INFINERA CORP
Form 10-Q
August 05, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 29, 2013

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: 001-33486

Infinera Corporation

(Exact name of registrant as specified in its charter)

Delaware	**77-0560433**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

140 Caspian Court

Sunnyvale, CA 94089

(Address of principal executive offices, including zip code)

(408) 572-5200

(Registrant s telephone number, including area code)

Indicate by checkmark 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 x 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 x No ¨

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

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

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

As of July 29, 2013, 118,068,260 shares of the registrant s Common Stock, $0.001 par value, were issued and outstanding.

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INFINERA CORPORATION

QUARTERLY REPORT ON FORM 10-Q

FOR THE FISCAL QUARTER ENDED JUNE 29, 2013

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PART I. FINANCIAL INFORMATION

Item 1. *Condensed Consolidated Financial Statements*

INFINERA CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par values)

(Unaudited)

	June 29, 2013	December 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 181,211	$ 104,666
Short-term investments	120,437	76,146
Accounts receivable, net of allowance for doubful accounts of $133 in 2013 and $94 in 2012	96,668	107,039
Other receivables	1,112	2,909
Inventory	121,317	127,809
Deferred inventory costs	850	1,029
Prepaid expenses and other current assets	14,495	9,899
Total current assets	536,090	429,497
Property, plant and equipment, net	78,391	80,343
Deferred inventory costs, non-current	38	100
Long-term investments	23,427	2,874
Cost-method investment	9,000	9,000
Long-term restricted cash	3,850	3,868
Deferred tax asset	0	805
Other non-current assets	5,564	1,683
Total assets	$ 656,360	$ 528,170
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 35,977	$ 61,428
Accrued expenses	18,221	25,483
Accrued compensation and related benefits	24,997	22,325
Accrued warranty	8,332	7,262
Deferred revenue	31,429	26,744
Deferred tax liability	0	805
Total current liabilities	118,956	144,047
Long-term debt	105,580	0
Accrued warranty, non-current	11,369	9,220

Deferred revenue, non-current	2,964	3,210
Other long-term liabilities	18,341	15,557
Commitments and contingencies (Note 14)		
Stockholders equity:		
Preferred stock, $0.001 par value		
Authorized shares 25,000 and no shares issued and outstanding	0	0
Common stock, $0.001 par value		
Authorized shares 500,000 as of June 29, 2013 and December 29, 2012		
Issued and outstanding shares 117,947 as of June 29, 2013 and 112,461 as of December 29, 2012	118	112
Additional paid-in capital	1,000,106	930,618
Accumulated other comprehensive loss	(3,420)	(2,228)
Accumulated deficit	(597,654)	(572,366)
Total stockholders equity	399,150	356,136
Total liabilities and stockholders equity	$ 656,360	$ 528,170

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

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INFINERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Revenue:				
Product	$ 120,153	$ 77,843	$ 227,962	$ 170,234
Ratable product and related support and services	494	523	1,028	1,054
Services	17,738	15,092	34,020	26,871
Total revenue	138,385	93,458	263,010	198,159
Cost of revenue:				
Cost of product	80,129	56,017	155,481	115,341
Cost of ratable product and related support and services	69	166	164	357
Cost of services	6,533	4,901	13,009	9,660
Total cost of revenue	86,731	61,084	168,654	125,358
Gross profit	51,654	32,374	94,356	72,801
Operating expenses:				
Research and development	31,681	31,676	61,407	62,661
Sales and marketing	17,155	17,777	35,201	36,019
General and administrative	11,426	12,320	21,298	23,404
Total operating expenses	60,262	61,773	117,906	122,084
Loss from operations	(8,608)	(29,399)	(23,550)	(49,283)
Other income (expense), net:				
Interest income	207	228	404	503
Interest expense	(849)	0	(849)	0
Other gain (loss), net:	(158)	149	(361)	(275)
Total other income (expense), net	(800)	377	(806)	228
Loss before income taxes	(9,408)	(29,022)	(24,356)	(49,055)
Provision for income taxes	601	527	932	1,106
Net loss	$ (10,009)	$ (29,549)	$ (25,288)	$ (50,161)
Net loss per common share				
Basic	$ (0.09)	$ (0.27)	$ (0.22)	$ (0.46)
Diluted	$ (0.09)	$ (0.27)	$ (0.22)	$ (0.46)
Weighted average shares used in computing net loss per common share				
Basic	116,911	110,403	115,609	109,534

Diluted	116,911	110,403	115,609	109,534

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

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INFINERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Net loss	$ (10,009)	$ (29,549)	$ (25,288)	$ (50,161)
Other comprehensive loss:				
Unrealized gain on auction rate securities classified as available-for-sale investments	0	45	0	60
Reclassification of realized gain on auction rate securities	0	(283)	(166)	(286)
Unrealized gain (loss) on all other available-for-sale investments	(99)	(17)	(108)	120
Foreign currency translation adjustment	(802)	(645)	(918)	(263)
Tax related to available-for-sale investment	0	60	0	0
Net change in accumulated other comprehensive loss	(901)	(840)	(1,192)	(369)
Comprehensive loss	$ (10,910)	$ (30,389)	$ (26,480)	$ (50,530)

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

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INFINERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 29, 2013	June 30, 2012
Cash Flows from Operating Activities:		
Net loss	$ (25,288)	$ (50,161)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	12,621	11,224
(Recovery of) provision for other receivables	(88)	0
Provision for doubtful accounts	40	0
Amortization of debt discount and issuance costs	630	0
Amortization of premium on investments	450	1,098
Stock-based compensation expense	16,159	20,367
Other gain	(243)	(501)
Changes in assets and liabilities:		
Accounts receivable	10,332	24,416
Other receivables	1,629	(477)
Inventory	791	(24,770)
Prepaid expenses and other assets	(4,083)	1,533
Deferred inventory costs	216	3,910
Accounts payable	(23,980)	(8,753)
Accrued liabilities and other expenses	(220)	(2,272)
Deferred revenue	4,440	(4,952)
Accrued warranty	3,219	837
Net cash used in operating activities	(3,375)	(28,501)
Cash Flows from Investing Activities:		
Purchase of available-for-sale investments	(130,828)	(42,853)
Proceeds from sale of available-for-sale investments	2,850	5,194
Proceeds from maturities and calls of investments	62,647	70,464
Purchase of property and equipment	(9,431)	(19,770)
Reimbursement of manufacturing capacity advance	0	50
Change in restricted cash	(6)	(230)
Net cash provided by (used in) investing activities	(74,768)	12,855
Cash Flows from Financing Activities:		
Proceeds from issuance of debt, net	144,469	0
Proceeds from issuance of common stock	12,496	7,093
Repurchase of common stock	(1,499)	(839)
Net cash provided by financing activities	155,466	6,254
Effect of exchange rate changes on cash	(778)	(78)
Net change in cash and cash equivalents	76,545	(9,470)
Cash and cash equivalents at beginning of period	104,666	94,458
Cash and cash equivalents at end of period	$ 181,211	$ 84,988

Supplemental disclosures of cash flow information:		
Cash paid for income taxes	$ 1,148	$ 595
Supplemental schedule of non-cash financing activities:		
Non-cash settlement for manufacturing capacity advance	$ 0	$ 275
Transfer of inventory to fixed assets	$ 4,684	$ 0

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

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INFINERA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Infinera Corporation (Infinera or the Company) prepared its interim condensed consolidated financial statements that accompany these notes in conformity with U.S. generally accepted accounting principles (U.S. GAAP) and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC), consistent in all material respects with those applied in the Company s Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

The Company has made estimates and judgments affecting the amounts reported in its condensed consolidated financial statements and the accompanying notes. The Company s actual results may differ materially from these estimates. The accounting estimates that require most significant, difficult, and subjective judgment include revenue recognition, stock-based compensation, inventory valuation, allowances for sales returns, allowances for doubtful accounts, accrued warranty, fair value measurement of the liability component of the convertible senior notes, cash equivalents, fair value measurement of investments, other-than-temporary impairments, derivative instruments and accounting for income taxes.

The interim financial information is unaudited, but reflects all adjustments that are, in management s opinion, necessary to provide a fair presentation of results for the interim periods presented. All adjustments are of a normal recurring nature. The Company reclassified certain amounts reported in previous periods to conform to the current presentation. This interim information should be read in conjunction with the consolidated financial statements in the Company s Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

There have been no material changes in the Company s significant accounting policies for the six months ended June 29, 2013 as compared to those disclosed in the Company s Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

2. Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2013-02, Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02). ASU 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The Company adopted the guidance for ASU 2013-02 beginning in its fiscal quarter ended March 30, 2013. Other than requiring additional disclosures, the Company s adoption of ASU 2013-02 did not have an impact on the Company s financial position, results of operations or cash flow.

In July 2013, the FASB issued Accounting Standards Update 2013-11, Income Taxes Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carry forward, a Similar Tax Loss, or a Tax Credit Carry forwards Exists (ASU 2013-11). ASU 2013-11 requires entities to present the unrecognized tax benefits in the financial statements as a liability and not combine it with deferred tax assets to the extent a net operating loss carry-forward, a similar tax loss, or a tax credit carry-forward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. ASU 2013-11 is effective for annual and interim periods for fiscal years beginning on or after December 15, 2013. The Company is currently evaluating its impact on the financial statements and disclosures.

3. Fair Value Measurements and Other-Than-Temporary Impairments

Fair Value Measurements

Pursuant to the accounting guidance for fair value measurements and its subsequent updates, fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

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Valuation techniques used by the Company are based upon observable and unobservable inputs. Observable or market inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s assumptions about market participant assumptions based on best information available. Observable inputs are the preferred source of values. These two types of inputs create the following fair value hierarchy:

Level 1	Quoted prices in active markets for identical assets or liabilities.
Level 2	Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3	Prices or valuations that require management inputs that are both significant to the fair value measurement and unobservable.

The Company measures its cash equivalents, derivative instruments and debt securities at fair value and classifies its securities in accordance with the fair value hierarchy. The Company s money market funds and U.S. treasuries are classified within Level 1 of the fair value hierarchy and are valued based on quoted prices in active markets for identical securities.

The Company classifies its certificates of deposit, commercial paper, corporate bonds, and foreign currency exchange forward contracts within Level 2 of the fair value hierarchy as follows:

Certificates of Deposit

The Company reviews market pricing and other observable market inputs for the same or similar securities obtained from a number of industry standard data providers. In the event that a transaction is observed for the same or similar security in the marketplace, the price on that transaction reflects the market price and fair value on that day. In the absence of any observable market transactions for a particular security, the fair market value at period end would be equal to the par value. These inputs represent quoted prices for similar assets or these inputs have been derived from observable market data, and result in the classification of these securities as Level 2 of the fair value hierarchy.

Commercial Paper

The Company reviews market pricing and other observable market inputs for the same or similar securities obtained from a number of industry standard data providers. In the event that a transaction is observed for the same or similar security in the marketplace, the price on that transaction reflects the market price and fair value on that day and then follows a revised accretion schedule to determine the fair market value at period end. In the absence of any observable market transactions for a particular security, the fair market value at period end is derived by accreting from the last observable market price. These inputs represent quoted prices for similar assets or these inputs have been derived from observable market data accreted mathematically to par, and result in the classification of these securities as Level 2 of the fair value hierarchy.

Corporate Bonds

The Company reviews trading activity and pricing for each of the corporate bond securities in its portfolio as of the measurement date and determines if pricing data of sufficient frequency and volume in an active market exists in order to support Level 1 classification of these securities. Since sufficient quoted pricing for identical securities is not available, the Company obtains market pricing and other observable market inputs for similar securities from a number of industry standard data providers. In instances where multiple prices exist for similar securities, these prices are used as inputs into a distribution-curve to determine the fair market value at period end. As a result, the Company classifies its corporate bonds as Level 2 of the fair value hierarchy.

Foreign Currency Exchange Forward Contracts

As discussed in Note 5, Derivative Instruments, to the Notes to Condensed Consolidated Financial Statements, the Company mainly holds non-speculative foreign exchange forward contracts to hedge certain foreign currency exchange exposures. The Company estimates the fair values of derivatives based on quoted market prices or pricing models using current market rates. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit risk, foreign exchange rates, and forward and spot prices for currencies. As a result, the Company classifies its derivative instruments as Level 2 of the fair value hierarchy.

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The Company classified its auction rate securities (ARS) within Level 3 of the fair value hierarchy. The Company s ARS were classified within Level 3 because they were valued, in part, by using inputs that were unobservable in the market and were significant to the valuation. During the first quarter of 2013, the Company disposed of its remaining $3.1 million (par value) ARS, with $0.1 million of ARS called at par value and $3.0 million of ARS tendered at 95% of par value. As of June 29, 2013, none of the Company s existing securities were classified as Level 3 securities.

The following tables represent the Company s fair value hierarchy for its assets and liabilities measured at fair value on a recurring basis (in thousands):

	As of June 29, 2013 Fair Value Measured Using				As of December 29, 2012 Fair Value Measured Using			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Money market funds	$ 109,851	$ 0	$ 0	$ 109,851	$ 25,560	$ 0	$ 0	$ 25,560
Certificates of deposit	0	1,681	0	1,681	0	2,160	0	2,160
Commercial paper	0	96,793	0	96,793	0	14,843	0	14,843
Corporate bonds	0	61,997	0	61,997	0	57,467	0	57,467
U.S. treasuries	6,007	0	0	6,007	15,020	0	0	15,020
ARS	0	0	0	0	0	0	2,873	2,873
Total assets	$ 115,858	$ 160,471	$ 0	$ 276,329	$ 40,580	$ 74,470	$ 2,873	$ 117,923
Liabilities								
Foreign currency exchange forward contracts	$ 0	$ 84	$ 0	$ 84	$ 0	$ 112	$ 0	$ 112

During the three and six months ended June 29, 2013, there were no transfers of assets or liabilities between Level 1 and Level 2 financial assets.

The Company s remaining Level 3 financial assets were disposed during the first quarter of 2013. The following tables present a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable (Level 3) inputs (in thousands):

		Six Months Ended				
	December 29, 2012	Total Net Gains Included in Other Comprehensive Loss	Calls	Sold	June 29, 2013
ARS available-for-sale	$ 2,873	$ 0	$ (92)[2]	$ (2,781)[3]	$ 0

		Three Months Ended			
	March 31, 2012	Total Net Gains Included in Other Comprehensive Loss	Calls	June 30, 2012
ARS available-for-sale	$ 7,556	44[1]	(4,804)[4]	$ 2,796

		Six Months Ended		
	December 31, 2011	Total Net Gains Included in Other	Calls	June 30, 2012

				Comprehensive Loss		
ARS	available-for-sale	$ 7,675	$	60[1]	$ (4,939)[4]	$ 2,796

(1) Amount represents the change in the non-credit loss related other-than-temporary impairments (OTTI) recorded in Accumulated other comprehensive loss in the accompanying condensed consolidated balance sheets.

(2) Amount represents the fair market value of the securities called at par value. Realized gains for the six months ended June 29, 2013 were not significant.

(3) Amount represents the fair market value of the securities sold at 95% par value. Realized gains for the six months ended June 29, 2013 were $0.2 million.

(4) Amount represents the fair market value of the securities called. Realized gains on these calls for the three and six months ended June 30, 2012 were $0.5 million in each period.

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Investments at fair value were as follows (in thousands):

	June 29, 2013			
	Adjusted Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$ 109,851	$ 0	$ 0	$ 109,851
Certificates of deposit	1,680	1	0	1,681
Commercial paper	96,794	16	(17)	96,793
Corporate bonds	62,091	5	(99)	61,997
U.S. treasuries	6,005	2	0	6,007
Total available-for-sale investments	$ 276,421	$ 24	$ (116)	$ 276,329

	December 29, 2012			
	Adjusted Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$ 25,560	$ 0	$ 0	$ 25,560
Certificates of deposit	2,160	0	0	2,160
Commercial paper	14,848	0	(5)	14,843
Corporate bonds	57,451	22	(6)	57,467
U.S. treasuries	15,015	5	0	15,020
ARS	2,707[1]	166	0	2,873
Total available-for-sale investments	$ 117,741	$ 193	$ (11)	$ 117,923

[1] Amount represents the par value less $0.4 million of credit-related OTTI recognized through earnings in prior years.

As of June 29, 2013, the Company s available-for-sale investments in certificates of deposit, commercial paper, corporate bonds, and U.S. treasuries have a contractual maturity term of no more than 17 months. Proceeds from sales, maturities and calls of available-for-sale investments were $65.5 million for the six months ended June 29, 2013, and $75.7 million for the six months ended June 30, 2012. Net realized gains (losses) on short-term and long-term investments were $0.2 million for the six months ended June 29, 2013 and were $0.5 million for the six months ended June 30, 2012. The specific identification method is used to account for gains and losses on available-for-sale investments.

Other-Than-Temporary Impairments

As a result of the Company s disposal of $3.1 million ARS (par value) during the first quarter of 2013, it recorded an approximately $0.2 million gain, which was recognized as Other gain (loss) in the Company s condensed consolidated statements of operations.

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A roll-forward of amortized cost, cumulative OTTI recognized in earnings and Accumulated other comprehensive loss is as follows (in thousands):

	Amortized Cost	Cumulative OTTI in Earnings	Unrealized Gain	OTTI Loss in Accumulated Other Comprehensive Loss	Accumulated Other Comprehensive Income (Loss)
Balance at December 29, 2012	$ 2,707	$ (394)	$ 784	$ (618)	$ 166
Call on investments	(87)	13	(25)	20	(5)
Investments sold	(2,620)	381	(759)	598	(161)
Balance at June 29, 2013	$ 0	$ 0	$ 0	$ 0	$ 0

4. Cost-method Investment

As of June 29, 2013, the Company s investment in a privately-held company was $9.0 million. This investment is accounted for as a cost-basis investment, as the Company owns less than 20% of the voting securities and does not have the ability to exercise significant influence over operating and financial policies of the entity. The Company s cost-method investment is carried at historical cost in its condensed consolidated financial statements and measured at fair value on a nonrecurring basis. If the Company believes that the carrying value of the cost basis investment is in excess of estimated fair value, the Company s policy is to record an impairment charge in Other income (expense), net in the accompanying condensed consolidated statements of operations to adjust the carrying value to estimated fair value, when the impairment is deemed other-than-temporary. The Company regularly evaluates the carrying value of this cost-method investment for impairment. As of June 29, 2013, no event had occurred that would adversely affect the carrying value of this investment, therefore, the fair value of the cost-method investment is not estimated. The Company did not record any impairment charges for this cost-method investment during the three and six months ended June 29, 2013 and June 30, 2012.

5. Derivative Instruments

Foreign Currency Exchange Forward Contracts

The Company enters into foreign currency exchange forward contracts to manage its exposure to fluctuations in foreign exchange rates that arise primarily from its Euro denominated receivables and Euro denominated restricted cash balance amounts that are pledged as collateral for certain stand-by and commercial letters of credit. Gains and losses on these contracts are intended to offset the impact of foreign exchange rate changes on the underlying foreign currency denominated accounts receivables and restricted cash, and therefore, do not subject the Company to material balance sheet risk. The forward contracts are with one high-quality institution and the Company consistently monitors the creditworthiness of the counterparty. None of the Company s derivative instruments contain credit-risk related contingent features, any rights to reclaim cash collateral or any obligation to return cash collateral. The forward contracts entered into during the three and six months ended June 29, 2013 were denominated in Euros and typically had maturities of no more than 30 days. The contracts are settled for U.S. dollars at maturity at rates agreed to at inception of the contracts.

As of June 29, 2013, the Company did not designate foreign currency exchange forward contracts related to Euro denominated receivables and restricted cash as hedges for accounting purposes, and accordingly changes in the fair value of these instruments are included in Other gain (loss), net in the accompanying condensed consolidated statements of operations. For the three months ended June 29, 2013 and June 30, 2012, the before-tax effect of foreign currency exchange forward contracts for Euro denominated receivables and restricted cash not designated as hedging instruments was a loss of $0.7 million and a gain of $0.6 million, respectively, included in Other gain (loss), net in the condensed consolidated statements of operations. For the six months ended June 29, 2013 and June 30, 2012, the before-tax effect of foreign currency exchange forward contracts for Euro denominated receivables and restricted cash not designated as hedging instruments was a loss of $0.2 million and a loss of $0.2 million, respectively, included in Other gain (loss), net in the condensed consolidated statement of operations.

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The fair value of derivative instruments not designated as hedging instruments in the Company s condensed consolidated balance sheets was as follows (in thousands):

	As of June 29, 2013		As of December 29, 2012	
	Gross Notional[1]	Other Accrued Liabilities	Gross Notional[1]	Other Accrued Liabilities
Foreign currency exchange forward contracts				
Related to Euro denominated receivables	$ 22,500	$ (79)	$ 22,882	$ (105)
Related to restricted cash	1,474	(5)	1,495	(7)
	$ 23,974	$ (84)	$ 24,377	$ (112)

[1] Represents the face amounts of forward contracts that were outstanding as of the period noted.

6. Balance Sheet Details

The following table provides details of selected balance sheet items (in thousands):

	June 29, 2013	December 29, 2012
Inventory		
Raw materials	$ 9,792	$ 13,003
Work in process	41,048	57,281
Finished goods [1]	70,477	57,525
Total inventory	$ 121,317	$ 127,809
Property, plant and equipment, net:		
Computer hardware	$ 8,920	$ 9,024
Computer software	16,296	15,834
Laboratory and manufacturing equipment	133,973	120,543
Furniture and fixtures	1,345	1,285
Leasehold improvements	34,566	33,370
Construction in progress	11,996	17,513
Subtotal	$ 207,096	$ 197,569
Less accumulated depreciation and amortization	(128,705)	(117,226)
Total property, plant and equipment, net	$ 78,391	$ 80,343
Accrued expenses:		
Loss contingency related to non-cancelable purchase commitments	$ 5,525	$ 5,401
Professional and other consulting fees	1,605	3,703
Taxes payable	1,707	3,588
Royalties	1,150	1,516
Accrued rebate and customer prepay liability	611	1,284
Other accrued expenses	7,623	9,991

Total accrued expenses	$ 18,221	$ 25,483

(1) Included in finished goods inventory at June 29, 2013 and December 29, 2012 were $20.3 million and $15.6 million, respectively, of inventory at customer locations for which product acceptance had not occurred.

The Company had $3.6 million of standby letters of credit outstanding as of June 29, 2013 and December 29, 2012. These consisted of $1.5 million related to a value added tax license, $1.4 million related to a customer proposal guarantee and $0.7 million related to property leases.

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7. Comprehensive Loss

Other comprehensive loss includes certain changes in equity that are excluded from net loss. The following table sets forth the changes in accumulated other comprehensive loss by component for the six months ended June 29, 2013 (in thousands):

	Unrealized Gain on Auction Rate Securities	Unrealized Gain on Other Available-for-Sale Securities	Foreign Currency Translation	Accumulated Tax Effect	Total
Balance at December 29, 2012	$ 166	$ 16	$ (1,650)	$ (760)	$ (2,228)
Other comprehensive loss before reclassifications	0	(108)	(918)	0	(1,026)
Amounts reclassified from accumulated other comprehensive loss	(166)	0	0	0	(166)
Net current-period other comprehensive loss	(166)	(108)	(918)	0	(1,192)
Balance at June 29, 2013	$ 0	$ (92)	$ (2,568)	$ (760)	$ (3,420)

The following table provides details about reclassifications out of accumulated other comprehensive loss for the six months ended June 29, 2013 (in thousands):

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss	Affected Line Item in the Statement Where Net Loss is Presented
Unrealized gain on auction rate securities	$ (166)	Other gain (loss), net
	0	Provision for income taxes
Total reclassifications for the period	$ (166)	Total, net of income tax

8. Basic and Diluted Net Loss Per Common Share

Basic net loss per common share is computed by dividing net loss by the weighted average number of vested common shares outstanding during the period. Diluted net loss per common share is computed using net loss and the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the assumed exercise of outstanding stock options, assumed vesting of outstanding restricted stock units (RSUs) and performance stock units (PSUs), assumed exercise of outstanding warrants, assumed conversion of convertible senior notes and assumed issuance of stock under the Company s employee stock purchase plan (ESPP) using the treasury stock method. Upon conversion of the Notes, it is the Company s intention to pay cash equal to the lesser of the aggregate principal amount and the conversion value of the Notes being converted, therefore, only the conversion spread relating to the Notes would be included in the Company s diluted earnings per share calculation unless their effect is anti-dilutive.

The following table sets forth the computation of net loss per common share basic and diluted (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012

Net loss	$ (10,009)	$ (29,549)	$ (25,288)	$ (50,161)
Weighted average common shares outstanding	116,911	110,403	115,609	109,534
Net loss per common share basic and diluted	$ (0.09)	$ (0.27)	$ (0.22)	$ (0.46)

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The Company had the following equity awards outstanding that could potentially dilute basic net loss per common share in the future, but were excluded from the computation of diluted loss per common share in the periods presented as their effect would have been anti-dilutive (in thousands):

	As of	
	June 29, 2013	June 30, 2012
Stock options	7,396	9,412
RSUs	6,362	7,054
PSUs	721	1,505
ESPP	601	816
Warrants to purchase common stock	0	93
Total	15,080	18,880

9. Convertible Senior Notes

In May 2013, the Company issued $150.0 million of 1.75% convertible senior notes due June 1, 2018 (the Notes). The Notes will mature on June 1, 2018, unless earlier purchased by the Company or converted. Interest is payable semi-annually in arrears on June 1 and December 1 of each year, commencing December 1, 2013. The net proceeds to the Company were approximately $144.5 million.

The Notes are governed by an indenture dated as of May 30, 2013 (the Indenture), between the Company, as issuer, and U.S. Bank National Association, as trustee. The Notes are unsecured and do not contain any financial covenants or any restrictions on the payment of dividends, the incurrence of senior debt or other indebtedness, or the issuance or repurchase of securities by the Company.

Upon conversion, it is the Company s intention to pay cash equal to the lesser of the aggregate principal amount and the conversion value of the Notes being converted and cash, shares of common stock or a combination of cash and shares of common stock, at the Company s election, for any remaining conversion obligation. The initial conversion rate is 79.4834 shares of common stock per $1,000 principal amount of Notes, subject to anti-dilution adjustments. The initial conversion price is approximately $12.58 per share of common stock.

Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events, including for any cash dividends. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest upon conversion of a Note. Accrued but unpaid interest will be deemed to be paid in full upon conversion rather than cancelled, extinguished or forfeited. Holders may convert their Notes under the following circumstances:

- during any fiscal quarter commencing after the fiscal quarter ending on September 28, 2013 (and only during such fiscal quarter) if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

- during the five business day period after any five consecutive trading day period (the measurement period) in which the trading price per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company s common stock and the conversion rate on each such trading day;

- upon the occurrence of specified corporate events described under the Indenture, such as a consolidation, merger or binding share exchange; or

at any time on or after December 1, 2017 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their Notes at any time, regardless of the foregoing circumstances.

If the Company undergoes a fundamental change as defined in the Indenture governing the Notes, holders may require the Company to repurchase for cash all or any portion of their Notes at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date. In addition, upon the occurrence of a make-whole fundamental change (as defined in the Indenture), the Company will, in certain circumstances, increase the conversion rate by a number of additional shares for a holder that elects to convert its Notes in connection with such make-whole fundamental change.

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The Notes consisted of the following (in thousands):

	Other Non-Current Assets	Long-term Debt	Additional Paid-in Capital
Principal amount	$ 0	$ 150,000	$ 0
Debt discount	0	(45,000)	0
Equity component	0	0	45,000
Debt issuance cost	3,872	0	(1,659)
Initial transaction amounts	**$ 3,872**	**$ 105,000**	**$ 43,341**
Amortization of debt issuance cost	(50)	0	0
Amortization of debt discount	0	580	0
Net carrying amount at June 29, 2013	**$ 3,822**	**$ 105,580**	**$ 43,341**

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the liability component over its carrying amount (debt discount) is amortized to interest expense over the term of the Notes. The remaining debt discount amount to be amortized over the remaining five years until maturity of the Notes was $44.4 million as of June 29, 2013.

In accounting for the issuance costs of $5.5 million related to the Notes, the Company allocated the total amount incurred to the liability and equity components of the Notes based on their relative values. Issuance costs attributable to the liability component were recorded as Other non-current assets and will be amortized to interest expense over the term of the Notes. The issuance costs attributable to the equity component were netted with the equity component in stockholders equity. Additionally, the Company recorded a deferred tax liability of $17.0 million in connection with the Notes, along with a corresponding reduction in valuation allowance; the impact of both was recorded to stockholders equity.

The Company determined that the embedded conversion option in the Notes does not require separate accounting treatment as a derivative instrument because it is both indexed to the Company s own stock and would be classified in stockholder s equity if freestanding.

The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Three and Six Months Ended June 29, 2013
Contractual interest expense	$ 219
Amortization of debt issuance costs	50
Amortization of debt discount	580
	$ 849

The effective interest rate of the liability component was 1.75%. The excess of the principal amount of the liability component over its carrying amount is amortized, using an effective interest rate of 5.12%, to interest expense over the term of the Notes.

As of June 29, 2013, the fair value of the Notes was $166.8 million. The fair value was determined based on the quoted bid price of the Notes in an over-the-counter market on June 28, 2013. The Notes are classified under Level 2 of the fair value hierarchy. Based on the closing price of the Company s common stock of $10.67 on June 28, 2013, the if-converted value of the Notes was less than their principal amount.

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10. Stockholders Equity

Stock-based Compensation Plans

The Company s stock-based compensation plans include stock options, RSUs, PSUs and employee stock purchases under the Company s ESPP. As of June 29, 2013, there were a total of 17.2 million shares available for grant under the Company s 2007 Equity Incentive Plan. The following tables summarize the Company s equity award activity and related information (in thousands, except per share data):

	Number of Options	Average Exercise Price Per Share	Aggregate Intrinsic Value
Outstanding at December 29, 2012	9,008	$ 7.13	$ 5,726
Options exercised	(1,195)	$ 6.15	$ 3,932
Options canceled	(417)	$ 7.95	
Outstanding at June 29, 2013	7,396	$ 7.25	$ 26,252
Vested and expected to vest as of June 29, 2013	7,381		$ 26,211
Exercisable at June 29, 2013	6,811	$ 7.18	$ 24,647

	Number of Restricted Stock Units	Weighted-Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Outstanding at December 29, 2012	6,703	$ 8.01	$ 38,873
RSUs granted	2,878	$ 6.90	
RSUs released	(2,748)	$ 8.30	$ 21,672
RSUs canceled	(471)	$ 7.70	
Outstanding at June 29, 2013	6,362	$ 7.40	$ 67,875
Expected to vest at June 29, 2013	6,166		$ 65,794

	Number of Performance Stock Units	Weighted-Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Outstanding at December 29, 2012	1,368	$ 10.53	$ 7,933
PSUs granted	552	$ 6.70	
PSUs released	(684)	$ 10.53	$ 4,284
PSUs canceled	(515)	$ 11.31	
Outstanding at June 29, 2013	721	$ 7.04	$ 7,688
Expected to vest at June 29, 2013	487		$ 5,194

The aggregate intrinsic value of unexercised options, unreleased RSUs and unreleased PSUs is calculated as the difference between the closing price of the Company s common stock of $10.67 at June 28, 2013 and the exercise prices of the underlying equity awards. The aggregate intrinsic value of the options which have been exercised and RSUs released is calculated as the difference between the fair market value of the common stock at the date of exercise or release and the exercise price of the underlying equity awards.

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The following table presents total stock-based compensation cost for instruments granted but not yet amortized, net of estimated forfeitures, of the Company s equity compensation plans as of June 29, 2013. These costs are expected to be amortized on a straight-line basis over the following weighted-average periods (in thousands, except for weighted-average period):

	Unrecognized Compensation Expense, Net	Weighted-Average Period (in years)
Stock options	2,094	1.1
RSUs	34,051	2.2
PSUs	2,634	1.9

Employee Stock Options

The ranges of estimated values of stock options and performance-based stock options granted, as well as ranges of assumptions used in calculating these values were based on estimates as follows:

	Three Months Ended		Six Months Ended June 30,	
Employee and Director Stock Options	**June 29, 2013**	**June 30, 2012**	**June 29, 2013**	**2012**
Volatility	N/A	N/A	N/A	65% - 68%
Risk-free interest rate	N/A	N/A	N/A	0.7% - 1.0%
Expected life	N/A	N/A	N/A	4.0 - 5.3 years
Estimated fair value	N/A	N/A	N/A	$3.75 - $3.76
Stock-based compensation expense (in thousands)	$722	$2,167	$1,525	$4,568

N/A Not applicable because the Company did not grant any options to employees for the periods presented.

Employee Stock Purchase Plan

The fair value of the ESPP shares was estimated at the date of grant using the following assumptions:

	Three Months Ended		Three Months Ended	
Employee Stock Purchase Plan	**June 29, 2013**	**June 30, 2012**	**June 29, 2013**	**June 30, 2012**
Volatility	46%	57%	46%	57%
Risk-free interest rate	0.1%	0.2%	0.1%	0.2%
Expected life	0.5 years	0.5 years	0.5 years	0.5 years
Estimated fair value	$1.87	$2.63	$1.87	$2.63
Stock-based compensation expense (in thousands)	$566	$861	$1,274	$1,758

Restricted Stock Units

During the three and six months ended June 29, 2013, the Company granted RSUs to members of the Company s board of directors and employees to receive an aggregate of 2.5 million shares and 2.9 million shares of the Company s common stock, respectively, at no cost. The Company accounted for the fair value of the RSUs using the closing market price of the Company s common stock on the date of grant. Amortization of stock-based compensation related to RSUs in the three and six months ended June 29, 2013 and June 30, 2012 was approximately $5.8 million and $12.7 million, respectively, and $7.3 million and $13.6 million, respectively.

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Performance Stock Units

During 2009, the Company granted PSUs primarily to members of the Company s board of directors and executive officers. The number of shares to be issued upon vesting of PSUs range from 0.5 to 2.0 times the number of PSUs granted depending on the relative performance of the Company s common stock price compared to the NASDAQ Composite Index over a three-year or four-year period. During the six months ended June 29, 2013, the Company released 0.5 million shares of PSUs based on a payout of 0.5 times of the target number of PSUs.

Pursuant to the Company s 2007 Equity Incentive Plan, during 2012, the Company granted 0.5 million shares of PSUs to certain of the Company s executive officers. These PSUs will only vest upon the achievement of certain specific revenue and operating profit criteria and are subject to each named executive officer s continued service to the Company. If the financial performance metrics are not met within the time limits specified in the award agreements, the PSUs will be cancelled. During the six months ended June 29, 2013, the Company released 0.2 million shares of PSUs upon achievement of certain performance goals.

Pursuant to the Company s 2007 Equity Incentive Plan, during the three and six months ended June 29, 2013, the Company granted 0.2 million and 0.6 million shares of PSUs, respectively, to certain of the Company s executive officers. The number of shares to be issued upon vesting of PSUs range from 0 to 1.5 times the number of PSUs granted depending on the relative performance of the Company s common stock price compared to the NASDAQ Telecom Composite Index over the span of one, two and three years of total shareholder returns.

Amortization of stock-based compensation related to PSUs in the three months ended June 29, 2013 was approximately $0.4 million. Amortization of stock-based compensation related to PSUs in the six months ended June 29, 2013 was a credit of approximately $0.4 million, including $1.0 million of expense offset by a $1.4 million decrease in fair value for one award classified as a liability award, in accordance with Accounting Standard Codification 718, Compensation Stock Compensation. Amortization of stock-based compensation related to PSUs in the three and six months ended June 30, 2012 was approximately $1.4 million and $1.8 million, respectively.

Common Stock Warrants

During the first quarter of 2013, warrants to purchase 92,592 shares of common stock were net exercised. The aggregate consideration for such exercises was approximately $0.5 million. As of June 29, 2013, there were no warrants of common stock outstanding.

Stock-Based Compensation

The following tables summarize the effects of stock-based compensation on the Company s condensed consolidated balance sheets and statements of operations for the periods presented (in thousands):

	June 29, 2013	December 29, 2012
Stock-based compensation effects in inventory	$ 3,875	$ 4,891
Stock-based compensation effects in deferred inventory cost	$ 17	$ 42
Stock-based compensation effects in fixed assets	$ 158	$ 171

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Stock-based compensation effects in net loss before income taxes				
Cost of revenue	$ 474	$ 686	$ 960	$ 1,292
Research and development	2,622	3,695	5,741	7,015
Sales and marketing	1,807	2,744	3,806	4,963
General and administration	1,591	2,705	2,360	4,928
	6,494	9,830	12,867	18,198
Cost of revenue amortization from balance sheet[1]	1,690	1,100	3,292	2,169

Total stock-based compensation expense	$ 8,184	$ 10,930	$ 16,159	$ 20,367

(1) Stock-based compensation expense deferred to inventory and deferred inventory costs in prior periods and recognized in the current period.

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11. Income Taxes

Provision for income taxes for the three and six months ended June 29, 2013 was $0.6 million and $0.9 million, respectively, or negative 6.4% and negative 3.8%, respectively, on a pre-tax loss of $9.4 million and $24.4 million, respectively. This compared to a tax provision of $0.5 million and $1.1 million, respectively, or negative 1.8% and negative 2.3%, respectively, on a pre-tax loss of $29.0 million and $49.1 million, respectively for the three and six months ended June 30, 2012. The difference between the Company s effective tax rates and the federal statutory rate of 35% is primarily attributable to unbenefited U.S. losses, foreign taxes provided on the income of the Company s foreign subsidiaries, non-deductible stock-based compensation expense, and various discrete items. The lower tax expense in 2013 relates to a release of transfer pricing reserves following a statute of limitations lapse.

The realization of tax benefits of deferred tax assets is dependent upon future levels of taxable income, of an appropriate character, in the periods the items are scheduled to be deductible or taxable. Based on the available objective evidence, management believes it is more likely than not that the domestic net deferred tax assets will not be realizable. Accordingly, the Company has provided a full valuation allowance against its domestic deferred tax assets, net of deferred tax liabilities, as of June 29, 2013 and December 29, 2012. In determining future taxable income, the Company makes assumptions to forecast federal, state and international operating income, the reversal of taxable temporary differences, and the implementation of any feasible and prudent tax planning strategies. The assumptions require significant judgment regarding the forecasts of future taxable income and are consistent with the Company s forecasts used to manage its business. The Company intends to maintain the remaining valuation allowance until sufficient positive evidence exists to support a reversal of, or decrease, in the valuation allowance.

12. Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company s chief operating decision maker is the Company s chief executive officer. The Company s chief executive officer reviews financial information presented on a consolidated basis, accompanied by information about revenue by geographic region for purposes of allocating resources and evaluating financial performance. The Company has one business activity, and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Accordingly, the Company is considered to be in a single reporting segment and operating unit structure.

Revenue by geographic region is based on the shipping address of the customer. The following tables set forth revenue and long-lived assets by geographic region (in thousands):

Revenue

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Americas:				
United States	$ 88,251	$ 65,790	$ 167,324	$ 136,688
Other Americas	3,802	1,515	4,519	5,507
	92,053	67,305	171,843	142,195
Europe, Middle East and Africa	31,954	23,278	70,760	49,429
Asia Pacific	14,378	2,875	20,407	6,535
Total revenue	$ 138,385	$ 93,458	$ 263,010	$ 198,159

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Property, plant and equipment, net

	June 29, 2013	December 29, 2012
United States	$ 75,974	$ 78,309
Other Americas	169	198
Europe, Middle East and Africa	841	24
Asia Pacific	1,407	1,812
Total property, plant and equipment, net	$ 78,391	$ 80,343

13. Guarantees

Product Warranties

Upon delivery of products, the Company provides for the estimated cost to repair or replace products or the related components that may be returned under hardware warranties. In general, hardware warranty periods range from one to five years. Hardware warranties provide the purchaser with protection in the event that the product does not perform to product specifications. During the warranty period, the purchaser s sole and exclusive remedy in the event of such defect or failure to perform is limited to the correction of the defect or failure by repair, refurbishment or replacement, at the Company s sole option and expense. The Company estimates its hardware warranty obligations based on the Company s historical experience of known product failure rates, use of materials to repair or replace defective products, and service delivery costs incurred in correcting product failures. In addition, from time to time, specific hardware warranty accruals may be made if unforeseen technical problems arise with specific products. Management periodically assesses the adequacy of the Company s recorded warranty liabilities and adjusts the amounts as necessary.

Activity related to product warranty was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Beginning balance	$ 16,672	$ 12,986	$ 16,482	$ 12,865
Charges to operations	6,178	3,103	10,346	5,824
Utilization	(2,055)	(1,831)	(4,138)	(3,804)
Change in estimate [(1)]	(1,094)	(556)	(2,989)	(1,183)
Balance at the end of the period	$ 19,701	$ 13,702	$ 19,701	$ 13,702

(1) The Company records hardware warranty liabilities based on the latest quality and cost information available as of that date. The favorable changes in estimate shown here are due to continued improvements in overall actual failure rates and the impact of these improvements on the Company s estimate of expected future returns and changes in the estimated cost of replacing failed units using either repaired or new units.

14. Litigation and Contingencies

Legal Matters

From time to time, the Company is subject to various legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, the Company does not expect that the ultimate costs to resolve these matters will have a material effect on its consolidated financial position, results of operations, or cash flows. A complete description of the Company s legal proceedings can be found in Item 3. Legal Proceedings of Part I of the Company s Annual Report on Form 10-K for the fiscal year ended

December 29, 2012 filed with the SEC on March 5, 2013. Any updates to the information contained in the Company s Annual Report on Form 10-K are set forth below.

Cheetah Patent Infringement Litigation

A hearing was held on July 16, 2013, during which the parties presented evidence to the U.S. District Court for the Eastern District of Texas Texarkana Division regarding the interpretation of various claim terms of patent no. 6,795,605 and patent no. 7,142,347. On July 24, 2013, the Court issued an order regarding claim construction, in which the Court agreed with some of the Company s proposed claim constructions.

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In addition to the ongoing Cheetah litigation, on June 10, 2013, the Company filed a Petition for Inter Partes Review to challenge the validity of Cheetah s patent no. 6,888,661 (the 661 Patent) in a separate proceeding before the United States Patent and Trademark Office. Cheetah has sued Finisar Corporation for infringement of the 661 Patent in the U.S. District Court for the Eastern District of Michigan.

Based on the information available at this time, the Company concluded that the likelihood of a loss with respect to this suit is reasonably possible. The Company has further concluded that the range of the reasonably possible loss is an insignificant amount and will not have a material adverse effect on the Company s business, consolidated financial position, results of operations, or cash flows. No provision has been made for this lawsuit in the Company s financial statements. Factors that the Company considered in the determination of the likelihood of a loss and the estimate of the range of that loss in respect to this matter included the merits of the case, the nature of the litigation (including the complex and technical nature of patent litigation), the length of time the matter has been pending, the lift of the stay by the court, the status of the plaintiff as a non-operating entity, the Company s intention to vigorously defend the case unless it can be settled for an insignificant amount and the likelihood of the plaintiff accepting an amount in this range. However, the outcome of such legal matters is inherently unpredictable and subject to significant uncertainties.

Cambrian Science Patent Infringement Litigation

On June 17, 2013, the U.S. District Court for the Central District of California issued an order regarding claim construction, in which the Court agreed with some of the Company s proposed claim constructions.

Based on the information available at this time, the Company concluded that the likelihood of a loss with respect to this suit is less than reasonably possible and therefore, a range of loss cannot be provided. As a result, the Company has made no provision for this lawsuit in its financial statements. Factors that the Company considered in the determination of the likelihood of a loss in respect to this matter included the merits of the case, the nature of the litigation (including the complex and technical nature of patent litigation), the length of time the matter has been pending, and the status of the plaintiff as a non-operating entity, and the Company s intention to vigorously defend this case.

Loss Contingencies

The Company is subject to the possibility of various losses arising in the ordinary course of business. These may relate to disputes, litigation and other legal actions. In the preparation of its quarterly and annual financial statements, the Company considers the likelihood of loss or the incurrence of a liability, including whether it is probable, reasonably possible or remote that a liability has been incurred, as well as the Company s ability to reasonably estimate the amount of loss, in determining loss contingencies. In accordance with U.S. GAAP, an estimated loss contingency is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company regularly evaluates current information to determine whether any accruals should be adjusted and whether new accruals are required. As of June 29, 2013, the Company has not accrued or recorded any such material liabilities.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

This quarterly report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include any expectation of earnings, revenues, gross margins, expenses or other financial items; any statements of the plans, strategies and objectives of management for future operations and personnel; factors that may affect our operating results; statements concerning new products or services, including future PIC capacity and new product costs, delivery dates and revenues; statements related to capital expenditures; statements related to future economic conditions, performance, market growth or our sales cycle; statements related to our convertible senior notes; statements related to the effects of litigation on our financial position, results of operations, or cash flows; statements as to industry trends and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as anticipate, believe, continue, could, estimate, expect, intend, may, or will, and similar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors included elsewhere in this Form 10-Q and in our other SEC filings, including our annual report on Form 10-K for the fiscal year ended December 29, 2012 filed on March 5, 2013. Such forward-looking statements speak only as of the date of this report. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements. The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and notes thereto included elsewhere in this quarterly report on Form 10-Q.

Overview

Infinera was founded in December 2000 with a unique vision for optical networking. Prior to Infinera, communications service provider optical networks were built from fairly commoditized products, broadly known as wavelength division multiplexing (WDM) systems. Continued growth in bandwidth demand and the rise of cloud services have increased the need for the delivery of high-capacity, low-cost bandwidth throughout the network. Infinera believes this can best be achieved with photonic integrated circuits (PICs) and that only through photonic integration can network operators efficiently scale their network bandwidth. To address the increasing demand for cloud-based services and data center connectivity, we introduced the Infinera Intelligent Transport Network in June 2013. We believe the Intelligent Transport Network helps carriers increase revenues with the timely delivery of reliable, differentiated services while reducing operating costs through scale, multi-layer convergence and automation.

Essential to our strategy has been the use of PICs as a way to deliver massive dense wavelength division multiplexing (DWDM) bandwidth in a very small power and space footprint, allowing the integration of high capacity switching into the same platform. We introduced the DTN platform based on the 100Gigabits per second (Gbps) PIC in 2004 and since then have made significant enhancements by increasing reach and fiber capacity for the long-haul market, adding the Infinera MTC, a 19-inch DTN chassis option tailored for the metro core market, and adding a submarine version of the DTN platform for the Submarine Line Terminating Equipment market. In addition, we introduced our ATN metro access platform (ATN platform), extending the benefits of Intelligent Transport to the edge of the network. In the second quarter of 2012, we started shipping the DTN-X platform, based on our third generation 500G PIC. The DTN-X platform provides high capacity 100G coherent DWDM in the form of 500G super-channels and integrates five Terabits per second of OTN switching into a single converged platform.

Our goal is to be the leading provider of Intelligent Transport Networks to communications service providers, internet content providers, cable operators, subsea network operators, and others. Our revenue growth will depend on the continued acceptance of our products, growth of communications traffic and the proliferation of bandwidth-intensive services, which increases the need for transport capacity. Our ability to increase our revenue and achieve profitability will be directly affected by the level of acceptance of our products in the long-haul and metro WDM markets and by our ability to cost-effectively develop and sell innovative products that leverage our technology advantages.

As of June 29, 2013, we have sold our network systems for deployment in the optical networks of 121 customers worldwide, including CenturyLink, Colt, Cox Communications, Dante, Deutsche Telekom, Equinix, Inc., Interoute, KDDI, Level 3, NTT, OTE, Pacnet Telefonica and TeliaSonera International. Since the commencement of shipping our DTN-X platform in the second quarter of 2012, we have 31 customers who have purchased our DTN-X platform. We do not have long-term sales commitments from our customers. To date, a few of our customers have accounted for a significant portion of our revenue. No customer accounted for over 10% of our revenue in the three months ended June 29, 2013 and one customer accounted for over 10% of our revenue in the three months ended June 30, 2012. One customer accounted for over 10% of our revenue in each of the six months ended June 29, 2013 and June 30, 2012. Our business will be harmed if any of our key customers do not generate as much revenue as we forecast, stop purchasing from us, or substantially reduce their orders to us.

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We are headquartered in Sunnyvale, California, with employees located throughout the Americas, Europe, and the Asia Pacific region. We expect to continue to add personnel in the United States and internationally to develop our products and provide additional geographic sales and technical support coverage. We primarily sell our products through our direct sales force, with a small portion sold indirectly through resellers. We derived 88% and 92% of our revenue from direct sales to customers in the three and six months ended June 29, 2013, respectively, and 99% and 98% of our revenue for the three and six months ended June 30, 2012, respectively. Our strategy is to leverage reseller channels where appropriate to expand our presence in certain geographies; however, we expect to continue generating a substantial majority of our revenue from direct sales. Our indirect channel revenues increased in the second quarter of 2013, both in absolute dollars and as a percentage of revenue, reflecting increased activities with strategic reseller accounts in a number of regions.

Our near-term year-over-year and quarter-over-quarter revenue will likely be volatile and may be impacted by several factors including general economic and market conditions, time-to-market development of new products, acquisitions of new customers and the timing of large product deployments.

In May 2013, we issued $150.0 million of 1.75% convertible senior notes (the Notes) due June 1, 2018. We intend to use the net proceeds for working capital and other general corporate purposes. See Note 9, Convertible Senior Notes, to the Notes to Condensed Consolidated Financial Statements for more information.

In 2013, we intend to continue to focus our efforts on leveraging the DTN-X platform to win new network footprint and gain market share. These efforts will be balanced with a focus on product cost improvements and overall prudent financial management.

We expect to continue to make significant investments in the business, and management currently believes that operating expenses for 2013 will range from $245 million to $250 million, including stock-based compensation expense of approximately $30 million to $35 million.

Critical Accounting Policies and Estimates

Management s Discussion and Analysis of Financial Condition and Results of Operations is based upon our condensed consolidated financial statements, which we have prepared in accordance with U.S. GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements. Management believes that there have been no significant changes during the six months ended June 29, 2013 to the items that we disclosed as our critical accounting policies and estimates in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

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Results of Operations

The following sets forth, for the periods presented, certain unaudited condensed consolidated statements of operations information (in thousands, except %):

	Three Months Ended					
	June 29, 2013		June 30, 2012			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Revenue:						
Product	$ 120,153	87%	$ 77,843	83%	$ 42,310	54%
Ratable product and related support and services	494	0%	523	1%	(29)	-6%
Services	17,738	13%	15,092	16%	2,646	18%
Total revenue	$ 138,385	100%	$ 93,458	100%	$ 44,927	48%
Cost of revenue:						
Product	$ 80,129	58%	$ 56,017	60%	$ 24,112	43%
Ratable product and related support and services	69	0%	166	0%	(97)	-58%
Services	6,533	5%	4,901	5%	1,632	33%
Total cost of revenue	$ 86,731	63%	$ 61,084	65%	$ 25,647	42%
Gross profit	$ 51,654	37%	$ 32,374	35%	$ 19,280	60%

	Six Months Ended					
	June 29, 2013		June 30, 2012			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Revenue:						
Product	$ 227,962	87%	$ 170,234	86%	$ 57,728	34%
Ratable product and related support and services	1,028	0%	1,054	0%	(26)	-2%
Services	34,020	13%	26,871	14%	7,149	27%
Total revenue	$ 263,010	100%	$ 198,159	100%	$ 64,851	33%
Cost of revenue:						
Product	$ 155,481	59%	$ 115,341	58%	$ 40,140	35%
Ratable product and related support and services	164	0%	357	0%	(193)	-54%
Services	13,009	5%	9,660	5%	3,349	35%
Total cost of revenue	$ 168,654	64%	$ 125,358	63%	$ 43,296	35%
Gross profit	$ 94,356	36%	$ 72,801	37%	$ 21,555	30%

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The following table summarizes our revenue by geography and sales channel for the periods presented (in thousands, except %):

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Total revenue by geography				
Domestic	$ 88,251	$ 65,790	$ 167,324	$ 136,688
International	50,134	27,668	95,686	61,471
	$ 138,385	$ 93,458	$ 263,010	$ 198,159
% Revenue by geography				
Domestic	64%	70%	64%	69%
International	36%	30%	36%	31%
	100%	100%	100%	100%
Total revenue by sales channel				
Direct	$ 122,234	$ 92,168	$ 243,082	$ 194,011
Indirect	16,151	1,290	19,928	4,148
	$ 138,385	$ 93,458	$ 263,010	$ 198,159
% Revenue by sales channel				
Direct	88%	99%	92%	98%
Indirect	12%	1%	8%	2%
	100%	100%	100%	100%

Revenue

Total revenue increased by $44.9 million, or 48%, during the three months ended June 29, 2013 compared to the corresponding period in 2012. Total revenue increased by $64.9 million, or 33%, during the six months ended June 29, 2013 compared to the corresponding period in 2012. The significant increase in revenues is primarily due to the strong adoption of our DTN-X platform by both new and existing customers. International revenue increased to 36%, of total revenue for the three and six months ended June 29, 2013 from 30% and 31%, respectively, of total revenue in the corresponding periods in 2012. The increase in international revenues reflects increased investments in sales resources in both Europe and Asia and our increased use of reseller channels to expand our presence geographically. While we expect international revenues to continue to grow in absolute dollars on a long-term basis as we increase our sales activities in Europe, Asia Pacific and other regions, international revenues may fluctuate as a percentage of total revenue depending on the size and timing of deployments both internationally and in the United States.

Total product revenue increased by $42.3 million, or 54%, during the three months ended June 29, 2013 compared to the corresponding period in 2012. Total product revenue increased by $57.7 million, or 34%, for the six months ended June 29, 2013 compared to the corresponding period in 2012. These increases were due to higher sales of our DTN-X platform to both new and existing customers in the first half of 2013. Total ratable revenue levels remained consistent at $0.5 million and $1.0 million for the three and six months ended June 29, 2013, respectively, compared to $0.5 million and $1.1 million for the corresponding periods in 2012, respectively.

Total services revenue increased by $2.6 million, or 18%, during the three months ended June 29, 2013 compared to the corresponding period in 2012 primarily reflecting the incremental recognition of $1.6 million in deployment services revenue, $0.8 million in software subscription revenue and $0.2 million for hardware warranty and spares management related services. Total services revenue increased by $7.1 million, or 27%, for the six months ended June 29, 2013 compared to the corresponding period in 2012 primarily reflecting the incremental recognition of $3.8 million in deployment services revenue, $1.5 million for hardware warranty and spares management related services and $1.8 million in software subscription revenue. As our installed customer base grows, we expect to continue to grow our extended hardware warranty and spares management services revenues in future periods.

Cost of Revenue and Gross Margin

Gross margin increased to 37% in the three months ended June 29, 2013 from 35% in the corresponding period of 2012. This increase primarily reflected our progress on yield improvements and cost reductions on the DTN-X platform.

Gross margin decreased to 36% in the six months ended June 29, 2013 from 37% in the corresponding period of 2012. The transition of a portion of our revenues from the DTN platform to our DTN-X platform, with its initial lower gross margins, contributed to a decline in gross margins in the first half of 2013. In addition, we continued to experience a higher level of lower margin network footprint sales in the first half of 2013, as we completed a significant number of new DTN-X deployments. These effects were offset by the inclusion of production ramp costs associated with the DTN-X and most notably some incremental LCM amounts related to our DTN-X inventory and shipments that were awaiting customer acceptance in the second quarter of 2012. We remain focused on achieving cost reductions on the DTN-X platform and expect improved yields and more mature manufacturing processes to contribute to improved gross margins over time.

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We do not have the visibility necessary to accurately predict quarterly gross margins beyond a one-quarter time horizon, but believe that increased revenues and improved product mix, combined with planned cost reductions on the DTN-X platform, may allow for some margin expansion in the second half of 2013 and in future years.

Operating Expenses

The following tables summarize our operating expenses for the periods presented (in thousands, except %):

	Three Months Ended					
	June 29, 2013		June 30, 2012			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Operating expenses:						
Research and development	$ 31,681	23%	$ 31,676	34%	$ 5	0%
Sales and marketing	17,155	13%	17,777	19%	(622)	-3%
General and administrative	11,426	8%	12,320	13%	(894)	-7%
Total operating expenses	$ 60,262	44%	$ 61,773	66%	$ (1,511)	-2%

	Six Months Ended					
	June 29, 2013		June 30, 2012			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Operating expenses:						
Research and development	$ 61,407	23%	$ 62,661	32%	$ (1,254)	-2%
Sales and marketing	35,201	14%	36,019	18%	(818)	-2%
General and administrative	21,298	8%	23,404	12%	(2,106)	-9%
Total operating expenses	$ 117,906	45%	$ 122,084	62%	$ (4,178)	-3%

The following table summarizes the stock-based compensation expense included in our operating expenses (in thousands):

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Research and development	$ 2,622	$ 3,695	$ 5,741	$ 7,015
Sales and marketing	1,807	2,744	3,806	4,963
General and administration	1,591	2,705	2,360	4,928
Total	$ 6,020	$ 9,144	$ 11,907	$ 16,906

Research and Development Expenses

Research and development expenses remained relatively flat during the three months ended June 29, 2013 compared to the corresponding period in 2012. Increases in cash compensation of $2.0 million and depreciation of $0.1 million were offset by decreases in stock-based compensation expenses of $1.1 million, equipment and software spending of $0.9 million, and professional outside services and other costs of $0.1 million.

Research and development expenses decreased by $1.3 million, or 2%, in the six months ended June 29, 2013 compared to the corresponding period in 2012 primarily due to decreases in equipment and software spending of $2.9 million, stock-based compensation expense of $1.3 million, professional and outside services costs of $0.6 million and other costs of $0.4 million. These decreases were offset by increased cash compensation and personnel related costs of $3.5 million and $0.4 million of increased depreciation.

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Sales and Marketing Expenses

Sales and marketing expenses decreased by $0.6 million, or 3%, during the three months ended June 29, 2013 compared to the corresponding period in 2012 primarily due to decreases in stock-based compensation of $0.9 million, travel and related expenses of $0.6 million, customer lab trials of $0.4 million and other marketing expenses of $0.2 million, offset by a $1.5 million increase in compensation and personnel-related expenses.

Sales and marketing expenses decreased by $0.8 million, or 2%, in the six months ended June 29, 2013 compared to the corresponding period in 2012 primarily due to decreases in stock-based compensation of $1.2 million, travel and related expenses of $0.9 million and customer lab trials of $0.8 million, offset by a $2.1 million increase in compensation and personnel-related expenses.

General and Administrative Expenses

General and administrative expenses decreased by $0.9 million, or 7%, during the three months ended June 29, 2013 compared to the corresponding period in 2012, primarily due to decreased stock-based compensation expense of $1.1 million, partially offset by increased consulting services expenses and other costs of $0.2 million.

General and administrative expenses decreased by $2.1 million, or 9%, in the six months ended June 29, 2013 compared to the corresponding period in 2012, primarily due to decreased stock-based compensation expense of $2.6 million, partially offset by increased depreciation and other costs of $0.5 million.

Other Income (Expense), Net

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
	(In thousands)			
Interest income	$ 207	$ 228	$ 404	$ 503
Interest expense	(849)		(849)	
Other gain (loss), net	(158)	149	(361)	(275)
Total income (expense), net	$ (800)	$ 377	$ (806)	$ 228

Interest income decreased by an insignificant amount in the three and six months ended June 29, 2013 compared to the corresponding period in 2012. The decrease was mainly due to lower total investments.

Interest expense for the three and six months ended June 29, 2013 consisted of cash interest payments and amortization of discount and issuance costs related to the Notes issued in May 2013.

Other gain (loss), net for the three months ended June 29, 2013 consisted of $0.2 million of realized and unrealized foreign currency transaction loss. Other gain (loss), net for the three months ended June 30, 2012 included $0.5 million of realized gain as a result of our AAA rated auction rate security (ARS) called at par value during the second quarter of 2012. This was offset by $0.3 million of realized and unrealized foreign currency transaction loss.

Other gain (loss), net for the six months ended June 29, 2013 included $0.6 million of realized and unrealized foreign currency transaction loss partially offset by a $0.2 million gain from the disposal of our remaining ARS. Other gain (loss), net for the six months ended June 30, 2012 included a loss of $0.8 million of realized and unrealized foreign currency transactions, offset by $0.5 million of realized gain as a result of our AAA rated ARS called at par value during the second quarter of 2012.

Income Tax Provision

Provision for income taxes for the three and six months ended June 29, 2013 was $0.6 million and $0.9 million, respectively, or negative 6.4% and negative 3.8%, respectively, on a pre-tax loss of $9.4 million and $24.4 million, respectively. This compared to a tax provision of

$0.5 million and $1.1 million, respectively, or negative 1.8% and negative 2.3%, respectively, on a pre-tax loss of $29.0 million and $49.1 million, respectively for the three and six months ended June 30, 2012. The difference between our effective tax rates and the federal statutory rate of 35% is primarily attributable to unbenefited U.S. losses, foreign taxes provided on the income of our foreign subsidiaries, non-deductible stock-based compensation expense, and various discrete items. The lower tax expense in the first six months of 2013 compared to the first six months of 2012 relates to a release of transfer pricing reserves following a statute of limitations lapse.

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The realization of tax benefits of deferred tax assets is dependent upon future levels of taxable income, of an appropriate character, in the periods the items are scheduled to be deductible or taxable. Based on the available objective evidence, management believes it is more likely than not that the domestic net deferred tax assets will not be realizable. Accordingly, we have provided a full valuation allowance against our domestic deferred tax assets, net of deferred tax liabilities, as of June 29, 2013 and December 29, 2012. In determining future taxable income, we make assumptions to forecast federal, state and international operating income, the reversal of taxable temporary differences, and the implementation of any feasible and prudent tax planning strategies. The assumptions require significant judgment regarding the forecasts of future taxable income and are consistent with our forecasts used to manage our business. We intend to maintain the remaining valuation allowance until sufficient positive evidence exists to support a reversal of, or decrease, in the valuation allowance.

Liquidity and Capital Resources

	Six Months Ended	
	June 29, 2013	June 30, 2012
	(In thousands)	
Net cash flow provided by (used in):		
Operating activities	$ (3,375)	$ (28,501)
Investing activities	$ (74,768)	$ 12,855
Financing activities	$ 155,466	$ 6,254

	June 29, 2013	December 29, 2012
	(In thousands)	
Cash and cash equivalents	$ 181,211	$ 104,666
Short-term and long-term investments	143,864	79,020
Long-term restricted cash	3,850	3,868
	$ 328,925	$ 187,554

Cash, cash equivalents, short-term and long-term investments and long-term restricted cash consist of highly-liquid investments in certificates of deposits, money market funds, commercial paper, corporate bonds and U.S. treasuries. The restricted cash balance amounts are pledged as collateral for certain stand-by and commercial letters of credit.

Operating Activities

Net cash used in operating activities for the six months ended June 29, 2013 was $3.4 million as compared to $28.5 million for the corresponding period in 2012. Cash flow from operating activities consists of net loss, adjusted for non-cash charges, plus or minus working capital changes. Our working capital accounts consist of accounts receivables and prepaid assets and other current assets. Claims against working capital include accounts payable, accrued expenses and other current liabilities and our convertible senior notes. Our working capital requirements can fluctuate significantly depending on the timing of deployments and the acceptance, billing and payment terms on those deployments. Additionally, our ability to manage inventory turns and our ability to negotiate favorable payment terms with our vendors may also impact our working capital requirements.

Net loss for the six months ended June 29, 2013 was $25.3 million, which included non-cash charges of $29.6 million, compared to a net loss of $50.2 million in the corresponding period in 2012, including non-cash charges of $32.2 million.

Net cash used to fund working capital was $7.7 million for the six months ended June 29, 2013. Accounts receivables decreased $10.3 million primarily due to improved timing of acceptance and invoicing of DTN-X deployments. Accounts payable decreased by $24.0 million primarily reflecting the timing of inventory purchases and improved linearity of supply during the period.

Net cash used to fund working capital was $10.5 million for the six months ended June 30, 2012. Inventory increased by $24.8 million primarily due to increased levels of DTN-X inventory in advance of shipments and increased levels of DTN inventory previously committed to the supply chain in response to the flooding events in Thailand in 2011. Accounts payable decreased by $8.8 million due to the timing of purchases and

payments of purchases during the period. Accrued liabilities decreased by $2.3 million primarily due to reduced levels of compensation and commission related accruals. These were partially offset by decreased accounts receivables of $24.4 million primarily driven by better linearity of invoicing and collections activities in the period.

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Investing Activities

Net cash used in investing activities in the six months ended June 29, 2013 was $74.8 million compared to net cash provided by investing activities of $12.9 million in the corresponding period of 2012. Net cash used in investing activities for the six months ended June 29, 2013 included $65.3 million from purchases, maturities, calls and sales of investments in the period, and $9.4 million of capital expenditures. The increase in net cash used in investing activities primarily related to the investment of the proceeds received from the issuance of the Notes. Net proceeds from investing activities for the six months ended June 30, 2012 included net proceeds of $32.8 million from purchases, maturities, calls and sales of investments in the period partially offset by $19.8 million of capital expenditures.

Financing Activities

Net proceeds from financing activities in the six months ended June 29, 2013 and June 30, 2012 were $155.5 million compared to $6.3 million in the corresponding period of 2012. Financing activities for the six months ended June 29, 2013 included net proceeds from the issuance of the Notes of $144.5 million and proceeds from the issuance of common stock under our stock-based compensation plans of $12.5 million. These activities were offset by $1.5 million related to the repurchase of shares from employees to satisfy minimum tax withholdings. Financing activities for the six months ended June 30, 2012 included issuance of common stock under our stock-based compensation plans of $7.1 million offset by $0.8 million related to the repurchase of shares from employees to satisfy minimum tax withholdings.

Liquidity

In May 2013, we issued $150.0 million of 1.75% convertible senior notes due June 1, 2018 (the Notes). The Notes will mature on June 1, 2018, unless earlier purchased by us or converted. Interest is payable semi-annually in arrears on June 1 and December 1 of each year, commencing December 1, 2013. The net proceeds from the Notes issuance were approximately $144.5 million. We intend to use the net proceeds for working capital and other general corporate purposes.

Upon conversion, it is our intention to pay cash equal to the lesser of the aggregate principal amount and the conversion value of the Notes being converted and cash, shares of common stock or a combination of cash and shares of common stock, at our election, for any remaining conversion obligation. The Notes will be convertible if during any 20 trading days during the 30 consecutive trading days of any fiscal quarter commencing after September 28, 2013, our common stock trades at a price exceeding 130% of the conversion price of approximately $12.58 per share applicable to the Notes. The Notes have not yet been convertible at the holders option. The carrying value of the Notes was $105.6 million as of June 29, 2013, which represents the liability component of the $150.0 million principal balance, net of $44.4 million debt discount. The debt discount is currently being amortized over the remaining five years until maturity of the Notes on June 1, 2018.

As of June 29, 2013, contractual obligations related to the Notes are payments of $1.3 million due within 2013, $2.6 million due each year from 2014 through 2017 and $151.3 million due in 2018. These amounts represent principal and interest cash payments over the term of the Notes. Any future redemption or conversion of the Notes could impact the amount or timing of our cash payments. See Note 9, Senior Convertible Notes, to the Notes to Condensed Consolidated Financial Statements for more information.

For 2013, capital expenditures are expected to be in the range of approximately $20 million to $25 million, primarily for product development.

We believe that our current cash and cash equivalents and investments will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. If these sources of cash are insufficient to satisfy our liquidity requirements beyond 12 months, we may require additional capital from equity or debt financings to fund our operations, to respond to competitive pressures or strategic opportunities, or otherwise. We may not be able to secure timely additional financing on favorable terms, or at all. The terms of any additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer dilution in their percentage ownership of us, and any new securities we issue could have rights, preferences and privileges senior to those of holders of our common stock.

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Off-Balance Sheet Arrangements

As of June 29, 2013, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Item 3. ***Quantitative and Qualitative Disclosures about Market Risk***

For quantitative and qualitative disclosures about market risk affecting us, see Quantitative and Qualitative Disclosures About Market Risk in Item 7A. of Part II of our Annual Report on Form 10-K for the fiscal year ended December 29, 2012, which is incorporated herein by reference. Our exposure to market risk has not changed materially since December 29, 2012, except for the changes related to our issuance of the Notes during the second quarter of 2013, as discussed below.

Market Risk and Market Interest Risk

In May 2013, we issued $150.0 million of 1.75% convertible senior notes due June 1, 2018. Holders may convert the Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, we will pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election.

As of June 29, 2013, the fair value of the Notes was $166.8 million. The fair value was determined based on the closing trading price of the Notes as of June 28, 2013. The fair value the Notes is subject to interest rate risk, market risk and other factors due to the convertible feature. The fair value of the convertible notes will generally increase as interest rates fall and decrease as interest rates rise. In addition, the fair value of the Notes will generally increase as our common stock price increases and will generally decrease as our common stock price declines in value. The interest and market value changes affect the fair value of our convertible notes but do not impact our financial position, cash flows or results of operations due to the fixed nature of the debt obligation. Additionally, we do not carry the convertible notes at fair value. We present the fair value of the convertible notes for required disclosure purposes.

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

An evaluation was performed by management, with the participation of our chief executive officer (CEO) and our chief financial officer (CFO), of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d -15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)). Disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Based on this evaluation, our CEO and CFO have concluded that, as of the end of the fiscal period covered by this quarterly report on Form 10-Q, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC s rules and forms and that such information is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within us have been detected. These inherent limitations include the

realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

From time to time, we are subject to various legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material effect on our consolidated financial position, results of operations, or cash flows. A complete description of our legal proceedings can be found in Item 3. Legal Proceedings of Part I of our Annual Report on Form 10-K for the fiscal year ended December 29, 2012 filed with the SEC on March 5, 2013. Any updates to the information contained in our Annual Report on Form 10-K are set forth below.

Cheetah Patent Infringement Litigation

A hearing was held on July 16, 2013, during which the parties presented evidence to the U.S. District Court for the Eastern District of Texas Texarkana Division regarding the interpretation of various claim terms of patent no. 6,795,605 and patent no. 7,142,347. On July 24, 2013, the Court issued an order regarding claim construction, in which the Court agreed with some of our proposed claim constructions.

In addition to the ongoing Cheetah litigation, on June 10, 2013, we filed a Petition for Inter Partes Review to challenge the validity of Cheetah s. patent no. 6,888,661 (the 661 Patent) in a separate proceeding before the United States Patent and Trademark Office. Cheetah has sued Finisar Corporation for infringement of the 661 Patent in the U.S. District Court for the Eastern District of Michigan.

Based on the information available at this time, we concluded that the likelihood of a loss with respect to this suit is reasonably possible. We have further concluded that the range of the reasonably possible loss is an insignificant amount and will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows. No provision has been made for this lawsuit in our financial statements. Factors that we considered in the determination of the likelihood of a loss and the estimate of the range of that loss in respect to this matter included the merits of the case, the nature of the litigation (including the complex and technical nature of patent litigation), the length of time the matter has been pending, the lift of the stay by the court, the status of the plaintiff as a non-operating entity, our intention to vigorously defend the case unless it can be settled for an insignificant amount and the likelihood of the plaintiff accepting an amount in this range. However, the outcome of such legal matters is inherently unpredictable and subject to significant uncertainties.

Cambrian Science Patent Infringement Litigation

On June 17, 2013, the U.S. District Court for the Central District of California issued an order regarding claim construction, in which the Court agreed with some of our proposed claim constructions.

Based on the information available at this time, we concluded that the likelihood of a loss with respect to this suit is less than reasonably possible and therefore, a range of loss cannot be provided. As a result, we have made no provision for this lawsuit in our financial statements. Factors that we considered in the determination of the likelihood of a loss in respect to this matter included the merits of the case, the nature of the litigation (including the complex and technical nature of patent litigation), the length of time the matter has been pending, and the status of the plaintiff as a non-operating entity, and our intention to vigorously defend this case.

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

A description of the risks and uncertainties associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risks and uncertainties associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 29, 2012. You should carefully consider such risks and uncertainties, together with the other information contained in this report, our Annual Report on Form 10-K for the fiscal year ended December 29, 2012 and in our other public filings. If any of such risks and uncertainties actually occurs, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report and in our other public filings. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occurs, our business, financial condition or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly.

We have a history of significant operating losses and may not achieve profitability on an annual basis in the future.

For the fiscal year ended December 29, 2012, we recorded a net loss of $85.3 million. As of December 29, 2012, our accumulated deficit was $572.4 million. As of June 29, 2013, our accumulated deficit was $597.7 million. We expect to continue to make significant expenditures related to the continued development of our business. These expenditures may include the addition of personnel related to the sales, marketing and research and development of our products and other costs related to the maintenance and expansion of our manufacturing facilities and research and development operations. We may therefore sustain significant operating losses and negative cash flows in the future. We will have to maintain significant increased revenue and product gross margins to achieve profitability on an annual basis.

Our revenue and operating results may fluctuate significantly, which could make our future results difficult to predict and could cause our operating results to fall below investor or analyst expectations.

Our revenue and operating results may fluctuate due to a variety of factors, many of which are outside of our control. Over the past four fiscal quarters, our revenue has ranged from $112.2 million to $138.4 million and our operating loss has ranged from $8.6 million to $18.2 million. As a result, comparing our operating results on a period-to-period basis may not be meaningful. Our budgeted expense levels are based, in large part, on our expectations of long-term future revenue and the development efforts associated with these future revenues. As a result, fluctuations in our revenue and gross margins will have a significant impact on our operating results. Given the relatively fixed nature of our operating costs including those relating to our personnel and facilities, particularly for our engineering personnel, any substantial adjustment to our expenses to account for lower levels of revenue will be difficult and may take time. Consequently, if our revenue does not meet projected levels in the short-term, our inventory levels and operating expenses would be high relative to revenue, resulting in additional operating losses.

In addition to other risks discussed in this section, factors that may contribute to fluctuations in our revenue and our operating results include:

- fluctuations in demand, sales cycles and prices for products and services, including discounts given in response to competitive pricing pressures;
- fluctuations in our product mix, including the mix of higher and lower margin products and significant mix changes resulting from new customer deployments;
- changes in customers budgets for optical communications network equipment purchases and changes in their purchasing cycles;
- order cancellations or reductions or delays in delivery schedules by our customers;
- timeliness of our customers payments for their purchases;
- our ability to control costs, including our operating expenses and the costs of components we purchase for our products;

readiness of customer sites for installation of our products;

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- the timing of product releases or upgrades by us or by our competitors. In particular, if we fail to achieve targeted release dates for our future products, or convert lab trials and field evaluations by potential customers into purchase orders, our revenue and operating results may be negatively impacted;

- any significant changes in the competitive dynamics of our market, including any new entrants, technological advances or substantial discounting of products;

- availability of third-party suppliers to provide contract engineering and installation services for us;

- the timing of recognizing revenue in any given quarter, including the impact of revenue recognition standards and any future changes in U.S. generally accepted accounting principles (U.S. GAAP) or new interpretations of existing accounting rules; and

- general economic conditions in domestic and international markets.

Many factors affecting our results of operations are beyond our control and make it difficult to predict our results for a particular quarter or to accurately predict future revenues beyond a one-quarter time horizon. If our revenue or operating results fall below the expectations of investors or securities analysts or below any guidance we may in the future provide to the market, the price of our common stock may decline substantially.

Our gross margins may fluctuate from quarter-to-quarter and may be adversely affected by a number of factors, some of which are beyond our control.

Our gross margins fluctuate from period-to-period and vary by customer and by product specification. Over the past four fiscal quarters, our gross margins have ranged from 34% to 37%. Our gross margins are likely to continue to fluctuate and will be affected by a number of factors, including:

- the mix in any period of the customers purchasing our products and the product mix, including the relative mix of higher and lower margin products and services;

- significant new customer deployments, often with a higher portion of lower or negative margin common equipment;

- price discounts negotiated by our customers;

- introduction of new products, such as the DTN-X platform, with initial sales at relatively small volumes and higher product costs;

- sales volume from each customer during the period;

- the amount of equipment we sell or expect to sell for a loss in any given quarter;

- increased price competition, including competition from low-cost producers from China;

charges for excess or obsolete inventory;

changes in the price or availability of components for our products;

changes in our manufacturing costs, including fluctuations in yields and production volumes; and

increased warranty or repair costs.

It is likely that the average unit prices of our products will decrease over time in response to competitive pricing pressures, increased negotiated sales discounts, new product introductions by us or our competitors or other factors. In addition, some of our customer contracts contain annual technology discounts that require us to decrease the sales price of our products to these customers. In response, we will need to reduce the cost of our products through manufacturing efficiencies, design improvements and cost reductions. If these efforts are not successful or if we are unable to reduce our costs to a greater extent than the reduction in the price of our products, our revenue and gross margin will decline, causing our operating results to decline. Fluctuations in gross margin may make it difficult to manage our business and achieve or maintain profitability.

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Aggressive business tactics by our competitors may harm our business.

The markets in which we compete are extremely competitive and have resulted in aggressive business tactics by our competitors, including:

- aggressively pricing their products, including offering significant one-time discounts and guaranteed future price decreases;
- providing financing, marketing and advertising assistance to customers;
- announcing competing products prior to market availability combined with extensive marketing efforts;
- influencing customer requirements to emphasize different product capabilities, such as greater minimum bandwidth requirements or higher transport speeds;
- offering to repurchase our equipment from existing customers; and
- asserting intellectual property rights.

The level of competition and pricing pressure tend to increase during periods of economic weakness or during periods when there are fewer network build-out projects. If we fail to compete successfully against our current and future competitors, or if our current or future competitors continue or expand aggressive business tactics, including those described above, demand for our products could decline, we could experience delays or cancellations of customer orders, or we could be required to reduce our prices or increase our expenses.

Our ability to increase our revenue will depend upon continued growth of demand by consumers and businesses for additional network capacity.

Our future success depends on factors that increase the amount of data transmitted over communications networks and the growth of optical communications networks to meet the increased demand for optical capacity. These factors include the growth of mobility, video, cloud-based services, increased broadband connectivity and the continuing adoption of high-capacity, revenue-generating services. If demand for such bandwidth does not continue, or slows down, the need for increased bandwidth across networks and the market for optical communications network products may not continue to grow and our product sales would be negatively impacted. In addition, if general economic conditions weaken, our customers and potential customers may slow or delay their purchase decisions, which would have an adverse effect on our business and financial condition.

Any delays in the development and introduction of our products, and any future delays in releasing new products or in releasing enhancements to our existing products may harm our business.

Because our products are based on complex technology, including, in some cases, the development of next-generation PICs and specialized ASICs, we may experience unanticipated delays in developing, improving, manufacturing or deploying these products. The development process for our PICs is lengthy, and any modifications to our PICs, including the development of our next-generation PICs, entail significant development cost and risks.

At any given time, various new product introductions and enhancements to our existing products, such as future products based on our next-generation PICs, are in the development phase and are not yet ready for commercial manufacturing or deployment. We rely on third parties, some of which are relatively early stage companies, to develop and manufacture components for our next-generation products, which can require custom development. The maturing process from laboratory prototype to customer trials, and subsequently to general availability, involves a significant number of simultaneous development efforts. These efforts often must be completed in a timely manner so that they may be introduced into the product development cycle for our systems, and include:

completion of product development, including the completion of any associated PIC development, such as our next-generation PICs, and the completion of associated module development, including modules developed by third parties;

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the qualification and multiple sourcing of critical components;

validation of manufacturing methods and processes;

extensive quality assurance and reliability testing and staffing of testing infrastructure;

validation of software; and

establishment of systems integration and systems test validation requirements.

Each of these steps, in turn, presents risks of failure, rework or delay, any one of which could decrease the speed and scope of product introduction and marketplace acceptance of our products. New generations of our PICs, specialized ASICs and intensive software testing are important to the timely introduction of new products and enhancements to our existing products, and are subject to these development risks. In addition, unexpected intellectual property disputes, failure of critical design elements, and a host of other development execution risks may delay, or even prevent, the introduction of new products or enhancements to our existing products. If we do not develop and successfully introduce or enhance products in a timely manner, our competitive position will suffer. In addition, if we do not develop and successfully introduce or enhance products in sufficient time so as to satisfy our customer s expectations, we may lose future business from such customers and harm our reputation and our customer relationships, either of which would harm our business and operating results.

The introduction of our DTN-X platform may adversely impact the timing of our revenues, our results of operations and our margins.

We began shipping our DTN-X platform in the second quarter of 2012 and recognized initial revenues for the DTN-X platform in the third quarter of 2012. As a relatively new product, we face increased product introduction risks including risks associated with customer qualification and evaluation of the DTN-X platform, delays in the development or manufacturing of the DTN-X platform, reliability, quality or other defects, and delays in customer purchases. In addition, the DTN-X platform is subject to more significant cost variations and increased difficulty in predicting customer demand and effectively managing inventory levels so that they are in line with anticipated demand.

The introduction of the DTN-X platform, with similar, but enhanced functionality to the DTN platform, increases the risk that customers may forego purchases of the DTN platform in favor of the DTN-X platform. Accordingly, a portion of our DTN platform revenues will be impacted by this new product as some of our customers and prospects will choose to purchase the DTN-X platform in place of the DTN platform. In addition, the introduction of the DTN-X platform may put pressure on the price of our existing DTN platform. Because the DTN-X platform is a new product for which customers may require additional testing requirements prior to acceptance, initial revenue recognition for the DTN-X platform may take longer than for sales of the DTN platform. Any delay in our ability to convert lab trials and field evaluations by potential customers into purchase orders, or in our ability to recognize revenue from the DTN-X may adversely impact our quarterly revenue results. In addition, if we are required to write off or write down a significant amount of inventory, our results of operations for the period would be adversely affected.

We may be required to recognize costs and expenses for our DTN-X platform before we can recognize the related revenue. Accordingly, as we can continue to ramp up the manufacture of our DTN-X platform, our margins related to the initial sales of the DTN-X platform may be negatively impacted. Such uncertainty related to the introduction and market acceptance of our DTN-X platform could have a material adverse effect on our business, financial condition, operating results and prospects.

The markets in which we compete are highly competitive and dominated by large corporations, and we may not be able to compete effectively.

Competition in the optical networking equipment market is intense, and we expect such competition to increase. A number of very large companies have historically dominated the optical communications network equipment industry. Our competitors include current wavelength division multiplexing suppliers, such as Alcatel-Lucent, Ciena Corporation, Cisco Systems, Ericsson, Fujitsu Limited, Huawei Technologies Co., NEC Corporation, Tellabs and ZTE Corporation. Competition in these markets is based on price, commercial terms, functionality, manufacturing capability, pre-existing installations, services, existing business and customer relationships, scalability and the ability of products and breadth and quality of services to meet our customers immediate and future network requirements. Other companies have, or may in the future develop, products that are or could be competitive with our products. In particular, if a competitor develops a photonic integrated circuit

with similar functionality to our PICs, our business could be harmed. Recent mergers from our competitors and any future acquisitions or combinations between or among our competitors may adversely affect our competitive position by strengthening our competitors.

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Many of our competitors have substantially greater name recognition and technical, financial and marketing resources, greater manufacturing capacity and better established relationships with incumbent carriers and other potential customers than we have. Many of our competitors have more resources to develop or acquire, and more experience in developing or acquiring, new products and technologies and in creating market awareness for those products and technologies. In addition, many of our competitors have the financial resources to offer competitive products at aggressive pricing levels that could prevent us from competing effectively. Further, many of our competitors have built long-standing relationships with some of our prospective customers and have the ability to provide financing to customers and could, therefore, have an inherent advantage in selling products to those customers.

We compete with low-cost producers from China that can increase pricing pressure on us and a number of smaller companies that provide competition for a specific product, customer segment or geographic market. These competitors often base their products on the latest available technologies. Due to the narrower focus of their efforts, these competitors may achieve commercial availability of their products more quickly than we can and may provide attractive alternatives to our customers.

Our large customers have substantial negotiating leverage, which may require that we agree to terms and conditions that result in increased cost of sales, decreased revenue and lower average selling prices and gross margins, all of which would harm our operating results.

Substantial changes in the optical networking industry have occurred over the last few years. Many potential customers have confronted static or declining revenue. Many of our customers have substantial debt burdens, many have experienced financial distress, and some have gone out of business, been acquired by other service providers, or announced their withdrawal from segments of the business. Consolidation in the markets in which we compete has resulted in changes in the structure of the communications networking industry, with greater concentration of purchasing power in a small number of large service providers, cable operators, internet content providers and government agencies. The increased concentration among our customer base may also lead to increased competition for new network deployments and increased negotiating power for our customers. This may require us to decrease our average selling prices which would have an adverse impact on our operating results.

Further, many of our customers are large communications service providers that have substantial purchasing power and leverage in negotiating contractual arrangements with us. Our customers have and may continue to seek advantageous pricing, payment and other commercial terms and may require us to develop additional features in the products we sell to them. If we are required to develop additional features for our product for a customer, we may be required to defer some of our revenue for such a customer until we have developed and delivered such additional features. We have and may continue to be required to agree to unfavorable commercial terms with these customers, including reducing the average selling price of our products or agreeing to extended payment terms in response to these commercial requirements or competitive pricing pressures. To maintain acceptable operating results, we will need to comply with these commercial terms, develop and introduce new products and product enhancements on a timely basis and continue to reduce our costs.

We expect the factors described above to continue to affect our business and operating results for an indeterminate period, in several ways, including:

- overall capital expenditures by many of our customers or potential customers may be flat or reduced;
- we will continue to have only limited ability to forecast the volume and product mix of our sales;
- managing expenditures and inventory will be difficult in light of the uncertainties surrounding our business; and
- increased competition will enable customers to insist on more favorable terms and conditions for sales, including product discounts, extended payment terms or financing assistance, as a condition of procuring their business.

If we are unable to offset any reductions in our average selling prices with increased sales volumes and reduced production costs, or if we fail to develop and introduce new products and enhancements on a timely basis, or if we disagree on our interpretation and compliance with the commercial terms of our customer agreements, our relationships with our customers and our operating results would be harmed.

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We must respond to rapid technological change and comply with evolving industry standards and requirements for our products to be successful.

The optical networking equipment market is characterized by rapid technological change, changes in customer requirements and evolving industry standards. We continually invest in research and development to sustain or enhance our existing products, but the introduction of new communications technologies and the emergence of new industry standards or requirements could render our products obsolete. Further, in developing our products, we have made, and will continue to make, assumptions with respect to which standards or requirements will be adopted by our customers and competitors. If the standards or requirements adopted by our prospective customers are different from those on which we have focused our efforts, market acceptance of our products would be reduced or delayed and our business would be harmed.

We are continuing to invest a significant portion of our research and development efforts in the development of our next-generation products. We expect our competitors to continue to improve the performance of their existing products and to introduce new products and technologies and to influence customers buying criteria so as to emphasize product capabilities that we do not, or may not, possess. To be competitive, we must properly anticipate future customer requirements and we must continue to invest significant resources in research and development, sales and marketing and customer support. If we do not anticipate these future customer requirements and invest in the technologies necessary to enable us to have and to sell the appropriate solutions, it may limit our competitive position and future sales, which would have an adverse effect on our business and financial condition. We may not have sufficient resources to make these investments and we may not be able to make the technological advances necessary to be competitive.

We are dependent on sole source and limited source suppliers for several key components, and if we fail to obtain these components on a timely basis, we will not meet our customers product delivery requirements.

We currently purchase several key components for our products from single or limited sources. In particular, we rely on our own production of certain components of our products, such as PICs, and on third parties as sole source suppliers for certain of the components of our products, including ASICs, field-programmable gate arrays, processors, and other semiconductor and optical components. We purchase these items on a purchase order basis and have no long-term contracts with many of these sole source suppliers. We have increased our reliance on third parties to develop and manufacture components for certain products (40 Gbps and 100 Gbps), some of which require custom development. For example, for the 40 Gbps application of our DTN platform, we purchase customized discrete components. If any of our sole or limited source suppliers suffer from capacity constraints, lower than expected yields, deployment delays, work stoppages or any other reduction or disruption in output, they may be unable to meet our delivery schedule which could result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships. Further, our suppliers could enter into exclusive arrangements with our competitors, refuse to sell their products or components to us at commercially reasonable prices or at all, go out of business or discontinue their relationships with us. We may be unable to develop alternative sources for these components.

The loss of a source of supply, or lack of sufficient availability of key components, could require us to redesign products that use such components, which could result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships. If we do not receive critical components for our products in a timely manner, we will be unable to deliver those components to our contract manufacturer in a timely manner and would, therefore, be unable to meet our prospective customers product delivery requirements. In addition, the sourcing from new suppliers may require us to re-design our products, which could cause delays in the manufacturing and delivery of our products. In the past, we have experienced delivery delays because of lack of availability of components or reliability issues with components that we were purchasing. In addition, some of our suppliers have gone out of business, limited their supply of components to us, or indicated that they may be going out of business. Historically, we have seen a tightening of supply with a number of our suppliers and we have experienced longer than normal lead times and supply delays. We may in the future experience a shortage of certain components as a result of our own manufacturing issues, manufacturing issues at our suppliers or contract manufacturers, capacity problem experiences by our suppliers or contract manufacturers, or strong demand in the industry for such components. A return to growth in the economy is likely to continue to create pressure on us and our suppliers to accurately project overall component demand and manufacturing capacity. These supplier disruptions may continue to occur in the future, which could limit our ability to produce our products and cause us to fail to meet a customer s delivery requirements. Such events could harm our reputation and our customer relationships, either of which would harm our business and operating results.

If we fail to accurately forecast demand for our products, we may have excess or insufficient inventory, which may increase our operating costs, decrease our revenue and harm our business.

We are required to generate forecasts of future demands for our products several months prior to the scheduled delivery to our prospective customers. This requires us to make significant investments before we know if corresponding revenue will be recognized. Lead times for materials and components, including ASICs, that we need to order for the manufacture of our products vary significantly and depend on factors such as the specific supplier, contract terms and demand for each component at a given time. In the past, we have experienced lengthening in

lead times for certain components. If the lead times for components are lengthened, we may be required to purchase increased levels of such components to satisfy our delivery commitments to our customers.

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If we overestimate demand for our products or particular elements of our products and increase our inventory in anticipation of customer orders that do not materialize, we will have excess inventory, we will face a risk of obsolescence and significant inventory write-downs and our fixed costs will be spread across fewer units, raising our per unit costs. If we underestimate demand for our products, we will have inadequate inventory, which could slow down or interrupt the manufacturing of our products and result in delays in shipments and our ability to recognize revenue. If actual market conditions are less favorable than our internal projections, additional inventory write-offs may be required. In addition, we may be unable to meet our supply commitments to customers, which could result in a loss of certain customer opportunities or a breach of our customer agreements that requires payment of damages for delay.

If our contract manufacturers do not perform as we expect, our business may be harmed.

We rely on third-party contract manufacturers to perform a significant portion of the manufacturing of our products, and our future success will depend on our ability to have sufficient volumes of our products manufactured in a cost-effective and quality-controlled manner. We have engaged third parties to manufacture certain elements of our products at multiple contract manufacturing sites located around the world but do not have long-term agreements in place with some of our manufacturers and suppliers. There are a number of risks associated with our dependence on contract manufacturers, including:

- reduced control over delivery schedules, particularly for international contract manufacturing sites;
- reliance on the quality assurance procedures of third parties;
- potential uncertainty regarding manufacturing yields and costs;
- potential lack of adequate capacity during periods of high demand;
- potential uncertainty related to the use of international contract manufacturing sites;
- limited warranties on components supplied to us;
- potential misappropriation of our intellectual property; and
- potential manufacturing disruptions (including disruptions caused by geopolitical events, military actions or natural disasters).

Any of these risks could impair our ability to fulfill orders. Our contract manufacturers may not be able to meet the delivery requirements of our customers, which could decrease customer satisfaction and harm our product sales. We do not have long-term contracts or arrangements with our contract manufacturers that will guarantee product availability, or the continuation of particular pricing or payment terms. If our contract manufacturers are unable or unwilling to continue manufacturing our products or components of our products in required volumes or our relationship with any of our contract manufacturers is discontinued for any reason, we would be required to identify and qualify alternative manufacturers, which could cause us to be unable to meet our supply requirements to our customers and result in the breach of our customer agreements. Qualifying a new contract manufacturer and commencing volume production is expensive and time-consuming and if we are required to change or qualify a new contract manufacturer, we would likely lose sales revenue and damage our existing customer relationships.

We are dependent on a small number of key customers for a significant portion of our revenue and the loss of, or a significant reduction in, orders from one or more of our key customers would reduce our revenue and harm our operating results.

A relatively small number of customers account for a large percentage of our revenue. As a result, our business will be harmed if any of our key customers do not generate as much revenue as we forecast, stop purchasing from us, or substantially reduce their orders to us. In addition, our

business will be harmed if we fail to maintain our competitive advantage with our key customers.

Our ability to continue to generate revenue from our key customers will depend on our ability to maintain strong relationships with these customers and introduce new products that are desirable to these customers at competitive prices, and we may not be successful at doing so. In most cases, our sales are made to these customers pursuant to standard purchase agreements rather than long-term purchase commitments, and orders may be cancelled or reduced readily. In the event of a cancellation or reduction of an order, we may not have enough time to reduce operating expenses to minimize the effect of the lost revenue on our business. Our operating results will continue to depend on our ability to sell our products to our key customers.

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If we fail to expand sales of our products into international markets or to sell our products to new types of customers, such as U.S. regional Bell operating companies and international postal, telephone and telegraph companies, our revenue will be harmed.

We believe that, in order to grow our revenue and business and to build a large and diverse customer base, we must successfully sell our products in international markets and to new types of customers, such as U.S. regional Bell operating companies and international postal, telephone and telegraph companies. We have limited experience selling our products internationally and to U.S. regional Bell operating companies and international postal, telephone and telegraph companies. Sales cycles for these customers are often very lengthy and competition for these customers is intense. To succeed in these sales efforts, we believe we must hire additional sales personnel to develop our relationships with these potential customers and develop and manage new sales channels through resellers, distributors and systems integrators. If we do not succeed in our efforts to sell to these customers, the size of our total addressable market will be limited. This, in turn, would harm our ability to grow our customer base and revenue.

If we fail to protect our intellectual property rights, our competitive position could be harmed or we could incur significant expense to enforce our rights.

We depend on our ability to protect our proprietary technology. We rely on a combination of methods to protect our intellectual property, including limiting access to certain information, and utilizing trade secret, patent, copyright and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. The steps we have taken to protect our proprietary rights may be inadequate to preclude misappropriation or unauthorized disclosure of our proprietary information or infringement of our intellectual property rights, and our ability to police such misappropriation, unauthorized disclosure or infringement is uncertain, particularly in countries outside of the United States. This is likely to become an increasingly important issue as we expand our operations and product development into countries that provide a lower level of intellectual property protection. We do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims, and even if patents are issued, they may be contested, circumvented or invalidated. Moreover, the rights granted under any issued patents may not provide us with a competitive advantage, and, as with any technology, competitors may be able to develop similar or superior technologies to our own now or in the future.

Protecting against the unauthorized use of our products, trademarks and other proprietary rights is expensive, difficult, time consuming and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity or scope of the proprietary rights of others. Such litigation could result in substantial cost and diversion of management resources, either of which could harm our business, financial condition and operating results. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to enforce their intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property.

Claims by others that we infringe their intellectual property could harm our business.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, many leading companies in the optical networking industry, including our competitors, have extensive patent portfolios with respect to optical networking technology. We expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps occur. From time to time, third parties may assert exclusive patent, copyright, trademark and other intellectual property rights to technologies and related standards that are important to our business or seek to invalidate the proprietary rights that we hold. Competitors or other third parties have, and may continue to assert claims or initiate litigation or other proceedings against us or our manufacturers, suppliers or customers alleging infringement of their proprietary rights, or seeking to invalidate our proprietary rights, with respect to our products and technology. In the event that we are unsuccessful in defending against any such claims, or any resulting lawsuit or proceedings, we could incur liability for damages and/or have valuable proprietary rights invalidated.

Any claim of infringement from a third party, even one without merit, could cause us to incur substantial costs defending against the claim, and could distract our management from running our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering our products. In addition, we might be required to seek a license for the use of such intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we may be required to develop non-infringing technology, which would require significant effort and expense and may ultimately not be successful. Any of these events could harm our business, financial condition and operating results. Competitors and other third parties have and may continue to assert infringement claims against our customers and sales partners. Any of these claims would require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims, because we generally indemnify our customers and sales partners from claims of infringement of proprietary rights of third parties. If any of these claims succeed, we may be forced to pay damages on behalf of our customers or sales partners, which could have an adverse effect on our business, financial condition and operating results.

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We incorporate open source software into our products. Although we monitor our use of open source software closely, the terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that such licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to seek licenses from third parties in order to continue offering our products, to re-engineer our products or to discontinue the sale of our products in the event re-engineering cannot be accomplished on a timely basis, any of which could adversely affect our business, operating results and financial condition.

We are currently involved in litigation with Cheetah and Level 3 whereby Cheetah alleges that we and Level 3 infringe on two Cheetah patents. In addition, Cambrian has filed suit against us and seven of our customers alleging that the use of our DTN platform by our customers infringes upon a Cambrian patent. Information regarding these matters is set forth in Item 1. Legal Proceedings and is incorporated herein by reference. We believe these lawsuits are without merit and intend to defend ourselves vigorously. We may enter into settlements or be subject to judgments that may, individually or in the aggregate, have a material adverse effect on our business, financial condition or operating results. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of litigation are inherently uncertain and may result in adverse rulings or decisions. In the event that Cheetah or Cambrian is successful in obtaining a judgment requiring us to pay damages, obtaining a judgment requiring us to indemnify our customers for damages imposed upon them, or obtaining an injunction preventing the sale of our products, our business and operating results could be harmed.

Our manufacturing process is very complex and the partial or complete loss of our manufacturing facility, or a reduction in yields or an inability to scale capacity to meet customer demands could harm our business.

The manufacturing process for certain components of our products, including our PICs, is technically challenging. In the event that any of these manufacturing facilities were fully or partially destroyed, as a result of fire, water damage, or otherwise, it would limit our ability to produce our products. Because of the complex nature of our manufacturing facilities, such loss would take a considerable amount of time to repair or rebuild. The partial or complete loss of any of our manufacturing facilities, or an event causing the interruption in our use of such facility for any extended period of time would cause our business, financial condition and operating results to be harmed.

Minor deviations in the PIC manufacturing process can cause substantial decreases in yields and, in some cases, cause production to be suspended. In the past, we have had significant variances in our PIC yields, including production interruptions and suspensions and may have continued yield variances, including additional interruptions or suspensions in the future. We expect our manufacturing yield for our next-generation PICs to be lower initially and increase as we achieve full production. Poor yields from our PIC manufacturing process or defects, integration issues or other performance problems in our products could limit our ability to satisfy customer demand requirements, and could cause us customer relations and business reputation problems, harming our business and operating results.

Our inability to obtain sufficient manufacturing capacity to meet demand, either in our own facilities or through foundry or similar arrangements with third parties, could harm our relationships with customers, our business and our operating results.

Unfavorable macroeconomic and market conditions may adversely affect our industry, business and gross margins.

Our business depends on the overall demand for additional bandwidth capacity and on the economic health and willingness of our customers and potential customers to make capital commitments to purchase our products and services. As a result of macroeconomic or market uncertainty, we may face new risks that we have not yet identified. In addition, a number of the risks associated with our business, which are disclosed in these risk factors, may increase in likelihood, magnitude or duration.

In the past, unfavorable macroeconomic and market conditions have resulted in sustained periods of decreased demand for optical communications products. These conditions may also result in the tightening of credit markets, which may limit or delay our customers ability to obtain necessary financing for their purchases of our products. A lack of liquidity in the capital markets or the continued uncertainty in the global economic environment may cause our customers to delay or cancel their purchases, increase the time they take to pay or default on their payment obligations, each of which would negatively affect our business and operating results. Continued weakness and uncertainty in the global economy could cause some of our customers to become illiquid, delay payments or adversely affect our collection of their accounts, which could result in a higher level of bad debt expense. In addition, currency fluctuations could negatively affect our international customers ability or desire to purchase our products.

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Challenging economic conditions have from time to time contributed to slowdowns in the telecommunications industry in which we operate. Such slowdowns may result in:

- reduced demand for our products as a result of constraints on capital spending by our customers, particularly service providers;
- increased price competition for our products, not only from our competitors, but also as a result of our customer s or potential customer s utilization of inventoried or underutilized products, which could put additional downward pressure on our near term gross profits;
- risk of excess or obsolete inventories;
- excess manufacturing capacity and higher associated overhead costs as a percentage of revenue; and
- more limited ability to accurately forecast our business and future financial performance.

A lack of liquidity and economic uncertainty may adversely affect our suppliers or the terms on which we purchase products from these suppliers. It may also cause some of our suppliers to become illiquid. Any of these impacts could limit our ability to obtain components for our products from these suppliers and could adversely impact our supply chain or the delivery schedule to our customers. This also could require us to purchase more expensive components, or re-design our products, which could cause increases in the cost of our products and delays in the manufacturing and delivery of our products. Such events could harm our gross margins and harm our reputation and our customer relationships, either of which could harm our business and operating results.

Product performance problems, including undetected errors in our hardware or software, or deployment delays could harm our business and reputation.

The development and production of new products with high technology content is complicated and often involves problems with software, components and manufacturing methods. Complex hardware and software systems, such as our products, can often contain undetected errors when first introduced or as new versions are released. In addition, errors associated with components we purchase from third parties, including customized components, may be difficult to resolve. We have experienced errors in the past in connection with our DTN platform, including failures due to the receipt of faulty components from our suppliers. We suspect that errors, including potentially serious errors, will be found from time to time in our products. Our products may suffer degradation of performance and reliability over time.

If reliability, quality or network monitoring problems develop, a number of negative effects on our business could result, including:

- delays in our ability to recognize revenue;
- costs associated with fixing software or hardware defects or replacing products;
- high service and warranty expenses;
- delays in shipments;

high inventory excess and obsolescence expense;

high levels of product returns;

diversion of our engineering personnel from our product development efforts;

delays in collecting accounts receivable;

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payment of damages for performance failures;

reduced orders from existing customers; and

declining interest from potential customers.

Because we outsource the manufacturing of certain components of our products, we may also be subject to product performance problems as a result of the acts or omissions of third parties.

From time to time, we encounter interruptions or delays in the activation of our products at a customer s site. These interruptions or delays may result from product performance problems or from issues with installation and activation, some of which are outside our control. If we experience significant interruptions or delays that we cannot promptly resolve, the associated revenue for these installations may be delayed or confidence in our products could be undermined, which could cause us to lose customers and fail to add new customers.

Our debt obligations may adversely affect our ability to raise additional capital and will be a burden on our future cash flows and cash resources, particularly if these obligations are settled in cash upon maturity or sooner upon an event of default.

In May 2013, we issued $150 million aggregate principal amount of 1.75% convertible senior notes due June 1, 2018 (the Notes). The degree to which we are leveraged could have important consequences, including, but not limited to, the following:

our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, litigation, general corporate or other purposes may be limited;

a substantial portion of our future cash balance may be dedicated to the payment of the principal of our indebtedness as we have the intention to pay the principal amount of the Notes in cash upon conversion if specified conditions are met or when due, such that we would not have those funds available for use in our business;

if upon any conversion of the Notes we are required to satisfy our conversion obligation with shares of our common stock or if a make-whole fundamental change occurs, our existing stockholders interest in us would be diluted; and

we may be more vulnerable to economic downturns, less able to withstand competitive pressures and less flexible in responding to changing business and economic conditions.

Our ability to meet our payment obligations under our debt instruments depends on our future cash flow performance. This, to some extent, is subject to general economic, financial, competitive, legislative and regulatory factors, as well as other factors which may be beyond our control. There can be no assurance that our business will generate positive cash flow from operations, or that additional capital will be available to us, in an amount sufficient to enable us to meet our debt payment obligations and to fund other liquidity needs. If we are unable to generate sufficient cash flow to service our debt obligations, we may need to refinance or restructure our debt, sell assets, reduce or delay capital investments, or seek to raise additional capital. If we were unable to implement one or more of these alternatives, we may be unable to meet our debt payment obligations. As a result, we may be more vulnerable to economic downturns, less able to withstand competitive pressures and less flexible in responding to changing business and economic conditions.

We may issue additional shares of our common stock in connection with the conversion of the Notes, and thereby dilute our existing stockholders and potentially adversely affect the market price of our common stock.

In the event that some or all of the Notes are converted into common stock, the ownership interests of existing stockholders will be diluted, and any sales in the public market of any shares of our common stock issuable upon such conversion of the Notes could adversely affect the prevailing market price of our common stock. In addition, the anticipated conversion of the Notes could depress the market price of our common stock.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.

Under Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer s economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders equity on our consolidated balance sheet at the issuance date and the value of the equity component would be treated as debt discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to record a greater amount of non-cash interest expense as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. We will report larger net losses in our financial results because ASC 470-20 will require interest to include both the amortization of the debt discount and the instrument s coupon interest, which could adversely affect our future financial results, the trading price of our common stock and the trading price of the Notes.

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The make-whole fundamental change provisions of the Notes may delay or prevent an otherwise beneficial takeover attempt of us.

If a make-whole fundamental change such as an acquisition of our company occurs prior to the maturity of the Notes, under certain circumstances, the conversion rate for the Notes will increase such that additional shares of our common stock will be issued upon conversion of the Notes in connection with such make-whole fundamental change. The increase in the conversion rate will be determined based on the date on which the make-whole fundamental change occurs or becomes effective and the price paid (or deemed paid) per share of our common stock in such transaction. This increase will be dilutive to our existing stockholders. Our obligation to increase the conversion rate upon the occurrence of a make-whole fundamental change may, in certain circumstances, delay or prevent a takeover of us that might otherwise be beneficial to our stockholders.

If we lose key personnel or fail to attract and retain additional qualified personnel when needed, our business may be harmed.

Our success depends to a significant degree upon the continued contributions of our key management, engineering, sales and marketing, and finance personnel, many of whom would be difficult to replace. For example, senior members of our engineering team have unique technical experience that would be difficult to replace. We do not have long-term employment contracts or key person life insurance covering any of our key personnel. Because our products are complex, we must hire and retain a large number of highly trained customer service and support personnel to ensure that the deployment of our products do not result in network disruption for our customers. We believe our future success will depend in large part upon our ability to identify, attract and retain highly skilled managerial, engineering, sales, marketing, finance and customer service and support personnel. Competition for these individuals is intense in our industry, especially in the San Francisco Bay Area where we are headquartered. We may not succeed in identifying, attracting and retaining appropriate personnel. The loss of the services of any of our key personnel, the inability to identify, attract or retain qualified personnel in the future or delays in hiring qualified personnel, particularly engineers and sales personnel, could make it difficult for us to manage our business and meet key objectives, such as timely product introductions.

Our sales cycle can be long and unpredictable, which could result in an unexpected revenue shortfall in any given quarter.

Our products have a lengthy sales cycle, which can extend from six to twelve months and may take even longer for larger prospective customers such as U.S. regional Bell operating companies, international postal, telephone and telegraph companies and U.S. competitive local exchange carriers. Our prospective customers conduct significant evaluation, testing, implementation and acceptance procedures before they purchase our products. We incur substantial sales and marketing expenses and expend significant management effort during this time, regardless of whether we make a sale.

Because the purchase of our equipment involves substantial cost, most of our customers wait to purchase our equipment until they are ready to deploy it in their network. As a result, it is difficult for us to accurately predict the timing of future purchases by our customers. In addition, product purchases are often subject to budget constraints, multiple approvals and unplanned administrative processing and other delays. If sales expected from customers for a particular quarter are not realized in that quarter or at all, our revenue will be negatively impacted.

Our international sales and operations subject us to additional risks that may harm our operating results.

We market, sell and service our products globally. In 2012, 2011 and 2010, we derived approximately 32%, 30% and 25%, respectively, of our revenue from customers outside of the United States. We have sales and support personnel in numerous countries worldwide. In addition, we have a large group of development personnel located in Bangalore, India; Beijing, China; and Kanata, Canada. We expect that significant management attention and financial resources will be required for our international activities over the foreseeable future as we continue to expand our international presence. In some countries, our successes in selling our products will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements for international sales of our products could impact our ability to maintain or increase international market demand for our products.

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Our international operations are subject to inherent risks, and our future results could be adversely affected by a variety of factors, many of which are outside of our control, including:

- greater difficulty in collecting accounts receivable and longer collection periods;
- difficulties of managing and staffing international offices, and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- the impact of recessions in economies outside the United States;
- tariff and trade barriers and other regulatory requirements or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- certification requirements;
- greater difficulty documenting and testing our internal controls;
- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences;
- political and economic instability;
- effects of changes in currency exchange rates which could negatively affect our financial results and cash flows; and
- service provider and government spending patterns.

International customers may also require that we comply with certain testing or customization of our products to conform to local standards. The product development costs to test or customize our products could be extensive and a material expense for us.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks could harm our international operations and reduce our international sales.

We may be adversely affected by fluctuations in currency exchange rates.

A portion of our sales are to countries outside of the United States, and are in currencies other than U.S. dollars, particularly the Euro. Accordingly, fluctuations in foreign currency rates, most notably the strengthening of the U.S. dollar against the Euro, could have a material impact on our revenue in future periods. We enter into foreign currency exchange forward contracts to reduce the impact of foreign currency fluctuations on accounts receivable denominated in Euro. These hedging programs reduce the impact of currency exchange rate movements on certain transactions, but do not cover all foreign-denominated transactions and therefore do not entirely eliminate the impact of fluctuations in exchange rates which could negatively affect our results of operations and financial condition.

If we fail to maintain effective internal control over financial reporting in the future, the accuracy and timing of our financial reporting may be adversely affected.

We are required to comply with Section 404 of the Sarbanes-Oxley Act of 2002. The provisions of the act require, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. Preparing our financial statements involves a number of complex processes, many of which are done manually and are dependent upon individual data input or review. These processes include, but are not limited to, calculating revenue, deferred revenue and inventory costs. While we continue to automate our processes and enhance our review and put in place controls to reduce the likelihood for errors, we expect that for the foreseeable future, many of our processes will remain manually intensive and thus subject to human error.

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Any acquisitions we make could disrupt our business and harm our financial condition and operations.

We have made strategic acquisitions of businesses, technologies and other assets in the past. While we have no current agreements or commitments, we may in the future acquire businesses, product lines or technologies. In the event of any future acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or they may be viewed negatively by customers, financial markets or investors and we could:

- issue stock that would dilute our current stockholders percentage ownership;
- incur debt and assume other liabilities; or
- incur amortization expenses related to goodwill and other intangible assets and/or incur large and immediate write-offs.

Acquisitions also involve numerous risks, including:

- problems integrating the acquired operations, technologies or products with our own;
- diversion of management s attention from our core business;
- assumption of unknown liabilities;
- adverse effects on existing business relationships with suppliers and customers;
- increased accounting compliance risk;
- risks associated with entering new markets; and
- potential loss of key employees.

We may not be able to successfully integrate any businesses, products, technologies or personnel that we might acquire in the future. Our failure to do so could have an adverse effect on our business, financial condition and operating results.

Our use and reliance upon development resources in India, China and Canada may expose us to unanticipated costs or liabilities.

We have established development centers in India, China and Canada and expect to continue to increase hiring of personnel for these facilities. There is no assurance that our reliance upon development resources in India, China or Canada will enable us to achieve meaningful cost reductions or greater resource efficiency. Further, our development efforts and other operations in these countries involve significant risks, including:

- difficulty hiring and retaining appropriate engineering resources due to intense competition for such resources and resulting wage inflation;

- the knowledge transfer related to our technology and exposure to misappropriation of intellectual property or confidential information, including information that is proprietary to us, our customers and other third parties;

- heightened exposure to changes in the economic, security and political conditions of India, China and Canada;

- fluctuation in currency exchange rates and tax risks associated with international operations; and

- development efforts that do not meet our requirements because of language, cultural or other differences associated with international operations, resulting in errors or delays.

Difficulties resulting from the factors above and other risks related to our operations in these countries could expose us to increased expense, impair our development efforts, harm our competitive position and damage our reputation.

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Unforeseen health, safety and environmental costs could harm our business.

Our manufacturing operations use substances that are regulated by various federal, state and international laws governing health, safety and the environment, including the Waste Electrical and Electronic Equipment and Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment regulations adopted by the European Union. If we experience a problem with these substances, it could cause an interruption or delay in our manufacturing operations or could cause us to incur liabilities for any costs related to health, safety or environmental remediation. We could also be subject to liability if we do not handle these substances in compliance with safety standards for storage and transportation and applicable laws. If we experience a problem or fail to comply with such safety standards, our business, financial condition and operating results may be harmed.

We are subject to governmental import and export controls that could subject us to liability or impair our ability to compete in international markets.

We are subject to export control laws that limit which products we sell and where and to whom we sell our products. U.S. export control laws also limit our ability to conduct product development activities in certain countries. In addition, various countries regulate the import of certain technologies and have enacted laws that could limit our ability to distribute our products or could limit our customers ability to implement our products in those countries. Changes in our products or changes in import and export regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the import and export of our products to certain countries altogether. Any change in import and export regulations or related legislation, shift in approach to the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Failure to comply with these and similar laws on a timely basis, or at all, decreased use of our products or any limitation on our ability to export or sell our products would adversely affect our business, financial condition and operating results.

If we need additional capital in the future, it may not be available to us on favorable terms, or at all.

Our business requires significant capital. We have historically relied on significant outside debt and equity financing as well as cash flow from operations to fund our operations, capital expenditures and expansion. We may require additional capital from equity or debt financings in the future to fund our operations or respond to competitive pressures or strategic opportunities. We have a history of significant operating losses. For 2012, we had a net loss of $85.3 million. In the event that we require additional capital, we may not be able to secure timely additional financing on favorable terms, or at all. The terms of any additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer dilution in their percentage ownership of our company, and any new securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, if and when we require it, our ability to grow or support our business and to respond to business challenges could be limited and our business will be harmed.

We are subject to government regulations that could adversely impact our business.

The Federal Communications Commission, or FCC, has jurisdiction over the entire U.S. communications industry and, as a result, our products and our U.S. customers are subject to FCC rules and regulations. Current and future FCC regulations affecting communications services, our products or our customers businesses could negatively affect our business. In addition, international regulatory standards could impair our ability to develop products for international customers in the future. Moreover, many jurisdictions are evaluating or implementing regulations relating to cyber security, privacy and data protection, which can affect the market and requirements for networking and communications equipment. Delays caused by our compliance with regulatory requirements could result in postponements or cancellations of product orders. Further, we may not be successful in obtaining or maintaining any regulatory approvals that may, in the future, be required to operate our business. Any failure to obtain such approvals could harm our business and operating results.

Natural disasters, terrorist attacks or other catastrophic events could harm our operations.

Our headquarters and the majority of our infrastructure, including our PIC fabrication manufacturing facility, are located in Northern California, an area that is susceptible to earthquakes and other natural disasters. Further, a terrorist attack aimed at Northern California or at our nation s energy or telecommunications infrastructure could hinder or delay the development and sale of our products. In the event that an earthquake, terrorist attack or other catastrophe were to destroy any part of our facilities, or certain of our contract manufacturers facilities, destroy or disrupt vital infrastructure systems or interrupt our operations for any extended period of time, our business, financial condition and operating results

would be harmed.

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Security incidents, such as data breaches and cyber-attacks, could compromise our intellectual property and proprietary or confidential information and cause significant damage to our business and reputation.

In the ordinary course of our business, we maintain sensitive data on our networks, including data related to our intellectual property and data related to our business and that of our customers and business partners that is considered proprietary or confidential information. We believe that companies in the technology industry have been increasingly subject to a wide variety of security incidents, cyber-attacks and other attempts to gain unauthorized access. While the secure maintenance of this information is critical to our business and reputation, our network and storage applications may be subject to unauthorized access by hackers or breached due to operator error, malfeasance or other system disruptions. It may be difficult to anticipate or immediately detect such security incidents or data breaches and the damage caused as a result. Accordingly, a data breach, cyber-attack, or unauthorized access or disclosure of our information, could compromise our intellectual property and reveal proprietary or confidential business information. In addition, these security incidents could also cause us to incur significant remediation costs and expenses, disrupt key business operations, subject us to liability and divert attention of management and key information technology resources, any of which could cause significant harm to our business and reputation.

The trading price of our common stock has been volatile and is likely to be volatile in the future.

The trading prices of our common stock and the securities of other technology companies have been and may continue to be highly volatile. Further, our common stock has limited prior trading history. Factors affecting the trading price of our common stock include:

- variations in our operating results;
- announcements of technological innovations, new services or service enhancements, strategic alliances or agreements by us or by our competitors;
- the gain or loss of customers;
- recruitment or departure of key personnel;
- changes in the estimates of our future operating results or external guidance on those results or changes in recommendations by any securities analysts that elect to follow our common stock;
- market conditions in our industry, the industries of our customers and the economy as a whole; and
- adoption or modification of regulations, policies, procedures or programs applicable to our business.

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or operating results. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. Each of these factors, among others, could harm the value of your investment in our common stock. Some companies that have had volatile market prices for their securities have had securities class action lawsuits filed against them. If a suit were filed against us, regardless of its merits or outcome, it could result in substantial costs and divert management s attention and resources.

Anti-takeover provisions in our charter documents and Delaware law could discourage delay or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law, which apply to us, may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of

three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our amended and restated certificate of incorporation and amended and restated bylaws:

- authorize the issuance of blank check convertible preferred stock that could be issued by our board of directors to thwart a takeover attempt;

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establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;

require that directors only be removed from office for cause and only upon a supermajority stockholder vote;

provide that vacancies on the board of directors, including newly-created directorships, may be filled only by a majority vote of directors then in office rather than by stockholders;

prevent stockholders from calling special meetings; and

prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders.

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Item 6. ***Exhibits***

Exhibit No.	Description
4.1	Indenture dated May 30, 2013, between the Registrant and U.S. Bank National Association, as trustee. (1)
10.1*	Consulting Agreement dated April 10, 2013, between the Registrant and Michael O. McCarthy III. (2)
10.2	Purchase Agreement dated May 23, 2013, between the Registrant and Morgan Stanley and Co. LLC and Goldman, Sachs & Co., as representatives of the initial purchasers. (3)
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

The certification attached as Exhibit 32.1 that accompanies this Quarterly Report on Form 10-Q is not deemed filed with the SEC and is not to be incorporated by reference into any filing of Infinera under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

* Management contracts or compensation plan or arrangements in which directors or executive officers are eligible to participate.

** XBRL information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934, and is not subject to liability under those sections, is not part of any registration statement or prospectus to which it relates and is not incorporated or deemed to be incorporated by reference into any registration statement, prospectus or other document.

(1) Incorporated by reference to exhibit filed with Registrant s Current Report on Form 8-K, filed with the SEC on May 30, 2013.

(2) Incorporated by reference to exhibit filed with Registrant s Current Report on Form 8-K, filed with the SEC on April 11, 2013.

(3) Incorporated by reference to exhibit filed with Registrant s Current Report on Form 8-K, filed with the SEC on May 24, 2013.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Infinera Corporation

By: /s/ Ita M. Brennan
Ita M. Brennan

Chief Financial Officer

(Duly Authorized Officer and Principal Financial Officer)

Date: August 5, 2013