates in foreign jurisdictions. as well as other risks and uncertainties discussed in Part I, Item 1A in this Annual Report on Form 10-K. Moreover, new risks and uncertainties emerge from time to time, and we undertake no obligation to update publicly or review the risks and uncertainties included in this Annual Report on Form 10-K, unless otherwise required by law.

ITEM 1. BUSINESS.

The Company was founded in 1982, and re-incorporated in Florida in 1992. The Company's worldwide headquarters are located at 250 Technology Park, Lake Mary, Florida 32746 and its telephone number is (407) 333-9911.

The Company designs, develops, manufactures, markets and supports software driven, three-dimensional (3-D) measurement, imaging and realization systems. The Company sells the majority of its products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building construction and law enforcement applications. The Company's FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker, FARO 3D Imager AMP, and their companion CAM2® software provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's FARO Focus^{3D} and FARO Freestyle^{3D} laser scanners, and their companion SCENE and FARO forensic software, are utilized for a wide variety of 3-D modeling, documentation and high-density surveying applications, including in two of the Company's key vertical markets—architecture, engineering and construction (AEC) and law enforcement.

Industry Background

The Company believes four principal forces drive the need for its products and services: 1) the widespread use by manufacturers of CAD in product development, which shortens product cycles; 2) the adoption by manufacturers of quality standards such as Six Sigma and ISO-9001 (and its offshoot QS-9000), which stress the measurement of every step in a manufacturing process to reduce or eliminate defects; 3) the inability of traditional measurement devices to address many manufacturing problems such as throughput, efficiency, and accuracy, especially with respect to large components for products such as automobiles, aircraft, heavy duty construction equipment and factory retrofits; and 4) the growing demand to capture large volumes of three-dimensional data for modeling and analysis.

CAD improves the manufacturing process. The creation of physical products involves the processes of design, engineering, production, and measurement and quality inspection. These basic processes have been profoundly affected by the computer hardware and software revolution that began in the 1980s. CAD software was developed to automate the design process, providing manufacturers with computerized 3-D design capability and shortening the time between design changes. Today, most manufacturers use some form of CAD software to create designs and engineering specifications for new products and to quantify and modify designs and specifications for existing products. While manufacturers

previously designed their products to remain in production for longer periods of time, current manufacturing practices must accommodate more frequent product introductions and modifications, while satisfying more stringent quality and safety standards. Assembly fixtures and measurement tools must be linked to the CAD design to enable production to keep up with the rate of design change.

Quality standards dictate measurement to reduce defects. QS-9000 is the name given to the Quality System Requirements of the automotive industry developed by Chrysler, Ford, General Motors and major truck manufacturers. Companies registered under QS-9000 are considered to have higher standards and better quality products. Six Sigma is a set of quality standards that embodies the principles of total quality management, focused on measuring results and reducing product or service failure rates to 3.4 per million. All aspects of a Six Sigma company's infrastructure must be analyzed, and if necessary, restructured to increase revenues and raise customer satisfaction levels. The all-encompassing nature of these and other quality standards has resulted in manufacturers measuring every aspect of their process, including stages of product assembly that may never have been measured before, in part because of the lack of suitable measurement equipment.

Traditional products do not measure up. A significant aspect of the manufacturing process entails measurement and quality inspection. Historically, manufacturers have measured and inspected products using hand-measurement tools such as scales, calipers, micrometers and plumb lines for simple measuring tasks, test (or check) fixtures for certain large manufactured products, and traditional (or fixed) coordinate measurement machines, or CMM, for objects that require higher precision measurement. However, the broader utility of each of these measurement methods is limited.

Although hand-measurement tools are often appropriate for simple geometric measurements, including hole diameters or length and width of a rectangular component, their use for complex part measurements, such as the fender of a car, is limited. Also, these devices do not allow for the measurements to be directly compared electronically to the CAD model of the part. Test fixtures (customized fixed tools used to make comparative measurements of complex production parts to master parts) are relatively expensive and must be reworked or discarded each time a dimensional change is made in the part being measured. In addition, these manual measuring devices do not permit the manufacturer to electronically compare the dimensions of an object with its CAD model.

Conventional CMMs are generally large, fixed-base machines that provide very high levels of precision and provide a link to the CAD model of the object being measured. However, fixed-base CMMs require that the object being measured be brought to the CMM and fit within the CMM's measurement grid. As manufactured subassemblies increase in size and become integrated into even larger assemblies, they become less transportable, thus diminishing the utility of a conventional CMM. Consequently, manufacturers must continue to use hand-measurement tools, or expensive customized test fixtures, to measure large or unconventionally shaped objects. In addition, some parts or assemblies are not easily accessible and cannot be measured using traditional devices.

The market demands three-dimensional data. Various factors contribute to increased market demand for FARO products and services. Conventional surveying equipment is limited to single-point measurements and does not have the capacity to capture and analyze large volumes of three-dimensional data. As data requirements for construction, civil engineering and forensic inspection projects become more complex, single-point measurement devices will become increasingly more difficult to utilize in those applications.

Escalating global competition has created a demand for higher quality products with shorter life cycles. Customers require more rapid design, greater control of the manufacturing process, tools to compare components to their CAD specifications, the ability to precisely

measure components that cannot be measured or inspected by conventional devices, and the ability to capture and analyze large volumes of three-dimensional data. Moreover, they increasingly require measurement capabilities to be integrated into manufacturing processes and to be available on the factory floor. These changing demands have driven the demand for FARO's products and services.

FARO Products

FaroArm. The FaroArm is a combination of a portable, six or seven-axis, articulated measurement arm, a computer, and CAM2 software programs, which are described below under "CAM2 Software".

Articulated Arm The articulated arm is comprised of three major joints, each of which may consist of one, two or three axes of motion. The articulated arm is available in a variety of sizes, configurations and precision levels suitable for a broad range of applications. To take a measurement, the operator simply touches the object to be measured with a probe at the end of the arm and presses a button. Data can be captured at either individual points or a series of points. Optical encoders located at each of the joints of the arm measure the angles at those joints, and this rotational measurement data is transmitted to an on-board controller that converts the arm angles to precise locations in 3-D space using xyz position coordinates and ijk orientation coordinates.

Computer The Company pre-installs its CAM2 software on either a notebook or desktop style computer or Microsoft Windows®-based Touch PC or Touch Pad, depending on the customer's need, and the measurement arm, computer and installed software are sold as a system. The Company purchases the computers sold with its products from various suppliers.

FARO Laser ScanArm. The FARO Laser ScanArm is a FaroArm equipped with a combination of a hard probe (like that in the FaroArm) and a non-contact laser line probe. This product provides the Company's customers the ability to measure products without touching them and offers a seven-axis contact/non-contact measurement device with a fully integrated laser scanner. The ScanArm is used for contact and non-contact measurement applications, including inspection, cloud-to-CAD comparison, rapid prototyping, reverse engineering and 3-D modeling.

FARO Gage. The FARO Gage is a smaller, higher-accuracy version of the FaroArm that is sold as a combination of an articulated arm device with a computer and software. The FARO Gage is also distinguished from the FaroArm by the special mounting features and software unique to the FARO Gage. The FARO Gage is targeted at machine tools and bench tops around machine tools, where basic measurements of smaller machined parts must be measured. The CAM2 FARO Gage software developed for this device, described below, features basic 2-D and 3-D measurements common to these applications.

FARO Laser Tracker. The FARO Laser Tracker combines a portable, large-volume laser measurement tool, a computer, and CAM2 software programs.

Laser Tracker Vantage The FARO Laser Tracker Vantage utilizes an ultra-precise laser beam to measure objects of up to 260 feet. It enables manufacturing, engineering, and quality control professionals to measure and inspect large parts, machine tools and other large objects on-site and in-process. With its greater angular resolution, repeatability, and accuracy, the FARO Laser Tracker Vantage advances already-proven tracker technology. Among its many enhanced features is TruADM™, which improves upon existing Absolute Distance Measurement (ADM) technology by providing the time-saving ability to reacquire the laser beam

without the need to return to a known reference point or the need to hold the target stationary.

Laser Tracker ION The FARO Laser Tracker ION is an interferometer (IFM)-based measurement system that provides the high accuracy and range to complete measurement tasks, such as in-line measurements, high-speed dynamic measurements, or high-accuracy machine calibration. The FARO Laser Tracker ION features Dual Distancing Systems, enabling the Tracker to catch the beam in the air and set the distance instantly with Agile ADM.

Computer The FARO Laser Tracker includes a notebook or desktop style computer or Microsoft Windows -based Touch PC or Touch Pad, depending on the customer's requirements, that includes the pre-installed CAM2 Software.

FARO 3D Imager AMP. The FARO 3D Imager AMP is a high-performance non-contact 3-D Imager, capable of collecting millions of points to generate infinitely-focused fringe patterns. The FARO 3D Imager AMP creates a highly-accurate point cloud of objects in the AMP's field of view. This technology is used in quality control to improve product quality and reduce scrap, as well as for reverse engineering and rapid manufacturing.

FARO Focus^{3D}. The FARO Focus^{3D} utilizes laser technology to measure and collect a cloud of data points, allowing for the detailed and precise three-dimensional rendering of an object or an area as large as a factory. This technology is currently used for factory planning, facility life-cycle management, quality control, forensic analysis and capturing large volumes of three-dimensional data. The FARO Focus^{3D} simplifies modeling, reduces project time and maintains or increases the accuracy of the image. The resulting data is used with major CAD systems or FARO's own proprietary SCENE software.

FARO Freestyle^{3D}. The FARO Freestyle^{3D}, which was released in January 2015, is a top-quality, high-precision, handheld scanner that quickly and reliably documents rooms, structures and objects in 3-D and creates high-definition point clouds. The applications of the FARO Freestyle^{3D} include architecture, construction, industrial production and forensics. The FARO Freestyle^{3D}'s durable carbon fiber design equips the user with a versatile and ergonomic tool for performing accurate scanning in confined spaces. The FARO Freestyle^{3D} can be used independently or as a complement to the FARO Focus^{3D}. The FARO Freestyle^{3D} comes with two software applications in addition to FARO's proprietary SCENE software: SCENE Capture, which is installed on a tablet computer to record and visualize the capturing of 3-D data, and SCENE Process, which processes the captured 3-D data.

FARO Software. The Company provides a family of proprietary CAD-based measurement and laser scanner software used with the Company's measurement and scanning devices.

CAM2 Measure 10 allows customers to complete measurement jobs quickly and gives customers the freedom to measure as required by the application. State-of-the-art functionalities improve every process where measuring is needed.

FARO CAM2 Smartinspect is the Company's CAM2 solution for measuring geometry and building dimensions. The software allows customers to quickly measure geometric features and report dimensions for control.

FARO SCENE software combines ease-of-use, networking, and an enhanced 3-D experience to deliver a complete scan processing solution. With SCENE, customers can display, analyze, administer and edit 3-D measurements in point clouds.

FARO Forensics software makes diagramming and pre-planning easier for law enforcement officers, firefighters and loss control engineers by allowing the users who need to draw site plans or crash or crime scene diagrams to be able to do so in a fast and efficient manner.

To support its product lines, the Company also offers extended warranties and comprehensive support, training and technology consulting services to its customers.

Customers

The Company's sales are diversified across a broad number of over 15,000 customers worldwide in a range of end market applications. The FARO metrology product lines (e.g. Arm, Gage, Laser ScanArm, Laser Tracker, and Imager AMP) are purchased primarily by customers in the automotive and aerospace markets and a diverse array of manufacturing customers from small machine shops to large industrials. The Company's Focus^{3D} and Freestyle^{3D} product lines provide precise three-dimensional renderings primarily to architecture, engineering, construction, and law enforcement customers. The Company's ten largest customers by revenue represented an aggregate of approximately 3.3% of the Company's total sales in 2014. No customer represented more than 1.0% of the Company's sales in 2014.

Sales and Marketing

The Company conducts its sales and marketing efforts on a decentralized basis in three main regions around the world: Americas, Europe/Africa and Asia-Pacific. The regional headquarters for the Americas is located in the Company's headquarters in Lake Mary, Florida; the Europe/Africa regional headquarters is located in Stuttgart, Germany; and the regional headquarters for the Asia-Pacific region is located in Singapore. At December 31, 2014, the Company employed 167, 157, and 166 sales and marketing specialists in the Americas, Europe/Africa, and Asia-Pacific regions, respectively. The Company sells most of its products through direct sales representation in the United States, Brazil, Mexico, Germany, Switzerland, United Kingdom, France, Italy, Singapore, Japan, China and India. The Company also sells its products through distributors, although this channel has historically represented a small percentage of total sales, and in 2014 represented 9.9% of total sales. Note 16 to the Company's Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K includes financial information about the Company's foreign and domestic operations.

The Company's sales and marketing efforts use a process of integrated lead qualification and sales demonstration. Once a customer opportunity is identified, the Company employs a team-based sales approach involving inside and outside sales personnel who are supported by application engineers. Each team has the ability to sell multiple product lines. The Company employs a variety of marketing techniques to promote brand awareness and customer identification.

Research and Development

The Company believes that its future success depends, in part, on its ability to maintain technological leadership, which will require ongoing enhancements of its products and the development of new applications and products that provide 3-D measurement solutions. The field of 3-D measurement continues to expand, and new technologies and applications will be essential to competing in this market. Accordingly, the Company intends to continue to make substantial investments in the development of new technologies, the commercialization of new products that build on the Company's existing technological base and the enhancement and development of additional applications for its products.

The Company's research and development efforts are directed primarily at enhancing the functional adaptability of its current products and developing new and innovative products that respond to specific requirements of the emerging market for 3-D measurement and

documentation systems. The Company's engineering development efforts will continue to focus on enhancing the mechanical hardware, electronics, and software in its existing products and developing new products for the CAM2 market. Research and development activities, especially with respect to new products and technologies, are subject to significant risks, and there can be no assurance that any of the Company's research and development activities will be completed successfully or on schedule, or, if completed, will be commercially accepted.

At December 31, 2014, the Company employed 156 scientists and technicians in its research and development efforts. Research and development expenses were approximately \$27.5 million in 2014, compared to \$22.4 million in 2013 and \$17.6 million in 2012.

Intellectual Property

The Company holds or has pending approximately 800 patents in the United States and related patents worldwide, which generally expire on a rolling basis between 2015 and 2033. The Company also has 21 registered or pending trademarks in the United States and worldwide, which generally expire on a rolling basis between 2015 and 2024.

The Company's success and its ability to maintain its competitive position depends, in large part, on its ability to protect its intellectual property. The Company relies on a combination of contractual provisions and trade secret laws to protect its proprietary information. However, there can be no assurance that the steps taken by the Company to protect its trade secrets and proprietary information will be sufficient to prevent misappropriation of its proprietary information or preclude third-party development of similar intellectual property.

Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. The Company intends to vigorously defend its proprietary rights against infringement by third parties. However, policing unauthorized use of the Company's products is difficult, particularly in foreign countries, and the Company may be unable to determine the extent, if any, to which unauthorized use of its products exists. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to the same extent as the laws of the United States.

The Company does not believe that any of its products infringe on the proprietary rights of third parties. There can be no assurance, however, that third parties will not claim infringement by the Company with respect to current or future products. Any such claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements, which could have a material adverse effect upon the Company's business, operating results and financial condition. In addition, such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company, if at all.

Manufacturing and Assembly

The Company manufactures its FaroArm, FARO Gage, FARO Laser ScanArm, FARO 3D Imager AMP and FARO Laser Tracker products in the Company's manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas, in its manufacturing facility located in Schaffhausen, Switzerland for customer orders from the Europe/Africa region, and in its manufacturing facility located in Singapore for customer orders from the Asia-Pacific region. The Company manufactures its FARO Focus^{3D} and FARO Freestyle^{3D} products in its facilities located in Schaffhausen, Switzerland and Stuttgart, Germany. In the fourth quarter of 2014, the Company relocated its facility in Kennett Square, Pennsylvania to a leased facility consisting of approximately 90,400 square feet in Exton, Pennsylvania.

The Company expects all its existing plants to have the production capacity necessary to support its volume requirements through 2015.

Manufacturing consists primarily of assembling and integrating components and subassemblies purchased from suppliers into finished products. The primary components, which include machined parts and electronic circuit boards, are produced by subcontractors according to the Company's specifications. All products are assembled, calibrated and tested for accuracy and functionality before shipment. The Company performs limited in-house circuit board assembly and component part machining. Typically, the Company enters into purchase commitments for manufacturing components to cover production requirements for 60 to 90 days.

The Company's manufacturing, engineering, and design headquarters have been registered to the ISO-9001 standard since July 1998. Semi-annual surveillance audits have documented continuous improvement to this multinational standard. Currently, the Company's manufacturing sites in Lake Mary, Florida; Stuttgart, Germany; Schaffhausen, Switzerland; and Singapore are jointly registered to ISO-9001 and ISO-17025. As a result of the Company's relocation of its Pennsylvania facility from Kennett Square to Exton, Pennsylvania, the ISO-9001 certification is being transitioned to the new facility. However, the Exton facility is registered to the ISO-17025 standard. In addition, the Company's service sites in the United States, Germany, Switzerland, India, Japan, China, Singapore, Mexico and Brazil have joint certification and accreditation to ISO-17025. The Company continues to examine its scope of registration as its business evolves and has chosen English as the standard business language for its operations.

The Company's efforts to register its manufacturing, engineering and design headquarters to the ISO-9001 standard in concert with the ISO9001:2008 Quality Management System Certification verifies the Company's commitment to quality through an internationally recognized standard. Additionally, the Company takes a global approach to ISO17025:2005 regarding the recognition of the Competence of Calibration and Testing Laboratories, seeking to have all locations registered with similar scopes of accreditation and capabilities for the products generated and serviced.

Competition

The Company's measurement systems compete in the broad and highly competitive market for measurement devices for manufacturing and industrial applications, which, in addition to portable articulated arms, laser tracker, 3-D imaging and laser scanner products, consist of fixed-base CMMs, templates and go/no-go gages, check fixtures, handheld measurement tools, and various categories of surveying equipment. In the FARO Gage product line, the Company competes with a number of manufacturers of handheld measurement tools and fixed-base CMMs, including some large, well-established companies. In the FaroArm, FARO Laser ScanArm, FARO Laser Tracker, FARO Focus^{3D} and FARO 3D Imager AMP product lines, the Company competes primarily with Hexagon Metrology, a division of Hexagon AB, and with Steinbichler Optotechink GmbH and GOM GmbH in the 3D Imager product lines. The Company also competes in these product lines with a number of other smaller competitors. The Company competes on the basis of technical innovation, product performance, quality and price with respect to all of its products.

The Company will be required to make continued investments in technology and product development to maintain and extend the technological advantage that it believes it currently has over its competition. However, the Company cannot be certain that its technology or its product development efforts will allow the Company to successfully compete as the industry evolves. As the market for the Company's measurement systems expands, additional competition may emerge and the Company's existing and future competitors may commit more resources to the markets in which the Company participates.

Government Regulation

The Company's operations are subject to numerous governmental laws and regulations, including those governing antitrust and competition, the environment, import and export of products, currency conversions and repatriation, taxation of foreign earnings and earnings of expatriate personnel and use of local employees and suppliers. The Company's foreign operations are subject to the U.S. Foreign Corrupt Practices Act, or FCPA, and similar foreign anti-corruption laws, which makes illegal any payments to government officials or government employees that are intended to induce their influence to assist the Company or to gain any improper advantage for the Company. The Company operates in certain regions in the Middle East, Africa, and Asia-Pacific that are more prone to risk under these anti-corruption laws.

Manufacturers of electrical goods are subject to the European Union's RoHS2 and WEEE directives, which took effect during 2006. RoHS2 prohibits the use of lead, mercury and certain other specified substances in electronics products, and WEEE makes producers of electrical goods financially responsible for specified collection, recycling, treatment, and disposal of covered electronic products and components. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China.

The Company currently holds WEEE registration and is in compliance with the directives of the European Union. Under the classification of Industrial Monitoring and Control Instruments, the Company's products have until July 22, 2017 to become compliant with the RoHS2 directive. Currently, only the FARO Laser Tracker ION does not meet the RoHS2 directive. However, if the Company is unable to bring the FARO Laser Tracker ION into compliance with the RoHS2 directive by July 22, 2017, it would be unable to sell the FARO Laser Tracker ION in European Union countries and China, and potentially in several states in the United States, which could have a material adverse effect on its sales and results of operations.

Backlog and Seasonality

At December 31, 2014, the Company had orders representing approximately \$14.1 million in sales outstanding. The majority of these specific orders were shipped by February 19, 2015, and, as of February 19, 2015, the Company had orders representing approximately \$13.1 million in sales outstanding. The Company believes that substantially all of the outstanding sales orders as of February 19, 2015 will be shipped during 2015. At December 31, 2013 and 2012, the Company had orders representing approximately \$18.7 million and \$18.0 million in sales outstanding, respectively.

The Company typically experiences greater order volume during the fourth quarter as customers spend the remaining balances of their capital expenditures budgets.

Employees

At December 31, 2014, the Company had 1,223 full-time employees, consisting of 490 sales and marketing professionals, 180 production staff, 156 research and development staff, 163 administrative staff, and 234 customer service/training/application engineering specialists. The Company is not a party to any collective bargaining agreements and believes its employee relations are satisfactory. Management believes that its future growth and success will depend in part on its ability to retain and continue to attract highly skilled personnel. The Company anticipates that it will be able to obtain the additional personnel required to satisfy its staffing requirements over the foreseeable future.

Geographic Information

The Company has three reportable segments based upon geographic regions: Americas, Europe/Africa and Asia-Pacific. The Company develops, manufactures, markets, supports and sells CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and three-dimensional documentation systems in each of these regions. These activities represent more than 99% of consolidated sales. The Company evaluates performance and allocates resources based upon profitable growth and assets deployed. Information regarding the Company's net sales, operating income, and long-lived assets by geographic region is set forth in Note 16 to the Consolidated Financial Statements under Part II, Item 8 to this Annual Report on Form 10-K.

Available Information

The Company makes available, free of charge on its Internet website at <http://www.faro.com>, its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission, or the SEC. You can find these reports on the Company's website at www.faro.com by first clicking "Investor Relations" and then "SEC Filings". The information on the Company's website is not a part of this Annual Report on Form 10-K.

These reports may also be obtained at the SEC's Public Reference Room at 100 F Street NE, Washington, DC 20549. Information on the operation of the Public Reference Room is available by calling the SEC at (800) SEC-0330. You may also access this information at the SEC's website at <http://www.sec.gov>. This site contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

ITEM 1A. RISK FACTORS.

The statements under this heading describe the most significant risks to the Company's business identified by management and should be considered carefully in conjunction with the discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7 of this Annual Report on Form 10-K and in the Company's Consolidated Financial Statements and notes thereto included in Part II, Item 8 of this Annual Report on Form 10-K.

Any of the following risks and uncertainties could materially and adversely affect our business, results of operations, liquidity, and financial condition. However, predicting or identifying all such risks and uncertainties is not possible. As a result, the following factors should not be considered to be a complete discussion of the Company's risks and uncertainties.

Competitors may develop products that make the Company's products obsolete or less competitive.

The CAM2 market is characterized by rapid technological change. Competitors may develop new or improved products, processes or technologies that may make the Company's products obsolete or less competitive.

As a result, the Company's success depends, in part, on its ability to maintain its technological advantage by developing new products and applications and enhancing its existing products, which can be complex and time-consuming and require substantial investment by the Company. Significant delays in new product releases or difficulties in

developing new products could adversely affect the Company's business and results of operations. The Company can provide no assurance that it will be able to adapt to evolving markets and technologies or maintain its technological advantage.

The Company's financial performance is dependent on the conditions of various industries, including the automotive, aerospace, and heavy equipment industries, which have from time to time experienced, and may again experience, significant disruptions in the economic environment.

A significant portion of the Company's sales are to manufacturers in the automotive, aerospace, and heavy equipment industries. The Company is dependent upon the continued viability and financial stability of its customers in these industries, which are highly cyclical and dependent upon the general health of the economy and consumer spending.

Reductions in defense spending could adversely affect the Company's business.

Certain of the Company's customers operate in the defense sector and depend significantly on U.S. government spending. In August 2011, Congress enacted the Budget Control Act of 2011 which imposes spending caps and certain reductions in defense spending over the next ten years. Automatic spending reductions, referred to as sequestration, were implemented in March 2013. Ongoing budgetary discussions in the federal government may result in other cuts to defense spending. Reductions in defense spending that impact the aerospace and defense industries could have an adverse effect on the Company's results of operations.

The buying process for most of the Company's customers for the its measurement products is highly decentralized and typically requires significant time and expense for the Company to further penetrate the potential market of a specific customer, which may delay the Company's ability to generate additional revenue.

The Company's success depends, in part, on its ability to further penetrate its customer base. During 2014, approximately 63% of the Company's revenue was attributable to sales to its existing customers. If the Company is not able to continue to further penetrate its existing customer base, its sales growth may decline. However, most of the Company's customers have a decentralized buying process for measurement devices, and the Company must spend significant time and resources to increase revenues from a specific customer. For example, the Company may provide products to only one of its customer's manufacturing facilities or for a specific product line within a manufacturing facility. The Company cannot offer any assurance that it will be able to maintain or increase the amount of sales to its existing customers, which could adversely affect its financial results.

The Company's ability to protect its patents and proprietary rights in the United States and foreign countries could adversely affect its revenues.

The Company's success depends, in large part, on its ability to obtain and maintain patents and other proprietary right protection for its processes and products in the United States and other countries. The Company also relies upon trade secrets, technical know-how and continuing inventions to maintain its competitive position. The Company seeks to protect its technology and trade secrets, in part, by confidentiality agreements with its employees and contractors. However, the Company's employees may breach these agreements or the Company's trade secrets may otherwise become known or be independently discovered by inventors. If the Company is unable to obtain or maintain protection of its patents, trade secrets and other proprietary rights, it may not be able to prevent third parties from using its proprietary rights, which could have a material adverse effect on the Company's results of operations.

The Company's patent protection involves complex legal and technical questions. Its patents may be challenged, narrowed, invalidated or circumvented. Further, the Company may be able to protect its proprietary rights from infringement by third parties only to the extent that its proprietary processes and products are covered by valid and enforceable patents or are effectively maintained as trade secrets. Furthermore, others may independently develop similar or alternative technologies or design around the Company's patented technologies. Litigation or other proceedings to defend or enforce its intellectual property rights could require the Company to spend significant time and money, which could have an adverse impact on the Company's financial condition.

Claims from others that the Company infringes their intellectual property rights may adversely affect its business and financial condition.

From time to time, the Company receives notices from others claiming it infringes their intellectual property rights. Resolving these claims may require the Company to enter into royalty or licensing agreements on unfavorable terms, require it to stop selling or to redesign affected products, or require it to pay damages. In addition, from time to time, the Company is involved in intellectual property lawsuits. The Company could in the future incur judgments or enter into settlements of lawsuits and claims that could have a material adverse effect on the Company's financial condition. Any litigation or interference proceedings, regardless of their outcome, may be costly and may require significant time and attention of the Company's management and technical personnel.

Product failures or product availability and performance issues could result in increased warranty costs, delays in new product introductions and enhancements and adversely affect the Company's business.

The Company regularly introduces new products and enhances existing products. Failures in the Company's new or existing products could result in increased warranty costs, delays in new product introductions, and a loss of sales and customers and have an adverse effect on the Company's business and financial condition.

The Company may not be able to achieve financial results within its target goals, and its operating results may fluctuate due to a number of factors, many of which are beyond its control.

The Company's ability to achieve financial results that are within its goals is subject to a number of factors beyond its control. Moreover, the Company's annual and quarterly operating results have varied significantly in the past and likely will vary significantly in the future. Factors that cause the Company's financial results to fluctuate include, but are not limited to, the following:

adverse changes in the manufacturing industry and general economic conditions;

the effectiveness of sales promotions;

geographic expansion in the Asia-Pacific region and other regions;

training and ramp-up time for new sales people;

investments in strategic sales, product or other initiatives;

investments in technologies and new products and product enhancements, including costs associated with new development and product introductions and the timing and market acceptance of new products and product enhancements;

shrinkage or other inventory losses due to product obsolescence, scrap or material price changes;

expansion of the Company's manufacturing capability;

the size and timing of customer orders, many of which are received towards the end of the quarter;

the amount of time that it takes to fulfill orders and ship the Company's products;

the length of the Company's sales cycle to new customers;

customer order deferrals in anticipation of new products and product enhancements;

start-up costs and ramp-up time associated with opening new sales offices outside of the United States;

variations in the effective income tax rate and the difficulty in predicting the tax rate on a quarterly and annual basis; and

litigation and regulatory action brought against the Company.

Any one or a combination of these factors could adversely affect the Company's annual and quarterly operating results in the future and could cause it to fail to achieve its target financial results.

The Company's growth depends on the ability of the Company's products to attain broad market acceptance.

The market for traditional fixed-base CMMs, check fixtures, handheld measurement tools, and surveying equipment is mature. Part of the Company's strategy is to continue to displace these traditional measurement devices. Displacing traditional measurement devices and achieving broad market acceptance of the Company's products requires significant effort to convince customers to reevaluate their historical measurement procedures and methodologies.

The potential size and growth rate of the CAM2 market is uncertain and difficult to quantify. If the CAM2 market does not continue to expand or does not expand as quickly as the Company anticipates, it may not be able to grow its sales, which may affect its financial results.

The Company markets seven closely interdependent products (FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker, FARO 3D Imager AMP, FARO Focus^{3D} and FARO Freestyle^{3D}) and related software for use in measurement, inspection, and high density surveying applications. Substantially all of the Company's revenues are currently derived from sales of these products and software, and it plans to continue its business strategy of focusing on the software-driven, 3-D measurement and inspection market. Consequently, the Company's financial performance will depend in large part on computer-based measurement, inspection, and high density surveying products achieving broad market acceptance. If its products cannot attain broad market acceptance, the Company will not grow as anticipated and may be required to make increased expenditures on research and development for new applications or new products.

The Company competes with manufacturers of measurement systems and traditional measurement devices, many of which have more resources than the Company and may develop new products and technologies.

The broad market for measurement devices is highly competitive. In the FARO Gage product line, the Company competes with manufacturers of handheld measurement tools and fixed-base CMMs, including some large, well-established companies. In the FaroArm, FARO Laser ScanArm, FARO Laser Tracker, FARO Focus^{3D} and FARO 3D Imager AMP product lines, the Company competes primarily with Hexagon Metrology, a division of Hexagon AB, and with Steinbichler Optotechink GmbH and GOM mbH in the 3D Imager product lines. The Company also competes in these product lines with a number of other smaller competitors. The Company competes on the basis of technical innovation, product performance, quality, and price with respect to all of its products.

The Company will be required to make continued investments in technology and product development to maintain the technological advantage that it believes it currently has over its competition. Some of the Company's competitors possess substantially greater financial, technical, and marketing resources than it possesses. Moreover, the Company cannot be certain that its technology or its product development efforts will allow it to successfully compete as the industry evolves. As the market for its measurement systems expands, additional competition may emerge and the Company's existing and future competitors may commit more resources to the markets in which the Company participates. The Company's results of operations could be adversely affected by pricing strategies pursued by competitors or technological or product developments by competitors.

The Company derives a substantial part of its revenues from its international operations, which are subject to greater volatility and often require more management time and expense to achieve profitability than its domestic operations.

The Company derives more than half of its revenues from international operations. The Company's international operations are subject to various risks, including:

difficulties in staffing and managing foreign operations;

political and economic instability;

unexpected changes in regulatory requirements and laws;

longer customer payment cycles and difficulty collecting accounts receivable;

compliance with export and import regulations and trade restrictions;

governmental restrictions on the transfer of funds to the Company from its operations outside the United States; and

burdens of complying with a wide variety of foreign laws and labor practices.

Several of the countries where the Company operates have emerging or developing economies, which may be subject to greater currency volatility, negative growth, high inflation, limited availability of foreign exchange and other risks. These factors may harm the Company's results of operations and any measures that it may implement to reduce the effect of volatile currencies and other risks of its international operations may not be effective.

Because a significant portion of the Company's revenues and expenses are denominated in foreign currencies, the Company faces significant exposure to foreign exchange rate risk.

The Company's results of operations are affected by fluctuations in exchange rates which can cause significant fluctuations in the Company's quarterly and annual results of operations. Fluctuations in exchange rates may have a material adverse effect on the Company's results of operations and financial condition, and could result in potentially significant foreign exchange gains and losses. To the extent that the percentage of its non-U.S. dollar revenues derived from international sales increases in the future, the Company's exposure to risks associated with fluctuations in foreign exchange rates will increase.

The Company is subject to the impact of governmental and other similar certification processes and regulations, which could adversely affect the Company's business and results of operations.

The Company's operations are subject to numerous governmental laws and regulations, including those governing antitrust and competition, the environment, import and export of products, currency conversions and repatriation, taxation of foreign earnings and earnings of expatriate personnel and use of local employees and suppliers. An inability to comply with these regulations or obtain any necessary certifications in a timely manner could have an adverse effect on the Company's operating results.

Manufacturers of electrical goods are subject to the European Union's RoHS2 and WEEE directives, which took effect during 2006. RoHS2 prohibits the use of lead, mercury and certain other specified substances in electronics products, and WEEE makes producers of electrical goods financially responsible for specified collection, recycling, treatment, and disposal of covered electronic products and components. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China.

The Company currently holds WEEE registration and is in compliance with the directives of the European Union. Under the classification of Industrial Monitoring and Control Instruments, the Company's products have until July 22, 2017 to become compliant with the RoHS2 directive. Currently, only the FARO Laser Tracker ION does not meet the RoHS2 directive. However, if the Company is unable to bring the FARO Laser Tracker ION into compliance with the RoHS2 directive by July 22, 2017, it would be unable to sell the FARO Laser Tracker ION in European Union countries and China, and potentially in several states in the United States, which could have a material adverse effect on its sales and results of operations.

Any failure to comply with the Foreign Corrupt Practices Act or similar anti-corruption laws could subject the Company to fines and penalties.

In 2012, the Company's monitorship expired pursuant to its settlement with the SEC and the Department of Justice, or DOJ, concerning certain payments made by the Company's China subsidiary that may have violated the Foreign Corrupt Practices Act, or the FCPA, and other applicable laws. The Company is, of course, still subject to such laws and has adopted and maintains a compliance plan designed to ensure compliance with these laws; however, in light of the Company's prior conduct, any future failure to comply with any such continuing obligations could result in the SEC and the DOJ aggressively seeking to impose penalties against the Company in the future. In addition, many countries in which the Company operates have increased regulation regarding anti-corruption practices generally. Compliance with such regulations could be costly and could adversely impact the Company's results of operations or delay entry into new markets.

The Company may not be able to identify or consummate acquisitions or achieve expected benefits from acquisitions, which could harm its growth.

The Company's growth strategy partly depends on its ability to obtain additional technologies, complementary product lines and sales channels through selective acquisitions

and strategic investments. The Company may not be able to identify and successfully negotiate suitable acquisitions, obtain financing for future acquisitions, if necessary, on satisfactory terms or otherwise complete acquisitions in the future. In the past, the Company has used its stock as consideration for acquisitions. The Company's common stock may not remain at a price at which it can be used as consideration for acquisitions without diluting the Company's existing shareholders, and potential acquisition candidates may not view the Company's stock attractively.

In addition, realization of the benefits of acquisitions often requires integration of some or all of the sales and marketing, distribution, manufacturing, engineering, software development, customer service, finance and administrative organizations of the acquired companies. The integration of acquisitions demands substantial attention from senior management and the management of the acquired companies. Any acquisition may be subject to a variety of risks and uncertainties including:

the inability to assimilate effectively the operations, products, technologies and personnel of the acquired companies (some of which may be located in diverse geographic regions);

the inability to maintain uniform standards, controls, procedures and policies;

the need or obligation to divest portions of the acquired companies; and

the potential impairment of relationships with customers.

The Company cannot offer any assurance that it will be able to identify or complete suitable acquisitions, integrate successfully any acquisitions, that any acquired companies will operate profitably, or that it will realize the expected synergies and other benefits from any acquisition.

The Company may face difficulties managing the effects of its growth.

If its business grows rapidly in the future, the Company expects it to result in:

increased complexity;

increased responsibility for existing and new management personnel; and

incremental strain on its operations and financial and management systems.

If the Company is not able to manage the effects of its future growth, its business, financial condition and operating results may be harmed.

The Company's dependence on suppliers for materials could impair its ability to manufacture its products.

Outside vendors provide key components used by the Company in the manufacture of its products. Any supply interruption in a limited source component would harm its ability to manufacture its products until a new source of supply is identified. In addition, an uncorrected defect or supplier's variation in a component, either known or

unknown to the Company, or incompatibility with its manufacturing processes could harm its ability to manufacture its products. The Company may not be able to find a sufficient alternative supplier in a reasonable period, or on commercially reasonable terms, if at all. If the Company fails to obtain a supplier for the manufacture of components of its potential products, it may experience delays or interruptions in its operations, which would adversely affect its business, results of operations and financial condition.

The disclosure requirements under the conflict minerals provisions of the Dodd-Frank Act could increase the Company's costs and limit the supply of certain metals used in its products and affect its reputation with customers and shareholders.

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as amended, or the Dodd-Frank Act, the SEC adopted disclosure requirements, which became effective in 2014, for public companies using certain minerals and metals in their products. These minerals and metals are generally referred to as conflict minerals regardless of their country of origin. Under these rules, the Company is required to perform due diligence and disclose its efforts to prevent the sourcing of such conflict minerals from the Democratic Republic of Congo or adjoining countries. Conflict minerals are commonly used in the manufacture of electronics and may be incorporated in the Company's products. As a result of these new regulations, the Company has incurred, and expects to continue to incur, additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the conflict minerals used in the Company's products. These new requirements could also adversely affect the sourcing, availability and pricing of such minerals, and the pool of suppliers who provide conflict free metals may be limited. As a result, the Company or its suppliers may not be able to obtain materials necessary for production of the Company's products in sufficient quantities or at competitive prices. In addition, since the Company's supply chain is complex, it may not be able to sufficiently verify the origins of all metals used in its products and confirm that they are conflict free, which may adversely affect the Company's reputation.

The Company's failure to attract and retain qualified personnel could lead to a loss of sales or decreased profitability.

The Company may not be able to attract and retain sufficient qualified personnel to support its growth. In addition, the loss of the Company's Chief Executive Officer, or other key personnel, could adversely affect its sales, profitability or growth. Moreover, the Company continues to rely in part on equity awards to attract and retain qualified personnel, which may result in an increase in compensation expense.

Risks generally associated with the Company's information systems could adversely affect the Company's business reputation and results of operations.

The Company relies on its information systems to obtain, rapidly process, analyze and manage data to, among other things:

facilitate the purchase and distribution of thousands of inventory items;

receive, process and ship orders on a timely basis;

accurately bill and collect from customers;

process payments to suppliers and employees; and

summarize results and manage the Company's business.

The Company's primary and back-up computer systems are subject to damage or interruption from power outages, computer and telecommunication failures, computer viruses, security breaches, natural disasters and errors by

employees. Though losses arising from some of these issues would be covered by insurance, interruptions of the Company's critical business computer systems or failure of its back-up systems could lead to a loss of sales or decreased profitability.

A cyberattack or security breach of the Company's systems may compromise the confidentiality, integrity, or availability of the Company's internal data, the availability of the Company's products and websites designed to support the Company's customers, or the Company's customer data. Computer hackers, foreign governments or cyber terrorists may attempt to penetrate the Company's network security and the Company's website. Unauthorized access to the Company's proprietary business information or customer data may be obtained through break-ins, sabotage, or breach of our secure network by an unauthorized party, computer viruses, computer denial-of-service attacks, employee theft or misuse or other misconduct. Because the techniques used by computer programmers who may attempt to penetrate and sabotage the Company's network security or the Company's website change frequently and may not be recognized until launched against a target, the Company may be unable to anticipate these techniques. It is also possible that unauthorized access to customer data may be obtained through inadequate use of security controls by customers, suppliers or other vendors. Any security breach, cyberattack or cyber security breach, and any incident involving the misappropriation, loss or other unauthorized disclosure of, or access to, sensitive or confidential customer information, whether by the Company or by one of its vendors, could require the Company to expend significant resources to remediate any damage, interrupt its operations and damage its reputation, and could also result in regulatory enforcement actions, material fines and penalties, litigation or other actions which could have a material adverse effect on the Company's business, reputation and results of operations.

The Company is in the process of implementing a global enterprise resource planning, or ERP system, which is expected to be completed in phases over the next year. ERP implementations are complex and time-consuming projects that involve substantial expenditures on system software and implementation activities. During implementation, the Company may encounter difficulties in operating its business, which could disrupt operations, including the ability to timely ship customer orders, determine inventory requirements, manage the supply chain, and otherwise adequately service customers, and lead to increased costs and other difficulties. Any significant delays or disruptions during the implementation of the ERP could have a material adverse effect on the Company's results of operations and cash flows.

The Company is subject to risks of natural disasters.

The Company has manufacturing facilities in each of its regions. The occurrence of one or more natural disasters, such as tornadoes, hurricanes, earthquakes, floods and other forms of severe weather where the Company has a manufacturing facility could result in physical damage to, and complete or partial closure of, the Company's manufacturing facilities, which could adversely affect the Company's business, operations and financial performance. Interruptions in the Company's manufacturing operations or damage to its manufacturing facilities could reduce the Company's revenues and increase its costs and the extent of losses from natural disasters and severe weather will be a function of both the severity of the event and the total amount of insured exposure. Although the Company maintains insurance coverage, it can offer no assurance that its insurance coverage will be adequate to cover any losses or that it will be able to maintain insurance at a reasonable cost in the future. If losses from business interruption or property damage exceed the amounts for which the Company is insured, the Company's business, results of operations and financial condition could be adversely affected.

The Company may experience volatility in its stock price.

The price of the Company's common stock has been, and may continue to be, highly volatile in response to various factors, many of which are beyond its control, including:

fluctuations in demand for, and sales of, the Company's products or prolonged downturns in the industries that the Company serves;

actual or anticipated variations in quarterly or annual operating results;

general economic uncertainties;

speculation in the press or investment community; and

announcements of technological innovations or new products by the Company or its competitors.

The market price of the Company's common stock may also be affected by its inability to meet analyst and investor expectations and failure to achieve projected financial results. Any failure to meet such expectations or projected financial results, even if minor, could cause the market price of the Company's common stock to decline significantly. Volatility in its stock price may result in the inability of the Company's shareholders to sell their shares at or above the price at which they purchased them.

The Company's relatively small public float and daily trading volume have in the past caused, and may in the future result in, significant volatility in its stock price. At December 31, 2014, the Company had approximately 17.0 million shares outstanding held by non-affiliates. The Company's daily trading volume for the year ended December 31, 2014 averaged approximately 128,303 shares.

In addition, stock markets have generally experienced a high level of price and volume volatility, and the market prices of equity securities of many companies have experienced wide price fluctuations not necessarily related to the operating performance of such companies. These broad market fluctuations may adversely affect the market price of the Company's common stock. In the past, securities class action lawsuits frequently have been instituted against such companies following periods of volatility in the market price of such companies' securities. If any such litigation is instigated against the Company, it could result in substantial costs and a diversion of management's attention and resources, which could have a material adverse effect on its results of operations and financial condition.

Anti-takeover provisions in the Company's articles of incorporation, its bylaws and provisions of Florida law could delay or prevent a change of control that you may favor.

The Company's articles of incorporation, its bylaws and provisions of Florida law could make it more difficult for a third party to acquire the Company. Although the Company believes such provisions are appropriate to protect long-term value for its shareholders, these provisions could discourage potential takeover attempts and could adversely affect the market price of the Company's shares. Because of these provisions, you might not be able to receive a premium on your investment. These provisions include:

a limitation on shareholders' ability to call a special meeting of the Company's shareholders;

advance notice requirements to nominate directors for election to the Company's board of directors or to propose matters that can be acted on by shareholders at shareholder meetings;

the Company's classified board of directors, which means that approximately one-third of its directors are elected each year; and

the authority of the board of directors to issue, without shareholder approval, preferred stock with such terms as the board of directors may determine.

The provisions described above could delay or make more difficult transactions involving a change in control of the Company or its management.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

The Americas

The Company's headquarters are located in a leased building in Lake Mary, Florida containing approximately 46,000 square feet. This facility houses the Company's sales, marketing, customer service/application operations and administrative staff. The Company's U.S. production, research and development, service operations and manufacturing are located in a leased building in Lake Mary, Florida consisting of approximately 35,000 square feet and a new leased facility consisting of approximately 90,400 square feet located in Exton, Pennsylvania containing research and development, manufacturing and service operations of the laser tracker and imager product lines. In the fourth quarter of 2014, the Company relocated to its Exton facility from its Kennett Square, Pennsylvania facility that consisted of two leased buildings totaling approximately 36,800 square feet.

Europe/Africa

The Company's European headquarters are located in a leased building in Stuttgart, Germany containing approximately 103,600 square feet. This facility houses the manufacturing, administration, sales, marketing and service management personnel for the Company's European operations. Additionally, the Company has a leased facility consisting of approximately 15,900 square feet located in Schaffhausen, Switzerland containing manufacturing operations for the Company's products shipped to customers in Europe and Africa.

Asia-Pacific

The Company's Asian headquarters are located in a leased building in Singapore containing approximately 22,000 square feet. This facility houses the administration, sales, marketing, production, service management personnel and manufacturing for the Company's Asia-Pacific operations. The Company's Japan headquarters are located in a leased building in Nagoya, Japan containing approximately 17,200 square feet. This facility houses the Company's Japan sales, marketing and service operations. The Company's China headquarters are located in a leased building in Shanghai, China containing approximately 25,500 square feet for sales, marketing and service operations.

The Company believes that its current facilities will be adequate for its foreseeable needs and that it will be able to locate suitable space for additional regional offices or enhanced production needs as necessary.

The information required by the remainder of this Item is incorporated herein by reference to Exhibit 99.1 to this Annual Report on Form 10-K.

ITEM 3. LEGAL PROCEEDINGS.

The Company is not involved in any legal proceedings other than routine litigation arising in the normal course of business, none of which the Company believes will have a material adverse effect on the Company's business, financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.****Market Information and Holders**

The Company's common stock is listed and traded on the NASDAQ Global Select Market under the symbol "FARO".

The following table sets forth, for the periods indicated, the high and low sales prices of the Company's common stock as reported by the NASDAQ Stock Market:

	2014		2013	
	High	Low	High	Low
First Quarter	\$ 59.90	\$ 48.70	\$ 45.88	\$ 31.10
Second Quarter	54.84	39.75	43.98	32.50
Third Quarter	59.35	44.52	42.88	33.50
Fourth Quarter	65.63	47.31	60.91	38.56

As of February 10, 2015, the Company had 49 holders of record of common stock.

Dividends

The Company has not paid any cash dividends on its common stock to date. The Company expects to retain future earnings for use in operating and expanding its business and does not anticipate paying any cash dividends in the reasonably foreseeable future.

Recent Sales of Unregistered Securities

During the year ended December 31, 2014, the Company did not sell any equity securities that were not registered under the Securities Act.

Purchases of Equity Securities

On November 24, 2008, the Company's Board of Directors approved a \$30 million share repurchase program. Acquisitions for the share repurchase program will be made from time to time at prevailing prices, as permitted by securities laws and other legal requirements and subject to market conditions and other factors. The share repurchase program may be

discontinued at any time. There is no restriction date or other restriction governing the period over which the Company can repurchase shares under the program. The Company did not purchase any shares in the year ended December 31, 2014 under the repurchase program. As of December 31, 2014, the Company had \$21.1 million available for repurchase under this share repurchase program.

Performance Graph

The following performance graph and related information shall not be deemed soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates it by reference into such filing.

The following line graph compares the cumulative five-year returns on the Company's common stock with (1) the cumulative returns of the NASDAQ Composite-Total Return and (2) the Morningstar Scientific & Technical Instruments Index.

For purposes of preparing the graph, we assumed that an investment of \$100 was made at market close on December 31, 2009, the last trading day before the beginning of the Company's fifth preceding fiscal year, with reinvestment of any dividends at the time they were paid. The Company did not pay any dividends during the period indicated.

The comparison in the graph below is based on historical data and is not necessarily indicative of future performance of the Company's common stock.

Company/Market/Peer Group	2009	2010	2011	2012	2013	2014
FARO Technologies, Inc.	\$ 100.00	\$ 153.17	\$ 214.55	\$ 166.42	\$ 271.92	\$ 292.35
NASDAQ Composite-Total Returns	\$ 100.00	\$ 118.02	\$ 117.04	\$ 137.47	\$ 192.62	\$ 221.02
Morningstar Scientific & Technical Instruments	\$ 100.00	\$ 129.77	\$ 129.89	\$ 151.89	\$ 192.23	\$ 201.65

ITEM 6. SELECTED FINANCIAL DATA.

in thousands, except share and per-share data	Year ended December 31,				
	2014	2013	2012	2011	2010
Consolidated Statement of Operations Data:					
Sales	\$ 341,826	\$ 291,784	\$ 273,395	\$ 254,164	\$ 191,775
Gross profit	188,914	161,893	149,619	143,689	113,398
Income from operations	37,340	30,154	31,554	32,858	16,927
Income before income tax expense	37,522	28,862	30,942	31,705	14,215
Net income	33,649	21,509	22,998	23,377	11,068
EBITDA (1)	44,862	35,835	37,786	38,353	20,470
Net income per common share:					
Basic	\$ 1.95	\$ 1.26	\$ 1.36	\$ 1.42	\$ 0.69
Diluted	\$ 1.93	\$ 1.25	\$ 1.34	\$ 1.39	\$ 0.68
Weighted average shares outstanding:					
Basic	17,247,727	17,087,104	16,910,830	16,503,773	16,153,831
Diluted	17,416,453	17,241,115	17,129,128	16,868,471	16,365,826

	As at December 31,				
	2014	2013	2012	2011	2010
Consolidated Balance Sheet Data:					
Working capital	\$ 273,352	\$ 263,166	\$ 232,396	\$ 197,539	\$ 162,814
Total assets	425,463	391,496	350,807	312,791	266,019
Total debt-capital leases	8	16	64	341	216
Total shareholders equity	343,854	315,950	282,736	247,898	212,477

Notes to Selected Financial Data

- (1) **EBITDA** represents earnings before interest, income taxes, depreciation, and amortization. EBITDA is a non-GAAP financial measure that is used by management to evaluate business performance in comparison to budgets, forecasts, and prior year financial results, providing a measure that management believes reflects the Company's core operating performance. The Company believes this will help investors perform trend analysis and better identify operating trends. EBITDA is useful for analytical purposes; however, it should not be considered an alternative to the Company's reported GAAP results, as there are limitations in using such financial measures. Furthermore, EBITDA measures shown for the Company may not be comparable to similarly titled measures used by other companies. The following table presents the reconciliation of net income reported in accordance with GAAP to EBITDA:

in thousands	Year ended December 31,				
	2014	2013	2012	2011	2010
Net income	\$ 33,649	\$ 21,509	\$ 22,998	\$ 23,377	\$ 11,068

Edgar Filing: FARO TECHNOLOGIES INC - Form 10-K

Add (deduct):

Interest expense	8	9	28	37	34
Interest income	(96)	(74)	(160)	(101)	(105)
Income taxes	3,873	7,353	7,944	8,328	3,147
Depreciation and amortization	7,428	7,038	6,976	6,712	6,326
Total adjustments	11,213	14,326	14,788	14,976	9,402
EBITDA	\$ 44,862	\$ 35,835	\$ 37,786	\$ 38,353	\$ 20,470

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following information should be read in conjunction with the Consolidated Financial Statements of the Company, including the notes thereto, included in Part II, Item 8 of this Annual Report on Form 10-K.

Overview

The Company designs, develops, manufactures, markets and supports software driven, three-dimensional (3-D) measurement, imaging and realization systems. The Company sells the majority of its products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building construction and law enforcement applications. The Company's FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker, FARO 3D Imager AMP, and their companion CAM2® software provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's FARO Focus^{3D} and FARO Freestyle^{3D} laser scanners, and their companion SCENE and FARO forensic software, are utilized for a wide variety of 3-D modeling, documentation and high-density surveying applications, including in two of the Company's key vertical markets—architecture, engineering and construction (AEC) and law enforcement.

The Company derives revenues primarily from the sale of its measurement equipment and their related multi-faceted software programs. Revenue related to these products is generally recognized upon shipment. In addition, the Company sells extended warranties and training and technology consulting services relating to its products. The Company recognizes the revenue from extended warranties on a straight-line basis over the term of the warranty and revenue from training and technology consulting services when the services are provided. The Company also receives royalties from licensing agreements for its historical medical technology and recognizes the revenue from these royalties as licensees use the technology.

The Company operates in international markets throughout the world and maintains sales offices in the United States, Brazil, Mexico, France, Germany, United Kingdom, Japan, Spain, Italy, Turkey, China, South Korea, India, Poland, the Netherlands, Malaysia, Thailand, Singapore and Vietnam. The Company manages and reports its global sales in three regions: the Americas, Europe/Africa and Asia-Pacific.

The Company manufactures its FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker and FARO 3D Imager AMP products in its manufacturing facility located in Switzerland for customer orders from the Europe/Africa region, in its manufacturing facility located in Singapore for customer orders from the Asia-Pacific region, and in its manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas. The Company manufactures its FARO Focus^{3D} and FARO Freestyle^{3D} products in its facility located in Stuttgart, Germany. The Company expects all of its existing plants to have the production capacity necessary to support its volume requirements through 2015.

The Company accounts for wholly owned foreign subsidiaries in the currency of the respective foreign jurisdiction. Therefore, fluctuations in exchange rates may have an impact on the value of the intercompany account balances denominated in different currencies. The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options. However, it does not use such instruments, and none were utilized in 2014, 2013 or 2012.

The Company has achieved continued sales and earnings growth over the last several years, with the exception of a loss in 2009, that resulted primarily from the decline of the global economy that year. The Company's historical sales and earnings growth were the result of a number of factors, including: continuing market demand for and acceptance of the Company's products; increased sales activity in part through additional sales staff worldwide, new products and product enhancements such as the FARO Edge Arm, FARO Laser ScanArm, FARO Focus^{3D}, FARO Freestyle, and the effect of acquisitions. However, the Company's historical financial performance is not indicative of its future financial performance.

Results of Operations

The following table sets forth, for the periods presented, the percentage of sales represented by certain items in the Company's consolidated statements of operations:

	Years ended December 31,		
	2014	2013	2012
Statement of Operations Data:			
Sales	100.0%	100.0%	100.0%
Cost of sales	44.7%	44.5%	45.3%
Gross margin	55.3%	55.5%	54.7%
Operating expenses:			
Selling and marketing	23.4%	24.6%	23.6%
General and administrative	10.7%	10.5%	10.6%
Depreciation and amortization	2.2%	2.4%	2.6%
Research and development	8.0%	7.7%	6.4%
Total operating expenses	44.3%	45.2%	43.2%
Income from operations	11.0%	10.3%	11.5%
Interest income	0.0%	0.0%	-0.1%
Other expense	0.0%	0.4%	0.3%
Interest expense	0.0%	0.0%	0.0%
Income before income tax expense	11.0%	9.9%	11.3%
Income tax expense	1.1%	2.5%	2.9%
Net Income	9.9%	7.4%	8.4%

2014 Compared to 2013

Sales. Total sales increased \$50.0 million, or 17.2%, to \$341.8 million in the year ended December 31, 2014 from \$291.8 million for the year ended December 31, 2013. The Company's sales growth was primarily driven by strong year-over-year unit sales growth across all product lines, including Arm (comprising the FaroArm, FARO Laser ScanArm, and FARO Gage), Laser Tracker (comprising the FARO Laser Tracker Vantage and ION products) and Laser Scanner (FARO Focus^{3D} product line) and across all geographic regions.

Arm sales growth of 18% was driven by an 11% increase in units sold and a higher average selling price due to the release of the Company's new Laser Line Probe HD for its FARO Laser ScanArm. The number of Laser Tracker units sold increased 16%; however the dollar amount of Laser Tracker sales grew 1% due to pricing pressures and the negative impact of foreign exchange rates. Sales of Laser Scanner grew 38% driven primarily by the continued adoption of the technology in the architecture, engineering, and construction (AEC), and law enforcement markets. Foreign exchange rates had a negative impact on sales of \$6.5 million for the year end December 31, 2014, primarily driven by the decline in the Euro and Yen. Product sales increased by \$45.3 million, or 19.0%, to \$284.1 million for the year ended December 31, 2014 from \$238.8 million in the year ended December 31, 2013, primarily reflecting the higher Laser Scanner and Arm sales described above. Service revenue increased by \$4.7 million, or 8.9%, to \$57.7 million for the year ended December 31, 2014 from \$53.0 million in the year ended December 31, 2013, primarily due to an increase in warranty revenue of \$3.0 million and customer service revenue of \$1.5 million, reflecting the higher unit sales year-over year.

Sales in the Americas region increased \$18.6 million, or 15.4%, to \$139.0 million for the year ended December 31, 2014 from \$120.4 million in the prior year period. Foreign exchange rates had a negative impact on sales of \$1.1 million, decreasing sales growth by 0.9 percentage points. Product sales in the Americas region increased by \$17.2 million, or 17.6%, to \$114.8 million for the year ended December 31, 2014 from \$97.6 million in the prior year, primarily driven by a 50% increase in Laser Scanner sales and a 14% growth in Arm sales. Service revenue in the Americas region increased by \$1.4 million, or 6.0%, to \$24.2 million for the year ended December 31, 2014 from \$22.8 million for the prior year, primarily due to an increase in customer service revenue of \$0.9 million and warranty revenue of \$0.8 million.

Sales in the Europe/Africa region increased \$16.7 million, or 16.2%, to \$120.1 million for the year ended December 31, 2014 from \$103.4 million in the year ended December 31, 2013. Foreign exchange rates had a negative impact on sales of \$1.8 million, decreasing sales growth by 1.7 percentage points. Product sales in the Europe/Africa region increased by \$13.7 million, or 16.6%, to \$96.4 million for the year ended December 31, 2014 from \$82.7 million in the prior year, primarily driven by a 29% increase in Laser Scanner sales and a 20% growth in Arm sales. Service revenue in the Europe/Africa region increased by \$3.0 million, or 14.8%, to \$23.7 million for the year ended December 31, 2014 from \$20.7 million in the prior year, primarily due to an increase in warranty revenue of \$2.0 million and customer service revenue of \$0.6 million.

Sales in the Asia-Pacific region increased \$14.7 million, or 21.7%, to \$82.7 million for the year ended December 31, 2014 from \$68.0 million in the year ended December 31, 2013. Foreign exchange rates had a negative impact on sales of \$3.6 million, decreasing sales growth by 5.4 percentage points. Product sales in the Asia-Pacific region increased by \$14.4 million, or 24.7%, to \$72.9 million for the year ended December 31, 2014 from \$58.5 million in the prior year, primarily driven by a 38% increase in Laser Scanner sales, a 25% growth in Laser Tracker sales, and a 20% growth in Arm sales. Service revenue in the Asia-Pacific region increased by \$0.3 million, or 3.3%, to \$9.8 million for the year ended December 31, 2014 from \$9.5 million in the prior year, primarily due to a modest increase in warranty and training revenue.

Gross profit. Gross profit increased by \$27.0 million, or 16.7%, to \$188.9 million for the year ended December 31, 2014 from \$161.9 million for the year ended December 31, 2013, driven by the increase in sales revenue. Foreign exchange rates had a negative impact on gross profit of \$2.2 million for the year ended December 31, 2014. Gross margin at 55.3% for the year ended December 31, 2014 was marginally lower than 55.5% for the year ended December 31, 2013. Gross margin from product revenue increased by 0.4 percentage points to 59.5% for the year ended December 31, 2014 from 59.1% for the year ended December 31,

2013, primarily as a result of lower manufacturing costs for the Company's Arm and Laser Tracker products and improved average selling prices for Arm products due to the release of the Company's new Laser Line Probe HD, partially offset by a less favorable overall sales mix with the strong year-over-year increase in units of Laser Scanners sold. This was partially offset by the impact of a write-off of primarily demonstration and service loaner inventory that became obsolete through release of new products totaling \$3.3 million, or a 1% impact on gross margin. Gross margin from service revenue decreased by 4.8 percentage points to 34.3% for the year ended December 31, 2014 from 39.1% for the year ended December 31, 2013, primarily due to an increase in headcount in customer service to support the growth in our product sales.

Selling and Marketing Expenses. Selling and marketing expenses increased by \$8.5 million, or 11.8%, to \$80.2 million for the year ended December 31, 2014 from \$71.7 million for the year ended December 31, 2013. The increase in selling and marketing expenses was primarily due to higher compensation costs of \$6.8 million, travel costs of \$0.6 million, advertising and trade show costs of \$0.7 million, and facility costs of \$0.4 million. The increase in compensation costs was driven by higher commissions, primarily reflecting the increase in sales volume in 2014, as well as an increase in headcount to support and contribute to increased demand and sales for the Company's products.

Worldwide sales and marketing headcount increased by 57, or 13.2%, to 490 at December 31, 2014 from 433 at December 31, 2013. Regionally, the Company's sales and marketing headcount increased by 31, or 22.8%, to 167 at December 31, 2014 from 136 at December 31, 2013 for the Americas; increased by 16, or 11.3%, to 157 at December 31, 2014 from 141 at December 31, 2013 in Europe/Africa; and increased by 10, or 6.4%, in Asia-Pacific to 166 at December 31, 2014 from 156 at December 31, 2013.

In 2014, the Company further leveraged its sales and marketing organization as, selling and marketing expenses decreased to 23.4% of sales in the year ended December 31, 2014 from 24.6% of sales in the year ended December 31, 2013. Regionally, selling and marketing expenses were 20.8% of sales in the Americas for the year ended December 31, 2014 compared to 21.4% of sales in the year ended December 31, 2013; 27.3% of sales for Europe/Africa for the year ended December 31, 2014 compared to 28.8% of sales in the prior year; and 22.3% of sales for Asia-Pacific for the year ended December 31, 2014 compared to 23.6% of sales in the prior year.

General and administrative expenses. General and administrative expenses increased by \$5.9 million, or 19.2%, to \$36.5 million, for the year ended December 31, 2014 from \$30.6 million in the year ended December 31, 2013, primarily due to higher compensation costs of \$4.0 million reflecting higher headcount and an increase in the Company's consulting and advisory services of \$1.9 million relating primarily to a new ERP system implementation and strategic planning initiatives. General and administrative expenses as a percentage of sales increased to 10.7% for the year ended December 31, 2014 from 10.5% for the year ended December 31, 2013.

Depreciation and amortization expenses. Depreciation and amortization expenses increased by \$0.4 million, or 5.5%, to \$7.4 million for the year ended December 31, 2014 from \$7.0 million in the year ended December 31, 2013, primarily due to the start of depreciation for the ERP system.

Research and development expenses. In 2014, the Company increased its investment in Research and Development to accelerate new product development by increasing engineering headcount by 17. As a result, research and development expenses increased \$5.1 million, or 22.7%, to \$27.5 million for the year ended December 31, 2014 from \$22.4 million for the year ended December 31, 2013. Research and development expenses as a percentage of sales increased to 8.0% for the year ended December 31, 2014 from 7.7% for the year ended December 31, 2013.

Other (income) expense. Other (income) expense decreased by \$1.5 million to \$0.2 million of income for the year ended December 31, 2014, from expense of \$1.3 million for the year ended December 31, 2013, primarily as a result of foreign exchange transaction gains resulting from changes in foreign exchange rates on the value of current intercompany account balances of the Company's subsidiaries denominated in different currencies.

Income tax expense. Income tax expense decreased by \$3.5 million to \$3.9 million for the year ended December 31, 2014 from \$7.4 million for the year ended December 31, 2013, primarily due to a discrete tax benefit of \$4.5 million recorded in the third quarter of 2014 due to a reduction in the valuation allowance partially offset by higher pre-tax income. The valuation allowance was originally established against net operating losses in certain foreign subsidiaries. During 2014, these foreign subsidiaries demonstrated a pattern of profitability that resulted in the Company concluding that the valuation allowance should be reversed. The Company's effective tax rate decreased to 10.3% for the year ended December 31, 2014 compared to 25.5% for the year ended December 31, 2013, primarily due to the discrete tax benefit. The Company's effective tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's effective tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

Net income. Net income increased by \$12.1 million to \$33.6 million for the year ended December 31, 2014 from \$21.5 million for the year ended December 31, 2013 as a result of the factors described above. Foreign exchange rates had a negative impact on net income of \$0.9 million for the year ended December 31, 2014.

EBITDA (Non-GAAP). Earnings before interest, income taxes, depreciation, and amortization (EBITDA) increased by \$9.1 million to \$44.9 million for the year ended December 31, 2014 from \$35.8 million for the year ended December 31, 2013, primarily as a result of strong year-over-year sales growth, partially offset by headcount growth and increased investment in research and development. Foreign exchange rates had a negative impact on EBITDA of \$1.0 million for the year ended December 31, 2014. EBITDA is not intended to be an alternative to any measure calculated in accordance with GAAP. Rather, EBITDA is used by management and is provided to further aid the Company's investors in understanding and evaluating the Company's core operating performance. A more detailed description of the rationales for utilizing EBITDA and a reconciliation of net income to EBITDA is included in Part II, Item 6 of this Annual Report on Form 10-K.

2013 Compared to 2012

Sales. Total sales increased \$18.4 million, or 6.7%, to \$291.8 million in the year ended December 31, 2013 from \$273.4 million for the year ended December 31, 2012. This increase resulted primarily from an increase in worldwide demand for the Company's products and services. Product sales increased by \$10.9 million, or 4.8%, to \$238.8 million for the year ended December 31, 2013 from \$227.9 million in the year ended December 31, 2012. Service revenue increased by \$7.5 million, or 16.4%, to \$53.0 million for the year ended December 31, 2013 from \$45.5 million in the year ended December 31, 2012 primarily due to an increase in warranty revenue.

Sales in the Americas region increased \$11.8 million, or 10.9%, to \$120.4 million for the year ended December 31, 2013 from \$108.6 million in the prior year period. Product sales in the Americas region increased by \$8.6 million, or 9.6%, to \$97.6 million for the year ended

December 31, 2013 from \$89.0 million in the prior year. Service revenue in the Americas region increased by \$3.2 million, or 16.5%, to \$22.8 million for the year ended December 31, 2013 from \$19.6 million for the prior year, primarily due to an increase in warranty revenue.

Sales in the Europe/Africa region increased \$3.3 million, or 3.3%, to \$103.4 million for the year ended December 31, 2013 from \$100.1 million in the year ended December 31, 2012. Product sales in the Europe/Africa region decreased by \$0.3 million, or 0.4%, to \$82.7 million for the year ended December 31, 2013 from \$83.1 million in the prior year. Service revenue in the Europe/Africa region increased by \$3.7 million, or 21.4%, to \$20.7 million for the year ended December 31, 2013 from \$17.0 million in the prior year, primarily due to an increase in warranty revenue.

Sales in the Asia-Pacific region increased \$3.3 million, or 5.0%, to \$68.0 million for the year ended December 31, 2013 from \$64.7 million in the year ended December 31, 2012. Product sales in the Asia-Pacific region increased by \$2.7 million, or 4.8%, to \$58.5 million for the year ended December 31, 2013 from \$55.8 million in the prior year. Service revenue in the Asia-Pacific region increased by \$0.6 million, or 6.6%, to \$9.5 million for the year ended December 31, 2013 from \$8.9 million in the prior year, primarily due to an increase in customer service revenue.

Gross profit. Gross profit increased by \$12.3 million, or 8.2%, to \$161.9 million for the year ended December 31, 2013 from \$149.6 million for the year ended December 31, 2012. Gross margin increased to 55.5% for the year ended December 31, 2013 from 54.7% for the year ended December 31, 2012. The increase in gross margin was primarily due to an increase in gross margin from service revenues to 39.1% for the year ended December 31, 2013 compared to 34.8% for the prior year as a result of an increase in higher margin warranty sales, and an increase in gross margin from product sales to 59.1% in the year ended December 31, 2013 from 58.7% in the prior year, primarily as a result of lower manufacturing costs, offset by lower average selling prices.

Selling and Marketing Expenses. Selling and marketing expenses increased by \$7.3 million, or 11.2%, to \$71.7 million for the year ended December 31, 2013 from \$64.4 million for the year ended December 31, 2012. This increase was primarily due to an increase in commissions and compensation expense of \$4.9 million, an increase in travel expenses of \$1.4 million, and an increase in marketing and advertising expenses of \$0.3 million.

Worldwide sales and marketing headcount increased by 68, or 18.6%, to 433 at December 31, 2013 from 365 at December 31, 2012. Regionally, the Company's sales and marketing headcount increased by 28, or 25.9%, to 136 at December 31, 2013 from 108 at December 31, 2012 for the Americas; increased by 18, or 14.6%, to 141 at December 31, 2013 from 123 at December 31, 2012 in Europe/Africa; and increased by 22, or 16.4%, in Asia-Pacific to 156 at December 31, 2013 from 134 at December 31, 2012.

As a percentage of sales, selling expenses increased to 24.6% of sales in the year ended December 31, 2013 from 23.6% of sales in the year ended December 31, 2012. Regionally, selling expenses were 21.4% of sales in the Americas for the year ended December 31, 2013 compared to 20.0% of sales in the year ended December 31, 2012; 28.8% of sales for Europe/Africa for the year ended December 31, 2013 compared to 26.4% of sales in the prior year; and 23.6% of sales for Asia-Pacific for the year ended December 31, 2013 compared to 25.1% of sales in the prior year.

General and administrative expenses. General and administrative expenses increased by \$1.5 million to \$30.6 million, or 5.3%, for the year ended December 31, 2013 from \$29.1 million in the year ended December 31, 2012, primarily due to an increase in compensation of \$1.8 million, bad debt expense of \$1.2 million, recruiting costs of \$1.0 million, and travel costs of \$0.2 million, partially offset by a decrease of \$2.9 million in professional fees related

to patent litigation and the FCPA matter. General and administrative expenses as a percentage of sales decreased to 10.5% for the year ended December 31, 2013 from 10.6% for the year ended December 31, 2012.

Depreciation and amortization expenses. Depreciation and amortization expenses remained flat at \$7.0 million for the years ended December 31, 2013 and December 31, 2012.

Research and development expenses. Research and development expenses increased \$4.8 million, or 27.5%, to \$22.4 million for the year ended December 31, 2013 from \$17.6 million for the year ended December 31, 2012, primarily due to an increase in compensation of \$2.5 million, subcontractor expenses of \$1.6 million, and material expenses of \$0.6 million. Research and development expenses as a percentage of sales increased to 7.7% for the year ended December 31, 2013 from 6.4% for the year ended December 31, 2012.

Other (income) expense. Other (income) expense increased by \$0.7 million to \$1.3 million of expense for the year ended December 31, 2013, from expense of \$0.6 million for the year ended December 31, 2012, primarily as a result of an increase in foreign exchange transaction losses resulting from changes in foreign exchange rates on the value of current intercompany account balances of the Company's subsidiaries denominated in different currencies.

Income tax expense. Income tax expense decreased by \$0.5 million to \$7.4 million for the year ended December 31, 2013 from \$7.9 million for the year ended December 31, 2012, primarily due to a decrease in pretax income. The Company's effective tax rate decreased to 25.5% for the year ended December 31, 2013 compared to 25.7% for the year ended December 31, 2012 and included a reduction in the income tax rates of 0.8% and 1.5% related to the tax benefit of the exercise of employee stock options in the years ended December 31, 2013 and 2012, respectively. The effective tax rate for the year ended December 31, 2013 also included the discrete tax benefit of 1.5% related to the retroactive legislative reinstatement on January 2, 2013 of the Research and Development tax credit for the year ended December 31, 2012, which is required to be included in the period the reinstatement was enacted into law. The Company's tax rate continued to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

Net income. Net income decreased by \$1.5 million to \$21.5 million for the year ended December 31, 2013 from \$23.0 million for the year ended December 31, 2012 as a result of the factors described above.

EBITDA (Non-GAAP). EBITDA decreased by \$2.0 million to \$35.8 million for the year ended December 31, 2013 from \$37.8 million for the year ended December 31, 2012, primarily due to an unfavorable impact of \$1.7 million from the change in foreign exchange rates and higher investment in research and development spending, partially offset by modest sales growth. EBITDA is not intended to be an alternative to any measure calculated in accordance with GAAP. Rather, EBITDA is used by management and is provided to further aid the Company's investors in understanding and evaluating the Company's core operating performance. A more detailed description of the rationales for utilizing EBITDA and a reconciliation of net income to EBITDA is included in Part II, Item 6 of this Annual Report on Form 10-K.

Liquidity and Capital Resources

Cash and cash equivalents decreased by \$15.3 million to \$109.3 million at December 31, 2014 from \$124.6 million at December 31, 2013. The decrease in cash and cash equivalents was primarily due to an increase in accounts receivable and inventory as a result of the Company's sales growth, partially offset by higher net income in 2014. Also impacting the comparison was \$18.7 million in capital expenditures mainly reflecting the Company's investment in the new facility in Exton, Pennsylvania and ERP implementation.

Of the Company's cash and cash equivalents, \$58.9 million was held by foreign subsidiaries. The Company's current intent is to indefinitely reinvest these funds in its foreign operations, as the cash is needed to fund on-going operations. In the event circumstances change, leading to the conclusion that these funds will not be indefinitely reinvested, the Company would need to provide at that time for the income taxes that would be triggered upon their repatriation.

The Company has an undrawn \$30 million under a credit facility it entered into on July 11, 2006. The terms of the loan arrangement was most recently amended on March 15, 2012. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 1.50% and 2.00% and require the Company to maintain a minimum cash balance of \$25 million and tangible net worth measured at the end of each of the Company's fiscal quarters. As of December 31, 2014, the Company was in compliance with all of the covenants under the Amended and Restated Loan Agreement, as amended. The term of the Amended and Restated Loan Agreement, as amended, expires on March 31, 2015. The Company does not expect to renew the agreement.

On December 21, 2012, the Company filed a shelf registration statement on Form S-3 with the SEC registering shares of common stock, preferred stock, and warrants to purchase common and preferred stock, either individually or in units, with a proposed maximum aggregate offering price of \$250 million. The registration statement was declared effective on January 7, 2013. The proceeds from any offerings with respect to this shelf registration statement, if any, would be used for either repayment or refinancing of debt, acquisition of additional businesses or technologies or for working capital and general corporate purposes.

The Company believes that its working capital, anticipated cash flow from operations, and credit facility will be sufficient to fund its long-term liquidity requirements for the foreseeable future.

The Company has no off balance sheet arrangements.

Contractual Obligations and Commercial Commitments

The Company is party to capital leases on equipment with an initial term of 36 to 60 months and other non-cancelable operating leases. These obligations are presented below as of December 31, 2014 (dollars in thousands):

Contractual Obligations	Total	Payments Due by Period			
		< 1 Year	1-3 Years	3-5 Years	> 5 Years
Operating lease obligations	\$ 26,799	\$ 6,668	\$ 8,961	\$ 4,829	\$ 6,341
Capital lease obligations	8	8			\$
Purchase obligations	14,776	14,776			
Total	\$ 41,583	\$ 21,452	\$ 8,961	\$ 4,829	\$ 6,341

The Company enters into purchase commitments for products and services in the ordinary course of business. These purchases generally cover production requirements for 60

to 90 days. The Company has a \$0.3 million liability for unrecognized tax benefits that is excluded from the contractual obligations table due to the uncertainty of the period of settlement, if any, with the respective taxing authorities.

Inflation

Inflation did not have a material impact on the Company's results of operations in recent years, and the Company does not expect inflation to have a material impact on its operations in 2015.

Critical Accounting Policies

The preparation of the Company's consolidated financial statements requires the Company's management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, as well as disclosure of contingent assets and liabilities. The Company bases its estimates on historical experience, along with various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Some of these judgments can be subjective and complex and, consequently, actual results may differ from these estimates under different assumptions or conditions. While for any given estimate or assumption made by the Company's management there may be other estimates or assumptions that are reasonable, the Company believes that, given the current facts and circumstances, it is unlikely that applying any such other reasonable estimate or assumption would materially impact the financial statements.

In response to the SEC's financial reporting release, FR-60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," the Company has selected its critical accounting policies for purposes of explaining the methodology used in its calculation, in addition to any inherent uncertainties pertaining to the possible effects on its financial condition. The critical policies discussed below are the Company's processes of recognizing revenue, the reserve for excess and obsolete inventory, income taxes, the reserve for warranties and goodwill impairment. These policies affect current assets and operating results and are therefore critical in assessing the Company's financial and operating status. These policies involve certain assumptions that, if incorrect, could have an adverse impact on the Company's operations and financial position.

Revenue Recognition

Revenue is recognized when the price is fixed, collectability is reasonably assured, the title and risks and rewards of ownership have passed to the customer and the earnings process is complete. Revenue related to the Company's measurement, imaging, and realization equipment and related software is generally recognized upon shipment, as the Company considers the earnings process complete as of the shipping date. Fees billed to customers associated with the distribution of products are classified as revenue. The Company warrants its products against defects in design, materials and workmanship for one year. A provision for estimated future costs relating to warranty expense is recorded when products are shipped. The Company separately sells extended warranties. Extended warranty revenues are recognized on a straight-line basis over the term of the warranty. Costs relating to extended warranties are recognized as incurred. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and when the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed and are deferred when billed in advance of the performance of services. Revenue from the licensing agreements for the use of the Company's technology for medical applications is generally recognized as licensees use

the technology. Amounts representing royalties for the current year and not received as of year-end are estimated as due based on historical data and recognized in the current year. Revenues are presented net of sales-related taxes.

Reserve for Excess and Obsolete Inventory

Since the value of inventory that will ultimately be realized cannot be known with exact certainty, the Company relies upon both past sales history and future sales forecasts to provide a basis for the determination of the reserve. Inventory is considered potentially obsolete if the Company has withdrawn those products from the market or had no sales of the product for the past 12 months and has no sales forecasted for the next 12 months. Inventory is considered potentially excess if the quantity on hand exceeds 12 months of expected remaining usage. The resulting obsolete and excess parts are then reviewed to determine if a substitute usage or a future need exists. Items without an identified current or future usage are reserved in an amount equal to 100% of the FIFO cost of such inventory. The Company's products are subject to changes in technologies that may make certain of its products or their components obsolete or less competitive, which may increase its historical provisions to the reserve.

Income Taxes

The Company reviews its deferred tax assets on a regular basis to evaluate their recoverability based upon expected future reversals of deferred tax liabilities, projections of future taxable income over a two-year period, and tax planning strategies that it might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence of recoverability, the Company establishes a valuation allowance against the net deferred assets of a taxing jurisdiction in which it operates, unless it is more likely than not that it will recover such assets through the above means. In the future, the Company's evaluation of the need for the valuation allowance will be significantly influenced by its ability to achieve profitability and its ability to predict and achieve future projections of taxable income over at least a two-year period.

Significant judgment is required in determining the Company's worldwide provision for income taxes. In the ordinary course of operating a global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company establishes provisions for income taxes when, despite the belief that tax positions are fully supportable, there remain certain positions that do not meet the minimum probability threshold as described by Accounting Standards Codification Topic 740, Income Taxes, which is a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority. In the ordinary course of business, the Company and its subsidiaries are examined by various federal, state, and foreign tax authorities. The Company regularly assesses the potential outcomes of these examinations and any future examinations for the current or prior years in determining the adequacy of its provision for income taxes. The Company assesses the likelihood and amount of potential adjustments and adjusts the income tax provision, the current tax liability and deferred taxes in the period in which the facts that gave rise to a revision become known.

Reserve for Warranties

The Company establishes at the time of sale a liability for the one year warranty included with the initial purchase price of equipment, based upon an estimate of the repair expenses likely to be incurred for the warranty period. The warranty period is measured in installation-months for each major product group. The warranty reserve is included in accrued

liabilities in the accompanying consolidated balance sheets. The warranty expense is estimated by applying the actual total repair expenses for each product group in the prior period and determining a rate of repair expense per installation-month. This repair rate is multiplied by the number of installation-months of warranty for each product group to determine the provision for warranty expenses for the period. The Company evaluates its exposure to warranty costs at the end of each period using the estimated expense per installation-month for each major product group, the number of units remaining under warranty and the remaining number of months each unit will be under warranty. The Company has a history of new product introductions and enhancements to existing products, which may result in unforeseen issues that increase its warranty costs. While such expenses have historically been within expectations, the Company cannot guarantee this will continue in the future.

Goodwill Impairment

Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. Goodwill is not amortized but is tested for impairment at least annually. The Company performs its annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of the recorded goodwill is impaired. If an asset is impaired, the difference between the value of the asset reflected in the financial statements and its current fair value is recognized as an expense in the period in which the impairment occurs.

Each period, and for any of its reporting units, the Company can elect to initially perform a qualitative assessment to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the Company believes, as a result of its qualitative assessment, that it is not more likely than not that the fair value of a reporting unit containing goodwill is less than its carrying amount, then the first and second steps of the quantitative goodwill impairment test are unnecessary. If the Company elects to bypass the qualitative assessment option, or if the qualitative assessment was performed and resulted in the Company being unable to conclude that it is not more likely than not that the fair value of a reporting unit containing goodwill is less than its carrying amount, the Company will perform the two-step quantitative goodwill impairment test. The Company performs the first step of the two-step quantitative goodwill impairment test by calculating the fair value of the reporting unit using a discounted cash flow method, and then comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, the Company performs the second step of the quantitative goodwill impairment test to measure the amount of the impairment loss, if any. Management has concluded there was no goodwill impairment for the years ended December 31, 2014, 2013 and 2012.

Stock-Based Compensation

The Company measures compensation cost for stock-based awards at fair value and recognizes compensation over the service period for awards expected to vest. The Company uses the Black-Scholes option-pricing model to value stock options, which requires the input of assumptions, including dividend yield, risk-free interest rate, the estimated length of time employees will retain their vested stock options before exercising them (expected term) and the estimated volatility of the Company's common stock price over the expected term. Furthermore, in calculating compensation expense for these awards, the Company is also required to estimate the extent to which options will be forfeited prior to vesting (forfeitures). Many factors are considered when estimating expected forfeitures, including types of awards, employee class and historical experience. To the extent actual results or updated estimates differ from current estimates, such amounts are recorded as a cumulative adjustment to the previously recorded amounts.

Impact of Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued an amendment to its accounting guidance related to revenue recognition. The amendment was the result of a joint project between the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue and to develop common revenue standards for U.S. GAAP and International Financial Reporting Standards. To meet those objectives, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers: Topic 606* (ASU 2014-09). ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The Company will adopt ASU 2014-09 in reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact of adopting this pronouncement on its consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Foreign Exchange Exposure

The Company conducts a significant portion of its business outside the United States. At present, 64% of its revenues are invoiced, and a significant portion of its operating expenses paid, in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the Company's results of operations and financial condition and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of the Company's operations cannot be accurately predicted due to the Company's constantly changing exposure to various currencies, the fact that all foreign currencies do not react in the same manner in relation to the U.S. dollar and the number of currencies involved, although the Company's most significant exposures are to the euro, Swiss franc, Japanese yen, and Brazilian real. To the extent that the percentage of its non-U.S. dollar revenues derived from international sales increases in the future, the Company's exposure to risks associated with fluctuations in foreign exchange rates may increase. The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options. However, it does not regularly use such instruments, and none were utilized in 2014, 2013 or 2012.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

FARO Technologies, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of FARO Technologies, Inc. (a Florida corporation) and subsidiaries (the Company) as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. 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 (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FARO Technologies Inc. and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on criteria established in the 2013 *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 25, 2015 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Orlando, Florida

February 25, 2015

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	December 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 109,289	\$ 124,630
Short-term investments	64,995	64,994
Accounts receivable, net	83,959	66,309
Inventories, net	59,334	48,940
Deferred income taxes, net	5,936	4,601
Prepaid expenses and other current assets	17,021	14,645
Total current assets	340,534	324,119
Property and equipment:		
Machinery and equipment	45,254	36,924
Furniture and fixtures	6,156	6,888
Leasehold improvements	19,676	11,765
Property and equipment at cost	71,086	55,577
Less: accumulated depreciation and amortization	(41,741)	(39,126)
Property and equipment, net	29,345	16,451
Goodwill	19,205	19,358
Intangible assets, net	9,109	8,112
Service inventory	20,646	19,033
Deferred income taxes, net	6,624	4,423
Total assets	\$ 425,463	\$ 391,496
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 15,437	\$ 14,881
Accrued liabilities	26,127	20,141
Income taxes payable		1,690
Current portion of unearned service revenues	23,572	21,331
Customer deposits	2,046	2,910
Total current liabilities	67,182	60,953
Unearned service revenues - less current portion	13,799	13,414
Deferred income tax liability		1,171
Other long-term liabilities	628	8
Total liabilities	81,609	75,546

Commitments and contingencies - See Note 12

Shareholders' equity:		
Preferred stock - par value \$0.01, 10,000,000 shares authorized; none issued		
Common stock - par value \$.001, 50,000,000 shares authorized; 17,997,665 and 17,868,372 issued; 17,317,430 and 17,188,137 outstanding, respectively	18	18
Additional paid-in capital	200,090	191,874
Retained earnings	159,516	125,867
Accumulated other comprehensive (loss) income	(6,695)	7,266
Common stock in treasury, at cost - 680,235 shares	(9,075)	(9,075)
 Total shareholders' equity	 343,854	 315,950
 Total liabilities and shareholders' equity	 \$ 425,463	 \$ 391,496

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except share and per share data)	Years ended December 31,		
	2014	2013	2012
SALES			
Product	\$ 284,147	\$ 238,841	\$ 227,905
Service	57,679	52,943	45,490
Total sales	341,826	291,784	273,395
COST OF SALES			
Product	114,994	97,630	94,103
Service	37,918	32,261	29,673
Total cost of sales (exclusive of depreciation and amortization, shown separately below)	152,912	129,891	123,776
GROSS PROFIT	188,914	161,893	149,619
OPERATING EXPENSES			
Selling and marketing	80,157	71,689	64,446
General and administrative	36,479	30,600	29,065
Depreciation and amortization	7,428	7,038	6,976
Research and development	27,510	22,412	17,578
Total operating expenses	151,574	131,739	118,065
INCOME FROM OPERATIONS	37,340	30,154	31,554
OTHER (INCOME) EXPENSE			
Interest income	(96)	(74)	(160)
Other (income) expense, net	(94)	1,357	744
Interest expense	8	9	28
INCOME BEFORE INCOME TAX EXPENSE	37,522	28,862	30,942
INCOME TAX EXPENSE	3,873	7,353	7,944
NET INCOME	\$ 33,649	\$ 21,509	\$ 22,998
NET INCOME PER SHARE - BASIC	\$ 1.95	\$ 1.26	\$ 1.36
NET INCOME PER SHARE - DILUTED	\$ 1.93	\$ 1.25	\$ 1.34
Weighted average shares - Basic	17,247,727	17,087,104	16,910,830

Weighted average shares - Diluted	17,416,453	17,241,115	17,129,128
-----------------------------------	------------	------------	------------

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)	Years ended December 31,		
	2014	2013	2012
Net income	\$ 33,649	\$ 21,509	\$ 22,998
Currency translation adjustments, net of tax	(13,961)	925	525
Comprehensive income	\$ 19,688	\$ 22,434	\$ 23,523

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**FOR THE YEARS ENDED DECEMBER 31, 2014, 2013, AND 2012**

Share data)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income		Common Stock in Treasury	Total
	Shares	Amounts			(Loss)			
As of December 31, 2012	16,700,875	\$ 17	\$ 169,780	\$ 81,360	\$ 5,816		\$ (9,075)	\$
Adjustment,				22,998				
Dividend and stock repurchase	14,339		4,018		525			
Share repurchase	258,430	1	6,161					
Share-based compensation expense			1,135					
As of December 31,	16,973,644	\$ 18	\$ 181,094	\$ 104,358	\$ 6,341		\$ (9,075)	\$
Adjustment,				21,509				
Dividend and stock repurchase	17,441		4,367		925			

To the extent that we have a rights plan in effect upon conversion of debentures, and we deliver shares of our common stock upon such conversion, you will receive, in addition to the shares of common stock, the rights under the rights plan. Prior to any conversion, the rights have separated from the common stock, in which case the conversion rate will be determined at the time of separation as if we distributed to all holders of common stock shares of our capital stock, evidences of indebtedness, assets, property, rights or warrants as described in clause (3) above, subject to readjustment in the event of expiration, termination or redemption of such rights.

Adjustments to the applicable conversion rate will be determined to the nearest 1/10,000th of a share, with five one-hundred-thousandths rounded upward (e.g., 0.765 rounded up to 0.7655). We will not be required to make an adjustment in the conversion rate unless the adjustment requires a change of at least 1% in the conversion rate. If we will carry forward any adjustments that are less than

conversion rate and make such carried-forward adjustment on each conversion date, and each settlement period trading day in respect to any conversion date, for any debentures.

Notwithstanding the conversion rate adjustment provision, if any conversion rate adjustment becomes effective, on an ex-dividend date relating to a required conversion rate adjustment occurs, during the period beginning on a conversion date and ending on the close of business on the last trading day of the corresponding observation period, if any, the board of directors will make adjustments to the conversion rate or the amount of cash or number of shares of common stock issuable upon conversion of the debentures, as may be necessary or appropriate to effect the intent of the foregoing conversion rate adjustment to avoid unjust or inequitable results, as determined in good faith by the board so long as such adjustments benefit the holders. Any adjustment made pursuant to this paragraph will apply to the adjustment or other term that would otherwise be applicable.

Recapitalizations, Reclassifications and Changes of Common Stock

In the case of any recapitalization, reclassification or change in our common stock (other than changes resulting from a stock split, subdivision or combination or a change in par value), a consolidation, merger or combination involving us, a sale, lease or other transfer to a third party of the consolidated assets of us or our subsidiaries substantially as an entirety, or any stock exchange, in each case, as a result of which our common stock would be converted into, or exchanged for, or constitute the right to receive, stock, other securities or other property or assets (including cash or any combination thereof), the conversion rate, effective time of the transaction, the right to convert a certain amount of debentures into the kind and amount of shares of common stock or other securities or other property or assets (including cash or any combination thereof) (the reference property) that a holder of one share of common stock immediately prior to such transaction would have received in lieu of account of such transaction. However, at and after the time of the transaction (x) the amount otherwise payable upon conversion of the debentures as set forth under Conversion above will continue to be payable in the form of a certain number of shares of our common stock otherwise deliverable upon conversion of the debentures as set forth under Conversion above will be instead be deliverable in the form of the amount of such reference property set forth above and the VWAP will be calculated based on the value of a unit of such reference property that a holder of one share of our common stock would have received in such transaction.

If the reference property consists solely of cash and the time of the applicable transaction occurs on or before the third business day after the last trading day in the observation period applicable to the conversion of a debenture, then (i) the consideration due upon such conversion shall consist of the lesser amount, per \$1,000 principal amount of such debenture, of (A) the product of (A) the amount of cash paid per share of common stock pursuant to such transaction and (B) the conversion price on the conversion date for such conversion; and (ii) such consideration shall be paid no later than the third business day after the later of such conversion date and such effective date.

If the transaction causes our common stock to be converted, we shall have the right to receive more than a single type of consideration (determined based in part upon any form of stockholder agreement) into which the reference property into which

S-37

Table of Contents

the debentures will be convertible will be deemed to be a weighted average of the types and amounts of consideration actually received by the holders of our common stock, our (or our successor's) right to deliver, in lieu of reference property, cash or a combination of cash and reference property described under "Payment upon Conversion." We warrant that the terms of the indenture not to become a party to any such transaction and the terms are consistent with the foregoing.

Adjustments of Prices

Whenever any provision of the indenture requires us to use the last reported prices or daily VWAP over a span of multiple trading days, we will make appropriate adjustments to account for any stock split or adjustment to the conversion rate that becomes effective on the event requiring an adjustment to the conversion rate within 90 days of the ex-dividend date of the event occurs, at any time during the period from which such prices are to be calculated.

Adjustment to Shares Delivered upon Conversion upon a Make-Whole Fundamental Change

If a fundamental change as defined below, other than a change of control as defined in clause (1) of the definition thereof (determined after giving effect to any exceptions or exclusions in such definition, but without regard to the proviso in clause (2) of the definition of "change of control") (such a transaction constituting a "make-whole fundamental change") occurs prior to November 1, 2017 and a holder elects to convert its debentures in connection with such make-whole fundamental change, we will, under the circumstances, increase the conversion rate for the debentures surrendered for conversion by a number of additional shares of our common stock (the "additional shares"), as described below. The conversion of debentures will be deemed for these purposes to occur in connection with such make-whole fundamental change when notice of conversion of the debentures is received by the conversion agent from, and including, the scheduled trading date following the effective date of the make-whole fundamental change up to, and including, the 35th trading day immediately following the effective date of such make-whole fundamental change (or, if following such make-whole fundamental change which is a fundamental change, the debentures have become due and payable as described under "Events of Default," then the date of business on the business day immediately preceding the date the debentures are due and payable).

Upon surrender of debentures for conversion in connection with such make-whole fundamental change, we will settle our conversion obligation by delivering shares of our common stock, or the cash equivalent thereof, to the holder.

combination of cash and shares of our common stock, under Conversion Rights Payment upon Conversion, increased conversion rate. However, if the consideration for the conversion of the debentures is common stock in such make-whole fundamental change comprised entirely of cash, for any conversion of debentures following the effective date of such make-whole fundamental change, the conversion obligation will be calculated based on the stock price (as such term is defined below) for the transaction and will be deemed to be an amount equal to the applicable conversion rate (including any adjustment as set forth in this section) multiplied by such applicable price. In the event the conversion obligation will be determined and paid in cash on the third business day following the conversion.

The number of additional shares by which the conversion obligation will be increased will be determined by reference to the table below based on the date on which the make-whole fundamental change occurs or becomes effective (the effective date) and the stock price paid per share of our common stock in the make-whole fundamental change. If the holders of our common stock receive only cash in the make-whole fundamental change, the stock price shall be the cash amount paid per share of our common stock; otherwise, the stock price shall be the average of the last reported closing bid price of our common stock over the five trading-day period ending on the trading day preceding the effective date of the make-whole fundamental change.

The stock prices set forth in the column headings of the table below will be adjusted as of any date on which the conversion rate of the debentures is otherwise adjusted. The adjusted stock price will equal the stock prices applicable immediately prior to the adjustment, multiplied by a fraction, the numerator of which is the conversion rate immediately prior to the adjustment and the denominator of which is the stock price adjustment and the denominator of which is the conversion rate as so adjusted. The number of additional shares will be adjusted in the same manner as the conversion rate is adjusted set forth under Conversion Rate Adjustments.

S-38

Table of Contents

The following table sets forth the stock price and the number of additional shares to be received per \$1,000 principal amount of debentures:

Effective Date	Stock Price
-----------------------	--------------------

The exact stock prices and effective dates may not be shown in the table above, in which case:

If the stock price is between two stock price amounts in the table or the effective date is between two effective dates in the table, the number of additional shares will be determined by straight-line interpolation between the number of additional shares set forth for the higher and lower stock price and the earlier and later effective dates, as applicable, for a 365- or 366-day year, as applicable.

If the stock price is greater than \$ [redacted] per share (subject to adjustment), no additional shares will be added to the conversion rate.

If the stock price is less than \$ [redacted] per share (subject to adjustment), no additional shares will be added to the conversion rate.

Notwithstanding the foregoing, in no event will the total number of shares of our common stock issuable upon conversion exceed [redacted] per \$1,000 principal amount of debentures, subject to adjustments in the same manner as the conversion rate set forth under [redacted] Conversion Rate Adjustments.

Our obligation to satisfy the additional shares requirement will not be considered a penalty, in which case the enforceability of the requirement would be subject to general principles of reasonableness and equitable remedies.

Holders May Require Us To Repurchase Their Debentures Upon a Fundamental Change

If a fundamental change, as described below, occurs, we will have the right, at its option, subject to the terms and conditions of the indenture, to require us to repurchase all or any portion of the holder's debentures in integral multiples of \$1,000 principal amount, at a price equal to 100% of the principal amount of the debentures to be repurchased, plus, except

described below, any accrued and unpaid interest (including contingent interest and additional interest, if any) to, but excluding, the fundamental change repurchase date, as described below.

However, if the fundamental change repurchase date is the record date for the payment of an installment of interest due before the related interest payment date, then the payment of interest becoming due on that interest payment date will be payable, on that interest payment date, to the holder of record as of the close of business on the record date, and the repurchase price will not include any accrued and unpaid interest.

We must repurchase the debentures on a date of our choice which we refer to as the fundamental change repurchase date. However, the fundamental change repurchase date must be no later than 35 days, and no earlier than 20 business days after the date we have mailed a notice of the fundamental change repurchase as described below.

Within 15 business days after the occurrence of a fundamental change, we must mail to all holders of debentures at the addresses shown on the register of the registrar, and to all owners as required by applicable law, a notice regarding the fundamental change. We must also publish the notice in a release disseminated through Dow Jones & Company, Bloomberg Business News or other similarly broad public medium that is customary for such press releases. The notice shall state, among other things:

the events causing the fundamental change;

S-39

Table of Contents

the date of the fundamental change;

the fundamental change repurchase date;

the last date on which a holder may exercise the repurchase right;

the fundamental change repurchase price;

the names and addresses of the paying agent and the conversion agent;

the procedures that holders must follow to exercise the repurchase right;

the conversion rate and any adjustments to the conversion rate that will result from the fundamental change; and

that debentures with respect to which a holder has received a fundamental change repurchase notice may be converted to debentures otherwise convertible, only if the holder withdraws the fundamental change repurchase notice in accordance with the terms of the indenture.

To exercise the repurchase right, a holder must deliver a fundamental change repurchase notice to the paying agent no later than the close of business on the business day immediately preceding the fundamental change repurchase date. The notice must state:

the certificate numbers of the debentures that the holder will deliver for repurchase, if they are in certificated form;

the principal amount of the debentures to be repurchased, which must be an integral multiple of \$1,000; and

that the debentures are to be repurchased by us pursuant to the fundamental change provisions of the indenture.

A holder may withdraw any fundamental change repurchase notice by delivering to the paying agent a written notice of withdrawal prior to the close of business on the business day immediately preceding the fundamental change repurchase date. The notice of withdrawal must state:

the name of the holder;

a statement that the holder is withdrawing its election to exercise the repurchase right; and
require us to repurchase its debentures;

the certificate numbers of the debentures being withdrawn, if they are in certificated form;

the principal amount of debentures being withdrawn, which must be an integral multiple of \$1,000; and

the principal amount, if any, of the debentures that are not subject to the fundamental change repurchase notice, which must be an integral multiple of \$1,000.

If the debentures are not in certificated form, the above requirements must comply with appropriate DTC procedures.

To receive payment of the fundamental change repurchase price for a debenture for which the holder has delivered and withdrawn a fundamental change repurchase notice, the holder must deliver the debenture, together with necessary endorsements, to the paying agent at any time after delivery of the fundamental change repurchase notice. We will pay the fundamental change repurchase price for the debenture on the later of the fundamental change repurchase date and the time of delivery of the debenture together with necessary endorsements.

For a discussion of certain tax consequences to a holder upon exercise of the repurchase right, see "Material U.S. Federal Income Tax Considerations."

If the paying agent holds on the fundamental change repurchase date money sufficient to pay the fundamental change repurchase price due on a debenture in accordance with the terms of the indenture, then, on and after the fundamental change repurchase date, the debenture will cease to be outstanding and interest on such debenture will cease to accrue, whether or not the holder delivers the debenture to the paying agent. Thereafter, the rights of the holder terminate, other than the right to receive the fundamental change repurchase price upon delivery of the debenture.

S-40

Table of Contents

A fundamental change will be deemed to have occurred upon a change of control of the Company or (2) upon a termination of trading.

A change of control will be deemed to have occurred after the original issuance of the debentures when any of the following has occurred:

(1) a person or group within the meaning of Section 304 of the Exchange Act other than the Company, our subsidiaries, or our employee benefit plans, files a Schedule TO or any schedule or report under the Exchange Act disclosing that such person or group has become the direct or indirect beneficial owner, as defined in Rule 13d-3 under the Exchange Act, of our common stock representing more than 50% of the voting power of our capital stock; or

(2) consummation of (A) any recapitalization, reclassification, or change of our common stock (other than changes resulting from a subdivision or combination or a change in par value) and the conversion of which our common stock would be converted into, or the exercise of, or would constitute solely the right to receive, stock, securities or other property or assets or (B) any share exchange, consolidation or merger of us pursuant to which our common stock will be converted into cash, securities or other property in any sale, lease or other transfer in one transaction or a series of transactions of the consolidated assets of us and our subsidiaries substantially as an entirety to any person or group within the meaning of Section 13(d) of the Exchange Act, other than our subsidiaries; *provided, however*, that any such share exchange, consolidation or merger will not be a change of control if the holders of our common equity immediately prior to such transaction collectively own, directly or indirectly, more than 50% of the classes of common equity of the continuing or surviving corporation or transferee or the parent thereof immediately prior to such transaction in substantially the same proportion as their ownership immediately prior to such share exchange, consolidation or merger.

However, a change of control will not be deemed to have occurred as a result of clause (2) above, and any transaction or event described in clause (2) above will not constitute a marketable securities fundamental change, in each case, if at least 90% of the consideration received or to be received by our common stockholders, excluding cash payments for fractional shares and cash payments in respect of statutory dissenters' rights, in connection with such transaction or event consists of shares of common stock (or depositary receipts or shares evidencing

common stock) traded on the New York Stock Exchange, the NASDAQ Global Select Market or the NASDAQ Global Market (or their respective successors) or which will be so traded or quoted when issued or exchanged in connection with such transaction or event (these securities being referred to as "convertible securities") and as a result of such transaction or event, our debentures become convertible into such publicly traded securities, excluding cash payments for fractional shares and cash payments in respect of statutory dissenters' rights (subject to the provisions set forth above under "Conversion Rights Upon Conversion"), as described above under "Recapitalizations, Reclassifications and Changes of Our Common Stock."

A termination of trading will be deemed to have occurred at the time as our common stock (or other common stock or convertible securities) ceases to be listed or quoted on the New York Stock Exchange, the NASDAQ Global Select Market or the NASDAQ Global Market (or their respective successors) for a period of 30 consecutive scheduled trading days.

The fundamental change provisions could discourage an acquirer of us. The fundamental change feature, however, is the result of management's knowledge of any specific person or entity obtaining control of us by any means or part of a plan by which management to adopt a series of anti-takeover provisions. The fundamental change conversion feature is a result of negotiations between us and the underwriters.

The term fundamental change is limited to specified transactions and may not include other events that might adversely affect our financial condition. In addition, the fundamental change provisions may not protect holders in the event of a highly leveraged transaction, reorganization, merger or similar transaction involving us. We could, in the future, enter into transactions, including recapitalizations, that would not constitute a fundamental change but would increase the amount of our indebtedness, including other secured indebtedness, outstanding or otherwise, which could adversely affect holders. Neither we nor our subsidiaries are prohibited from incurring debt, including other

Table of Contents

unsubordinated indebtedness or secured indebtedness, indenture. The incurrence of significant amounts of debt could adversely affect our ability to service our debt, including the debentures.

The definition of fundamental change includes a phrase the sale, lease or other transfer of the consolidated assets of our subsidiaries substantially as an entirety. There is no established definition of the phrase substantially as an entirety under applicable law. Accordingly, the ability of a holder of the debentures to require us to cause us to repurchase its debt as a result of the conveyance, transfer, sale, lease or other disposition of less than all of our assets may be uncertain.

If a fundamental change were to occur, we may not have sufficient funds to pay the principal and accrued and unpaid interest on the debentures tendered for repurchase. Our ability to pay these amounts may be limited by restrictions on our ability to use cash and funds through dividends from our subsidiaries, the terms of our then existing borrowing arrangements or otherwise. See **Factors – Risks Related to the Debentures**. We may not have the ability to raise the funds necessary to settle conversion of the debentures if we irrevocably commit to settle in cash or shares (instead of solely in shares) or to repurchase the debentures as required or to repay the debentures upon maturity or early redemption or acceleration. If we fail to repurchase the debentures within the time following a fundamental change, we will be in default under the indenture. In addition, we have, and may in the future have, incurred indebtedness with similar fundamental change provisions that are permitting the holders thereof to require us to repurchase the debentures upon the occurrence of similar events or on specific dates.

Consolidation, Merger and Sale of Assets

The indenture provides that we may not consolidate with or into any other person or sell, lease or otherwise dispose of the consolidated assets of us and our subsidiaries substantially as an entirety to another person, unless:

the resulting, surviving or transferee person (if not the Company) (the successor company) will be a corporation organized and existing under the laws of the United States of America, any state thereof or the District of Columbia; the successor company (if not us) will expressly assume the obligations under the supplemental indenture, executed and delivered to us in form reasonably satisfactory to the trustee, all of our obligations under the debentures and the indenture;

immediately after giving effect to such transaction, or event of default under the indenture shall have or be continuing; and

we shall have delivered to the trustee an officers' and an opinion of counsel, each stating that the consolidation, merger or transfer and such supplemental indentures comply with the indenture.

The successor company will succeed to, and be substituted for, us and may exercise every right and power of us under the indenture but in the case of a conveyance, transfer or lease, we will be released from the obligation to pay the principal of and interest on the debentures.

Although these types of transactions are permitted under the indenture, certain of the foregoing transactions could constitute a fundamental change (as defined above) permitting each holder to require us to repurchase the debentures of such holder under the terms above.

SEC and Other Reports

We shall deliver to the trustee copies of our annual reports and the information, documents and other reports (or copies or portions of any of the foregoing as the SEC may by rule or regulations prescribe) which we are required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act within 15 days after we are required to file such annual and quarterly reports, information, documents and other reports with the SEC. Documents that are filed by us with the SEC via its EDGAR system (or any successor thereto) and are publicly available shall be deemed to be delivered to the trustee as of the time such documents are so filed.

Table of Contents

Events of Default

The following will constitute events of defaults under the indenture, subject to any additional limitations, qualifications and cure periods included in the indenture:

we fail to pay the principal of any debenture when it becomes payable at its stated maturity, upon any repurchase or redemption, or otherwise;

we fail to pay any interest on the debentures when it becomes due, and such failure continues for a period of 30 days past the applicable due date;

we fail to satisfy our conversion obligation upon exercise of a holder's conversion right and such failure continues for a period of five calendar days following the scheduled settlement date for such conversion;

we fail to comply with our notice obligations under the indenture, May Require Us to Repurchase Their Debentures Upon Fundamental Change, on a timely basis;

we fail to comply with our obligations under the indenture, Merger and Sale of Assets;

we fail to perform or observe any of our other covenants or warranties in the indenture or in the debentures for which we are liable after written notice to us from the trustee or to us as trustee from the holders of at least 25% in principal amount of the outstanding debentures;

default by the Company or any subsidiary in the payment of principal or interest on any mortgage, agreement or other instrument under which there may be outstanding, or to which there may be secured or evidenced, any indebtedness for money borrowed in excess of \$10.0 million (or its functional currency equivalent) in the aggregate of the Company and any subsidiary, whether such indebtedness now exists or hereafter be created; and

certain events of bankruptcy, insolvency and reorganization involving us or any of our significant subsidiaries.

The foregoing will constitute events of default whatever the reason for such event of default and whether it is voluntary or involuntary or is effected by operation of law or pursuant to a judgment, decree or order of any court or any order, rule or

regulation of any administrative or governmental body

If a default under the indenture occurs and is continuing or is known to the trustee, the trustee must mail to each holder of the debentures notice of the default within 15 days after it becomes known to the trustee. The trustee may withhold notice to the holders of the debentures if it believes doing so is in the interests of the holders of the debentures, except defaults in non-payment of principal or interest on the debentures when due or in the payment of any conversion or redemption or repurchase obligation.

If an event of default (other than an event of default relating to certain events of bankruptcy, insolvency or reorganization) occurs and continues, the trustee or the holders of at least 25% of the principal amount of the outstanding debentures may declare the principal and accrued and unpaid interest on the outstanding debentures to be immediately due and payable. In case of an event of bankruptcy, insolvency or reorganization as defined above, the principal and accrued and unpaid interest on the outstanding debentures will automatically become immediately due and payable. Under certain circumstances, the holders of a majority of the aggregate principal amount of the outstanding debentures may rescind such acceleration with respect to the debentures discussed below, waive these past defaults.

Notwithstanding the foregoing, the indenture for the debentures provides that, to the extent elected by the Company, the sole remedy for an event of default relating to the failure by the Company to deliver to the trustee any documents or reports that we are required to file with the SEC pursuant to Section 15(d) of the Exchange Act will for the first 365 days after the occurrence of such an event of default consist exclusively of the right to receive additional interest on the debentures equal to 0.50% per annum on the principal amount of the debentures. If we do not so elect, such additional interest will be payable in the same manner and on the same dates as the stated interest payable on the debentures. After the 365th day after such event of default (or such event of default relating to the reporting obligations is waived on or prior to such 365th day), the debentures will be subject to acceleration as provided above. The provisions of the indenture described in this paragraph will not affect the rights of the holders of debentures in the event of the occurrence of an event of default. If we do

S-43

Table of Contents

not elect to pay the additional interest upon an event of default, in accordance with this paragraph, the debentures will be subject to acceleration as provided above.

In order to elect to pay the additional interest as the sole remedy during the first 365 days after the occurrence of an event of default relating to the failure to comply with the reporting obligations, in accordance with the immediately preceding paragraph, we will notify all holders of debentures and the trustee and pay the interest on such election. Upon our failure to timely give such notice, the additional interest, the debentures will be subject to acceleration as provided above.

If any portion of the amount payable on the debentures upon acceleration is considered by a court to be unearned income (through the allocation of the value of the instrument to the holder of an embedded warrant or otherwise), the court could disallow the recovery of any such portion.

The holders of a majority in aggregate principal amount of the outstanding debentures will have the right to direct the method and place of any proceedings for any remedy available to the trustee or of exercising any trust or power conferred upon the trustee, subject to limitations specified in the indenture. The trustee, however, may refuse to follow any direction that is contrary to law or the indenture or that the trustee determines to be prejudicial to the rights of any other holder of the debentures that would involve the trustee in personal liability. Before instituting any action under the indenture, the trustee will be entitled to an indemnification satisfactory to it in its sole discretion against all losses and expenses caused by taking or not taking the action.

The holders of a majority in aggregate principal amount of the outstanding debentures may waive any past defaults under the indenture, except a default due to the non-payment of principal or interest, a failure to convert any debentures, a default under our failure to repurchase any debentures when required by the terms of the indenture or a default in respect of a covenant that cannot be amended without the consent of the holder affected.

No holder of the debentures may pursue any remedy under the indenture, except in the case of a default due to the non-payment of principal or interest on the debentures or a default in respect of payment of the consideration due upon conversion of a debenture, unless:

the holder has given the trustee written notice of a default

the holders of at least 25% in principal amount of the debentures make a written request to the trustee to remedy;

the holder or holders offer and, if requested, provide indemnification reasonably satisfactory to the trustee for all related losses or expenses; and

the trustee fails to comply with the request within 60 days of receipt of the request and offer of indemnity, and do not receive, during those 60 days, from holders of a majority of the aggregate principal amount of the debentures then outstanding a direction that is inconsistent with the request.

The indenture will require us every year to deliver to the trustee a statement as to performance of our obligations under the indenture and as to the existence of any defaults.

A default in the payment of the debentures, or a default in respect to the debentures that causes them to be accelerated, will give rise to a cross-default under our existing or future debt arrangements.

Modification and Amendment

Except as provided below, the consent of the holders of a majority in aggregate principal amount of the outstanding debentures (voting as a single class) is required to modify or amend the indenture. However, a modification or amendment requires the consent of the holder of each outstanding debenture affected by such modification or amendment if it would:

reduce the principal amount of or change the stated interest rate of any debenture;

reduce the rate or extend the time for payment of interest on any debenture;

S-44

Table of Contents

reduce any amount payable upon repurchase or redemptions of any debenture or change the time at which or circumstances under which the debentures may or shall be repurchased;

impair the right of a holder to institute suit for payment of any debenture;

change the currency in which any debenture is payable;

impair the right of a holder to convert any debenture into the number of shares of common stock or any other securities receivable upon conversion;

modify the redemption provisions of the indenture in a manner adverse to the holders of the debentures;

reduce the quorum or voting requirements under the indenture (including reducing the percentage in aggregate principal amount of outstanding debentures whose holders must consent to a waiver of compliance with any provision of the indenture or the debentures or a waiver of any default or event of default);

change our obligation to maintain an office or agencies in the places and for the purposes specified in the indenture;

subject to specified exceptions, amend or modify certain provisions of the indenture relating to amendment or modification or waiver of provisions of the indenture;

change the ranking of the debentures; or

reduce the percentage of debentures required for consent to any amendment or modification of the indenture.

The Company and the trustee may modify certain provisions of the indenture without the consent of the holders of the debentures, including to:

add guarantees with respect to the debentures or securities other than debentures;

evidence the assumption of our obligations by a successor person under the provisions of the indenture relating to consolidations, mergers and sales of assets;

surrender any of the Company's rights or powers under the indenture, including, but not limited to, conversion

options;

add covenants or events of default for the benefit of debentures;

cure any ambiguity or correct any inconsistency in indenture;

establish the forms or terms of the debentures;

evidence the acceptance of appointment by a successor;

provide for uncertificated debentures in addition to certificated debentures; *provided, however*, that uncertificated debentures are issued in registered form for purposes of Section 163(f) of the Internal Revenue Code of 1986, as amended (the Code), or in a manner such that the uncertificated debentures are described in Section 163(f) of the Code;

conform, as necessary, the indenture and the form of the debentures, to the Description of Debentures in this prospectus supplement; and

make other changes to the indenture or forms or terms of the debentures, provided no such change individually or aggregate with all other such changes has or will have a material adverse effect on the interests of the holders of the debentures.

Satisfaction and Discharge

We may satisfy and discharge our obligations under the indenture by delivering to the registrar for cancellation all outstanding debentures or by depositing with the trustee or delivering to the holders, as applicable, after the debentures have become payable, whether at stated maturity, or any purchase date, conversion or otherwise, cash and/or (in the case of conversion) applicable) shares of common stock sufficient to pay a

S-45

Table of Contents

outstanding debentures and paying all other sums payable under the indenture by us. Such discharge is subject to terms and conditions set forth in the indenture.

Calculations in Respect of Debentures

Except as otherwise provided above, we will be responsible for making all calculations called for under the debentures. Such calculations include, but are not limited to, determination of the daily VWAP of our common stock, accrued interest payable on the debentures and the conversion rate of the debentures. We will make all these calculations in good faith and, absent material error, our calculations will be final and binding on holders of the debentures. We will provide a schedule of our calculations to the trustee and the conversion agent, and each of the trustee and the conversion agent is entitled to rely conclusively upon the accuracy of our calculations without independent verification. We will forward our calculations to any holder of debentures upon the request of that holder.

Trustee

The Bank of New York Mellon is the trustee, registrar, paying agent and conversion agent. The Bank of New York Mellon, in each of its capacities, including without limitation as trustee, registrar, paying agent, conversion agent and bid solicitor, assumes no responsibility for the accuracy or completeness of the information concerning us or our affiliates or any other party contained in this prospectus supplement or the related documents or for any failure by us or any other party to disclose events that may have occurred and may affect the significance or accuracy of such information.

We maintain banking relationships in the ordinary course of business with the trustee and its affiliates. The trustee and its affiliates is also a lender under certain of our credit facilities.

Notices

Except as otherwise described herein, notices to registered holders of the debentures will be given by mail to the addresses appearing in the security register. Notices will be deemed to have been given on the date of mailing.

Governing Law

The indenture provides that it and the debentures will be governed by, and construed in accordance with, the internal laws of the State of New York.

Book-Entry, Delivery and Form

We have obtained the information in this section concerning the book-entry system and procedures from sources we believe to be reliable, but we take no responsibility for the accuracy of this information.

The debentures will be issued as fully-registered global debentures which will be deposited with, or on behalf of, The Depository Trust Company, New York, New York, which we refer to as DTC, and registered, at the request of DTC, in the name of CDO. Beneficial interests in the global debentures will be represented through book-entry accounts of financial institutions acting on behalf of beneficial owners as direct or indirect participants with DTC.

Debentures represented by a global debenture can be exchanged for definitive debentures, in registered form only if:

- DTC notifies us that it is unwilling or unable to continue as the depository for that global debenture and we do not appoint a successor depository within 90 days after receiving notice;

- at any time DTC ceases to be a clearing agency registered under the Securities Exchange Act of 1934 and we do not appoint a successor depository within 90 days after receiving notice that DTC has ceased to be registered as a clearing agency;

- we in our sole discretion determine that that global debenture will be exchangeable for definitive debentures, in registered form and notify the trustee of our decision; or

S-46

Table of Contents

an event of default with respect to the debentures represented by that global debenture, has occurred and is continuing.

A global debenture that can be exchanged as described in the preceding sentence will be exchanged for definitive debentures issued in denominations of \$1,000 and integral multiples of \$1,000 in excess thereof in registered form for the same amount. The definitive debentures will be registered in the name of the owners of the beneficial interests in the global debenture directed by DTC.

We will make principal and interest payments on all debentures represented by a global debenture to the paying agent or its nominee. We will make payment to DTC or its nominee, as the registered owner and the sole holder of the debentures represented by the global debenture, for all purposes under the indenture. Accordingly, we, the trustee and any paying agent will not have any responsibility or liability for:

any aspect of DTC's records relating to, or payment made on behalf of, beneficial ownership interests in a debenture represented by a global debenture;

any other aspect of the relationship between DTC and its participants or the relationship between those participants and the owners of beneficial interests in a global debenture through those participants; or

the maintenance, supervision or review of any of DTC's records relating to those beneficial ownership interests.

DTC has advised us that its current practice is to credit payments to participants' accounts on each payment date with payment amounts proportionate to their respective beneficial interests in the principal amount of the global debenture as shown on DTC's records, upon DTC's receipt of funds and corresponding information. The underwriters will initially designate the accounts to be credited. Payments by participants to owners of beneficial interests in a global debenture will be governed by standard instructions and customary practices, as is the case with debentures held for customer accounts registered in street name, the sole responsibility of those participants. Book-entry debentures may be more difficult to pledge because of the lack of physical debenture.

So long as DTC or its nominee is the registered owner and holder of the debenture, DTC or its nominee, will be considered the registered owner and holder of the debentures represented by that global

for all purposes of the indenture. Owners of beneficial interests in the debentures will not be entitled to have the debentures registered in their names, will not receive or be entitled to the physical delivery of the debentures in definitive form and will not be considered owners or holders of debentures under the terms of the indenture. Accordingly, each person owning a beneficial interest in a global debenture must rely on the procedures of DTC, if that person is not a DTC participant, on the procedures of the DTC participant through which that person owns its interest in the debenture, for any rights of a holder of debentures. The laws of some jurisdictions require that certain purchasers of securities receive the physical delivery of the securities in certificated form. These laws may impair the ability to transfer beneficial interests in the debenture. Beneficial owners may experience delays in receiving distributions on their debentures since distributions will be made to DTC and must then be transferred through DTC to intermediaries to the beneficial owner's account.

We understand that, under existing industry practices, DTC may request holders to take any action, or if an owner of a beneficial interest in a global debenture desires to take any action, DTC, if the holder is entitled to take under the indenture, then DTC may request that the participants holding the relevant beneficial interests authorize to take that action and those participants would authorize the beneficial owners owning through such participants to take that action or would otherwise act upon the instructions of DTC as beneficial owners owning through them.

Beneficial interests in a global debenture will be shown on the books of DTC and transfers of those ownership interests will be effected through DTC through, records maintained by DTC and its participants in the global debenture. The conveyance of notices and other communications by DTC to its participants and by its participants to owners of beneficial interests in the debentures will be governed by arrangements among them, subject to any applicable regulatory requirements in effect.

DTC has advised us that it is a limited-purpose trust company organized under the New York banking law, a banking organization within the meaning of the New York Banking Law, a member of the Federal Reserve

Table of Contents

System, a clearing corporation within the meaning of the New York Uniform Commercial Code and a clearing agent under the Securities Exchange Act of 1934.

DTC holds the securities of its participants and facilitates clearance and settlement of securities transactions among participants in such securities through electronic book-entry changes in accounts of its participants. The electronic book-entry system eliminates the need for physical certificates. DTC's participants include securities brokers and dealers, including underwriters, banks, trust companies, clearing corporations and certain other organizations, some of which, and/or their representatives, own DTC. Banks, brokers, dealers, trust companies and others that clear through or maintain a clearing relationship with a participant, either directly or indirectly, have access to DTC's book-entry system. The rules of DTC and its participants are on file with the Securities and Exchange Commission.

DTC has advised us that the above information with respect to DTC has been provided to its participants and other members of the financial community for informational purposes only and is not intended to serve as a representation, warranty or other modification of any kind.

Global Clearance and Settlement Procedures

Initial settlement for the debentures will be made in immediately available funds. Secondary market trading between DTC's participants will occur in the ordinary way in accordance with DTC rules and will be settled in immediately available funds through DTC's Same-Day Funds Settlement System.

Table of Contents

Material U.S. Federal Income Tax Considerations

This section is a discussion of the material U.S. federal income tax considerations relating to the purchase, ownership and disposition of the debentures and, to the extent set forth below, any common stock that may be issued upon conversion. This summary does not provide a complete analysis of all potential tax considerations. The information provided below is based on existing authorities and interpretations which are subject to change or differing interpretations by the Internal Revenue Service (the "IRS") with retroactive effect. There can be no assurances that the IRS will not challenge the tax consequences described herein, and we have not obtained, nor do we intend to obtain, a ruling from the IRS with respect to the U.S. federal income tax consequences of owning or disposing of the debentures or common stock. This summary generally applies only to investors that purchase the debentures in the initial offering at their issue price and hold the debentures and common stock as capital assets (i.e., property held for investment). The summary does not discuss the effect of the U.S. federal estate and gift tax laws or the effect of any applicable foreign, state or local laws. In addition, this discussion does not address tax considerations applicable to an investor's particular circumstances or to investors that are subject to special tax rules, including, without limitation,

banks, insurance companies or other financial institutions;

controlled foreign corporations, passive foreign investment companies, regulated investment companies and real estate investment trusts and shareholders of such entities that are not holders of debentures;

persons subject to the alternative minimum tax;

entities that are tax-exempt for U.S. federal income tax purposes and retirement plans, individual retirement accounts and tax-deferred accounts;

dealers and traders in securities or currencies;

S corporations, partnerships and other pass-through entities, including entities and arrangements classified as partnerships for U.S. federal tax income purposes, and beneficial owners of such entities that hold the debentures;

certain former citizens or long-term residents of the United States;

U.S. Holders, as defined below, whose functional currency is not the U.S. dollar; and

persons holding debentures as part of a conversion, constructive sale, wash sale or other integrated transaction, hedge, straddle or synthetic security.

As used herein, the term "U.S. Holder" means a beneficial owner of debentures or, to the extent set forth below, common stock, for U.S. federal income tax purposes is:

an individual who is a citizen or resident of the United States;

a corporation, or an entity treated as a corporation for U.S. federal income tax purposes, created or organized under the laws of the United States or any political subdivision thereof,

an estate the income of which is subject to U.S. federal income taxation regardless of its source, or

a trust if it is subject to the primary supervision of a United States court and the control of one or more United States persons (as defined for U.S. federal tax purposes) or has a valid election in effect under applicable U.S. Treasury regulations to be treated as a United States person.

A "non-U.S. Holder" is a beneficial owner of debentures or, to the extent set forth below, shares of common stock that is not a U.S. Holder. If a partnership (including for this purpose a limited liability partnership, domestic or foreign, treated as a partnership for U.S. federal income tax purposes) is a beneficial owner of a debenture or common stock acquired upon conversion of a debenture, the tax treatment of a partner in the partnership will depend upon the tax status of the partner and the activities of the partnership. If you are a holder of a debenture or common stock acquired upon conversion of a debenture that is a partnership, and partners in such partnership, you should consult their own tax

Table of Contents

advisors about the U.S. federal income tax consequences of purchasing, owning and disposing of the debentures and the common stock into which the debentures may be converted.

You are urged to consult your own tax advisor with respect to the application of the U.S. federal income tax laws to your particular situation, as well as any tax consequences of ownership, conversion and disposition of the debentures and common stock received on conversion of the debentures arising under the U.S. federal estate or gift tax rules, the laws of any state, local, non-U.S. or other taxing jurisdiction or under any applicable tax treaty.

Classification of the Debentures

Under the indenture governing the debentures, we have agreed, and by acceptance of a beneficial interest in a debenture, the holder of a debenture will be deemed to have agreed, that the debentures as indebtedness for U.S. federal income tax purposes are that is subject to the Treasury Regulations governing contingent payment debt instruments (the "contingent payment debt regulations"). Pursuant to the terms of the indenture, we and the holder agree (in the absence of an administrative determination or a judicial ruling to the contrary) to be bound by our application of the contingent payment debt regulations to the debentures, including our determination of the projected payment stream (as described below) and the comparable yield (as described below), which is the rate at which interest is deemed to accrue on the debentures for U.S. federal income tax purposes.

No statutory or judicial authority directly addresses all aspects of the treatment of the debentures or instruments similar to the debentures for U.S. federal income tax purposes. The IRS has issued a ruling addressing the U.S. federal income tax classification and treatment of instruments similar, although not identical, to the debentures, and concluded that the instruments addressed in that published guidance were subject to the contingent payment debt regulations. In addition, the IRS has addressed various aspects of the potential applicability of certain provisions of the Code to the instruments addressed in the published guidance. However, the ruling is limited to its facts, and the proper application of the contingent payment debt regulations to the debentures is uncertain in a number of respects. Therefore, no assurance can be given that the IRS will not determine that the debentures should be treated differently. A different treatment of the debentures upon a successful challenge by the IRS or a change in law could significantly affect the timing and character of income, gain or loss with respect to an investment in the debentures. Specifically, a holder may

required to accrue interest at a lower rate, and might result in capital gain rather than ordinary income upon a taxable event of the debentures. Accordingly, you should consult your tax advisor regarding the U.S. federal income tax consequences of your investment in the debentures and the applicability of applicable legislation (and the prospects of applicable future legislation) as well as with respect to any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction. We cannot predict the possible effects of changes in such tax laws.

The remainder of this discussion assumes that the debentures will be treated as indebtedness subject to the contingent payment debt regulations as discussed above.

U.S. Holders

Interest Accruals on the Debentures

Under the contingent payment debt regulations, a U.S. Holder, regardless of its method of accounting for U.S. federal income tax purposes, will be required to accrue interest income on the debentures on a constant yield basis at an assumed yield (the "comparable yield") that was determined at the time of the issue of the debentures. Accordingly, U.S. Holders generally will be required to include interest in income, in each year prior to maturity, in excess of the fixed interest payments and contingent interest payments, if any, on the debentures. The comparable yield for the debentures is based on the yield at which, at the time of issue, we could have issued a non-convertible fixed-rate instrument with no contingent payments, but with terms and conditions otherwise similar to those of the debentures. We determined the comparable yield to be 3.5%, compounded semi-annually.

Solely for purposes of determining the amount of interest to accrue, we assume that a U.S. Holder is required to accrue, we

S-50

Table of Contents

were required to construct a projected payment schedule of the debentures representing a series of payments the and timing of which produce a yield to maturity on the equal to the comparable yield. The projected payment includes the amount of each noncontingent payment an estimate for each contingent payment, taking into account conversion feature. Holders that wish to obtain the projected payment schedule may do so by submitting a written request such information to Jefferies Group, Inc., Investor Relations, 11 Madison Avenue, New York, New York 10022.

The comparable yield and projected payment schedule provided for any purpose other than the determination of your interest accruals and adjustments thereof in respect of the debentures for U.S. federal income tax purposes does not constitute a projection or representation by us of the actual amount that will be paid on the debentures or the value at any time of the common stock into which the debentures may be converted.

The precise manner of determining the comparable yield is not entirely clear. It is possible that the IRS could challenge our determination of the comparable yield and projected payment schedule. The yield, if redetermined as a result of such a challenge, could be greater or less than the comparable yield provided by us, and the projected payment schedule could materially from the projected payment schedule we have provided. In such case, the taxable income of a holder arising from ownership, sale, exchange, conversion, redemption or other disposition of a debenture could be increased or decreased.

Based on the comparable yield and the issue price of the debentures, a U.S. Holder (regardless of its accounting treatment) will be required to accrue interest as the sum of the daily portions of interest on the debentures for each day in the taxable period in which the U.S. Holder holds the debenture, adjusted upward or downward to reflect the difference, if any, between the actual and projected amount of any contingent payments on the debentures (as set forth below). The issue price of the debentures is the price at which a substantial amount of the debentures is sold to the public, excluding sales to bond houses, brokers or similar entities or organizations acting in the capacity as underwriters, agents or wholesalers (the "issue price").

The daily portions of interest in respect of a debenture are determined by allocating to each day in an accrual period an equal ratable portion of interest on the debenture that accrues over the accrual period. The amount of interest on a debenture that accrues in an accrual period is the product of the comparable yield

debenture (adjusted to reflect the length of the accrual period) multiplied by the adjusted issue price of the debenture as of the beginning of the accrual period. The adjusted issue price of a debenture as of the beginning of any accrual period is (x) the sum of the issue price of the debenture and any interest previously accrued thereon (disregarding any positive or negative adjustments described above) minus (y) the amount of any noncontingent payments made on the debenture and the amount of any projected payments on the debenture during the previous accrual periods.

Adjustments to Interest Accruals on the Debenture

In addition to the interest accrual discussed above, a U.S. Holder will be required to recognize interest income equal to the amount of the excess of actual payments over projected payments (a positive adjustment) in respect of a debenture for a taxable year. For this purpose, the payments in a taxable year include the fair market value of property (including common stock received in connection with a conversion to the extent treated as issued on the projected interest schedule) received in that year and also should include any additional interest received in that year. If a U.S. Holder receives actual payments that are less than the projected payments in respect of a debenture for a taxable year, the U.S. Holder will incur a negative adjustment equal to the amount of the difference. This negative adjustment will (i) first reduce the amount of interest in respect of the debenture that a U.S. Holder would otherwise be required to include in income in that taxable year and (ii) to the extent of any excess, give rise to an ordinary loss equal to that portion of such excess that does not exceed the excess of (A) the amount of all previous interest included in income on the debenture over (B) the total amount of the U.S. Holder's previous negative adjustments treated as ordinary loss on the debenture in prior taxable years. Any negative adjustment in excess of the amounts described in (i) and (ii) will be carried forward to reduce future interest income in respect of the debentures or, if there is no future interest income in respect of the debentures, to reduce the negative adjustment carryforward on the debenture in the taxable year in which the debenture is sold, converted, exchanged, redeemed or retired, to reduce the amount realized on the sale, conversion, exchange, redemption or retirement, or, if the debenture is converted, on the conversion,

Table of Contents

exchange, redemption or retirement of the debentures. A negative adjustment is not subject to the two percent floor limitation imposed on miscellaneous deductions under Section 163(j) of the Code.

Amounts treated as interest under the contingent payment rules and regulations are treated as original issue discount for all purposes under the Code.

Sale, Conversion, Exchange, Redemption or Retirement of Debentures

Upon a sale, conversion, exchange, redemption or retirement of a debenture for cash, cash and our common stock, or solely for common stock, a U.S. Holder will generally recognize a gain or loss equal to the difference between (i) the amount realized from the sale, conversion, exchange, redemption or retirement, if any, plus any net negative adjustment carried forward, and (ii) the U.S. Holder's adjusted tax basis in the debenture. A U.S. Holder's adjusted tax basis in a debenture will generally be equal to the U.S. Holder's purchase price for the debenture, increased by interest income previously accrued by the U.S. Holder (determined without regard to any positive or negative adjustments to interest accruals described above) and decreased by the amount of any noncontingent payments and the pro rata amount of any contingent payments previously made on the debentures to the U.S. Holder. A U.S. Holder generally will recognize any gain as interest income, and any loss as ordinary loss to the extent of the excess of previous interest inclusions over previous negative adjustments previously taken into account as interest loss, and the balance as capital loss. The deductibility of interest losses is subject to limitations. A U.S. Holder that sells debentures at a loss that meets certain thresholds may be required to file a disclosure statement with the IRS.

A U.S. Holder's tax basis in our common stock received upon conversion of a debenture will equal the then current fair market value of such common stock. The U.S. Holder's holding period for the common stock received will commence on the day immediately following the date of conversion.

Constructive Distributions

The terms of the debentures allow for changes in the Conversion Rate of the debentures under certain circumstances. A Variable Conversion Rate that allows holders of debentures to receive a number of shares of common stock on conversion may increase the holder's proportionate interests in our earnings and profits or assets.

case, the holders of debentures would be treated as though they received a distribution in the form of our stock. Such a constructive stock distribution could be taxable to the holders of the debentures, although they would not actually receive any cash or other property. Not all changes in Conversion Rate that result in the holders of debentures to receive more stock on conversion will, however, increase the holders' proportionate interests in our earnings and profits or assets. For example, a change in the Conversion Rate could simply prevent the dilution of the holders' interests upon a stock split or other change in capital structure. Changes of this type, if made pursuant to a bona fide readjustment formula, are not treated as constructive stock distributions. Conversely, if an event occurs that dilutes the holders' interests and the Conversion Rate is not adjusted, the resulting increase in the proportionate interests of our debenture holders could be treated as a taxable stock distribution to them. Such taxable constructive stock distributions resulting from a change in, or failure to change, the Conversion Rate, that is treated as a dividend distribution, would be treated in the same manner as dividends paid in cash or other property and would result in a taxable dividend to the recipient to the extent of our current or accumulated earnings and profits, with any excess treated as a tax-free return of the holder's investment or as capital gain. Deemed dividends received by U.S. Holders may not be eligible for the reduced rates of tax applicable to qualified dividends or to the dividends received deduction generally available to U.S. corporations. U.S. Holders should consult their tax advisors regarding whether any taxable constructive stock distribution would be eligible for the maximum 15% rate (effective for taxable years through 2010) described in the paragraph above or the dividends received deduction.

Dividends on Common Stock

If we make a distribution in respect of our common stock, including any common stock acquired upon conversion of a debenture, from our current or accumulated earnings and profits as determined under U.S. federal income tax principles, the distribution will be treated as a dividend and will be included in the U.S. Holder's income when

Table of Contents

paid. If the distribution exceeds our current and accumulated earnings and profits, the excess will be treated first as a return of the U.S. Holder's investment, up to the U.S. Holder's basis in its common stock, and any remaining excess will be treated as capital gain. If the U.S. Holder is a U.S. corporation, it generally will be able to claim a dividends received deduction for its portion of any distribution taxed as a dividend. Subject to certain exceptions, dividends received by non-corporate U.S. Holders are taxed at a maximum rate of 15% for taxable years through 2010, provided that certain holding period requirements are met.

Sale, Exchange or Other Disposition of Common Stock

A U.S. Holder generally will recognize capital gain or loss on the sale, exchange or other disposition of common stock. The U.S. Holder's gain or loss will equal the difference between the proceeds received by the holder and the holder's adjusted basis in the stock. The proceeds received by the U.S. Holder generally will include the amount of any cash and the fair market value of any other property received for the stock. The gain or loss recognized by a U.S. Holder on a sale, exchange or other disposition of common stock will be long-term capital gain or loss if the holder held the common stock for more than one year, or short-term capital gain or loss if the holder held the common stock for one year or less, at the time of the transaction. Long-term capital gains of non-corporate taxpayers are taxed at a maximum 15% rate for taxable years through 2010. Short-term capital gains are taxed at ordinary income rates. The deductibility of capital losses is subject to limitations.

Non-U.S. Holders

The following discussion is limited to the U.S. federal income tax consequences relevant to a non-U.S. Holder (as defined in the prospectus supplement).

Payments with Respect to, and Conversion or Disposition of, the Debentures

All payments on the debentures made to you, including (i) the payment of contingent interest, (ii) any payment on the debenture in excess of stated interest and (iii) the amount of any cash and the fair market value of shares of common stock received upon the conversion, redemption or retirement of a debenture will generally be exempt from U.S. federal income or withholding tax, provided that:

you do not own, actually or constructively, 10% or more of the total combined voting power of all classes of our stock, and you do not vote within the meaning of Section 871(h)(3) of the Internal Revenue Code.

you are not a controlled foreign corporation with which we are, directly or indirectly, a related person;

you provide your name and address, and certify, under penalties of perjury, that you are not a United States resident as defined under the Code (which certification may be satisfied by an IRS Form W-8BEN (or successor form)), or that you are not a U.S. holder of your debenture through certain intermediaries, and that such intermediaries satisfy the certification requirements set forth in applicable Treasury Regulations;

the gain is not effectively connected with the active conduct of a U.S. trade or business (or in the case of an applicable income tax treaty, not attributable to a permanent establishment in the United States);

the holder is an individual who has been present in the United States for fewer than 183 days in the taxable year of disposition and certain other requirements are met;

we are not, or were not within the shorter of the five-year period preceding such disposition and the period that the U.S. holder held the debenture, a U.S. real property holding corporation (USRPHC). We believe that we are not, and do not anticipate becoming, a USRPHC for U.S. federal income tax purposes.

If you cannot satisfy the requirements described in the bullet points above, the 30% United States federal withholding tax will apply with respect to payments of interest on the debentures, including contingent interest and payments treated as interest on the debentures, unless you provide us with a properly completed (1) IRS Form W-8BEN (or successor form) claiming an exemption from or reduction in withholding under the provisions of an applicable United States income tax treaty or (2) IRS Form W-8ECI (or successor form) stating that interest on the debenture is not subject to withholding tax because it is not effectively connected with your conduct of a United States trade or business. If you are a non-U.S. Holder engaged in a trade or business in the United States

S-53

Table of Contents

and interest on a debenture is effectively connected with the active conduct of that trade or business (and if required by an applicable income tax treaty is attributable to a U.S. permanent establishment maintained by you), you will be subject to United States federal income tax on that interest on a net income basis (and not subject to the 30% withholding tax, provided the certification requirements described above are satisfied) in the same manner as if you were a U.S. person as defined under the Code. If you are a non-U.S. Holder that is foreign corporation may be subject to a branch profits tax equal to 30% (or lower rate as may be prescribed under an applicable United States income tax treaty) on its earnings and profits for the taxable year, subject to adjustments that are effectively connected with the conduct of a trade or business in the United States.

If you are an individual who fails to meet the test described in the fifth bullet point above, except as otherwise provided by an applicable income tax treaty, you will be subject to a flat rate of U.S. federal income tax on the gain derived from a sale of the debenture, which may be offset by U.S. source capital losses, even though you are not considered a resident of the United States.

Dividends on Common Stock and Constructive Distributions

Dividends paid to a non-U.S. Holder on common stock or on conversion of a debenture (and any taxable constructive dividends resulting from certain adjustments, or failure to make adjustments, to the number of shares of common stock issued on conversion, as described under

U.S. Holders Constructive Distributions above) will be subject to U.S. withholding tax at a 30% rate. The withholding tax, however, may be reduced under the terms of an applicable income tax treaty between the United States and the non-U.S. Holder's country of residence. A non-U.S. Holder may demonstrate its entitlement to treaty benefits by delivering a properly executed IRS Form W-8BEN or appropriate successor form. If you are eligible for a reduced rate of U.S. withholding tax pursuant to an income tax treaty, you may obtain a refund of the excess amounts withheld by filing an appropriate claim for refund with the IRS.

Any dividends on our common stock that are effectively connected with your active conduct of a trade or business in the United States (and, if required by an applicable income tax treaty, are attributable to a U.S. permanent establishment maintained by you) will be subject to U.S. federal income tax on a net income basis at applicable individual or corporate rates in the same manner as if you were a U.S. holder, as described above, unless an applicable income tax treaty provides otherwise) but will

subject to withholding tax provided you comply with certification and disclosure requirements. Any such effectively connected dividends received by a non-U.S. holder that is a corporation may also, under certain circumstances, be subject to the branch profits tax at a 30% rate or such lower rate as prescribed under an applicable U.S. income tax treaty.

If a Non-U.S. Holder is deemed to have received a dividend subject to U.S. withholding tax under the circumstances described above under U.S. Holders Constructive Ownership, we (or our paying agent) may withhold the withholding tax from cash payments of interest on the debentures or from payments on conversion, redemption or repurchase of

Sale, Exchange, or Other Disposition of Common Stock

You will generally not be subject to U.S. federal income tax on gain realized on the sale, exchange or other disposition of common stock unless:

- the gain is effectively connected with your active conduct of a trade or business in the United States (or in the case of a nonresident alien, an applicable tax treaty, the gain is attributable to a permanent establishment maintained by you in the United States);

- you are an individual who has been present in the United States for 183 days or more in the taxable year of disposition; or

- we are a USRPHC (as described above under U.S. Holders Payments with Respect to, and Constructive Ownership of, the Debentures)). We believe that we are not and do not anticipate becoming, a USRPHC for U.S. federal income tax purposes.

Table of Contents

Backup Withholding and Information Reporting

The Code and the Treasury regulations require those who make specified payments to report the payments to the IRS. The specified payments are interest, dividends, and proceeds from the sale of securities by brokers to their customers. The required information reporting is designed to enable the IRS to determine whether the recipient properly reported the payments in income. This reporting regime is reinforced by backup withholding rules. These rules require payors to withhold tax from payments subject to information reporting if the recipient fails to cooperate with the reporting regime by failing to provide his taxpayer identification number to the payor, furnishing an incorrect identification number, or repeatedly failing to report interest or dividends on his tax return. The withholding tax rate is currently 28%.

Any amounts withheld under the backup withholding rules may be allowed as a refund or a credit against your U.S. federal income tax liability provided the required information is furnished to the IRS.

U.S. Holders

Payments of interest or dividends to U.S. Holders of debt securities or common stock (other than U.S. Holders that are exempt from reporting, such as corporations), and the proceeds from the disposition of debentures or common stock, generally will be subject to information reporting, and will be subject to backup withholding unless the holder provides us or our paying agent with his correct taxpayer identification number and complies with applicable certification requirements.

Non-U.S. Holders

We must report annually to the IRS the interest and/or dividends paid to each non-U.S. Holder and the tax withheld, if any, with respect to such interest and/or dividends, including any tax withheld pursuant to the rules described under

Non-U.S. Holders Payments with Respect to, and Certain Disposition of, the Debentures and Non-U.S. Holders Common Stock and Constructive Distribution .

The gross proceeds from the disposition of debentures or common stock may be subject to information reporting and backup withholding. If you sell your debentures or common stock outside the United States through a non-U.S. office of a non-U.S. broker and the sales proceeds are paid to you outside the United States, then the U.S. backup withholding and information reporting requirements generally will not apply to that sale.

However, U.S. information reporting, but not backup withholding, will generally apply to a payment of sales proceeds, even if the payment is made outside the United States, if you sell your common stock through a non-U.S. office of a broker that

is a United States person;

derives 50% or more of its gross income in specific years from the active conduct of a trade or business in the United States;

is a controlled foreign corporation for U.S. tax purposes;

is a foreign partnership, if at any time during its tax year

one or more of its partners are United States persons and the aggregate hold more than 50% of the income or capital interests in the partnership; or

the foreign partnership is engaged in a U.S. trade or business.

unless the broker has documentary evidence in its files that you are a non-U.S. person and certain other conditions are met, the payment is otherwise establish an exemption.

If you receive payments of the proceeds of a sale of de our common stock to or through a U.S. office of a broker, the payment is subject to both U.S. backup withholding and U.S. information reporting unless you properly provide a Form W-8BEN certifying that you are a non-U.S. person and otherwise establish an exemption.

S-55

Table of Contents

Underwriting

We intend to offer the debentures through the underwriters. Jefferies & Company, Inc. is acting as sole book-runner of this offering and Jefferies & Company, Inc. and Citigroup Global Markets Inc. are acting as joint lead managers of this offering. Subject to the terms and conditions contained in the purchase agreement between us and the underwriters, we have agreed to sell to the underwriters and the underwriters have agreed to purchase from us, the principal amount of debentures listed opposite their names below.

Underwriters	Principal Amount of Debentures
Jefferies & Company, Inc.	\$
Citigroup Global Markets Inc.	
Total	\$ 300,000,000

The underwriters have agreed to purchase all of the debentures sold pursuant to the purchase agreement if any of these debentures are purchased. If an underwriter defaults, the purchase agreement provides that the purchase commitments of the nondefaulting underwriters may be increased or the purchase agreement terminated.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act. We will also contribute to payments the underwriters may be required to make in respect of those liabilities.

The underwriters are offering the debentures, subject to their approval, when, as and if issued to and accepted by them, subject to the approval of legal matters by their counsel, including the offering of the debentures, and other conditions contained in the purchase agreement, such as the receipt by the underwriters of certain certificates and legal opinions. The underwriters reserve the right to withdraw, cancel or modify offers to the public and to accept or reject orders in whole or in part.

The prospectus and this prospectus supplement, together with any applicable supplement, may also be used by Jefferies & Company, Inc. in connection with offers and sales of the offered securities in market-making transactions, including block positioning and block trades, at negotiated prices related to prevailing market prices at the time of sale. Jefferies & Company, Inc. may act as principal or agent in such transactions.

Commissions and Discounts

The underwriters have advised us that they propose initially to offer the debentures to the public at the respective public offering price on the cover page of this prospectus, and to dealers at the public offering price less a commission not in excess of 3% of the principal amount of the debentures. The underwriters may allow the dealers to offer a discount not in excess of 3% of the principal amount of the debentures. After the initial public offering, the public offering price, concession and discount may be changed.

The expenses of the offering, not including the underwriting discount, are estimated to be \$ 1,000,000 and are payable by us.

New Issue of Securities

The debentures are new issues of securities with no established trading market. We do not intend to apply for listing of the debentures on any national securities exchange or for quotation of the debentures on any automated dealer quotation system. We have been advised by Jefferies & Company, Inc. and Citigroup Global Markets Inc. that they presently intend to make a market for the debentures after completion of the offering. However, we are under no obligation to do so and may discontinue any market-making activities at any time without any notice. We cannot assure the liquidity of the trading market for the debentures that an active public market for the debentures will develop. If an active public trading market for the debentures does not develop, the market price and liquidity of the debentures may be adversely affected.

S-56

Table of Contents

New York Stock Exchange Listing

Our common stock is currently listed on the New York Exchange under the symbol JEF. We intend to list the common stock issuable upon conversion of the debentures on the New York Stock Exchange.

FINRA Regulation

Jefferies & Company, Inc., our broker-dealer subsidiary, is a member of FINRA and will participate in the distribution of the debentures. Accordingly, the offering will be conducted in accordance with Conduct Rule 2720 of FINRA. The underwriters will not confirm sales of the debentures to any account unless they exercise discretionary authority without the prior specific approval of the customer.

No Sales of Similar Securities

We, our directors and our chief financial officer have agreed during the period beginning on the date hereof and continuing until the date sixty (60) days after the date of this prospectus supplement, and subject to limited exceptions, neither we nor they will, without the prior consent of Jefferies & Company, Inc., pledge, sell or otherwise dispose of (or enter into any arrangement to offer, pledge, sell or otherwise dispose of), directly or indirectly, any shares of common stock, any securities substantially equivalent to the debentures or the common stock or any securities convertible into or exchangeable for, shares of common stock or similar securities, or enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of the common stock or similar securities.

Price Stabilization and Short Positions

In connection with the offering, the underwriters are permitted to engage in transactions that stabilize the market price of the debentures. If the underwriters create a short position in the debentures in connection with the offering, *i.e.*, if they sell more debentures than are on the cover page of this prospectus supplement, the underwriters may reduce that short position by purchasing debentures in the open market. A short sale is covered if the short position is no greater than the debentures available for sale by the underwriters under the over-allotment option. The underwriters can close out a covered short sale by exercising the over-allotment option or by purchasing debentures in the open market. In determining the source of debentures to close

covered short sale, the underwriters will consider, among other things, the open market price of debentures compared to the price available under the over-allotment option. The underwriters may also sell debentures in excess of the over-allotment option without creating a naked short position. The underwriters must not create any naked short position by purchasing debentures in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the debentures in the open market after the offering could adversely affect investors who purchase in the open market. Purchases of a security to stabilize the price or to reduce a short position could cause the price of the security to be higher than it might be in the absence of such purchases. Purchases of a security to stabilize the price or to reduce a short position could cause the price of the security to be higher than it might be in the absence of such purchases.

The underwriters also may impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the underwriter's representatives have repurchased debentures sold by or for the account of such underwriter in stabilizing or short covering transactions.

Neither we nor any of the underwriters makes any representation or prediction as to the direction or magnitude of any effect these transactions described above may have on the price of the debentures. In addition, neither we nor any of the underwriters makes any representation that the underwriters will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

Over-allotment option

We have granted to the underwriters an option, exercisable before the 30th day after the date of this prospectus supplement, to purchase up to an additional \$45.0 million aggregate principal amount of the debentures at a price equal to the price at which the underwriters purchased the initial debentures. The

S-57

Table of Contents

underwriters may exercise this option solely for the purchase of securities covering over-allotments, if any, made in connection with the offering.

Market-Making Resales by Affiliates

This prospectus supplement and the accompanying prospectus may be used by Jefferies & Company, Inc. in connection with offers and sales of the debentures in market-making transactions (and offers and sales of the underlying common stock in connection with such market-making activity). In a market-making transaction, Jefferies & Company, Inc. may resell a security it acquired from other holders, after the original offering and sale of the security. Resales of this kind may occur in the open market or may be privately negotiated at prevailing market prices at the time of the resale or at related or negotiated prices. In these transactions, Jefferies & Company, Inc. may act as principal or agent for the counterparty in a transaction in which Jefferies & Company, Inc. acts as principal, or as agent for both parties to the transaction in which Jefferies & Company, Inc. does not act as principal. Jefferies & Company, Inc. may receive compensation in the form of discounts and commissions from both counterparties in some cases. Other members of Jefferies Group, Inc. may also engage in transactions of this kind and may use this prospectus for this purpose.

Jefferies Group, Inc. does not expect to receive any proceeds from market-making transactions. Jefferies Group, Inc. does not expect that Jefferies & Company, Inc. or any other affiliate of Jefferies Group, Inc. in these transactions will pay any proceeds from its market-making resales to Jefferies Group, Inc.

Information about the trade and settlement dates, as well as the purchase price, for a market-making transaction will be provided to the purchaser in a separate confirmation of sale.

Unless Jefferies Group, Inc. or an agent informs you in a separate confirmation of sale that your security is being purchased in connection with the original offering and sale, you may assume that you are purchasing your security in a market-making transaction.

Notice to Prospective Investors in the European Economic Area

In relation to each member state of the European Economic Area that has implemented the Prospectus Directive (each, a "member state"), with effect from and including the date on which the Prospectus Directive is implemented in that relevant member state (the relevant implementation date), an offer of securities

described in this prospectus supplement may not be made available to the public in that relevant member state prior to the public offering of the prospectus in relation to the debentures that has been approved by the competent authority in that relevant member state or, if not so appropriate, approved in another relevant member state and has been notified to the competent authority in that relevant member state, shall be all in accordance with the Prospectus Directive, except in those circumstances in effect from and including the relevant implementation date that the offer of securities may be offered to the public in that relevant member state at any time:

to any legal entity that is authorized or regulated to operate in the financial markets or, if not so authorized or regulated, is a company whose corporate purpose is solely to invest in securities;

to any legal entity that has two or more of (1) an average of at least 250 employees during the last financial year; (2) a balance sheet of more than 43,000,000 and (3) an annual turnover of more than 50,000,000, as shown in its financial statements or consolidated accounts;

to fewer than 100 natural or legal persons (other than qualified investors as defined below) subject to obtaining the prior written consent of the representatives for any such offer; or

in any other circumstances that do not require the preparation of a prospectus pursuant to Article 3 of the Prospectus Directive.

Each purchaser of debentures described in this prospectus supplement located within a relevant member state will be deemed to have represented, acknowledged and agreed that it is a qualified investor within the meaning of Article 2(1)(e) of the Prospectus Directive.

For purposes of this provision, the expression an offer to the public in any relevant member state means the

Table of Contents

communication in any form and by any means of sufficient information on the terms of the offer and the securities offered so as to enable an investor to decide to purchase or subscribe the securities, as the expression may be varied in any member state by any measure implementing the Prospectus Directive in that member state, and the expression "Prospectus Directive" means Directive 2003/71/EC and includes any measure implementing measure in each relevant member state.

The sellers of the debentures have not authorized and do not authorize the making of any offer of debentures through any financial intermediary on their behalf, other than offers made by the underwriters with a view to the final placement of the debentures as contemplated in this prospectus supplement. Accordingly, no purchaser of the debentures, other than the underwriters, is authorized to make any further offer of debentures on behalf of the sellers or the underwriters.

Notice to Prospective Investors in the United Kingdom

This prospectus supplement is only being distributed to and is only directed at, persons in the United Kingdom that are professional investors within the meaning of Article 2(1)(e) of the Prospectus Directive that are also (i) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (ii) high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). This prospectus supplement and its contents are confidential and should not be distributed, published or reproduced (in whole or in part) or disclosed by recipients to any other persons in the United Kingdom. Any person in the United Kingdom that is not a relevant person should not act or rely on this document or any of its contents.

Notice to Prospective Investors in Hong Kong

The debentures may not be offered or sold in Hong Kong by any means of any document other than (i) in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32, Laws of Hong Kong), (ii) to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) and any rules made thereunder, or (iii) in other circumstances which do not result in the document being a prospectus within the meaning of the Companies Ordinance (Cap. 32, Laws of Hong Kong). This document, advertisement, invitation or document relating to the debentures may be issued or may be in the possession of any person.

purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (if permitted to do so under the laws of Hong Kong) other than with respect to debentures which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) and any rules made thereunder.

Notice to Prospective Investors in Japan

The debentures offered in this prospectus supplement have not been registered under the Securities and Exchange Law of Japan. The debentures have not been offered or sold and will not be offered or sold, directly or indirectly, in Japan or to or for the account of any resident of Japan, except (i) pursuant to an exemption from the registration requirements of the Securities and Exchange Law and (ii) in compliance with any other applicable requirements of Japanese law.

Notice to Prospective Investors in Singapore

This prospectus supplement has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this prospectus supplement and any other information or material in connection with the offer or sale, or invitation to subscription or purchase, of the debentures may not be distributed, nor may the debentures be offered or sold, nor made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the "SFA") or a relevant person pursuant to Section 275(1), or any person to whom an invitation is made pursuant to Section 275(1A), and in accordance with the conditions specified in

S-59

Table of Contents

Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provisions of the SFA, in each case subject to compliance with conditions set forth in the SFA.

Where the debentures are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is held by one or more individuals, each of whom is an accredited investor; or

a trust (where the trustee is not an accredited investor) the sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

the rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the debentures pursuant to an offer made under Section 275 of the SFA;

to an institutional investor (for corporations, under the definition of institutional investor in Section 275 of the SFA) or to a relevant person defined in Section 275 of the SFA, or to any person pursuant to an offer made on terms that such shares, debentures and units of shares and debentures of that corporation or such rights and interest in that trust are acquired at a consideration of not less than \$100,000 (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by the issue of securities or other assets, and further for corporations in accordance with the conditions specified in Section 275 of the SFA;

where no consideration is or will be given for the transfer;

where the transfer is by operation of law.

Other Relationships

The underwriters and certain of their affiliates have performed investment banking, advisory and general financing services for us from time to time for which they have received customary fees and expenses. The underwriters and certain of their affiliates from time to time, engage in transactions with and perform other services for us in the ordinary course of their business.

of New York Mellon will be a trustee in respect of the offered by this prospectus and currently acts as trustee 7.75% Senior Notes due 2012, our 5.5% Senior Notes our 6.25% Senior Debentures due 2036, our 5.875% S due 2014, our 8.5% Senior Notes due 2019 and our 6.4 Debentures due 2027.

S-60

Table of Contents

Legal Matters

The validity of the debentures has been passed on for us by Morgan, Lewis & Bockius LLP, New York, New York. Morgan, Lewis & Bockius LLP, New York, New York is counsel for the underwriters in connection with this offering. Certain persons Morgan, Lewis & Bockius LLP hold shares of our common stock and have invested in funds managed by us. Dewey & LeBoeuf LLP has from time to time acted as counsel for Jefferies Financial Inc. and its subsidiaries and may do so in the future.

Experts

The consolidated financial statements of Jefferies Group Inc. for the years ended December 31, 2008 and 2007, and for each of the years in the three-year period ended December 31, 2008, and management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2008, have been incorporated by reference herein and in the registration statement in reliance on the reports of KPMG LLP, independent registered public accounting firm, incorporated by reference herein, and on the authority of said firm as experts in accounting and auditing. The report of KPMG LLP refers to changes on the consolidated financial statements, effective January 1, 2009. The Company has adopted Statement of Financial Accounting Standards

Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51, and EITF 03-06-1, Determining Whether Instruments With a Variable Based Payment Transactions are Participating Securities. The Company has retrospectively adjusted the consolidated financial statements and for all periods included therein.

Where You Can Find More Information

As required by the Securities Act of 1933, we filed a registration statement relating to the securities offered by this prospectus with the Securities and Exchange Commission. This prospectus is a part of that registration statement, which includes additional information.

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and obtain a copy of any document we file at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. These SEC filings are available to the public from the SEC's web site at

<http://www.sec.gov>.

Incorporation of Certain Information by Reference

The SEC allows us to incorporate by reference the information we file with the SEC, which means that we can disclose important information to you by referring you to those documents. Information incorporated by reference is considered to be part of this prospectus. Information that we file later with the SEC will automatically update information in this prospectus. In making your decision, you should rely on the later information over different information included in this prospectus or the prospectus supplement. We incorporate by reference the documents listed below and all future filings made with the SEC under Section 13(a), 15(d) of the Securities Exchange Act of 1934 until this prospectus is completed:

Annual Report on Form 10-K for the year ended December 31, 2008, filed on February 27, 2009;

Quarterly Report on Form 10-Q for the quarter ended March 31, 2009, filed on May 8, 2009;

Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, filed on August 6, 2009;

Current Report on Form 8-K filed on June 24, 2009;

Current Report on Form 8-K filed on June 25, 2009.

S-61

Table of Contents

Current Report on Form 8-K filed on June 26, 2009

Current Report on Form 8-K filed on September 24, 2009

All documents we file pursuant to Section 13(a), 13(c) and 15(d) of the Exchange Act after the date of this prospectus before the later of the completion of the offering of securities described in this prospectus and the date our affiliates complete offering securities pursuant to this prospectus shall be incorporated by reference in this prospectus from the date of such documents.

You may obtain copies of these documents, at no cost, from our Internet website (www.jefferies.com), or by writing to us at the following address:

Investor Relations
Jefferies Group, Inc.
520 Madison Avenue
12th Floor
New York, New York 10022
(212) 284-2550

S-62

Table of Contents

PROSPECTUS

JEFFERIES GROUP, INC.

Debt Securities
Convertible Debt Securities
Warrants
Preferred Stock
Depositary Shares
Purchase Contracts
Units
Common Stock

The securities may be offered in one or more series, in prices and on terms to be determined at the time of the

We will provide the specific terms of these securities in supplements to this prospectus. You should read this prospectus and the accompanying prospectus supplement carefully before you invest.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this prospectus or the accompanying prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

Jefferies Group, Inc. may use this prospectus in the initial sale of these securities. In addition, Jefferies & Company, Inc. or other affiliate of Jefferies Group, Inc. may use this prospectus in a market-making transaction in any of these securities after the initial sale. UNLESS JEFFERIES GROUP, INC. OR ITS AFFILIATE INFORMS THE PURCHASER OTHERWISE IN THE COMPANY'S CONFIRMATION OF SALE, THIS PROSPECTUS IS BEING USED IN A MARKET-MAKING TRANSACTION.

This prospectus is dated October 20, 2009

Table of Contents

EXPLANATORY NOTE

The prospectus contained herein relates to all of the fo

the initial offering of debt securities, convertible d
securities, warrants, preferred stock, depositary sha
purchase contracts, units and common stock issua
Jefferies Group, Inc.;

the offering of such securities by the holders there

market-making transactions that may occur on a co
delayed basis in the securities described above, aft
initially offered and sold.

When the prospectus is delivered to an investor in the
secondary offering described above, the investor will b
of that fact in the confirmation of sale or in a prospect
supplement. When the prospectus is delivered to an inv
is not so informed, it is delivered in a market-making t

To the extent required, the information in the prospect
including financial information, will be updated at the
each offering. Upon each such offering, a prospectus s
to the base prospectus will be filed.

TABLE OF CONTENTS

WHERE YOU CAN FIND MORE INFORMATION
INCORPORATION OF CERTAIN INFORMATION
REFERENCE
EXPLANATORY NOTE REGARDING FINANCIAL
STATEMENTS
JEFFERIES GROUP, INC.
DESCRIPTION OF SECURITIES WE MAY OFFER
Debt Securities
Convertible Debt Securities
Warrants
Preferred Stock
Depository Shares
Purchase Contracts
Units
Common Stock
FORM, EXCHANGE AND TRANSFER
BOOK-ENTRY PROCEDURES AND SETTLEMENT
RATIO OF EARNINGS TO FIXED CHARGES
USE OF PROCEEDS
PLAN OF DISTRIBUTION
MARKET-MAKING REALES BY AFFILIATES
CERTAIN ERISA CONSIDERATIONS
LEGAL MATTERS
EXPERTS

You should rely only on the information provided in the prospectus and the prospectus supplement, as well as the information incorporated by reference. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any jurisdiction where the offer is not permitted. You should assume that the information in this prospectus, the prospectus supplement or any documents incorporated by reference is accurate as of any date other than the date of the applicable document.

Table of Contents

Where You Can Find More Information

As required by the Securities Act of 1933, as amended, the registration statement relating to the securities offered in this prospectus with the Securities and Exchange Commission. This prospectus is a part of that registration statement, which contains additional information.

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and obtain a copy of any document we file at the SEC's Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549. You may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. These SEC filings are available to the public from the SEC's web site at <http://www.sec.gov>.

Incorporation of Certain Information by Reference

The SEC allows us to incorporate by reference the information we file with the SEC, which means that we can disclose important information to you by referring you to those documents. Information incorporated by reference is considered to be a part of this prospectus. Information that we file later with the SEC will automatically update information in this prospectus. In order for you to rely on the later information over different information included in this prospectus or the prospectus supplements, we incorporate by reference the documents listed below and all future filings made with the SEC under Section 13(a), 15(d) of the Securities Exchange Act of 1934, as amended.

Annual Report on Form 10-K for the year ended December 31, 2008, filed on February 27, 2009;

Quarterly Report on Form 10-Q for the quarter ended March 31, 2009, filed on May 8, 2009.

Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, filed on August 6, 2009;

Current Reports on Form 8-K filed on June 24, 2009, June 26, 2009 and September 24, 2009; and

The description of our common stock contained in our Registration Statement on Form 10 filed on April 1, 2009, and any further amendment or report filed thereafter for the purpose of updating such description.

All documents we file pursuant to Section 13(a), 13(c) 15(d) of the Exchange Act after the date of this prospectus before the later of the completion of the offering of the securities described in this prospectus and the date our affiliates commence offering securities pursuant to this prospectus shall be incorporated by reference in this prospectus from the date of such documents.

You may obtain copies of these documents, at no cost, from our Internet website (www.jefferies.com), or by writing to us or telephoning us at the following address:

Investor Relations
Jefferies Group, Inc.
520 Madison Avenue
12th Floor
New York, New York 10022
(212) 284-2550

Explanatory Note Regarding Financial Statements

The FASB has issued its Accounting Standards Codification (ASC) Explanatory Note Regarding Financial Statements, which reflects how generally accepted accounting principles are currently organized and presented.

We adopted the FASB's changes to Accounting Standards Codification (ASC) 810, Consolidation, which establishes standards for the accounting and reporting of noncontrolling interests in subsidiaries on January 1, 2009. Prior to January 1, 2009, we reported minority interest within liabilities on our Consolidated Statements of

Table of Contents

Financial Condition. The changes to ASC 810 require clearly identify and present ownership interests in subsidiaries held by parties other than the entity in the consolidated financial statements within the equity section but separate from the equity and, accordingly, we now present non-controlling interests within stockholders' equity, separately from our own equity. The changes to ASC 810 also require that revenues, expenses, income or loss, and other comprehensive income or loss be reported in the consolidated financial statements at the consolidated amounts, which include amounts attributable to both owners of the parent and noncontrolling interests. Net income or loss and other comprehensive income or loss shall be attributed to the parent and noncontrolling interests. Prior to January 1, 2009, we recorded minority interest in earnings of consolidated subsidiaries in the determination of net income (loss). These changes were reflected in the financial statements included in our Quarterly Report on Form 10-Q for the first quarter of 2009, filed with the SEC on May 8, 2009 and our Quarterly Report on Form 10-Q, for the second quarter ended June 30, 2009, filed with the SEC on August 6, 2009, both of which are incorporated herein by reference.

In connection with the filing of the registration statement for this prospectus as a part, we have recast prior financial statements to retrospectively reflect the adoption of the changes to ASC 810. In addition, these recast financial statements reflect the retrospective application of the FASB's changes to ASC 260, Earnings Per Share, also adopted on January 1, 2009. As of January 1, 2009, net earnings are allocated among common shareholders and participating securities based on their share in earnings. The adoption of these changes reduces previously reported earnings per share.

These recast financial statements, together with the related management's discussion and analysis of financial condition, results of operations and selected financial information for the years ended December 31, 2008, have been filed with the SEC as a Current Report on Form 8-K, filed June 25, 2009, and are incorporated herein by reference. The financial statements, management's discussion and analysis of financial condition, results of operations and selected financial information included in the Current Report on Form 8-K supersede those included in our Annual Report on Form 10-K for 2008, filed on February 10, 2009, and incorporated herein by reference. See Note 1 to the recast financial statements filed with the Current Report on Form 8-K for an explanation of the calculation of earnings per share under ASC 260.

Jefferies Group, Inc.

Jefferies Group, Inc. and its subsidiaries (we , us) is an independent, full-service global securities and investment banking firm serving companies and their investors. We provide services to companies capital markets, merger and acquisition, restructuring and other financial advisory services. We provide investment research and trade execution in equity, equity and fixed income securities, including corporate bonds, government and agency securities, repo finance, mortgage asset-backed securities, municipal bonds, whole loans, emerging markets debt, convertible securities as well as commodities and derivatives. We also provide asset management services and products to institutions and other investors. On June 18, 2009, Jefferies was designated as a primary dealer at the Federal Reserve Bank of New York.

Our principal operating subsidiary, Jefferies, was founded in 1991. Since 2000, we have pursued a strategy of continued growth and diversification, whereby we have sought to increase our presence in the business in each of the markets we serve, while at the same time expanding the breadth of our activities in an effort to mitigate the cyclical nature of the financial markets in which we operate. Our growth plan has been achieved through internal growth, supported by the ongoing addition of experienced personnel in targeted areas, as well as the acquisition from time to time of complementary businesses.

As of June 30, 2009, we had 2,307 employees. We maintain offices in more than 25 cities throughout the world and our executive offices located at 520 Madison Avenue, New York, New York 10022. Our telephone number there is (212) 345-0000 and our Internet address is www.jefferies.com.

Table of Contents

Description of Securities We May Offer

Debt Securities

Please note that in this section entitled Debt Securities, references to Jefferies, we, us, ours or our refer only to Jefferies Company and not to its consolidated subsidiaries. Also, in this section, references to holders mean those who own debt securities registered in their own names, on the books that Jefferies Company trustee maintains for this purpose, and not those who own beneficial interests in debt securities registered in street name or debt securities issued in book-entry form through one of our clearing depositaries. Owners of beneficial interests in the debt securities should read the section below entitled Book-Entry Procedures and Settlement.

General

The debt securities offered by this prospectus will be either secured or unsecured obligations and will be either senior or subordinated debt. We will issue senior debt under a senior debt indenture and we will issue subordinated debt under a subordinated debt indenture. We sometimes refer to the senior debt indenture and the subordinated debt indenture individually as an indenture and collectively as the indentures. The indentures have been filed with the SEC and are exhibits to the registration statement of which this prospectus forms a part. You can obtain copies of the indentures by following the directions outlined in Where You Can Obtain Prospectus Information, or by contacting the applicable indenture trustee.

A form of each debt security, reflecting the particular terms and provisions of a series of offered debt securities, has been filed with the SEC or will be filed with the SEC at the time of the filing of the exhibits to the registration statement of which this prospectus forms a part.

The following briefly summarizes the material provisions of the indentures and the debt securities, other than pricing and other terms disclosed for a particular issuance in an accompanying prospectus supplement. You should read the more detailed provisions of the applicable indenture, including the detailed terms, for provisions that may be important to you. You should also read the particular terms of a series of debt securities, which will be described in more detail in an accompanying prospectus supplement. So that you may easily locate the more detailed provisions, the numbers in parentheses below refer to sections of the applicable indenture or, if no indenture is specified,

in each of the indentures. Wherever particular sections or terms of the applicable indenture are referred to, such sections and terms, if defined, are defined by the terms of the applicable indenture and the statement in this prospectus is qualified by that reference.

Unless otherwise provided for a particular issuance in an accompanying prospectus supplement, the trustee under the senior debt indenture and the subordinated debt indenture shall be The Bank of New York Mellon.

The indentures provide that our unsecured senior or subordinated debt securities may be issued in one or more series, with different terms, in each case as we authorize from time to time. We reserve the right to reopen a previous issue of a series of debt securities by issuing additional debt securities of such series.

Types of Debt Securities

We may issue fixed or floating rate debt securities.

Fixed rate debt securities will bear interest at a fixed rate as described in the prospectus supplement. This type includes zero-coupon debt securities, which bear no interest and are sold at a price lower than the principal amount. Material federal income tax consequences and other special considerations are applicable to any debt securities issued at a discount as described in the applicable prospectus supplement.

Upon the request of the holder of any floating rate debt security, the calculation agent will provide the interest rate then in effect for that debt security, and, if determined, the interest rate that will become effective on the next interest reset date. The calculation agent's determination of any interest rate, and its calculation of the amount of interest for any interest period, will be final and binding in the absence of manifest error.

All percentages resulting from any interest rate calculation applicable to a debt security will be rounded upward or downward, as appropriate, to the next higher or lower one hundredth of a percentage point. All amounts

Table of Contents

used in or resulting from any calculation relating to a c will be rounded upward or downward, as appropriate, nearest cent, in the case of U.S. dollars, or to the nearest corresponding hundredth of a unit, in the case of a currency other than U.S. dollars, with one-half cent or one-half of a corresponding hundredth of a unit or more being rounded

In determining the base rate that applies to a floating rate security during a particular interest period, the calculation agent may obtain rate quotes from various banks or dealers active in the relevant market, as described in the prospectus supplement. The reference banks and dealers may include the calculation agent itself and its affiliates, as well as any underwriter, dealer or participant participating in the distribution of the relevant floating rate securities and its affiliates, and they may include affiliates of Jefferies.

Information in the Prospectus Supplement

The prospectus supplement for any offered series of debt securities will describe the following terms, as applicable:

the title;

whether the debt is senior or subordinated;

the total principal amount offered;

the percentage of the principal amount at which the debt securities will be sold and, if applicable, the method of determining the price;

the maturity date or dates;

whether the debt securities are fixed rate debt securities or floating rate debt securities;

if the debt securities are fixed rate debt securities, the interest rate at which the debt security will bear interest, if applicable, and the interest payment dates;

if the debt security is an original issue discount debt security, the yield to maturity;

if the debt securities are floating rate debt securities, the interest rate basis; any applicable index currency or basket of currencies; any applicable index currency or basket of currencies spread or spread multiplier or initial, maximum or minimum rate; the interest reset, determination, calculation and payment dates; and the day count used to calculate interest payments.

for any period;

the date or dates from which any interest will accrue and the date or dates from which such date or dates will be determined, and the interest payment dates and any related record dates;

if other than in U.S. Dollars, the currency or currencies in which payment will be made;

any provisions for the payment of additional amounts or interest, including taxes;

the denominations in which the currency or currencies of the securities will be issuable if other than denominated in U.S. Dollars, \$1,000 and integral multiples thereof;

the terms and conditions on which the debt securities may be redeemed at the option of Jefferies;

any obligation of Jefferies to redeem, purchase or repurchase debt securities at the option of a holder upon the occurrence of any event and the terms and conditions of redemption, purchase or repayment;

the names and duties of any co-trustees, depositaries, authenticating agents, calculation agents, paying agents, transfer agents or registrars for the debt securities;

any material provisions of the applicable indentures or supplemental indentures in this prospectus that do not apply to the debt securities;

any other specific terms of the debt securities.

The terms on which a series of debt securities may be convertible into or exchangeable for other securities of Jefferies or its subsidiary entity will be set forth in the prospectus supplement relating to such series. Such terms will

Table of Contents

include provisions as to whether conversion or exchange is mandatory, at the option of the holder or at our option. We may include provisions pursuant to which the number of securities to be received by the holders of such series of securities may be adjusted.

We will issue the debt securities only in registered form. For currently anticipated, debt securities of a series will trade in book-entry form, and global notes will be issued in physical (paper) form, as described below under "Book-Entry Form and Settlement." Unless otherwise provided in the applicable prospectus supplement, we will issue debt securities denominated in U.S. Dollars and only in denominations of \$1,000 and multiples thereof.

The prospectus supplement relating to offered securities denominated in a foreign or composite currency will specify the denomination of the offered securities.

The debt securities may be presented for exchange, and securities other than a global security may be presented for registration of transfer, at the principal corporate trust office of The Bank of New York Mellon in New York City. Holders will not have to pay any service charge for any registration or exchange of debt securities, but we may require payment of a sum sufficient to cover any tax or other governmental charges payable in connection with such registration of transfer (Section 3.05).

Market-Making Transactions. If you purchase your debt securities or any of our other securities we describe in this prospectus in a market-making transaction, you will receive information regarding the price you pay and your trade and settlement dates in a confirmation of sale. A market-making transaction is one in which Jefferies & Company, Inc. or one of our affiliates resells securities that it has previously acquired from another holder. A market-making transaction in a particular security occurs only if it is an original issuance and sale of the security.

Payment and Paying Agents

Distributions on the debt securities other than those represented by global notes will be made in the designated currency and require the surrender of the debt securities at the principal corporate trust office of The Bank of New York Mellon in New York City. Payment will be made to the registered holder at the close of business on the record date for such payment. Interest payments will be made at the principal corporate trust office of The Bank of New York Mellon in New York City, or by a check mailed to the registered holder.

holder at his registered address. Payments in any other
will be specified in the prospectus supplement.

Calculation Agents

Calculations relating to floating rate debt securities and
debt securities will be made by the calculation agent, a
that we appoint as our agent for this purpose. We may
of our affiliates as calculation agent. We may appoint a
institution to serve as calculation agent from time to time
original issue date of the debt security without your consent
without notifying you of the change. The initial calculation
will be identified in the prospectus supplement.

Senior Debt

We will issue senior debt securities under the senior debt
indenture. Senior debt will rank on an equal basis with
other unsecured debt except subordinated debt.

Subordinated Debt

We will issue subordinated debt securities under the subordinated
debt indenture. Subordinated debt will rank subordinated
junior in right of payment, to the extent set forth in the
subordinated debt indenture, to all our senior debt.

If we default in the payment of any principal of, or prepayment
any, or interest on any senior debt when it becomes due and
payable after any applicable grace period, then, unless
the default is cured or waived or

Table of Contents

ceases to exist, we cannot make a payment on account or redeem or otherwise acquire the subordinated debt securities.

If there is any insolvency, bankruptcy, liquidation or other proceeding relating to us or our property, then all senior debt securities shall be paid in full before any payment may be made to any subordinated debt securities.

Furthermore, if we default in the payment of the principal or accrued interest on any subordinated debt securities that are declared due and payable upon an event of default under the subordinated debt indenture, holders of all our senior debt securities shall first be entitled to receive payment in full in cash before any such subordinated debt can receive any payments.

Senior debt means:

- the principal, premium, if any, and interest in respect of the indebtedness of Jefferies for money borrowed and the indebtedness evidenced by securities, notes, debentures or other similar instruments issued by us, including subordinated debt securities;

- all capitalized lease obligations;

- all obligations representing the deferred purchase price of property; and

- all deferrals, renewals, extensions and refundings of obligations of the type referred to above;

but senior debt does not include:

- subordinated debt securities;

- any indebtedness that by its terms is subordinated to senior debt on an equal basis with, subordinated debt securities;

- indebtedness that is subordinated to a senior debt security of ours specified above.

The effect of this last provision is that we may not issue or guarantee any indebtedness for money borrowed which is junior to the senior debt securities and senior to the subordinated debt securities.

Covenants

Limitations on Liens. The senior indenture provides that we will not, and will not permit any designated subsidiary to, incur, assume or guarantee any indebtedness for money borrowed by or for us or any designated subsidiary if such indebtedness is secured by a pledge of, lien on, or security interest in any shares of common stock of any designated subsidiary, without providing that each series of senior debt securities, in our option, any other indebtedness ranking equally and ratably with such indebtedness, is secured equally and ratably (in priority prior to) such other secured indebtedness (Section 10.01).

Limitations on Transactions with Affiliates. The senior indenture provides that we will not, and will not permit any designated subsidiary to, sell, lease, transfer or otherwise dispose of any of our real or personal properties or assets to, or purchase any property or asset from, or enter into any transaction, contract, agreement, understanding, loan, advance or guaranty with, or for the benefit of, any affiliate of ours unless:

the transaction with the affiliate is made on terms that are no less favorable to us or the subsidiary than those that would have been obtained in a comparable transaction with an unrelated third person; and

in the case of any affiliate transaction involving consideration in excess of \$25 million in any fiscal year, we deliver to the trustee a certificate to the effect that our board of directors has determined that the transaction complies with the requirements described in the above bullet point and that the transaction has been approved by a majority of the independent, disinterested members of our board of directors.

This covenant will not apply to any employment agreement entered into in the ordinary course of business and consistent with our past practices, to any transaction between or among us and our subsidiaries or to transactions entered into prior to the date the notes are issued.

Table of Contents

Limitations on Mergers and Sales of Assets. The indentures provide that we will not merge or consolidate or transfer all or substantially all of our assets substantially as an entirety, and another person will not acquire, transfer or lease its assets substantially as an entirety to

either (1) we are the continuing corporation, or (2) the transferee is a successor corporation, if other than us, is a U.S. corporation, and expressly assumes by supplemental indenture all of the obligations evidenced by the securities issued pursuant to the indenture; and

immediately after the transaction, there would not be a default in the performance of any covenant or condition of the indenture (Section 8.01).

Other than the restrictions described above, the indentures do not contain any covenants or provisions that would protect the interests of the debt securities in the event of a highly leveraged transaction.

Modification of the Indentures

Under the indentures, we and the relevant trustee can enter into supplemental indentures to establish the form and terms of any new series of debt securities without obtaining the consent of the holder of debt securities (Section 9.01).

We and the trustee may, with the consent of the holder of a majority in aggregate principal amount of the debt securities of such series, modify the applicable indenture or the rights of the holder of the securities of such series.

No such modification may, without the consent of each holder of an affected security:

extend the fixed maturity of any such securities;

reduce the rate or change the time of payment of interest on such securities;

reduce the principal amount of such securities or the amount of interest, if any, on such securities;

change any obligation of ours to pay additional amounts;

reduce the amount of the principal payable on account of any securities issued originally at a discount;

adversely affect the right of repayment or repurchase or any other option of the holder;

reduce or postpone any sinking fund or similar pro

change the currency or currency unit in which any securities are payable or the right of selection there

impair the right to sue for the enforcement of any payment on or after the maturity of such securities

reduce the percentage of securities referred to above holders need to consent to the modification or a without the consent of such holders; or

change any obligation of ours to maintain an office (Section 9.02).

Defaults

Each indenture provides that events of default regarding of debt securities will be:

our failure to pay required interest on any debt security of such series for 30 days;

our failure to pay principal or premium, if any, on any security of such series when due;

our failure to make any required scheduled installment payment for 30 days on debt securities of such series;

our failure to perform for 90 days after notice any covenant in the relevant indenture other than a covenant included in the relevant indenture solely for the benefit of the series of debt securities other than such series;

Table of Contents

our failure to pay beyond any applicable grace period or acceleration of, indebtedness in excess of \$10,000.

certain events of bankruptcy or insolvency, whether or not (Section 5.01).

If an event of default regarding debt securities of any series under the indentures should occur and be continuing, either the trustee or the holders of 25% in the principal amount of outstanding debt securities of such series may declare a default security of that series due and payable (Section 5.02). We are required to file annually with the trustee a statement of compliance as to the fulfillment by us of our obligations under the indentures during the preceding year (Section 10.05).

No event of default regarding one series of debt securities under an indenture is necessarily an event of default regarding other series of debt securities.

Holder of a majority in principal amount of the outstanding debt securities of any series will be entitled to control certain actions of the trustee under the indentures and to waive past defaults regarding such series (Sections 5.12 and 5.13). The trustee generally cannot be required by any of the holders of debt securities to take any action, unless one or more of such holders shall have provided to the trustee reasonable security or collateral (Section 6.02).

If an event of default occurs and is continuing regarding debt securities, the trustee may use any sums that it holds under the relevant indenture for its own reasonable compensation and expenses incurred prior to paying the holders of debt securities of such series (Section 5.06).

Before any holder of any series of debt securities may bring an action for any remedy, except payment on such holder's debt security when due, the holders of not less than 25% in the principal amount of the debt securities of that series outstanding must request the trustee to take action. Holders must also provide the satisfactory security and indemnity against liabilities incurred by the trustee for taking such action (Sections 5.07 and 5.08).

Defeasance

Except as may otherwise be set forth in an accompanying prospectus supplement, after we have deposited with the trustee cash or government securities, in trust for the benefit of the holders sufficient to pay the principal of, premium, if any,

interest on the debt securities of such series when due, satisfied certain other conditions, including receipt of a written opinion of counsel that holders will not recognize taxable gain for federal income tax purposes, then:

we will be deemed to have paid and satisfied our obligations on all outstanding debt securities of such series, with the exception of known as defeasance and discharge (Section 14.02).

we will cease to be under any obligation, other than to pay when due the principal of, premium, if any, and interest on such debt securities, relating to the debt securities of such series, which is known as covenant defeasance (Section 14.03).

When there is a defeasance and discharge, the applicable provisions will no longer govern the debt securities of such series and we will no longer be liable for payments required by the terms of the debt securities of such series and the holders of such debt securities will be entitled only to the deposited funds. When there is a covenant defeasance, however, we will continue to be obligated to make payments when due if the deposited funds are not sufficient.

Payment of Additional Amounts

If so noted in the applicable prospectus supplement for the debt security, we will pay to the holder of any debt security of such series that is a United States Alien (as defined below) such additional amount as may be necessary so that every net payment of principal and interest on the debt security, after deduction or withholding for any tax on account of any present or future tax, assessment or governmental charge imposed upon or as a result of such security by the United States or any taxing authority thereof or thereunder, will not be less than the amount provided in such debt security.

Table of Contents

security to be then due and payable. We will not be required, however, to make any payment of additional amounts in respect of an account of:

any tax, assessment or other governmental charge that would not have been imposed but for the existence of any former connection between such holder (or between such holder, fiduciary, settlor, beneficiary of, member or shareholder), or any possessor of a power over, such holder, if such holder is an estate, trust, partnership or corporation) and the United States, including, without limitation, such holder (or such holder, settlor, beneficiary, member, shareholder or possessor) who has been or having been a citizen or resident or treated as a resident of the United States or being or having been engaged in a trade, business or present in the United States or having been or had a permanent establishment in the United States;

any tax, assessment or other governmental charge that would not have been imposed but for the presentation by such holder of the debt security for payment on a date more than 15 days after the date on which such payment became due and payable or the date on which payment thereof is duly provided, whichever occurs later;

any estate, inheritance, gift, sales, transfer, excise, property or similar tax, assessment or other governmental charge;

any tax, assessment or other governmental charge imposed by reason of such holder's past or present status as a foreign investment company, a controlled foreign corporation, a personal holding company or foreign personal holding company with respect to the United States, or as a company which accumulates earnings to avoid United States income tax;

any tax, assessment or other governmental charge that is payable otherwise than by withholding from payment of the principal of, or interest on, such debt security;

any tax, assessment or other governmental charge that would be withheld by any paying agent from any payment of the principal of, or interest on, any debt security if such payment can be made without withholding by any other paying agent;

any tax, assessment or other governmental charge that would be imposed by reason of a holder's present or former status as (i) the actual or constructive owner of 10% or more of the total combined voting power of our stock, as determined

purposed of Section 871(h)(3)(B) of the Internal Revenue Code of 1986, as amended (the Code), (or any similar provision) or (ii) a controlled foreign corporation that is related to us, as determined for purposes of Section 881(c)(3)(C) of the Code (or any successor

any tax, assessment or other governmental charge or interest received by (1) a 10% shareholder of ours as defined in Section 871(h)(3)(B) of the Internal Revenue Code, as amended and the regulations that may be promulgated thereunder), or (2) a controlled foreign corporation that is related to us within the meaning of the Code; or

any combinations of items identified in the bullet points listed above.

In addition, we will not be required to pay any additional amounts to any holder who is a fiduciary or partnership or other entity whose sole beneficial owner of such debt security to the extent of such debt security is a beneficiary or settlor with respect to such fiduciary, or a partner or member of such partnership or a beneficial owner thereof would not have been entitled to the payment of such additional amount if such beneficiary, settlor, member or beneficial owner been the sole owner of the debt security.

The term United States Alien means any corporation, partnership, individual or fiduciary that is, for United States federal income tax purposes, a foreign corporation, a nonresident alien individual, a nonresident fiduciary of a foreign estate or trust, or a foreign partnership one or more of the members of which is, for United States federal income tax purpose, a foreign corporation, a nonresident alien individual or a nonresident fiduciary of an estate or trust.

Table of Contents

Redemption upon a Tax Event

If so noted in the applicable prospectus supplement for the issuance, we may redeem the debt securities in whole, or in part, on not more than 60 days and not less than 30 days before a redemption price equal to 100% of their principal amount plus all accrued but unpaid interest through the redemption date. We will determine that as a result of a change in tax law (as defined below):

we have or will become obligated to pay additional amounts, as described under the heading "Payment of Additional Amounts"; or

there is a substantial possibility that we will be required to pay such additional amounts.

A change in tax law that would trigger the provisions of the preceding paragraph is any change in or amendment to the laws, treaties, regulations or rulings of the United States or a subdivision or taxing authority thereof, or any proposed change in the laws, treaties, regulations or rulings, or any change in the official application, enforcement or interpretation of the laws, treaties, regulations or rulings (including a holding by a court of competent jurisdiction in the United States) or any other action (other than an action predicated on law generally known or in effect before the date of the applicable prospectus supplement) that would apply to a particular issuance of debt securities to which this section applies, except for proposals before the Congress prior to that date, or by any taxing authority or a court of competent jurisdiction in the United States, or the official proposal of the action, whether or not the action or proposal was taken or made with respect to such securities.

Prior to the publication of any notice of redemption, we will deliver to the Trustee an officers' certificate stating that we are entitled to effect the aforementioned redemption and so long as a statement of facts showing that the conditions precedent to our right to so redeem have occurred, and an opinion of counsel to that effect such effect based on such statement of facts.

Governing Law

Unless otherwise stated in the prospectus supplement, the debt securities and the indentures will be governed by New York law.

Concerning the Trustee under the Indentures

We have and may continue to have banking and other relationships with The Bank of New York Mellon, or a subsidiary thereof.

subsequent trustee, in the ordinary course of business.

Convertible Debt Securities

Please note that in this section entitled Convertible Debt Securities, references to Jefferies, we, us, ours or our members, our Jefferies Group, Inc. and not to its consolidated subsidiaries. In this section, references to holders mean those who own convertible debt securities registered in their own names in the books that Jefferies or the trustee maintains for this purpose, and not those who own beneficial interests in convertible debt securities registered in street name or in convertible debt securities issued in book-entry form through one or more depositaries. Owners of beneficial interests in the convertible debt securities should read the section below entitled Book-Entry Procedures and Settlement.

The convertible debt securities offered by this prospectus are our unsecured senior debt obligations and will be convertible into shares of our common stock. We will issue convertible debt securities under an indenture (convertible securities). The terms of the indenture (convertible securities) are substantially the same as the senior debt indenture described above under Description of Debt Securities, except for: the inclusion of provisions with respect to the conversion of securities; the omission of provisions comparable to those described above under Description of Debt Securities- Definitions; the omission of provisions comparable to those described above under Description of Debt Securities- Covenants; and the omission of provisions comparable to those described above under Description of Debt Securities- Limitations on Liens and on Transactions with Affiliates.

Table of Contents

Unless otherwise provided for a particular issuance in an accompanying prospectus supplement, the trustee under the indenture (convertible securities) will be The Bank of Montreal. The prospectus supplement for any offered series of convertible debt securities will describe all material terms of each series.

Warrants

Please note that in this section entitled Warrants, references to Jefferies, we, us, ours or our refer only to Jefferies Group and not to its consolidated subsidiaries. Also, in this section, references to holders mean those who own warrants registered in their own names, on the books that Jefferies or its agent maintains for this purpose, and not those who own beneficial interests in warrants registered in street name or in warrants issued through a book-entry form through one or more depositaries. Ownership of beneficial interests in the warrants should read the section entitled Book-Entry Procedures and Settlement.

General

We may offer warrants separately or together with our equity securities.

We may issue warrants in such amounts or in as many series as we wish. This section summarizes terms of the warrants that apply generally to all series. Most of the financial and specific terms of your warrant will be described in the prospectus supplement. Those terms may vary from the terms described

The warrants of a series will be issued under a separate warrant agreement to be entered into between us and one or more trust companies, as warrant agent, as set forth in the prospectus supplement. A form of each warrant agreement, including a form of warrant certificate representing each warrant, reflecting the particular terms and provisions of a series of offered warrants, will be filed with the SEC at the time of the offering and incorporated by reference in the registration statement of which this prospectus forms a part. You can obtain a copy of any form of warrant agreement when it has been filed by following the directions outlined in Where You Can Find More Information or by contacting the applicable warrant agent.

The following briefly summarizes the material provisions of the warrant agreements and the warrants. As you read this prospectus, please remember that the specific terms of your warrant will be described in the prospectus supplement will supplement the general terms applicable, may modify or replace the general terms described

this section. You should read carefully the prospectus supplement and the more detailed provisions of the warrant agreement and the warrant certificate, including the defined terms, for provisions that may be important to you. If there are differences between the prospectus supplement and this prospectus, the prospectus supplement will control. Thus, the statements made in this prospectus may not apply to your warrant.

Types of Warrants

We may issue debt warrants or equity warrants. A debt warrant is a warrant for the purchase of our debt securities on terms and conditions determined at the time of sale. An equity warrant is a warrant for the purchase or sale of our equity securities. We may also issue warrants for the purchase or sale of, or whose cash value is determined by reference to the performance, level or value of, one or more of the following: securities of one or more issuers, including those issued by us and described in this prospectus; debt or equity securities issued by third parties; a currency or currencies; a commodity or commodities; and other financial or economic or other measure or instrument, including the occurrence or non-occurrence of any event or circumstance, or one or more indices or baskets of these items.

Information in the Prospectus Supplement

The prospectus supplement will contain, where applicable, the following information about the warrants:

the specific designation and aggregate number of, and the price at which we will issue, the warrants;

the currency or currency unit with which the warrants will be purchased and in which any payments due to or from the warrant holder upon exercise must be made;

Table of Contents

the date on which the right to exercise the warrants; and the date on which that right will expire or, if you continuously exercise the warrants throughout that specific date or dates on which you may exercise t

whether the exercise price may be paid in cash, by exchange of warrants or other securities or both, and method of exercising the warrants;

whether the warrants will be settled by delivery of underlying securities or other property or in cash;

whether and under what circumstances we may call warrants prior to their expiration date, in which case holders will be entitled to receive only the applicable cancellation amount, which may be either a fixed amount or an amount that varies during the term of the warrants in accordance with a schedule or formula;

whether the warrants will be issued in global or non-global form, although, in any case, the form of a warrant or unit will correspond to the form of the unit and of the security or purchase contract included in that unit;

the identities of the warrant agent, any depositaries, paying, transfer, calculation or other agents for the

any securities exchange or quotation system on which the warrants or any securities deliverable upon exercise of the warrants may be listed;

whether the warrants are to be sold separately or with securities, as part of units or otherwise, and if the warrants are to be sold with the securities of another company or companies, certain information regarding such companies; and

any other terms of the warrants.

If warrants are issued as part of a unit, the prospectus supplement will specify whether the warrants will be separable from the securities in the unit before the warrants' expiration date.

No holder of a warrant will, as such, have any rights or claims in the debt securities, equity securities or other warrant property purchasable under or in the warrant, including any right to payment thereunder.

Our affiliates may resell our warrants in market-making transactions after their initial issuance. We discuss these transactions above under Debt Securities Information in the Prospectus Supplement Market-Making Transaction

**Additional Information in the Prospectus Supplement
Debt Warrants**

In the case of debt warrants, the prospectus supplement contain, where appropriate, the following additional information:

the designation, aggregate principal amount, current terms of the debt securities that may be purchased upon exercise of the debt warrants; and

the designation, terms and amount of debt securities to be issued together with each of the debt warrants and, if any, after which the debt warrants and debt securities may be separately transferable.

No Limit on Issuance of Warrants

The warrant agreements will not limit the number of warrants or other securities that we may issue.

Modifications

We and the relevant warrant agent may, without the consent of the warrant holders, amend each warrant agreement and the terms of the issue of warrants, for the purpose of curing any ambiguity, correcting or supplementing any defective or inconsistent provision, or in any other manner that we may deem necessary, desirable and that will not adversely affect the interests of the holders of the outstanding unexercised warrants in any material respect.

Table of Contents

We and the relevant warrant agent also may, with the consent of the holders of at least a majority in number of the outstanding unexercised warrants affected, modify or amend the warrant agreement and the terms of the warrants.

No such modification or amendment may, without the consent of each holder of an affected warrant:

- reduce the amount receivable upon exercise, cancel the warrants, or shorten the expiration;

- shorten the period of time during which the warrants may be exercised;

- otherwise materially and adversely affect the exercise of the warrants by the beneficial owners of the warrants; or

- reduce the percentage of outstanding warrants who must consent to modification or amendment of the warrant agreement or the terms of the warrants.

Merger and Similar Transactions Permitted; No Restrictive Covenants or Events of Default

The warrant agreements will not restrict our ability to merge, consolidate with, or sell our assets to, another firm or to enter into any other transactions. If at any time there is a merger, consolidation involving us or a sale or other disposition of substantially all of our assets, the successor or assuming corporation will be substituted for us, with the same effect as if it had been named in the warrant agreement and in the warrants. We will be relieved of any further obligation under the warrant agreement with respect to the warrants, and, in the event of any such merger, consolidation or other disposition, we as the predecessor corporation will not be required to exist or time thereafter be dissolved, wound up or liquidated.

The warrant agreements will not include any restrictions on our ability to put liens on our assets, including our interests in our subsidiaries, nor will they provide for any events of default or remedies upon the occurrence of any events of default.

Warrant Agreements Will Not Be Qualified under the Trust Indenture Act

No warrant agreement will be qualified as an indenture under the Trust Indenture Act. Therefore, holders of warrants issued under a warrant agreement will not have the protection of the Trust Indenture Act with respect to their warrants.

Enforceability of Rights by Beneficial Owner

Each warrant agent will act solely as our agent in connection with the issuance and exercise of the applicable warrants and will not assume any obligation or relationship of agency or trust with any registered holder of or owner of a beneficial interest in any warrant. A warrant agent will have no duty or responsibility in the case of any default by us under the applicable warrant agreement or warrant certificate, including any duty or responsibility to initiate any proceedings at law or otherwise or to make any demand upon us.

Holders may, without the consent of the applicable warrant agent, enforce by appropriate legal action, on their own behalf, their right to exercise their warrants, to receive debt securities, in the case of debt warrants, and to receive payment, if any, for their warrants in the case of universal warrants.

Governing Law

Unless otherwise stated in the prospectus supplement, the warrant agreement and each warrant agreement will be governed by New York law.

Preferred Stock

As of the date of this prospectus, our authorized capital structure includes 10 million shares of preferred stock, 125,000 shares of which were issued and outstanding as of March 31, 2006. In February 2006, we issued \$125.0 million of Series A convertible preferred stock in a private placement. Our Series A convertible preferred stock has a 3.25% annual, cumulative cash dividend and is currently convertible into 4,105,138 shares of our common stock.

Table of Contents

common stock at an effective conversion price of approximately \$30.45 per share. The Series A convertible preferred stock is callable beginning in 2016 and will mature in 2036.

The following briefly summarizes the material terms of the preferred stock, other than pricing and related terms disclosed in a particular issuance in an accompanying prospectus supplement. You should read the particular terms of any series of preferred stock we offer which will be described in more detail in the prospectus supplement prepared for such series, together with the more detailed provisions of our certificate of incorporation and certificate of designations relating to each particular series of preferred stock, for provisions that may be important to you. The certificate of designations relating to a particular series of preferred stock offered by way of an accompanying prospectus supplement will be filed with the SEC at the time of the offering and incorporated by reference in the registration statement, of which this prospectus forms a part. You can obtain a copy of the document by following the directions outlined in [Where to Find More Information](#). The prospectus supplement will disclose whether any of the terms summarized below do not apply to a particular series of preferred stock being offered.

General

Under our certificate of incorporation, our board of directors is authorized to issue shares of preferred stock in one or more series and to establish from time to time a series of preferred stock with the following terms specified:

the number of shares to be included in the series;

the designation, powers, preferences and rights of the shares of the series; and

the qualifications, limitations or restrictions of such shares, except as otherwise stated in the certificate of incorporation.

Prior to the issuance of any series of preferred stock, our board of directors will adopt resolutions creating and designating each series as a series of preferred stock and the resolutions will be incorporated in the certificate of designations as an amendment to the certificate of incorporation. The term board of directors includes any authorized committee.

The rights of holders of the preferred stock offered may not be adversely affected by the rights of holders of any shares of preferred stock that may be issued in the future, provided that future issuances are first approved by the holders of the

of preferred stock adversely affected. The board of directors may, in its discretion, cause shares of preferred stock to be issued in public or private transactions for any proper corporate purpose. Examples of such corporate purposes include issuances to obtain additional financing in connection with acquisitions or otherwise, and issuances to our officers, directors and employees pursuant to benefit plans or otherwise. Shares of preferred stock will not have the effect of rendering more difficult or discouraging the acquisition of us deemed undesirable by our board of directors.

The preferred stock will be, when issued, fully paid and nonassessable. Holders of preferred stock will not have preemptive or subscription rights to acquire more of our common stock.

We will name the transfer agent, registrar, dividend disbursement agent and redemption agent for shares of each series of preferred stock in the prospectus supplement relating to such series.

Our affiliates may resell our preferred stock in market-making transactions after its initial issuance. We discuss these transactions above under "Debt Securities—Information in the Prospectus Supplement—Market-Making Transactions."

Rank

Unless otherwise specified for a particular series of preferred stock in an accompanying prospectus supplement, each series of preferred stock will rank on an equal basis with each other series of preferred stock and prior to the common stock, as to dividends and distributions of assets.

Table of Contents

Dividends

Holder of each series of preferred stock will be entitled to receive cash dividends, when, as and if declared by our board of directors, out of funds legally available for dividends. The rates and terms of payment of dividends will be set forth in the prospectus supplement relating to each series of preferred stock. Dividends will be payable to holders of record of preferred stock as they appear on our books or, if applicable, the records of the transfer agent referred to below under Depositary Shares, on the record date as fixed by the board of directors. Dividends on any series of preferred stock may be cumulative or noncumulative.

We may not declare, pay or set apart for payment dividends on any series of preferred stock unless full dividends on any other series of preferred stock that ranks on an equal or senior basis have been paid or sufficient funds have been set apart for payment of such dividends.

For a series of preferred stock that pay dividends on a cumulative basis, we will not pay dividends until all prior dividend periods of the other series of preferred stock that pay dividends on a cumulative basis; or

for a series of preferred stock that pay dividends on a noncumulative basis, we will not pay dividends until the immediately preceding dividend period of the other series of preferred stock that pay dividends on a noncumulative basis.

Partial dividends declared on shares of preferred stock of one series and other series of preferred stock ranking on an equal basis with that series of preferred stock will be declared pro rata. A pro rata declaration means that the ratio of dividends declared per share to accrued dividends per share will be the same for both series of preferred stock.

Similarly, we may not declare, pay or set apart for payment dividends or non-stock dividends or make other payments on the common stock or any other of our stock ranking junior to the preferred stock until full dividends on the preferred stock have been paid or set apart for payment for:

for a series of preferred stock that pay dividends on a cumulative basis; or

for a series of preferred stock that pay dividends on a noncumulative basis, we will not pay dividends until the immediately preceding dividend period if the preferred stock pays dividends on a noncumulative basis.

Conversion and Exchange

The prospectus supplement for any series of preferred stock will state the terms, if any, on which shares of that series of preferred stock are convertible into or exchangeable for shares of our common stock.

Redemption

If so specified in the applicable prospectus supplement, preferred stock may be redeemable at any time, in whole or in part, at our option or at the option of the holder thereof, and may be mandatorily redeemed.

Any partial redemptions of preferred stock will be made at the discretion that our board of directors decides is equitable.

Unless we default in the payment of the redemption price, dividends will cease to accrue after the redemption date of preferred stock called for redemption and all rights of such shares will terminate except for the right to receive the redemption price.

Liquidation Preference

Upon our voluntary or involuntary liquidation, dissolution or winding up, holders of each series of preferred stock will be entitled to receive distributions upon liquidation in the amount set forth in the prospectus supplement relating to such series of preferred stock, plus an amount equal to any accrued and unpaid dividends. Such distributions will be made before any distribution is made on any securities ranking junior relating to preferred stock in liquidation, including common stock.

If the liquidation amounts payable relating to the preferred stock of any series and any other securities ranking on a parity with the liquidation rights are not paid in full, the holders of the preferred stock of such series and such other securities will share in such distribution of our available assets on a ratable basis in proportion to the full liquidation preferences. Holders of any series of preferred stock will not be entitled to any other distributions from us after they have received their full liquidation preference.

Table of Contents

Voting Rights

The holders of shares of our preferred stock will have the following rights, except:

- as otherwise stated in the prospectus supplement;
- as otherwise stated in the certificate of designation establishing such series; and
- as required by applicable law.

Depositary Shares

The following briefly summarizes the material provisions of the deposit agreement and of the depositary shares and depositary receipts, other than pricing and related terms disclosed in the prospectus supplement for a particular issuance in an accompanying prospectus supplement. You should read the particular terms of any depositary shares and any depositary receipts that we offer and any deposit agreement relating to a particular series of preferred stock which are described in more detail in a prospectus supplement. The prospectus supplement will also state whether any of the generalized provisions summarized below do not apply to the depositary shares or depositary receipts being offered. The form of deposit agreement, including the form of depositary receipt, is an exhibit to the registration statement of which this prospectus forms a part. You can obtain copies of these documents by following the directions outlined in "Where You Can Get More Information." You should read the more detailed provisions of the deposit agreement and the form of depositary receipt for provisions that may be important to you.

General

We may, at our option, elect to offer fractional shares of preferred stock, rather than full shares of preferred stock. In such cases, we will issue receipts for depositary shares, each of which will represent a fraction of a share of a particular series of preferred stock.

We will deposit the shares of any series of preferred stock represented by depositary shares under a deposit agreement between us and a bank or trust company selected by us, with its principal office in the United States and having a combined net worth and surplus of at least \$50,000,000, as preferred stock. Each owner of a depositary share will be entitled to all the rights and preferences of the underlying preferred stock, including dividend, voting, redemption, conversion and liquidation.

proportion to the applicable fraction of a share of preferred stock represented by such depositary share.

The depositary shares will be evidenced by depositary shares issued pursuant to the deposit agreement. Depositary shares will be distributed to those persons purchasing the fractional shares of preferred stock in accordance with the terms of the applicable prospectus supplement.

Our affiliates may resell depositary shares in market-making transactions after their initial issuance. We discuss these transactions above under "Debt Securities - Information - Prospectus Supplement - Market-Making Transactions".

Dividends and Other Distributions

The preferred stock depositary will distribute all cash and other cash distributions received in respect of the depositary shares of preferred stock to the record holders of depositary shares of preferred stock in proportion to the number of depositary shares owned by such holders.

The preferred stock depositary will distribute any property other than cash received by it in respect of the preferred stock to the record holders of depositary shares entitled thereto. If the preferred stock depositary determines that it is not feasible to make such distribution, it may, with our approval, sell the property and distribute the net proceeds from such sale to the record holders.

Table of Contents

Redemption of Preferred Stock

If a series of preferred stock represented by depositary shares is to be redeemed, the depositary shares will be redeemed first and the proceeds received by the preferred stock depositary will be used to redeem the redemption, in whole or in part, of such series of preferred stock. The depositary shares will be redeemed by the preferred stock depositary at a price per depositary share equal to the applicable fraction of the redemption price per share payable in respect of the shares of preferred stock so redeemed.

Whenever we redeem shares of preferred stock held by depositary shares, the preferred stock depositary will redeem as of the same date the number of depositary shares representing shares of preferred stock so redeemed. If not all the depositary shares are to be redeemed, the depositary shares to be redeemed will be selected by the preferred stock depositary by lot or ratably or by any other equitable method as the preferred stock depositary may decide.

Voting Deposited Preferred Stock

Upon receipt of notice of any meeting at which the holders of a series of deposited preferred stock are entitled to vote, the preferred stock depositary will mail the information contained in such notice of meeting to the record holders of the depositary shares relating to such series of preferred stock. Each record holder of such depositary shares on the record date will be required to instruct the preferred stock depositary to vote the amount of preferred stock represented by such holder's depositary shares. The preferred stock depositary will try to vote the amount of preferred stock represented by such depositary shares in accordance with such instructions.

We will agree to take all actions that the preferred stock depositary determines as necessary to enable the preferred stock depositary to vote as instructed. The preferred stock depositary will abstain from voting shares of any series of preferred stock held by it for which it does not receive specific instructions from the holders of depositary shares representing such shares.

Amendment and Termination of the Deposit Agreement

The form of depositary receipt evidencing the depositary shares and any provision of the deposit agreement may at any time be amended by agreement between us and the preferred stock depositary. However, any amendment that materially and adversely alters any existing right of the holders of depositary shares will not be effective unless such amendment has been

approved by the holders of at least a majority of such shares then outstanding. Every holder of an outstanding receipt at the time any such amendment becomes effective is deemed, by continuing to hold such depositary receipt, to have accepted and agreed to such amendment and to be bound by the deposit agreement, which has been amended thereby. The deposit agreement may be terminated only if:

all outstanding depositary shares have been redeemed;

a final distribution in respect of the preferred stock has been made to the holders of depositary shares in connection with our liquidation, dissolution or winding up.

Charges of Preferred Stock Depositary; Taxes and Governmental Charges

We will pay all transfer and other taxes and governmental charges arising solely from the existence of the depositary arrangement. We also will pay charges of the depositary in connection with the initial deposit of preferred stock and any redemption of preferred stock. Holders of depositary receipts will pay other taxes and governmental charges and such other charges as may be applicable, including a fee for the withdrawal of shares of preferred stock upon surrender of depositary receipts, as are expressly provided in the deposit agreement to be for their accounts.

Resignation and Removal of Depositary

The preferred stock depositary may resign at any time by delivering to us notice of its intent to do so, and we may at any time remove the preferred stock depositary, any such resignation or removal to take effect upon the

Table of Contents

appointment of a successor preferred stock depositary and the acceptance of such appointment. Such successor preferred stock depositary must be appointed within 60 days after delivery of notice of resignation or removal and must be a bank or other company having its principal office in the United States and having a combined capital and surplus of at least \$50,000,000.

Miscellaneous

The preferred stock depositary will forward all reports and communications from us which are delivered to the preferred stock depositary and which we are required to furnish to the holders of the deposited preferred stock.

Neither we nor the preferred stock depositary will be liable if either is prevented or delayed by law or any circumstance beyond its control in performing its obligations under the deposit agreement. Our obligations and those of the preferred stock depositary under the deposit agreement will be limited to their performance in good faith of their duties thereunder and we will not be obligated to prosecute or defend any legal proceeding in respect of any depositary shares, depositary receipts or other preferred stock unless satisfactory indemnity is furnished to us. The preferred stock depositary may rely upon written advice of counsel or accountants, or upon information provided by us or other persons of depositary receipts or other persons believed to be correct and on documents believed to be genuine.

Purchase Contracts

We may issue purchase contracts for the purchase or sale of:

debt or equity securities issued by us or securities issued by other parties, a basket of such securities, an index or index of securities or any combination of the foregoing as set forth in the applicable prospectus supplement;

currencies; or

commodities.

Each purchase contract will entitle the holder thereof to purchase or sell, and obligate us to sell or purchase, on specified terms securities, currencies or commodities at a specified purchase price which may be based on a formula, all as set forth in the applicable prospectus supplement. We may, however, satisfy our obligations, if any, with respect to any purchase contract by delivering cash of value of such purchase contract or the cash value of the securities or otherwise deliverable or, in the case of purchase contracts for

underlying currencies, by delivering the underlying currency set forth in the applicable prospectus supplement. The prospectus supplement will also specify the methods by which holders may purchase or sell such securities, currencies, commodities and any acceleration, cancellation or termination provisions or other provisions relating to the settlement of a purchase contract.

The purchase contracts may require us to make periodic payments to the holders thereof or vice versa, which payments may be deferred to the extent set forth in the applicable prospectus supplement, and those payments may be unsecured or secured on some basis. The purchase contracts may require the holders thereof to secure their obligations in a specified manner as described in the applicable prospectus supplement. All purchase contracts may require holders to satisfy their obligations thereunder when the purchase contracts are issued. Our obligation to settle such pre-paid purchase contracts on the relevant settlement date may constitute indebtedness. Accordingly, all pre-paid purchase contracts will be issued under either the senior indenture or the subordinated indenture.

Table of Contents

Units

As specified in the applicable prospectus supplement, we may issue units consisting of one or more purchase contracts for debt securities, depositary shares, preferred shares, common shares or any combination of such securities. The applicable prospectus supplement will describe:

the terms of the units and of the purchase contracts for debt securities, depositary shares, preferred shares and common shares comprising the units, including when and under what circumstances the securities comprising the units may be traded separately;

a description of the terms of any unit agreement governing the units; and

a description of the provisions for the payment, settlement, transfer or exchange of the units.

Common Stock

Our authorized capital stock includes 500 million shares of common stock, 171,081,538 of which were issued and outstanding as of May 1, 2009. The following briefly summarizes the terms of our common stock. You should read the more detailed provisions of our certificate of incorporation and by-laws for provisions that may be important to you. You can obtain these documents by following the directions outlined in the section titled "You Can Find More Information."

General

Each holder of common stock is entitled to one vote per share in the election of directors and for all other matters to be voted on by the stockholders. Except as otherwise provided by law, the holders of common stock vote as one class together with holders of preferred stock (if they have voting rights). Holders of common stock may not cumulate their votes in the election of directors. All holders are entitled to share equally in the dividends that may be declared by the board of directors, but only after payment of dividends required to be paid on outstanding shares of preferred stock.

Upon our voluntary or involuntary liquidation, dissolution or winding up, holders of common stock share ratably in the assets remaining after payments to creditors and provision for the preference of any preferred stock. There are no preemptive

other subscription rights, conversion rights or redemption rights, and scheduled installment payment provisions relating to our common stock. All of the outstanding shares of our common stock are fully paid and nonassessable. The transfer agent and registrar for the common stock is American Stock Transfer. The common stock is listed on the New York Stock Exchange under the symbol JEF.

Our affiliates may resell our common stock after its initial issuance in market-making transactions. We discuss these transactions above under *Debt Securities Information* in our *Prospectus Supplement – Market-Making Transactions*.

Delaware Law, Certificate of Incorporation and By-Laws Provisions that May Have an Antitakeover Effect

The following discussion concerns certain provisions of Delaware law and our certificate of incorporation and by-laws that may delay, deter or prevent a tender offer or takeover attempt that a stockholder might consider to be in its best interest, including tender offers or attempts that might result in a premium being paid above the market price for its shares.

Delaware Law. We are subject to the provisions of Section 203 of the Delaware General Corporation Law. In general, Section 203 prohibits a publicly held Delaware corporation from entering into a business combination with an interested stockholder for a period of three years after the date of the transaction in which the stockholder became an interested stockholder, unless:

the stockholder, prior to the business combination the corporation was an interested stockholder; or
the stockholder, prior to the business combination, the corporation's directors approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder; or

Table of Contents

upon consummation of the transaction which results in the interested stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the outstanding voting stock of the corporation at the time the transaction was consummated, excluding for the purpose of determining the number of shares outstanding those shares owned by the corporation's officers and directors and by employees of the corporation in plans in which employee participants do not have a right to vote, and the interested stockholder has determined confidentially whether shares held subject to the tender offer plan will be tendered in a tender or exchange offer.

at or subsequent to the time the business combination was approved by the corporation's board of directors and authorized at an annual or special meeting of its stockholders and not by written consent, by the affirmative vote of 66 2/3% of its outstanding voting stock which is not owned by the interested stockholder.

A business combination includes mergers, asset sales or other transactions resulting in a financial benefit to the stockholder. An interested stockholder is a person who, together with any affiliates or associates, owns (or within three years did own) 15% or more of the corporation's voting stock.

Certificate of Incorporation and By-Laws. Our by-laws provide that special meetings of stockholders may be called by the Secretary only at the request of a majority of our board of directors or by any person authorized by the board of directors to call a special meeting. Written notice of a special meeting of the place, date and hour of the meeting and the purpose of the meeting is called must be given between 10 and 60 days before the date of the meeting, and only business specified in the notice may come before the meeting. In addition, our by-laws provide that directors be elected by a plurality of votes cast at a meeting and does not include a provision for cumulative voting for directors. Under cumulative voting, a minority stockholder holding a sufficient percentage of a class of shares may be able to ensure the election of one or more directors.

Form, Exchange and Transfer

We will issue securities only in registered form; no securities will be issued in bearer form. We will issue each security of our common stock in book-entry form only, unless otherwise specified in the applicable prospectus supplement. We will issue our common stock in both certificated and book-entry form, unless otherwise specified in the applicable prospectus supplement. Securities in book-entry form will be represented by a global security.

in the name of a depositary, which will be the holder of securities represented by the global security. Those who have beneficial interests in a global security will do so through participants in the depositary's system, and the rights of indirect owners will be governed solely by the applicable procedures of the depositary and its participants. Only the depositary will be entitled to transfer or exchange a security in global form, since it will be the sole holder of the securities. Book-entry securities are described below under "Book-Entry Procedures and Settlement".

If any securities are issued in non-global form or cease to be book-entry securities (in the circumstances described in this section), the following will apply to them:

The securities will be issued in fully registered form in the denominations stated in the prospectus supplement. You may exchange securities for securities of the same series in larger denominations or combined into fewer securities of the same series of larger denominations, as long as the total amount of securities is not changed.

You may exchange, transfer, present for payment or tender securities at the office of the relevant trustee or agent as indicated in the prospectus supplement. You may also report lost, stolen, destroyed or mutilated securities at that office. We may appoint another entity to perform these functions or you may perform them yourself.

You will not be required to pay a service charge to exchange their securities, but they may be required to pay a tax or other governmental charge associated with the transfer or exchange. The transfer or exchange, and any redemption, will be made only if our transfer agent is satisfied with the proof of legal ownership. The transfer agent may require an indemnity before replacing any securities.

If we have the right to redeem, accelerate or settle securities before their maturity or expiration, and we exercise that right as to less than all those securities, we may transfer or exchange of those securities during the redemption period beginning 15 days before the day we mail the notice of redemption and ending on

Table of Contents

the day of that mailing, in order to freeze the list of securities to be included in the mailing and to prepare the mailing. We may also refuse to register or exchange any security selected for early settlement, except that we will continue to permit transfers and payments of the unsettled portion of any security being participated in.

If fewer than all of the securities represented by a certificate that are payable or exercisable in part are presented for payment or exercise, a new certificate will be issued for the remaining amount of securities.

Book-Entry Procedures And Settlement

Most offered securities will be book-entry (global) securities. Upon issuance, all book-entry securities will be represented by one or more fully registered global securities, without regard to any restrictions on transfer. Each global security will be deposited with, or on behalf of, the Depository Trust Company or DTC, a securities depository. All securities will be registered in the name of DTC or a nominee of DTC. DTC will thus be the only registered holder of these securities.

Purchasers of securities may only hold interests in the securities through DTC if they are participants in the DTC system. Purchasers may also hold interests through a securities intermediary—banks, brokerage houses and other institutions that maintain securities accounts for customers—that has a securities account with DTC or its nominee. DTC will maintain accounts showing the security holdings of its participants, and these participants in turn maintain accounts showing the security holdings of their customers. Some of these customers may themselves be securities intermediaries holding securities for their customers. The beneficial owner of a book-entry security will hold the security indirectly through a hierarchy of intermediaries, with DTC at the top and the beneficial owner's own securities intermediary at the bottom.

The securities of each beneficial owner of a book-entry security will be evidenced solely by entries on the books of the beneficial owner's securities intermediary. The actual purchaser of securities will generally not be entitled to have the securities represented by the global securities registered in its name. The purchaser will not be considered the owner under the declaration. In no event will a beneficial owner will also not be able to obtain a paper certificate evidencing the holder's ownership of securities. The book-entry system for holding securities eliminates the need for the physical movement of certificates and is the system through which most publicly traded common stock is held in the United States. However, the laws of some jurisdictions require some purchasers of securities to take physical delivery of their securities.

definitive form. These laws may impair the ability to trade book-entry securities.

A beneficial owner of book-entry securities represented by a global security may exchange the securities for definitive securities only if:

DTC is unwilling or unable to continue as depositary for the global security and we do not appoint a qualified replacement depositary for DTC within 90 days; or

we in our sole discretion decide to allow some or all of the book-entry securities to be exchangeable for definitive securities in registered form.

Unless we indicate otherwise, any global security that is exchangeable will be exchangeable in whole for definitive securities in registered form, with the same terms and conditions, aggregate principal amount. Definitive securities will be issued in the name or names of the person or persons specified in a written instruction to the registrar of the securities. We will base its written instruction upon directions that it receives from its participants.

In this prospectus, for book-entry securities, references to actions taken by security holders will mean actions taken by DTC in accordance with instructions from its participants, and references to payment of notices of redemption to security holders will mean payment of notices of redemption to DTC as the registered holder of the securities for distribution to participants in accordance with the procedures.

DTC is a limited purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a clearing corporation within the meaning of the New York Uniform Commercial Code and a clearing agency registered under section 17A of the Securities Exchange Act of 1934. The rules applicable to DTC and its participants are on file with the SEC.

Table of Contents

We will not have any responsibility or liability for any of the records relating to, or payments made on account of, our ownership interest in the book-entry securities or for our supervising or reviewing any records relating to the book-entry securities ownership interests.

Clearstream and Euroclear

Links have been established among DTC, Clearstream Banking SA (societe anonyme, Luxembourg (Clearstream Banking SA) and Euroclear (two international clearing systems that perform functions similar to those that DTC performs in the U.S.) to facilitate the initial issuance of book-entry securities and the cross-market transfers of book-entry securities associated with secondary market trading.

Although DTC, Clearstream Banking SA and Euroclear have agreed to the procedures provided below in order to facilitate cross-market transfers, they are under no obligation to perform such transfers and the procedures may be modified or discontinued at any time.

Clearstream Banking SA and Euroclear will record the ownership interests of their participants in much the same way as DTC. DTC will record the aggregate ownership of each of the U.S. agents of Clearstream Banking SA and Euroclear and the participants in DTC.

When book-entry securities are to be transferred from the account of a DTC participant to the account of a Clearstream Banking SA participant or a Euroclear participant, the purchaser must provide instructions to Clearstream Banking SA or Euroclear to the DTC participant at least one business day prior to settlement. Clearstream Banking SA or Euroclear, as the case may be, may instruct its U.S. agent to receive book-entry securities and make payment. After settlement, Clearstream Banking SA or Euroclear will credit its participant's account. Credit for the book-entry securities will appear on the next day (European time).

Because settlement is taking place during New York business hours, DTC participants can employ their usual procedure for sending book-entry securities to the relevant U.S. agent for the benefit of Clearstream Banking SA or Euroclear participants. The sale proceeds will be available to the DTC seller on the settlement date. Thus, to the DTC participant, a cross-market transaction will settle no differently than a trade between DTC participants.

When a Clearstream Banking SA or Euroclear participant wishes to transfer book-entry securities to a DTC participant,

must send instructions to Clearstream Banking SA or Euroclear through a participant at least one business day prior to the trade date. In these cases, Clearstream Banking SA or Euroclear will instruct its U.S. agent to transfer the book-entry securities against cash payment. The payment will then be reflected in the account of the Clearstream Banking SA or Euroclear participant the following business day, with the proceeds back-valued to the value date (which may be the preceding day, when settlement occurs in New York). If settlement is not completed on the intended value date (i.e., a trade fails), proceeds credited to the Clearstream Banking SA or Euroclear participant's account would instead be valued at the actual settlement date.

Ratio of Earnings to Fixed Charges

Our consolidated ratios of earnings to fixed charges and earnings to combined fixed charges and preferred stock dividends for each of the fiscal years in the five year period ended December 31, 2008 and for the six month period ended June 30, 2009 are as follows:

	Year Ended December 31,				
	2008(3)	2007	2006	2005	2004
Ratio of Earnings to Fixed Charges(1)		3.0	4.5	5.5	5.5
Ratio of Earnings to Combined Fixed Charges and Convertible Preferred Stock Dividends(2)		2.9	4.4	5.5	5.5

(1) The ratio of earnings to fixed charges is computed as (a) income from continuing operations before income taxes plus fixed charges by (b) fixed charges. Fixed charges consist of interest expense on all long-term

Table of Contents

indebtedness and the portion of operating lease rental expense that is representative of the interest factor (deemed to be one-third of operating lease rentals).

(2) The ratio of earnings to combined fixed charges and stock dividends is computed by dividing (a) income from continuing operations before income taxes plus fixed charges by the sum of (b) fixed charges and (c) convertible preferred stock dividends. Fixed charges consist of interest on all long-term indebtedness and the portion of operating lease rental expense that is representative of the interest factor (deemed to be one-third of operating lease rentals).

(3) Earnings for the year ended December 31, 2008 were insufficient to cover fixed charges by approximately \$746.2 million.

Use of Proceeds

Unless otherwise set forth in the applicable prospectus supplement, we intend to use the net proceeds from the securities we offer by this prospectus for general corporate purposes, which may include, among other things:

additions to working capital;

the redemption or repurchase of outstanding equity securities;

the repayment of indebtedness; and

the expansions of our business through internal growth and acquisitions.

We may raise additional funds from time to time through debt financing, including borrowings under credit facilities to finance our business and operations.

Plan of Distribution

We may offer the securities to or through underwriters by ourselves directly, through agents, or through a combination of any of these methods of sale. Any such underwriters, dealers, or agents may include our affiliates. The details of any such offering will be set forth in the any prospectus supplement relating to the offering.

Jefferies & Company, Inc., our broker-dealer subsidiary, is a member of the Financial Industry Regulatory Authority.

participate in distributions of the offered securities. All offerings of offered securities in which Jefferies & Company participates will conform to the requirements set forth in Rule 2720. Furthermore, any underwriters offering the securities will not confirm sales to any accounts over which they exercise discretionary authority without the prior approval of the customer.

In compliance with the guidelines of FINRA, the maximum commission or discount to be received by any FINRA member independent broker dealer may not exceed 8% of the principal amount of securities offered pursuant to this prospectus. We anticipate, however, that the actual commission or discount to be received in any particular offering of securities will be significantly less than this amount.

Market-Making Resales by Affiliates

This prospectus may be used by Jefferies & Company, Inc. in connection with offers and sales of the securities in market-making transactions (and offers and sales of any securities covered by this prospectus and underlying securities that are incidental to such market-making activity). In a market-making transaction, Jefferies & Company, Inc. may acquire a security it acquires from other holders, after the original purchase and sale of the security. Resales of this kind may occur in the market or may be privately negotiated at prevailing market prices at the time of resale or at related or negotiated prices. In market-making transactions, Jefferies & Company, Inc. may act as principal agent, including as agent for the counterparty in a transaction in which Jefferies & Company, Inc. acts as principal, or as agent for both counterparties in a transaction in which Jefferies & Company, Inc. does not act as principal. Jefferies & Company, Inc. may receive compensation in the form of discounts and commissions, including from both counterparties in some transactions. Other affiliates of Jefferies Group, Inc. may also engage in transactions of this kind and may use this prospectus for similar purposes.

Table of Contents

Jefferies Group, Inc. does not expect to receive any proceeds from market-making transactions. Jefferies Group, Inc. does not expect that Jefferies & Company, Inc. or any other affiliate thereof in these transactions will pay any proceeds from its market-making resales to Jefferies Group, Inc.

Information about the trade and settlement dates, as well as the purchase price, for a market-making transaction will be provided to the purchaser in a separate confirmation of sale.

Unless Jefferies Group, Inc. or an agent informs you in a separate confirmation of sale that your security is being purchased in an original offering and sale, you may assume that you are purchasing your security in a market-making transaction.

Certain ERISA Considerations

Jefferies Group, Inc. has certain affiliates that provide or administer many employee benefit plans. Jefferies Group, Inc. and its affiliates may each be considered a party in interest within the meaning of the Employee Retirement Income Security Act of 1974 (ERISA), or a disqualified person under corresponding provisions of the Internal Revenue Code of 1986 (the Code) relating to many employee benefit plans. Prohibited transactions within the meaning of ERISA and the Code may result if the offered securities are acquired by or with the assets of another employee benefit plan relating to which Jefferies Group, Inc. or any of its affiliates is a service provider, unless those securities are acquired under an exemption for transactions effected on behalf of that plan by a qualified professional asset manager, an in-house asset manager or under any other available exemption. Additional special considerations may arise in connection with the acquisition of capital securities by or with the assets of another employee benefit plan. The assets of a pension or other employee benefit plan may include assets held in the general account of an insurance company that are deemed to be covered by ERISA. Any employee benefit plan or other entity subject to such provisions of ERISA or the Code proposing to purchase offered securities should consult with its legal counsel.

Legal Matters

Morgan, Lewis & Bockius LLP, New York, New York, has rendered an opinion to us regarding the validity of the securities to be offered by the prospectus. Any underwriters will also be advised about the validity of the securities and other legal matters by their own counsel, which will be named in the prospectus supplement.

Experts

The consolidated financial statements of Jefferies Group of December 31, 2008 and 2007, and for each of the years in the three-year period ended December 31, 2008, and management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2008, have been incorporated by reference herein and in the registration statement in reliance on the reports of KPMG LLP, independent registered public accounting firm, incorporated by reference herein, and on the authority of said firm as experts in accounting and auditing. The Company adopted Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51, and FSP EITF 03-06-1, Determining the Fair Value of Instruments Granted in Share-Based Payment Transactions, and retrospectively adjusted the consolidated financial statements as of and for all periods presented therein.

Table of Contents

% Senior Convertible Debentures due 20

Prospectus Supplement

Jefferies & Company

Citi

2009