INFINERA CORP
Form 10-Q
August 01, 2014
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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 28, 2014
OR

o 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 check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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, 2014, 123,670,547 shares of the registrant's Common Stock, $0.001 par value, were issued and outstanding.

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FOR THE FISCAL QUARTER ENDED JUNE 28, 2014
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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 28, 2014	December 28, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$83,307	$124,330
Short-term investments	230,694	172,660
Accounts receivable, net of allowance for doubtful accounts of $41 in 2014 and $43 in 2013	120,686	100,643
Inventory	130,853	123,685
Prepaid expenses and other current assets	20,167	17,752
Total current assets	585,707	539,070
Property, plant and equipment, net	76,886	79,668
Long-term investments	37,086	64,419
Cost-method investment	9,000	9,000
Long-term restricted cash	4,404	3,904
Other non-current assets	5,571	4,865
Total assets	$718,654	$700,926
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$33,162	$39,843
Accrued expenses	22,546	22,431
Accrued compensation and related benefits	28,742	33,899
Accrued warranty	13,860	12,374
Deferred revenue	29,657	32,402
Total current liabilities	127,967	140,949
Long-term debt, net	112,932	109,164
Accrued warranty, non-current	14,088	10,534
Deferred revenue, non-current	6,187	4,888
Other long-term liabilities	18,173	17,581
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, $0.001 par value Authorized shares – 25,000 and no shares issued and outstanding	—	—
Common stock, $0.001 par value Authorized shares – 500,000 as of June 28, 2014 and December 28, 2013 Issued and outstanding shares – 123,615 as of June 28, 2014 and 119,887 as of December 28, 2013	124	120
Additional paid-in capital	1,046,375	1,025,661
Accumulated other comprehensive loss	(3,113)	(3,486)
Accumulated deficit	(604,079)	(604,485)
Total stockholders' equity	439,307	417,810

Total liabilities and stockholders' equity	$718,654	$700,926

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 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Revenue:				
Product	$142,364	$120,647	$266,606	$228,990
Services	23,035	17,738	41,608	34,020
Total revenue	165,399	138,385	308,214	263,010
Cost of revenue:				
Cost of product	85,906	80,198	164,344	155,645
Cost of services	9,240	6,533	15,211	13,009
Total cost of revenue	95,146	86,731	179,555	168,654
Gross profit	70,253	51,654	128,659	94,356
Operating expenses:				
Research and development	31,738	31,681	61,084	61,407
Sales and marketing	18,082	17,155	35,944	35,201
General and administrative	12,381	11,426	24,635	21,298
Total operating expenses	62,201	60,262	121,663	117,906
Income (loss) from operations	8,052	(8,608)	6,996	(23,550)
Other income (expense), net:				
Interest income	337	207	673	404
Interest expense	(2,728)	(849)	(5,405)	(849)
Other gain (loss), net	(264)	(158)	(993)	(361)
Total other income (expense), net	(2,655)	(800)	(5,725)	(806)
Income (loss) before income taxes	5,397	(9,408)	1,271	(24,356)
Provision for income taxes	617	601	865	932
Net income (loss)	$4,780	$(10,009)	$406	$(25,288)
Net income (loss) per common share				
Basic	$0.04	$(0.09)	$ 0.00	$(0.22)
Diluted	$0.04	$(0.09)	$ 0.00	$(0.22)
Weighted average shares used in computing net income (loss) per common share				
Basic	123,128	116,911	122,240	115,609
Diluted	126,758	116,911	126,112	115,609

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

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INFINERA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Net income (loss)	$4,780	$(10,009)	$406	$(25,288)
Other comprehensive income (loss):				
Reclassification of realized gain on auction rate securities	—	—	—	(166)
Unrealized gain (loss) on all other available-for-sale investments	13	(99)	62	(108)
Foreign currency translation adjustment	87	(802)	331	(918)
Tax related to available-for-sale investment	—	—	(20)	—
Net change in accumulated other comprehensive income (loss)	100	(901)	373	(1,192)
Comprehensive income (loss)	$4,880	$(10,910)	$779	$(26,480)

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 28, 2014	June 29, 2013
Cash Flows from Operating Activities:		
Net income (loss)	$406	$(25,288)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	12,813	12,621
Amortization of debt discount and issuance costs	4,092	630
Amortization of premium on investments	1,747	450
Stock-based compensation expense	13,476	16,159
Other gain	(22)	(291)
Changes in assets and liabilities:		
Accounts receivable	(20,043)	10,332
Inventory	(8,107)	791
Prepaid expenses and other assets	(3,389)	(2,238)
Accounts payable	(6,428)	(23,980)
Accrued liabilities and other expenses	(3,318)	(220)
Deferred revenue	(1,448)	4,440
Accrued warranty	5,040	3,219
Net cash used in operating activities	(5,181)	(3,375)
Cash Flows from Investing Activities:		
Purchase of available-for-sale investments	(158,496)	(130,828)
Proceeds from sale of available-for-sale investments	9,824	2,850
Proceeds from maturities and calls of investments	116,290	62,647
Purchase of property and equipment	(9,985)	(9,431)
Change in restricted cash	(491)	(6)
Net cash used in investing activities	(42,858)	(74,768)
Cash Flows from Financing Activities:		
Proceeds from issuance of debt, net	—	144,469
Proceeds from issuance of common stock	8,401	12,496
Minimum tax withholding paid on behalf of employees for net share settlement	(1,619)	(1,499)
Net cash provided by financing activities	6,782	155,466
Effect of exchange rate changes on cash	234	(778)
Net change in cash and cash equivalents	(41,023)	76,545
Cash and cash equivalents at beginning of period	124,330	104,666
Cash and cash equivalents at end of period	$83,307	$181,211
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net of refunds	$482	$1,148
Cash paid for interest	$1,313	$—
Supplemental schedule of non-cash financing activities:		
Transfer of inventory to fixed assets	$978	$4,684

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 (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 28, 2013.

The Company has made certain estimates, assumptions and judgments that can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Significant estimates, assumptions and judgments made by management 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, fair value measurement of cash equivalents, investments and derivative instruments, other-than-temporary impairments and accounting for income taxes. Management believes that the estimates and judgments upon which they rely are reasonable based upon information available to them at the time that these estimates and judgments are made. To the extent there are material differences between these estimates and actual results, the Company’s consolidated financial statements will be affected.

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 28, 2013.

There have been no material changes in the Company’s significant accounting policies for the six months ended June 28, 2014 as compared to those disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 28, 2013.

2. Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("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 reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. ASU 2013-11 is effective for annual and interim periods for fiscal years beginning on or after December 15, 2013. The Company's adoption of ASU 2013-11 during the first quarter of 2014 had no impact on the Company’s financial position, results of operations or cash flow.

In May 2014, the FASB issued Accounting Standards Update 2014-09, "Revenue from Contracts from Customers" ("ASU 2014-09"). ASU 2014-09 provides a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 will require an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update creates a five-step model that requires entities to exercise judgment when considering the terms of the contract(s) which include (i) identifying the contract(s) with the customer, (ii) identifying the separate performance obligations in the contract, (iii) determining the transaction price, (iv) allocating the transaction price to the separate performance obligations, and (v) recognizing revenue when each performance obligation is satisfied. ASU 2014-09 will be effective for the Company’s first quarter of 2017. The Company has the option to apply the provisions of ASU 2014-09 either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of applying this ASU recognized at the date of initial application. Early adoption is not permitted. The Company is currently evaluating the method and impact the adoption of ASU 2014-09 will have on the Company's condensed consolidated financial statements.

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In June 2014, the FASB issued Accounting Standards Update No. 2014-12, "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period" ("ASU 2014-12"). ASU 2014-12 requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation—Stock Compensation, as it relates to such awards. ASU 2014-12 is effective for us in our first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all awards granted or modified after the effective date; or (ii) retrospective to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter, with the cumulative effect of applying ASU 2014-12 as an adjustment to the opening retained earnings balance as of the beginning of the earliest annual period presented in the financial statements. The Company is currently evaluating the impact of the pending adoption on ASU 2014-12 on our condensed consolidated financial statements.

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.

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 the 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, foreign currency exchange forward contracts 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.

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

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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.

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. If 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.

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 of June 28, 2014, 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 28, 2014 Fair Value Measured Using				As of December 28, 2013 Fair Value Measured Using			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Money market funds	$16,741	$—	$ —	$16,741	$51,749	$—	$ —	$51,749
Certificates of deposit	—	3,560	—	3,560	—	3,840	—	3,840
Commercial paper	—	82,673	—	82,673	—	85,860	—	85,860
Corporate bonds	—	186,006	—	186,006	—	150,595	—	150,595
U.S. treasuries	8,838	—	—	8,838	4,804	—	—	4,804
Foreign currency exchange forward contracts	—	—	—	—	—	29	—	29
Total assets	$25,579	$272,239	$ —	$297,818	$56,553	$240,324	$ —	$296,877
Liabilities								
Foreign currency exchange forward contracts	$—	$62	$ —	$62	$—	$26	$ —	$26

During the three and six months ended June 28, 2014, there were no transfers of assets or liabilities between Level 1 and Level 2.

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

	June 28, 2014			
	Adjusted Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$16,741	$—	$—	$16,741
Certificates of deposit	3,560	—	—	3,560
Commercial paper	82,675	4	(6)	82,673
Corporate bonds	186,069	29	(92)	186,006

U.S. treasuries	8,835	5	(2	) 8,838
Total available-for-sale investments	$297,880	$38	$(100	) $297,818

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	December 28, 2013			
	Adjusted Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$51,749	$—	$—	$51,749
Certificates of deposit	3,840	—	—	3,840
Commercial paper	85,870	2	(12)	85,860
Corporate bonds	150,711	27	(143)	150,595
U.S. treasuries	4,802	2	—	4,804
Total available-for-sale investments	$296,972	$31	$(155)	$296,848

As of June 28, 2014, the Company's available-for-sale investments have a contractual maturity term of no more than 18 months. Net realized gains (losses) on short-term and long-term investments for the three and six months ended June 28, 2014 were insignificant in both periods. Net realized gains (losses) on short-term and long-term investments were zero and $0.2 million for the three and six months ended June 29, 2013, respectively. The specific identification method is used to account for gains and losses on available-for-sale investments.

As of June 28, 2014 and December 28, 2013, the Company held $53.3 million and $64.6 million of cash in banks, respectively.

Other-Than-Temporary Impairments

As a result of the Company's disposal of $3.1 million of its remaining auction rate securities (par value) during the first quarter of 2013, it recorded an approximately $0.2 million gain, which was recognized as other gain (loss), net in the Company's condensed consolidated statements of operations.

A roll-forward of amortized cost, cumulative other-than-temporary impairments ("OTTI") recognized in earnings and accumulated other comprehensive loss for the six months ended June 29, 2013 were 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	$—	$—	$—	$—	$—

4. Cost-method Investment

As of June 28, 2014, the Company's investment in a privately-held company was $9.0 million. This investment is accounted for as a cost-method 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 28, 2014, 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 28, 2014 and June 29, 2013.

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 and British pound 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 fluctuations 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. The forward contracts entered into during the three and six months ended June 28, 2014 were denominated in euros and British pounds, and had maturities of no more than 35 days. The contracts are settled for U.S. dollars at maturity at rates agreed to at inception of the contracts.

As of June 28, 2014, the Company did not designate foreign currency exchange forward contracts 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 28, 2014 and June 28, 2013, the before-tax effect of foreign currency exchange forward contracts and restricted cash was an insignificant loss and a loss of $0.7 million, respectively. For the six months ended June 28, 2014 and June 29, 2013, the before-tax effect of foreign currency exchange forward contracts and restricted cash was a loss of $0.4 million and a loss of $0.2 million, respectively.

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 28, 2014			As of December 28, 2013		
	Gross Notional[(1)]	Prepaid Expenses and Other Assets	Other Accrued Liabilities	Gross Notional[(1)]	Prepaid Expenses and Other Assets	Other Accrued Liabilities
Foreign currency exchange forward contracts						
Related to euro denominated receivables	$12,458	—	$ (53)	$16,867	27	$ —
Related to British pound denominated receivables	1,266	—	(4)	13,271	—	(26)
Related to restricted cash	1,381	—	(6)	1,391	2	—
	$15,105	$—	$ (63)	$31,529	$29	$ (26)

(1) Represents the face amounts of forward contracts that were outstanding as of the period noted.

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6. Balance Sheet Details

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

	June 28, 2014	December 28, 2013
Inventory:		
Raw materials	$11,160	$14,311
Work in process	40,641	49,172
Finished goods [1]	79,052	60,202
Total inventory	$130,853	$123,685
Property, plant and equipment, net:		
Computer hardware	$8,270	$9,692
Computer software[2]	17,578	16,988
Laboratory and manufacturing equipment	154,181	146,834
Furniture and fixtures	1,344	1,347
Leasehold improvements	36,687	35,913
Construction in progress	7,278	8,950
Subtotal	$225,338	$219,724
Less accumulated depreciation and amortization	(148,452)	(140,056)
Total property, plant and equipment, net	$76,886	$79,668
Accrued expenses:		
Loss contingency related to non-cancelable purchase commitments	$5,019	$5,120
Professional and other consulting fees	1,131	1,411
Taxes payable	2,990	2,372
Royalties	1,804	1,540
Accrued rebate and customer prepay liability	566	3,807
Accrued interest on convertible senior notes	219	219
Other accrued expenses	10,817	7,962
Total accrued expenses	$22,546	$22,431

(1) Included in finished goods inventory at June 28, 2014 and December 28, 2013 were $17.8 million and $9.2 million, respectively, of inventory at customer locations for which product acceptance had not occurred.

(2) Included in computer software at June 28, 2014 and December 28, 2013 were $7.9 million and $7.9 million, respectively, related to an enterprise resource planning ("ERP") system that the Company implemented during 2012. The unamortized ERP costs at June 28, 2014 and December 28, 2013 were $5.7 million and $6.3 million, respectively.

Restricted Cash

The Company’s long-term restricted cash balance is primarily comprised of certificates of deposit, of which the majority is not insured by the Federal Deposit Insurance Corporation. These amounts primarily collateralize the Company’s issuances of stand-by and commercial letters of credit. Additionally, the Company’s restricted cash balance includes a leave encashment fund for India employees and a corporate bank card deposit for employees in the United Kingdom.

The following table sets forth the Company's outstanding standby letters of credit (in thousands):

	June 28, 2014	December 28, 2013
Value added tax license	$1,451	$1,430
Customer proposal guarantee	1,876	1,446
Property leases	699	699
Total standby letters of credit	$4,026	$3,575

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7. Accumulated Comprehensive Loss

Other comprehensive loss includes certain changes in equity that are excluded from net income (loss). The following table sets forth the changes in accumulated other comprehensive loss by component for the six months ended June 28, 2014 (in thousands):

	Unrealized Gain on Other Available-for-Sale Securities	Foreign Currency Translation	Accumulated Tax Effect	Total
Balance at December 28, 2013	$ (124)	$ (2,602)	$ (760)	$ (3,486)
Net current-period other comprehensive loss	62	331	(20)	373
Balance at June 28, 2014	$ (62)	$ (2,271)	$ (780)	$ (3,113)

8. Basic and Diluted Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is computed using net income (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 conversion of convertible senior notes from the conversion spread, and assumed issuance of stock under the Company’s employee stock purchase plan (“ESPP”) using the treasury stock method. The Company includes the common shares underlying PSUs in the calculation of diluted net income per share only when they become contingently issuable. In net loss periods, these potentially diluted common shares are anti-dilutive and therefore, excluded from the diluted net loss calculation.

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

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Numerator:				
Net income (loss)	$4,780	$(10,009)	$406	$(25,288)
Denominator:				
Basic weighted average common shares outstanding	123,128	116,911	122,240	115,609
Effect of dilutive securities:				
Employee equity plans	3,630	—	3,872	—
Diluted weighted average common shares outstanding	126,758	116,911	126,112	115,609
Net income (loss) per common share				
Basic	$0.04	$(0.09)	$ 0.00	$(0.22)
Diluted	$0.04	$(0.09)	$ 0.00	$(0.22)

The number of shares outstanding used in the computation of basic and diluted net income (loss) per share does not include the effect of the following potential outstanding common stock. The effects of these potentially outstanding shares were not included in the calculation of diluted net income (loss) per share because their effect would have been anti-dilutive under the treasury stock method or the performance condition of the award has not been met (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Stock options	766	7,396	914	7,396
Restricted stock units	338	6,362	569	6,362
Performance stock units	—	721	—	721
Employee stock purchase plan shares	697	601	708	601
Total	1,801	15,080	2,191	15,080

In the three and six months ended June 28, 2014, the Company excluded the potential shares issued upon early conversion of the convertible senior notes in the calculation of diluted earnings per share because the market price was below the conversion price. In the future, the Company would include these dilutive effects of the convertible senior notes in the calculation of diluted net income per common share if the market price is above the conversion price. Upon conversion of the convertible senior notes, it is the Company's intention to pay cash equal to the lesser of the aggregate principal amount or 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.

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

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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 canceled, extinguished or forfeited. Holders may convert their Notes under the following circumstances:

- during any fiscal quarter commencing after the fiscal quarter ended 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.

The amounts recorded in connection with the issuance of the Notes and related amortization consisted of the following (in thousands):

	Other Non-Current Assets	Long-Term Debt	Additional Paid-in Capital
Principal amount	$ —	$ 150,000	$ —
Debt discount	—	(45,000)	—
Equity component	—	—	45,000
Debt issuance cost	3,872	—	(1,659)
Initial transaction amounts	$ 3,872	$ 105,000	$ 43,341
Amortization of debt issuance cost	(682)	—	—
Amortization of debt discount	—	7,932	—
Net carrying amount at June 28, 2014	$ 3,190	$ 112,932	$ 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 years until maturity of the Notes was $37.1 million as of June 28, 2014.

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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 initially recorded a deferred tax liability of $17.0 million in connection with the issuance of the Notes, and 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 Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Contractual interest expense	$656	$219	$1,313	$219
Amortization of debt issuance costs	164	50	324	50
Amortization of debt discount	1,908	580	3,768	580
Total interest expense	$2,728	$849	$5,405	$849

The coupon rate was 1.75%. The debt discount and debt issuance costs are amortized, using an annual effective interest rate of 10.23%, to interest expense over the term of the Notes.

As of June 28, 2014, the fair value of the Notes was $160.1 million. The fair value was determined based on the quoted bid price of the Notes in an over-the-counter market on June 27, 2014. The Notes are classified as Level 2 of the fair value hierarchy. Based on the closing price of the Company's common stock of $9.55 on June 27, 2014, the if-converted value of the Notes was less than their principal amount.

10. Stockholders' Equity

Stock-based Compensation Plans

The Company has stock-based compensation plans pursuant to which the Company has granted stock options, RSUs and PSUs. The Company also has an ESPP for all eligible employees. As of June 28, 2014, there were a total of 17.5 million shares of common stock available for grant under the Company's 2007 Equity Incentive Plan ("2007 Plan").

The following tables summarize the Company's equity award activity and related information (in thousands, except per share data):

	Number of Options	Weighted-Average Exercise Price Per Share	Aggregate Intrinsic Value
Outstanding at December 28, 2013	6,367	$ 7.26	$17,452
Options granted	25	$ 9.02	
Options exercised	(456)	$ 5.87	$1,379
Options canceled	(40)	$ 11.58	
Outstanding at June 28, 2014	5,896	$ 7.34	$14,355
Vested and expected to vest as of June 28, 2014	5,893		$14,347
Exercisable at June 28, 2014	5,770	$ 7.34	$14,102

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	Number of Restricted Stock Units	Weighted-Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Outstanding at December 28, 2013	6,583	$7.72	$64,443
RSUs granted	2,293	$8.29	
RSUs released	(2,441)	$7.66	$20,824
RSUs canceled	(313)	$7.24	
Outstanding at June 28, 2014	6,122	$7.98	$58,464
Expected to vest at June 28, 2014	5,880		$56,151

	Number of Performance Stock Units	Weighted-Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Outstanding at December 28, 2013	721	$7.04	$7,054
PSUs granted	446	$7.04	
PSUs released	(255)	$6.36	$2,097
PSUs canceled	(73)	$7.19	
Outstanding at June 28, 2014	839	$7.21	$8,009
Expected to vest at June 28, 2014	625		$5,969

The aggregate intrinsic value of unexercised options is calculated as the difference between the closing price of the Company's common stock of $9.55 at June 27, 2014 and the exercise prices of the underlying options. The aggregate intrinsic value of the options that have been exercised is calculated as the difference between the fair market value of the common stock at the date of exercise and the exercise price of the underlying options. The aggregate intrinsic value of unreleased RSUs and unreleased PSUs is calculated using the closing price of the Company's common stock of $9.55 at June 27, 2014. The aggregate intrinsic value of RSUs and PSUs released is calculated using the fair market value of the common stock at the date of release.

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 28, 2014. 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	422	1.6
RSUs	35,613	2.4
PSUs	2,782	1.6

Employee Stock Options

The estimated values of stock options, as well as assumptions used in calculating these values were based on estimates as follows (expense amounts in thousands):

	Three Months Ended		Six Months Ended	
Employee and Director Stock Options	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Volatility	N/A	N/A	52%	N/A
Risk-free interest rate	N/A	N/A	1.3%	N/A
Expected life	N/A	N/A	4.3 years	N/A

Estimated fair value	N/A	N/A	$3.85	N/A
Total stock-based compensation expense	$127	$722	$515	$1,525

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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 (expense amounts in thousands):

	Three Months Ended		Six Months Ended	
Employee Stock Purchase Plan	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Volatility	49%	46%	49% - 51%	46%
Risk-free interest rate	0.02%	0.14%	0.02% - 0.11%	0.10%
Expected life	0.25 years	0.5 years	0.25 - 0.5 years	0.5 years
Estimated fair value	$2.05	$1.87	$2.05 - $2.57	$1.87
Total stock-based compensation expense	$843	$566	$1,634	$1,274

Restricted Stock Units

During the three and six months ended June 28, 2014, the Company granted RSUs to employees and members of the Company’s board of directors to receive an aggregate of 1.8 million shares and 2.3 million shares of the Company’s common stock, respectively. 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 28, 2014 and June 29, 2013 was approximately $5.3 million and $10.3 million, respectively, and $5.8 million and$12.7 million, respectively.

Performance Stock Units

Pursuant to the Company’s 2007 Plan, during fiscal 2012, the Company granted 0.5 million shares of PSUs to certain of its 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 canceled. During the three and six months ended June 28, 2014, the Company did not release any shares subject to these PSUs.
Pursuant to the Company’s 2007 Plan, during fiscal 2013, the Company granted 0.6 million shares of PSUs to certain of its 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. During the three and six months ended June 28, 2014, the Company released no shares and 0.3 million shares of PSUs, respectively, based on a payout of 1.5 times of the target number of PSUs.

The ranges of estimated values of the PSUs granted, as well as assumptions used in calculating these values were based on estimates as follows:

	Year Ended December 28, 2013
Infinera Volatility	55%
NASDAQ Telecom Composite Index Volatility	23%
Risk-free interest rate	0.42%
Correlation with NASDAQ Telecom Composite Index	0.56
Estimated fair value	$6.27 - $7.06

Pursuant to the Company's 2007 Plan, during the three and six months ended June 28, 2014, the Company granted 0.1 million shares and 0.4 million shares of PSUs, respectively, to certain of its 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 iShares North American Tech-Multimedia Networking ("IGN") Index over the span of one, two and three years of total shareholder returns.

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The ranges of estimated values of the PSUs granted, as well as assumptions used in calculating these values were based on estimates as follows:

	Three Months Ended June 28, 2014	Six Months Ended
Infinera Volatility	50%	49% - 50%
IGN Index Volatility	25%	25%
Risk-free interest rate	0.71%	0.66% - 0.71%
Correlation with IGN Index	0.60	0.60
Estimated fair value	$6.59 - $7.53	$6.59 - $7.60

Amortization of stock-based compensation related to PSUs in the three and six months ended June 28, 2014 was approximately $0.6 million and $1.0 million, respectively. 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 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."

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 28, 2014	December 28, 2013
Stock-based compensation effects in inventory	$3,228	$3,189
Stock-based compensation effects in deferred inventory cost	$13	$15
Stock-based compensation effects in fixed assets	$132	$145

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Stock-based compensation effects included in net income (loss) before income taxes				
Cost of revenue	$477	$474	$929	$960
Research and development	2,080	2,622	4,218	5,741
Sales and marketing	1,815	1,807	3,535	3,806
General and administration	1,549	1,591	3,079	2,360
	5,921	6,494	11,761	12,867
Cost of revenue – amortization from balance sheet[1)]	883	1,690	1,715	3,292
Total stock-based compensation expense	$6,804	$8,184	$13,476	$16,159

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

11. Income Taxes

Provision for income taxes for the three and six months ended June 28, 2014 was $0.6 million and $0.9 million, respectively, on pre-tax income of $5.4 million and $1.3 million, respectively. This compared to a tax provision of $0.6 million and $0.9 million, respectively, on pre-tax losses of $9.4 million and $24.4 million, respectively, for the three and six months ended June 29, 2013. In all periods, the tax expense primarily represents foreign taxes of the Company's overseas subsidiaries compensated on a cost plus basis and remains relatively similar in all periods, regardless of the level of consolidated earnings. The Company does not provide for tax on U.S. income, nor benefit U.S. losses, because of its significant loss carryforward position and a corresponding full valuation allowance. The release of transfer pricing reserves in the future will have a beneficial impact to tax expense, but the timing of the

impact depends on factors such as expiration of the statute of limitations or

settlements with tax authorities. No significant releases are expected in the near future based on information available at this time.

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 28, 2014 and December 28, 2013. 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 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 ("CEO"). The Company's CEO 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. 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 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Americas:				
United States	$136,342	$88,251	$247,033	$167,324
Other Americas	4,760	3,802	8,296	4,519
	141,102	92,053	255,329	171,843
Europe, Middle East and Africa	19,234	31,954	44,847	70,760
Asia Pacific and Japan	5,063	14,378	8,038	20,407
Total revenue	$165,399	$138,385	$308,214	$263,010

Property, plant and equipment, net

	June 28, 2014	December 28, 2013
United States	$74,157	$76,850
Other Americas	283	319
Europe, Middle East and Africa	1,022	1,451
Asia Pacific and Japan	1,424	1,048
Total property, plant and equipment, net	$76,886	$79,668

13. Guarantees

Product Warranties

Upon delivery of products, the Company provides for the estimated cost to repair or replace products including 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 or

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replacement. The Company estimates its hardware warranty obligations based on the Company's historical experience of known product failure rates, use of materials and labor 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 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Beginning balance	$26,385	$16,672	$22,908	$16,482
Charges to operations	6,800	6,178	12,360	10,346
Utilization	(2,370)	(2,055)	(5,612)	(4,138)
Change in estimate [1]	(2,867)	(1,094)	(1,708)	(2,989)
Balance at the end of the period	$27,948	$19,701	$27,948	$19,701

(1) The Company records hardware warranty liabilities based on the latest quality and cost information available as of that date. The changes in estimate shown here are due to changes in overall actual failure rates and the resulting impact of these changes on the Company's estimate of expected future returns, as well as changes in the estimated cost and the mix of new versus used units related to replacement of failed 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.

Cambrian Science Patent Infringement Litigation

On July 12, 2011, the Company was notified by Level 3 that Cambrian Science Corporation ("Cambrian") filed suit against Level 3 and six other defendants, including Cox Communications, Inc., XO Communications, LLC, Global Crossing Limited, 360Networks (USA), Inc., Integra Telecom, Inc. and IXC, Inc. dba Telekenex (collectively, the "Defendants") in the U.S. District Court for the Central District of California alleging infringement of patent no. 6,775,312 (the "'312 Patent") and requesting damages for such alleged infringement (the "Cambrian Claim"). The nature of the Cambrian Claim involves allegations of infringement of the '312 Patent resulting from the Defendants' use of certain products and systems in the Defendants' networks, including our DTN platform. On August 24, 2011, Cambrian amended the complaint to name the Company as a defendant. The Company assumed the defense of the Cambrian Claim and filed an answer to Cambrian's complaint on September 21, 2011, in which the Company denied infringement of the '312 Patent and raised other defenses. Cambrian filed a second amended complaint on October 6, 2011, which included many of the same allegations as in the original complaint. The Company filed its answer to the second amended complaint on October 21, 2011, in which the Company maintained the same denials and defenses as in the Company's initial answer. On December 23, 2011, the Company filed a motion requesting that the court stay the case with respect to each of the above-noted customer Defendants. Cambrian filed its opposition to the Company's motion on December 30, 2011. The Company's request was denied in the court's decision on March 7, 2012. The Company presented evidence on the appropriate meanings of relevant key words used in the patent claims during a claim construction hearing on November 20, 2012.

On June 17, 2013, the court issued an order regarding claim construction, in which the court agreed with almost all of the Company's proposed claim constructions. On October 17, 2013, the parties met for a court-mandated mediation. On April 24, 2014, the Company filed two motions for summary judgment relating to non-infringement and Cambrian's claim to an earlier date of invention. The court held a hearing on the summary judgment motions on June 9, 2014. On July 2, 2014, the court granted the Company's motion for summary judgment on non-infringement and entered a final judgment of non-infringement of the '312 Patent. Cambrian may appeal the court's ruling of non-infringement to the Court of Appeals for the Federal Circuit. The Company is seeking to recover certain costs and

attorney's fees from Cambrian.

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Based on the information available at this time, the Company has 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. Accordingly, the Company has accrued an insignificant amount, which did not have a material adverse effect on the Company's business, consolidated financial position, results of operations, or cash flows. Factors that the Company considered in the determination of the likelihood of a loss and the estimate 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 status of the plaintiff as a non-operating entity and the likelihood of the plaintiff accepting the estimated amount. However, the outcome of such legal matters is inherently unpredictable and subject to significant uncertainties.

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 28, 2014, the Company has not accrued or recorded any such material liabilities other than for the accrual associated with the Cambrian lawsuit.

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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 our expectations regarding earnings, revenue, gross margin, expenses, cash flows and 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 revenue; 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 issued in May 2013; 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 a 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 28, 2013 filed on February 21, 2014. 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

We were founded in December 2000 with a unique vision for optical networking. Prior to this, communications service provider optical networks were built from fairly commoditized products, broadly known as wavelength division multiplexing ("WDM") systems. Recent growth in bandwidth demand has increased the need for the delivery of high-capacity low-cost bandwidth throughout the network. We believe that in many cases, traditional point-to-point network architectures do not provide the required flexibility to meet this demand. It takes large amounts of low-cost bandwidth, pervasive Optical Transport Network ("OTN") switching, and the intelligence of bandwidth management to manage these larger networks and deliver high-capacity services quickly and cost-effectively. We believe this can best be achieved with photonic integrated circuits ("PICs") and that only through photonic integration can network operators efficiently scale their network bandwidth without significant increases in space, power or operational workload.

We provide optical transport networking equipment, software and services to telecommunications service providers, internet content providers, cable operators, and wholesale network operators, including subsea network operators (collectively, "Service Providers") across the globe. Optical transport networks are deployed by Service Providers facing significant demands for transmission capacity prompted by increased use of high-speed Internet access, mobile broadband, high-definition video streaming services, business Ethernet services, cloud-based services and wholesale bandwidth services.

The Infinera Intelligent Transport Network is an architecture for Service Providers to address the increasing demand for cloud-based services and data center connectivity. This architectural approach helps Service Providers use time as a weapon to increase revenues with reliable, differentiated services while reducing operating costs through scale, multi-layer convergence and automation. The Infinera Intelligent Transport Network is based on platforms built with our unique PICs.

Traffic patterns in the optical network continue to grow to accommodate increased demands for transmission capacity prompted by increased use of high-speed Internet access, mobile broadband, streaming high-definition video services, business Ethernet services, cloud-based services and wholesale bandwidth services. We believe that the Infinera Intelligent Transport Network architecture is uniquely enabled to deliver improvements in these areas compared to

competitive WDM systems that still rely on discrete optical components rather than PICs. We also believe that this enables Service Providers to deploy reliable, high-capacity, efficient optical network solutions

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that are easy to use and to improve the integration between the layers of Service Provider networks with the lowest total cost of ownership.

Our DTN platform currently supports 10 Gigabits per second ("Gbps") and 40 Gbps WDM transmission capacity combined with integrated switching capabilities. Our DTN-X platform supports 100 Gbps WDM transmission capacity with 500 Gbps super-channels and also integrates 5 Terabits per second of OTN switching capacity in a single bay. The DTN-X platform leverages the unique capabilities of our 500 Gbps PICs to deliver high-capacity Intelligent Transport Networks that reduce power, cooling and space, while simplifying transport network operations. Our ATN platform supports direct wavelength connectivity to DTN and DTN-X nodes, reducing equipment costs and providing unique network management capabilities across our Intelligent Transport Network.

As of June 28, 2014, we have sold our network systems for deployment in the optical networks of 133 customers worldwide, including CenturyLink, Colt, Cox Communications, DANTE, Deutsche Telekom, Equinix, Interoute, KDDI, Level 3, NTT, OTE, Pacnet, Rostelecom, Telefonica, TeliaSonera International Carrier, Vodafone and XO Communications. Since the commencement of shipping our DTN-X platform in the second quarter of 2012, we have 46 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. Two customers each accounted for over 10% of our revenue in the second quarter of 2014, and no customer accounted for over 10% of our revenue in the corresponding period in 2013. Two customers each accounted for over 10% of our revenue in the six months ended June 28, 2014, and one customer accounted for over 10% of our revenue in the corresponding period in 2013.

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 97% and 98% of our revenue from direct sales to customers in the three and six months ended June 28, 2014, respectively, and 88% and 92% of our revenue for the three and six months ended June 28, 2013, respectively. Our strategy is to leverage channel partners where appropriate to expand our presence in certain geographies; however, we expect to continue generating a substantial majority of our revenue from direct sales.

In the remainder of 2014, our goal is to continue our growth in the 100 Gbps technology cycle with additional network builds to both new and existing customers. We also anticipate customers who deployed the DTN-X platform over the past two years to buy additional capacity for their networks, which if they do, will drive both additional revenue and also improve gross margin levels. Given the lower than expected research and development expenses incurred during the first half of fiscal 2014, we currently expect to ramp up our research and development spending levels in the second half of the fiscal year to allow us to execute on our future product roadmap, including additional features for our long-haul offerings and new products for adjacent markets. We anticipate generating positive cash flows over the remainder of the fiscal year.

Our 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.

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 the U.S. generally accepted accounting principles ("U.S. GAAP"). The preparation of these financial statements requires management to make estimates, assumptions and judgments that can 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

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months ended June 28, 2014 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 28, 2013.

Results of Operations

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

	Three Months Ended							
	June 28, 2014		June 29, 2013					
	Amount	% of total revenue	Amount	% of total revenue	Change		% Change	
Revenue:								
Product	$142,364	86 %	$120,647	87 %	$21,717		18	%
Services	23,035	14 %	17,738	13 %	5,297		30	%
Total revenue	$165,399	100 %	$138,385	100 %	$27,014		20	%
Cost of revenue:								
Product	$85,906	52 %	$80,198	58 %	$5,708		7	%
Services	9,240	6 %	6,533	5 %	2,707		41	%
Total cost of revenue	$95,146	58 %	$86,731	63 %	$8,415		10	%
Gross profit	$70,253	42 %	$51,654	37 %	$18,599		36	%

	Six Months Ended							
	June 28, 2014		June 29, 2013					
	Amount	% of total revenue	Amount	% of total revenue	Change		% Change	
Revenue:								
Product	$266,606	87 %	$228,990	87 %	$37,616		16	%
Services	41,608	13 %	34,020	13 %	7,588		22	%
Total revenue	$308,214	100 %	$263,010	100 %	$45,204		17	%
Cost of revenue:								
Product	$164,344	53 %	$155,645	59 %	$8,699		6	%
Services	15,211	5 %	13,009	5 %	2,202		17	%
Total cost of revenue	$179,555	58 %	$168,654	64 %	$10,901		6	%
Gross profit	$128,659	42 %	$94,356	36 %	$34,303		36	%

Revenue

Total revenue increased by $27.0 million, or 20%, during the three months ended June 28, 2014 compared to the corresponding period in 2013 and increased by $45.2 million, or 17%, during the six months ended June 28, 2014 compared to the corresponding period in 2013.

Total product revenue increased by $21.7 million, or 18%, during the three months ended June 28, 2014 compared to the corresponding period in 2013 as a result of growth across multiple customer verticals. We continue to see customers adding new routes and additional capacity to their existing networks. In addition, we continue to win opportunities with new customers wanting to adopt our platforms.

Total product revenue increased by $37.6 million, or 16%, during the six months ended June 28, 2014 compared to the corresponding period in 2013. This increase was driven by relatively stronger demand across our customer base as they continue to deploy our products to meet the growing bandwidth needs of their networks.

Total services revenue increased by $5.3 million, or 30%, during the three months ended June 28, 2014 compared to the corresponding period in 2013. Total services revenue increased by $7.6 million, or 22%, during the six months

ended June 28, 2014 compared to the corresponding period in 2013. The increase in both the quarter

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and year-to-date periods of fiscal 2014 was due to higher levels of deployment services as customers build out new networks utilizing our teams' expertise as well as higher on-going support services as we continue to grow our installed base.

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

	Three Months Ended					
	June 28, 2014		June 29, 2013			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Total revenue by geography						
Domestic	$136,342	82 %	$88,251	64 %	$48,091	54 %
International	29,057	18 %	50,134	36 %	(21,077)	(42)%
	$165,399	100 %	$138,385	100 %	$27,014	20 %
Total revenue by sales channel						
Direct	$160,310	97 %	$122,234	88 %	$38,076	31 %
Indirect	5,089	3 %	16,151	12 %	(11,062)	(68)%
	$165,399	100 %	$138,385	100 %	$27,014	20 %
	Six Months Ended					
	June 28, 2014		June 29, 2013			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Total revenue by geography						
Domestic	$247,033	80 %	$167,324	64 %	$79,709	48 %
International	61,181	20 %	95,686	36 %	(34,505)	(36)%
	$308,214	100 %	$263,010	100 %	$45,204	17 %
Total revenue by sales channel						
Direct	$300,784	98 %	$243,082	92 %	$57,702	24 %
Indirect	7,430	2 %	19,928	8 %	(12,498)	(63)%
	$308,214	100 %	$263,010	100 %	$45,204	17 %

International revenue decreased by $21.1 million to 18% of total revenue for the three months ended June 28, 2014 from 36% of total revenue in the corresponding period in 2013. International revenue decreased by $34.5 million to 20% of total revenue for the six months ended June 28, 2014 from 36% of total revenue in the corresponding period in 2013. In absolute dollars, international revenue declined as we experienced strong demand led by Europe in the first half of 2013, which we have not been able to duplicate in the first half of 2014. In addition, as a percentage of total revenue, international revenue decreased during the three and six months ended June 28, 2014 due to strong demand within North America.

We believe that our DTN-X platform is well positioned as existing customers continue to build out their networks and as we gain new opportunities to deploy our networks with new customers. We continue to see strong demand across our customer base including both new customers as well as growth with existing customers. As a result, we currently expect that these dynamics will drive our revenue slightly higher in the third quarter of 2014 on a sequential basis and represent significant year-over-year growth.

Cost of Revenue and Gross Margin

Gross margin increased to 42% in the three months ended June 28, 2014 from 37% in the corresponding period of 2013. The increase was primarily driven by customers adding an increased volume of capacity to the DTN-X networks they have built over the last few years.

Gross margin increased to 42% in the six months ended June 28, 2014 from 36% in the corresponding period of 2013. This increase was primarily due to improvements in revenue mix, including both the mix of customers as well as the ratio of new network builds to capacity adds to existing networks.

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Based on our current outlook, we expect that gross margin in the third quarter of 2014 will decline slightly as compared to the prior quarter as we anticipate a significant number of new network builds.

Operating Expenses

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

	Three Months Ended June 28, 2014		June 29, 2013			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Operating expenses:						
Research and development	$31,738	19 %	$31,681	23 %	$57	0.2 %
Sales and marketing	18,082	11 %	17,155	13 %	927	5 %
General and administrative	12,381	7 %	11,426	8 %	955	8 %
Total operating expenses	$62,201	37 %	$60,262	44 %	$1,939	3 %

	Six Months Ended June 28, 2014		June 29, 2013			
	Amount	% of total revenue	Amount	% of total revenue	Change	% Change
Operating expenses:						
Research and development	$61,084	20 %	$61,407	23 %	$(323)	(1) %
Sales and marketing	35,944	12 %	35,201	14 %	743	2 %
General and administrative	24,635	8 %	21,298	8 %	3,337	16 %
Total operating expenses	$121,663	40 %	$117,906	45 %	$3,757	3 %

Research and Development Expenses

Research and development expenses increased by $0.1 million, or 0.2%, during the three months ended June 28, 2014 compared to the corresponding period in 2013 primarily due to increased facilities and depreciation costs of $0.8 million and costs of professional outside services of $0.2 million. These increases were primarily offset by $0.9 million of decreased prototype and non-recurring engineering expenses due to the timing of certain projects.

Research and development expenses decreased by $0.3 million, or 1%, during the six months ended June 28, 2014 compared to the corresponding period in 2013 primarily due to a decrease in prototype and non-recurring engineering expense due to timing of certain projects of $1.6 million and decreased stock-based compensation expense of $1.5 million due to lower equity activity as compared to the prior year. These decreases were partially offset by increased facilities and depreciation costs of $1.1 million, increased costs of professional outside services of $0.8 million, increased compensation costs of $0.6 million due to higher headcount and other discretionary spending of $0.2 million.

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Sales and Marketing Expenses

Sales and marketing expenses increased by $0.9 million, or 5%, during the three months ended June 28, 2014 compared to the corresponding period in 2013 primarily due to increased compensation costs of $0.9 million due to higher headcount to support the continued expansion of our business, as well as increased travel and trade show related expenses of $0.5 million. These increases were partially offset by $0.6 million in lower costs related to customer lab trials.

Sales and marketing expenses increased by $0.7 million, or 2%, during the six months ended June 28, 2014 compared to the corresponding period in 2013 primarily due to increased travel, trade show and other marketing related expenses of $0.9 million, increased compensation costs due to increased headcount of $0.5 million and $0.2 million in lower costs of professional outside services. These increases were partially offset by $0.9 million in lower costs related to customer lab trials.

General and Administrative Expenses

General and administrative expenses increased by $1.0 million, or 8%, during the three months ended June 28, 2014 compared to the corresponding period in 2013 primarily due to higher compensation and personnel-related costs of $0.6 million due to an increase in headcount along with increased costs of professional outside services of $0.3 million.

General and administrative expenses increased by $3.3 million, or 16%, during the six months ended June 28, 2014 compared to the corresponding period in 2013 primarily due to higher compensation and personnel-related costs of $2.1 million and increased costs of professional outside services of $1.1 million.

Other Income (Expense), Net

	Three Months Ended				Six Months Ended			
	June 28, 2014	June 29, 2013	Change	% Change	June 28, 2014	June 29, 2013	Change	% Change
	(In thousands)							
Interest income	$337	$207	$130	63 %	$673	$404	$269	67 %
Interest expense	(2,728)	(849)	(1,879)	221 %	(5,405)	(849)	(4,556)	537 %
Other gain (loss), net	(264)	(158)	(106)	67 %	(993)	(361)	(632)	175 %
Total other income (expense), net	$(2,655)	$(800)	$(1,855)	232 %	$(5,725)	$(806)	$(4,919)	610 %

Interest income increased by $0.1 million and $0.3 million during the three and six months ended June 28, 2014, respectively, compared to the corresponding periods in 2013. These increases were primarily driven by a higher investment balance as a result of both our cash generated from operations over the past year and the proceeds from the issuance in May 2013 of $150.0 million aggregate principal amount of 1.75% convertible senior notes due June 1, 2018 (the "Notes"), partially offset by lower investment returns.

Interest expense for the three and six months ended June 28, 2014 consisted of cash interest payments and amortization of discount and issuance costs related to the Notes.

The change in other gain (loss), net for the three months ended June 28, 2014 as compared to the same period of 2013 was primarily due to an increase in realized and unrealized foreign currency transaction loss. The change in other gain (loss), net for the six months ended June 28, 2014 as compared to the same period of 2013 was primarily due to a $0.8 million increase in realized and unrealized foreign currency transaction loss, partially offset by $0.2 million gain from the disposal of our remaining auction rate securities.

Income Tax Provision

Provision for income taxes for the three and six months ended June 28, 2014 was $0.6 million and $0.9 million, respectively, on pre-tax income of $5.4 million and $1.3 million, respectively. This compared to a tax provision of $0.6 million and $0.9 million, respectively, on a pre-tax loss of $9.4 million and $24.4 million, respectively, for the

three and six months ended June 28, 2013. In all periods, the tax expense primarily represents foreign taxes of our overseas subsidiaries compensated on a cost plus basis and remains relatively similar in all periods, regardless of the level of consolidated earnings. We do not provide for tax on U.S. income, nor benefit U.S.

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losses, because of our significant loss carryforward position and a corresponding full valuation allowance. The release of transfer pricing reserves in the future will have a beneficial impact to tax expense, but the timing of the impact depends on factors such as expiration of the statute of limitations or settlements with tax authorities. No significant releases are expected in the near future based on information available at this time.

Liquidity and Capital Resources

	Six Months Ended	
	June 28, 2014	June 29, 2013
	(In thousands)	
Net cash flow provided by (used in):		
Operating activities	$(5,181)	$(3,375)
Investing activities	$(42,858)	$(74,768)
Financing activities	$6,782	$155,466

	June 28, 2014	December 28, 2013
	(In thousands)	
Cash and cash equivalents	$83,307	$124,330
Short-term and long-term investments	267,780	237,079
Long-term restricted cash	4,404	3,904
	$355,491	$365,313

Cash, cash equivalents and short-term investments consist of highly-liquid investments in certificates of deposits, money market funds, commercial paper, corporate bonds and U.S. treasuries. Long-term investments primarily consist of corporate bonds. The restricted cash balance amounts are primarily pledged as collateral for certain stand-by and commercial letters of credit related to customer proposal guarantees, value added tax licenses and property leases.

Operating Activities

Net cash used in operating activities for the six months ended June 28, 2014 was $5.2 million as compared to $3.4 million for the corresponding period in 2013.

Net income for the six months ended June 28, 2014 was $0.4 million, which included non-cash charges of $32.1 million, compared to a net loss of $25.3 million for the corresponding period in 2013, including non-cash charges of $29.6 million.

Net cash used to fund working capital was $37.7 million for the six months ended June 28, 2014. Accounts receivables increased by $20.0 million primarily due to timing of invoicing of DTN-X deployments during the period. Inventory increased by $8.1 million due to increased levels of DTN-X inventory, including increased levels of inventory awaiting customer acceptance. Accounts payable decreased by $6.4 million primarily reflecting timing of purchases and payments of purchases during the period.

Net cash used to fund working capital was $7.7 million for the six months ended June 29, 2013. Accounts receivables decreased by $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.

Investing Activities

Net cash used in investing activities in the six months ended June 28, 2014 was $42.9 million compared to net cash provided by investing activities of $74.8 million in the corresponding period of 2013. Investing activities for the six months ended June 28, 2014 included net cash used of $32.4 million associated with purchases, maturities and sales of investments in the period and $10.0 million of capital expenditures. Investing activities for the six months ended June 28, 2013 included net cash used of $65.3 million associated with purchases, maturities, calls and sales of investments in the period, and $9.4 million of capital expenditures.

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Financing Activities

Net cash provided by financing activities in the six months ended June 28, 2014 was $6.8 million compared to $155.5 million in the corresponding period of 2013. Financing activities for the six months ended June 28, 2014 and the corresponding period in 2013 included net proceeds from the exercise of stock options and issuance of shares under the employee stock purchase plan ("ESPP"). These proceeds were offset by the minimum tax withholdings paid on behalf of employees for net share settlements of restricted stock units. Financing activities for the six months ended June 28, 2013 included net proceeds from the issuance of the Notes of $144.5 million.

Liquidity

We believe that our current cash, cash equivalents and investments, together with cash generated from operations, exercise of employee stock options and purchases under our ESPP 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.

In May 2013, we issued the Notes, which 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 and intended to be used 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 as cash, shares of common stock or a combination of cash and shares of common stock, at our election, for any remaining conversion obligation. The carrying value of the Notes was $112.9 million as of June 28, 2014, which represents the liability component of the $150.0 million principal balance, net of $37.1 million debt discount. The debt discount is currently being amortized over the remaining term until maturity of the Notes on June 1, 2018. Any future redemption or conversion of the Notes could impact the timing of the repayment of these Notes.

As of June 28, 2014, contractual obligations related to the Notes are payments of $1.3 million due within 2014, $2.6 million due each year from 2015 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. For more information regarding the Notes, see Note 9, “Convertible Senior Notes,” to the Notes to Condensed Consolidated Financial Statements.

As of June 28, 2014, we had $314.0 million of cash, cash equivalents, and short-term investments, including $16.9 million of cash and cash equivalents held by our foreign subsidiaries. Our cash in foreign locations is used for operational and investing activities in those locations, and we do not currently have the need or the intent to repatriate those funds to the United States. Our policy with respect to undistributed foreign subsidiaries’ earnings is to consider those earnings to be indefinitely reinvested. If we were to repatriate these funds, we would be required to accrue and pay U.S. taxes on such amounts, however, due to our significant net operating loss carryforward position for both federal and state tax purposes, as well as the full valuation allowance provided against our U.S. and state net deferred tax assets, we would currently be able to offset any such tax obligations in their entirety. However, foreign withholding taxes may be applicable.

Off-Balance Sheet Arrangements

As of June 28, 2014, 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.

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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 28, 2013, which is incorporated herein by reference. Our exposure to market risk has not changed materially since December 28, 2013.

Market Risk and Market Interest Risk

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 28, 2014, the fair value of the Notes was $160.1 million. The fair value was determined based on the quoted bid price of the Notes in an over-the-counter market on June 27, 2014. The fair value of the Notes is subject to interest rate risk, market risk and other factors due to the convertible feature. The fair value of the 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 the 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 Notes at fair value. We present the fair value of the Notes for required disclosure purposes only.

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.

Cambrian Science Patent Infringement Litigation

On July 12, 2011, we were notified by Level 3 that Cambrian Science Corporation ("Cambrian") filed suit against Level 3 and six other defendants, including Cox Communications, Inc., XO Communications, LLC, Global Crossing Limited, 360Networks (USA), Inc., Integra Telecom, Inc. and IXC, Inc. dba Telekenex (collectively, the "Defendants") in the U.S. District Court for the Central District of California alleging infringement of patent no. 6,775,312 (the "'312 Patent") and requesting damages for such alleged infringement (the "Cambrian Claim"). The nature of the Cambrian Claim involves allegations of infringement of the '312 Patent resulting from the Defendants' use of certain products and systems in the Defendants' networks, including our DTN platform. On August 24, 2011, Cambrian amended the complaint to name us as a defendant. We assumed the defense of the Cambrian Claim and filed an answer to Cambrian's complaint on September 21, 2011, in which we denied infringement of the '312 Patent and raised other defenses. Cambrian filed a second amended complaint on October 6, 2011, which included many of the same allegations as in the original complaint. We filed our answer to the second amended complaint on October 21, 2011, in which we maintained the same denials and defenses as in our initial answer. On December 23, 2011, we filed a motion requesting that the court stay the case with respect to each of the above-noted customer Defendants. Cambrian filed its opposition to our motion on December 30, 2011. Our request was denied in the court's decision on March 7, 2012. We presented evidence on the appropriate meanings of relevant key words used in the patent claims during a claim construction hearing on November 20, 2012.

On June 17, 2013, the court issued an order regarding claim construction, in which the court agreed with almost all of our proposed claim constructions. On October 17, 2013, the parties met for a court-mandated mediation. On April 24, 2014, we filed two motions for summary judgment relating to non-infringement and Cambrian's claim to an earlier date of invention. The court held a hearing on the summary judgment motions on June 9, 2014. On July 2, 2014, the court granted our motion for summary judgment on non-infringement and entered a final judgment of non-infringement of the '312 Patent. Cambrian may appeal the court's ruling of non-infringement to the Court of Appeals for the Federal Circuit. We are seeking to recover certain costs and attorney's fees from Cambrian.

Based on the information available at this time, we have 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. Accordingly, we have accrued an insignificant amount, which did not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows. Factors that we considered in the determination of the likelihood of a loss and the estimate 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 status of the plaintiff as a non-operating entity and the likelihood of the plaintiff accepting the estimated amount. However, the outcome of such legal matters is inherently unpredictable and subject to significant uncertainties.

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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 28, 2013. 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 28, 2013 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 28, 2013, we recorded a net loss of $32.1 million, and for the quarter ended June 28, 2014, we recorded net income of $4.8 million. As of December 28, 2013, our accumulated deficit was $604.5 million. As of June 28, 2014, our accumulated deficit was $604.1 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 require 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 $139.1 million to $165.4 million and our operating income (loss) has ranged from income of $8.1 million to a loss of $7.1 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 transport network equipment purchases and changes in their purchasing cycles;
- order cancellations or reductions or delays in delivery schedules by our customers;
- the payment terms offered to our customers;

- our ability to control costs, including our operating expenses and the costs of components we purchase for our products;

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- readiness of customer sites for installation of our products;

- 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. GAAP or new interpretations of existing accounting rules;

- the impact of a significant natural disaster, such as an earthquake, severe weather, or tsunami or other flooding, as well as interruptions or shortages in the supply of utilities such as water and electricity, in a key location such as our Northern California facilities, which is located near major earthquake fault lines; 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 revenue 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 40% to 48%. 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 margin common equipment;

- price discounts negotiated by our customers;

- introduction of new products 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 in any given quarter;

- increased price competition;

- 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

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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.

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 optical transport products and other portfolio 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 when competing for larger high-profile opportunities or during periods of economic weakness 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 transport 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

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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;
- 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 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 transport equipment market is intense, and we expect such competition to increase. A number of very large companies have historically dominated the optical transport network equipment industry. Our competitors include current WDM suppliers, such as Alcatel-Lucent, Ciena Corporation, Cisco Systems, Inc., Coriant, Huawei Technologies Co. Ltd. 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.

Many of our competitors have substantially greater name recognition and technical, financial and marketing resources 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.

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

Substantial changes in the optical transport 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.

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

The optical transport 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,

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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, some of which require custom development. 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 demand 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.

If we overestimate market demand for our products and, as a result, increase our inventory in anticipation of customer orders that do not materialize, we will have excess inventory, which could result in increased risk of obsolescence and

significant inventory write-downs. Furthermore, this will result in reduced production volumes and our fixed costs will be spread across fewer units, increasing 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. In addition, we may be unable to meet our

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supply commitments to customers, which could result in a loss of certain customer opportunities or a breach of our customer agreements resulting in payment of damages.

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 canceled 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 gain traction in adjacent markets, such as the metro market, our ability to increase revenue will be harmed.

We believe that, in order to grow our revenue and business, we must successfully sell our products in international markets and gain traction in adjacent markets. We have a limited history and experience selling our products into developing international markets, such as in Asia Pacific, Middle East and Africa, and Latin America. In addition, many of the companies we compete against in international markets have greater name recognition and a more substantial sales and marketing presence.

We also believe it is important to expand our product offerings into adjacent markets. Our ability to be successful in these markets, such as the metro market, will require us to timely develop new products with unique requirements focused on space, power consumption and cost. In addition, to succeed in our sales efforts, we believe we must hire additional sales personnel to meet the increasing needs of these customers and develop the necessary relationships. If we do not succeed in our efforts to sell into these markets or gain market acceptance of new products to address these markets, the size of our total addressable market will be limited. This, in turn, would harm our ability to grow our customer base and increase revenue.

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 our customers, our business and our operating results.

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

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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 transport networking industry, including our competitors, have extensive patent portfolios with respect to optical transport 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 addition, we have had certain patent licenses with third parties that have not been renewed, and if we cannot successfully renew these licenses, we could face claims of infringement. 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.

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 involved in litigation with Cambrian whereby Cambrian alleged that we and seven of our customers infringe one of Cambrian's patents. Information regarding this matter is set forth in Part II, Item 1. “Legal Proceedings,” and is incorporated herein by reference.

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

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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. 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;

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- delays in collecting accounts receivable;

- payment of liquidated damages, performance guarantees or similar penalties;

- 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.

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 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 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; and

- 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.

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 that 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,

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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 ("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.

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 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 outside debt or 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 2013, we had a net loss of $32.1 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.

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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. 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. During the first half of fiscal 2014 and in the fiscal years 2013 and 2012, we derived approximately 20%, 36% and 32%, 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 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.

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.

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;
- political, social and economic instability, including wars, terrorism, political unrest, boycotts, curtailment of trade and other business restrictions;
- tariff and trade barriers and other regulatory requirements or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- less effective protection of intellectual property than is afforded to us in the United States or other developed countries;
- local laws and practices that favor local companies, including business practices that we are prohibited from engaging in by the Foreign Corrupt Practices Act and other anti-corruption laws and regulations;
- certification requirements;
- greater difficulty documenting and testing our internal controls;
- potentially adverse tax consequences;

- effects of changes in currency exchange rates that could negatively affect our financial results and cash flows; and
- service provider and government spending patterns.

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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.

Our international operations are subject to increasingly complex foreign and U.S. laws and regulations, including but not limited to anti-corruption laws, such as the Foreign Corrupt Practices Act and the UK Bribery Act and equivalent laws in other jurisdictions, antitrust or competition laws, and data privacy laws, among others. Violations of these laws and regulations could result in fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business and on our ability to offer our products and services in one or more countries, and could also materially affect our reputation, our international expansion efforts, our ability to attract and retain employees, our business, and our operating results. Although we have implemented policies, procedures and training designed to ensure compliance with these laws and regulations, there can be no complete assurance that any individual employee, contractor, or agent will not violate our policies. Additionally, the costs of complying with these laws (including the costs of investigations, auditing and monitoring) could also adversely affect our current or future business.

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, and therefore subject to foreign currency fluctuation. Accordingly, fluctuations in foreign currency rates could have a material impact on our revenue in future periods. We also have exposure to currency exchange rates as a result of the growth in our non-U.S. dollar denominated operating expense in Europe, Asia and Canada. We currently enter into foreign currency exchange forward contracts to reduce the impact of foreign currency fluctuations on accounts receivable denominated in euro and the British pound. 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 that 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.

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;

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- 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.

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 regulations that could adversely affect our business.

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.

Our product or manufacturing standards could also be impacted by new or revised environmental rules and regulations or other social initiatives. For instance, the SEC adopted new disclosure requirements in 2012 relating to the sourcing of certain minerals from the Democratic Republic of Congo and certain other adjoining countries. Those rules, which required reporting for the first time in calendar 2014, could adversely affect our costs, the availability of minerals used in our products and our relationships with customers and suppliers.

The Federal Communications Commission ("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.

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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, floods 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 man-made or natural 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.

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.

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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;
- 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
10.1*	Infinera Corporation 2007 Employee Stock Purchase Plan, incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K as filed on May 20, 2014.
10.2*	Form of 2007 Employee Stock Purchase Plan Subscription Agreement, incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K as filed on May 20, 2014.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, 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 of 1934, 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

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

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 of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, 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.

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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/ BRAD FELLER Brad Feller Chief Financial Officer (Duly Authorized Officer and Principal Financial Officer)
Date:	August 1, 2014