

FINISAR CORP  
Form 10-Q  
September 11, 2009

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

**(Mark One)**

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

**For the Quarterly Period Ended August 2, 2009**

**or**

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

**For the transition period from            to  
Commission file number 000-27999**

**Finisar Corporation**

*(Exact name of Registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**94-3038428**

*(I.R.S. Employer  
Identification No.)*

**1389 Moffett Park Drive**

**Sunnyvale, California**

*(Address of principal executive offices)*

**94089**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**408-548-1000**

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

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

Indicate by check mark 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 ☐

Accelerated filer ☒

Non-accelerated filer ☐  
(Do not check if a smaller reporting  
company)

Smaller reporting  
company ☐

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

At August 31, 2009, there were 515,017,220 shares of the registrant's common stock, \$.001 par value, issued and outstanding.



**INDEX TO QUARTERLY REPORT ON FORM 10-Q**  
**For the Quarter Ended August 2, 2009**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	4
<u>Item 1. Financial Statements:</u>	4
<u>Condensed Consolidated Balance Sheets as of August 2, 2009 and April 30, 2009</u>	4
<u>Condensed Consolidated Statements of Operations for the three month periods ended August 2, 2009 and August 3, 2008</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the three month periods ended August 2, 2009 and August 3, 2008</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	35
<u>Item 3. Quantitative and Qualitative Disclosure About Market Risk</u>	41
<u>Item 4. Controls and Procedures</u>	41
<b><u>PART II OTHER INFORMATION</u></b>	41
<u>Item 1. Legal Proceedings</u>	41
<u>Item 1A. Risk Factors</u>	41
<u>Item 6. Exhibits</u>	53
<u>Signatures</u>	54
<u>EX-10.1</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-31.3</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	
<u>EX-32.3</u>	

**Table of Contents**

**FORWARD LOOKING STATEMENTS**

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We use words like anticipates, believes, plans, expects, future, intends and similar expressions to identify these forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events; however, our business and operations are subject to a variety of risks and uncertainties, and, consequently, actual results may materially differ from those projected by any forward-looking statements. As a result, you should not place undue reliance on these forward-looking statements since they may not occur.

Certain factors that could cause actual results to differ from those projected are discussed in Item 1A. Risk Factors. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events.

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**FINISAR CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	August 2, 2009	April 30, 2009 *
	(In thousands, except share and per share data)	
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 60,327	\$ 37,129
Short-term available-for-sale investments	92	92
Accounts receivable, net of allowance for doubtful accounts of \$2,184 at August 2, 2009 and \$1,069 at April 30, 2009	99,466	81,820
Accounts receivable, other	8,512	10,033
Inventories	108,686	107,764
Prepaid expenses	5,568	6,795
Current assets associated with discontinued operations		4,863
Total current assets	282,651	248,496
Property, plant and improvements, net	79,492	81,606
Purchased technology, net	15,267	16,459
Other intangible assets, net	13,102	13,427
Minority investments	14,289	14,289
Other assets	2,427	2,584
Non-current assets associated with discontinued operations		3,527
Total assets	\$ 407,228	\$ 380,388
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 52,264	\$ 48,421
Accrued compensation	9,048	11,428
Other accrued liabilities (Note 10)	25,102	30,513
Deferred revenue	2,073	1,053
Current portion of long-term debt (Note 12)	6,173	6,107
Non-cancelable purchase obligations	657	2,965
Current liabilities associated with discontinued operations		3,810
Total current liabilities	95,317	104,297
Long-term liabilities:		
Convertible notes (Note 11)	135,490	134,255
Long-term debt, net of current portion (Note 12)	13,737	15,305
Other non-current liabilities	2,352	3,161
Deferred income taxes	973	1,149
Total liabilities	247,869	258,167

## Stockholders' equity:

Preferred stock, \$0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at August 2, 2009 and April 30, 2009

Common stock, \$0.001 par value, 750,000,000 shares authorized, 486,006,907 shares issued and outstanding at August 2, 2009 and 477,492,057 shares issued and outstanding at April 30, 2009

	486	477
Additional paid-in capital	1,838,083	1,830,807
Accumulated other comprehensive income	6,552	2,662
Accumulated deficit	(1,685,762)	(1,711,725)
 Total stockholders' equity	 159,359	 122,221
 Total liabilities and stockholders' equity	 \$ 407,228	 \$ 380,388

\* The condensed consolidated balance sheet at April 30, 2009 has been derived from audited consolidated financial statements at that date, revised for retrospective application of FASB Staff Position Accounting Principles Board Opinion No. 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1).

**Table of Contents**

**FINISAR CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited, in thousands, except share and per share data)

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008 *</b>
Revenues	\$ 128,725	\$ 115,774
Cost of revenues	98,130	74,135
Amortization of acquired developed technology	1,193	850
Gross profit	29,402	40,789
Operating expenses:		
Research and development	21,047	17,413
Sales and marketing	6,819	6,876
General and administrative	9,621	8,511
Amortization of purchased intangibles	701	129
Total operating expenses	38,188	32,929
Income (loss) from operations	(8,786)	7,860
Interest income	10	968
Interest expense	(2,434)	(5,243)
Other income (expense), net	253	103
Income (loss) from continuing operations before income taxes	(10,957)	3,688
Provision for income taxes	159	746
Net income (loss) from continuing operations	\$ (11,116)	\$ 2,942
Income (loss) from discontinued operations, net of income taxes	\$ 37,079	\$ (125)
Net income	\$ 25,963	\$ 2,817
Net income (loss) per share:		
Basic		
Continuing operations	\$ (0.02)	\$ 0.01
Discontinued operations	\$ 0.08	\$ (0.00)
Diluted		
Continuing operations	\$ (0.02)	\$ 0.01
Discontinued operations	\$ 0.07	\$ (0.00)
Weighted average number of common shares outstanding:		
Basic	481,444	310,133



Diluted	502,106	311,614
---------	---------	---------

\* The condensed consolidated statement of operations for the three months ended August 3, 2008 has been revised for the retrospective application of FSP APB 14-1. See Note 1. Basis of Presentation.

See accompanying notes.

Table of Contents

**FINISAR CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited, in thousands)

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>
<b>Operating activities</b>		
Net income	\$ 25,963	\$ 2,817
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	7,418	6,647
Stock-based compensation expense	4,872	3,057
Amortization of beneficial conversion feature of convertible notes		1,146
Non-cash interest cost on 2.5% convertible senior subordinated notes	1,235	1,235
Amortization of purchased technology and finite lived intangibles	778	268
Amortization of acquired developed technology	1,362	1,246
Loss on sale or retirement of assets	21	413
Gain on remeasurement of derivative liability		(1,135)
(Gain) loss on sale of equity investment	(375)	
(Gain) loss on sale of a product line	(1,250)	919
Gain on sale of discontinued operations	(36,053)	
Other than temporary decline in fair market value of equity security		735
Changes in operating assets and liabilities:		
Accounts receivable	(17,646)	(9,181)
Inventories	(834)	(8,980)
Other assets	2,638	(1,979)
Deferred income taxes	(176)	551
Accounts payable	3,843	6,302
Accrued compensation	(2,720)	(876)
Other accrued liabilities	(5,718)	(436)
Deferred revenue	168	523
Net cash provided by (used in) operating activities	(16,474)	3,272
<b>Investing activities</b>		
Purchases of property, equipment and improvements	(3,150)	(5,643)
Sale of short and long-term investments, net	14	8,852
Proceeds from sale of equity investment	375	
Purchase of intangible assets	(375)	
Proceeds from disposed product line	1,250	
Proceeds from sale of discontinued operations	40,683	
Net cash provided by investing activities	38,797	3,209
<b>Financing activities</b>		
Repayment of convertible notes related to acquisition		(11,918)
Proceeds from term loan		20,000
Repayments of liability related to sale-leaseback of building		(101)
Repayments of borrowings under notes	(1,503)	(492)

Edgar Filing: FINISAR CORP - Form 10-Q

Proceeds from exercise of stock options and stock purchase plan, net of repurchase of unvested shares	2,378	3,087
Net cash provided by financing activities	875	10,576
Net increase in cash and cash equivalents	23,198	17,057
Cash and cash equivalents at beginning of period	37,129	79,442
Cash and cash equivalents at end of period	\$ 60,327	\$ 96,499
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 341	\$ 81
Cash paid for taxes	\$ 180	\$ 179

See accompanying notes.

**Table of Contents**

**FINISAR CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**1. Basis of Presentation**

***Description of Business***

Finisar Corporation is a leading provider of optical subsystems and components that connect local area networks, or LANs, storage area networks, or SANs, metropolitan area networks, or MANs, fiber-to-home networks, or FTTx, cable television networks, or CATV, and wide area networks, or WANs. The Company's optical subsystems consist primarily of transceivers and transponders which provide the fundamental optical-electrical interface for connecting the equipment used in building these networks. These products rely on the use of digital and analog RF semiconductor lasers in conjunction with integrated circuit design and novel packaging technology to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable using a wide range of network protocols, transmission speeds and physical configurations over distances from 100 meters up to 200 kilometers. The Company also provides products for dynamically switching network traffic from one optical link to another across multiple wavelengths without first converting to an electrical signal known as reconfigurable optical add/drop multiplexers, or ROADMs. The Company's line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications and passive optical components used in building MANs. The Company's manufacturing operations are vertically integrated and include integrated circuit design and internal assembly and test capabilities for the Company's optical subsystem products, as well as key components used in those subsystems. The Company sells its optical subsystem and component products to manufacturers of storage and networking equipment such as Alcatel-Lucent, Brocade, Cisco Systems, EMC, Emulex, Ericsson, Hewlett-Packard Company, Huawei, IBM, Juniper, Qlogic, Siemens and Tellabs.

On August 29, 2008, Finisar completed a business combination with Optium Corporation, a leading designer and manufacturer of high performance optical subsystems for use in telecommunications and CATV systems, through the merger of Optium with a wholly-owned subsidiary of Finisar. The Company believes that the combination of the two companies created the world's largest supplier of optical components, modules and subsystems for the communications industry and will leverage Finisar's leadership position in the storage and data networking sectors of the industry and Optium's leadership position in the telecommunications and CATV sectors to create a more competitive industry participant. In addition, as a result of the combination, the Company has realized and expects to realize cost synergies related to operating expenses and manufacturing costs resulting from (1) the transfer of production to lower cost locations, (2) improved purchasing power associated with being a larger company and (3) cost synergies associated with the integration of components into product designs previously purchased in the open market by Optium. At the closing of the merger, the Company issued 160,808,659 shares of Finisar common stock, valued at approximately \$242.8 million, in exchange for all of the outstanding common stock of Optium.

The Company formerly provided network performance test systems through its Network Tools Division. On July 15, 2009 the Company consummated the sale of substantially all of the assets of the Network Tools Division to JDS Uniphase Corporation ( "JDSU" ). In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, the operating results of this business, the assets and liabilities through the date of its disposition and for all applicable prior periods are reported as discontinued operations in the condensed consolidated financial statements for the period ended August 2, 2009. See Note 3 for further details regarding the sale of division.

Finisar Corporation was incorporated in California in April 1987 and reincorporated in Delaware in November 1999. Finisar's principal executive offices are located at 1389 Moffett Park Drive, Sunnyvale, California 94089, and its telephone number at that location is (408) 548-1000.

The accompanying unaudited condensed consolidated financial statements as of August 2, 2009 and for the three month periods ended August 2, 2009 and August 3, 2008, have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC" ), and include the accounts of Finisar Corporation and its wholly-owned subsidiaries (collectively, "Finisar" or the "Company" ). Inter-company accounts and transactions have been

eliminated in consolidation. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position at August 2, 2009 and its operating results and cash flows for the three month periods ended August 2, 2009 and August 3, 2008. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements and notes for the fiscal year ended April 30, 2009. The Company has evaluated subsequent events through September 11, 2009, the date these financial statements were issued.

## **Table of Contents**

### ***Fiscal Periods***

The Company maintains its financial records on the basis of a fiscal year ending on April 30, with fiscal quarters ending on the Sunday closest to the end of the period (thirteen-week periods).

### ***Reclassifications***

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These changes had no impact on the Company's previously reported financial position, results of operations and cash flows.

### ***Convertible Senior Subordinated Notes***

In May 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) Accounting Principles Board Opinion No. 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1). FSP APB 14-1 addresses instruments commonly referred to as Instrument C from Emerging Issues Task Force ( EITF ) Issue No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash upon Conversion*, which requires the issuer to settle the principal amount in cash and the conversion spread in cash or net shares at the issuer's option. FSP APB 14-1 requires that issuers of these instruments account for their liability and equity components separately by bifurcating the conversion option from the debt instrument, classifying the conversion option in equity and then accreting the resulting discount on the debt as additional interest expense over the expected life of the debt. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years and requires retrospective application to all periods presented. On May 1, 2009, the Company adopted the provisions of FSP APB 14-1 on a retrospective basis and reflected additional interest expense of \$1.2 million for each of the three months ended August 2, 2009 and August 3, 2008, respectively, in its Condensed Consolidated Statement of Operations. In addition, the retrospective adoption of FSP APB 14-1 decreased debt issuance costs included in other assets by an aggregate of \$313,000, decreased convertible senior notes, net included in long-term liabilities by \$7.7 million, and increased total stockholders' equity by \$7.4 million after a charge of \$12.1 million to accumulated deficit on its Condensed Consolidated Balance Sheet as of April 30, 2009. See Note 11 for the impact of the adoption of FSP APB 14-1 on prior period balances.

### ***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

## **2. Summary of Significant Accounting Policies**

### ***Revenue Recognition***

The Company's revenue transactions consist predominately of sales of products to customers. The Company follows SEC Staff Accounting Bulletin ( SAB ) No. 104, *Revenue Recognition*, and EITF Issue 00-21, *Revenue Arrangements with Multiple Deliverables*. Specifically, the Company recognizes revenue when persuasive evidence of an arrangement exists, title and risk of loss have passed to the customer, generally upon shipment, the price is fixed or determinable, and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, the arrangement is divided into separate units of accounting if certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. In cases where there is objective and reliable evidence of the fair value of the undelivered item in an arrangement but no such evidence for the delivered item, the residual method is used to allocate the arrangement consideration. For units of accounting which include more than one deliverable, the Company generally recognizes all revenue and cost of revenue for the unit of accounting during the period in which the last undelivered item is delivered.

At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with sales, recorded as a component of cost of revenues. The Company's customers and distributors generally do not have return rights. However, the Company has established an allowance for estimated customer returns, based on

historical experience, which is netted against revenue.

**Table of Contents**

Sales to certain distributors are made under agreements providing distributor price adjustments and rights of return under certain circumstances. Revenue and costs relating to distributor sales are deferred until products are sold by the distributors to end customers. Revenue recognition depends on notification from the distributor that product has been sold to the end customer. Also reported by the distributor are product resale price, quantity and end customer shipment information, as well as inventory on hand. Deferred revenue on shipments to distributors reflects the effects of distributor price adjustments and, the amount of gross margin expected to be realized when distributors sell-through products purchased from the Company. Accounts receivable from distributors are recognized and inventory is relieved when title to inventories transfers, typically upon shipment from the Company at which point the Company has a legally enforceable right to collection under normal payment terms.

***Segment Reporting***

Statement of Financial Accounting Standards ( SFAS ) No. 131, *Disclosures about Segments of an Enterprise and Related Information* ( SFAS 131 ), establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. Prior to the first quarter of fiscal 2010, the Company had determined that it operated in two segments consisting of optical subsystems and components and network test systems. After the sale of the assets of the Network Tools Division to JDSU in the first quarter of fiscal 2010, the Company has one reportable segment consisting of optical subsystems and components.

***Concentrations of Credit Risk***

Financial instruments which potentially subject the Company to concentrations of credit risk include cash, cash equivalents, available-for-sale and restricted investments and accounts receivable. The Company places its cash, cash equivalents and available-for-sale investments with high-credit quality financial institutions. Such investments are generally in excess of FDIC insurance limits. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Generally, the Company does not require collateral or other security to support customer receivables. The Company performs periodic credit evaluations of its customers and maintains an allowance for potential credit losses based on historical experience and other information available to management. Losses to date have not been material. The Company's five largest customers represented 48.0% of total accounts receivable at August 2, 2009 and April 30, 2009, respectively. As of August 2, 2009, two customers accounted for 18% and 10%, respectively, of total accounts receivable. As of April 30, 2009, two customers accounted for 19% and 17%, respectively, of total accounts receivable.

The Company sells products primarily to customers located in Asia and North America. During the three months ended August 2, 2009 and August 3, 2008, sales of optical subsystems and components to one customer represented 16% and 18%, respectively, of total revenues. No other customer accounted for more than 10% of total revenues in either of these fiscal periods.

Included in the Company's condensed consolidated balance sheet at August 2, 2009 are the net assets of the Company's manufacturing operations, substantially all of which are located at its overseas manufacturing facilities and which total approximately \$73 million.

***Foreign Currency Translation***

The functional currency of the Company's foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rate on the balance sheet dates. Revenues and expenses are translated using average exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in the determination of net loss.

***Research and Development***

Research and development expenditures are charged to operations as incurred.

***Advertising Costs***

Advertising costs are expensed as incurred. Advertising is used infrequently in marketing the Company's products. Advertising costs were \$12,000 and \$6,000 in the three months ended August 2, 2009 and August 3, 2008, respectively.



***Shipping and Handling Costs***

The Company records costs related to shipping and handling in cost of sales for all periods presented.

9

---

**Table of Contents*****Cash and Cash Equivalents***

Finisar's cash equivalents consist of money market funds and highly liquid short-term investments with qualified financial institutions. Finisar considers all highly liquid investments with an original maturity from the date of purchase of three months or less to be cash equivalents.

***Investments******Available-for-Sale Investments***

Available-for-sale investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and equity securities. Pursuant to SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, the Company has classified its investments as available-for-sale. Available-for-sale securities are stated at market value, which approximates fair value, and unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized. A decline in the market value of the security below cost that is deemed other than temporary is charged to earnings, resulting in the establishment of a new cost basis for the security.

***Other Investments***

The Company uses the cost method of accounting for investments in companies that do not have a readily determinable fair value in which it holds an interest of less than 20% and over which it does not have the ability to exercise significant influence. For entities in which the Company holds an interest of greater than 20% or in which the Company does have the ability to exercise significant influence, the Company uses the equity method. In determining if and when a decline in the market value of these investments below their carrying value is other-than-temporary, the Company evaluates the market conditions, offering prices, trends of earnings and cash flows, price multiples, prospects for liquidity and other key measures of performance. The Company's policy is to recognize an impairment in the value of its minority equity investments when clear evidence of an impairment exists, such as (a) the completion of a new equity financing that may indicate a new value for the investment, (b) the failure to complete a new equity financing arrangement after seeking to raise additional funds or (c) the commencement of proceedings under which the assets of the business may be placed in receivership or liquidated to satisfy the claims of debt and equity stakeholders. The Company's minority investments in private companies are generally made in exchange for preferred stock with a liquidation preference that is intended to help protect the underlying value of the investment.

***Fair Value Accounting***

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB Statement No. 115* ( SFAS 159 ). FAS 159 expands the use of fair value accounting to eligible financial assets and liabilities. SFAS 159 is effective as of the beginning of an entity's first fiscal year commencing after November 15, 2007. The Company evaluated its existing financial instruments and elected not to adopt the fair value option to account for its financial instruments. As a result, SFAS 159 did not have any impact on the Company's financial condition or results of operations for the periods presented in this report. However, because the SFAS 159 election is based on an instrument-by-instrument election at the time the Company first recognizes an eligible item or enters into an eligible firm commitment, the Company may decide to elect the fair value option on new items should business reasons support doing so in the future.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. This statement applies to accounting pronouncements that require or permit fair value measurements with certain exclusions. The statement provides that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 defines fair value based upon an exit price model.

SFAS 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

which are the following: Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

## **Table of Contents**

The Company adopted the effective portions of SFAS 157 on May 1, 2008. In February 2008, the FASB issued FASB Staff Positions (FSP) 157-1 and 157-2 ( FSP 157-1 and FSP 157-2 ). FSP 157-1 amends SFAS 157 to exclude SFAS No. 13, *Accounting for Leases* and its related interpretive accounting pronouncements that address leasing transactions, while FSP 157-2 delays the effective date of the application of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company adopted the provisions of FSP 157-2 in first quarter of fiscal 2010 on a prospective basis for its non-financial assets and liabilities that are not recognized or disclosed at fair value on a recurring basis. The adoption of FSP 157-2 did not have a material impact on the financial condition, results of operations or cash flows of the Company.

The Company classifies investments within Level 1 if quoted prices are available in active markets. Level 1 assets include instruments valued based on quoted market prices in active markets which generally include money market funds, corporate publicly traded equity securities on major exchanges and U.S. Treasury notes with quoted prices on active markets. The Company classifies items in Level 2 if the investments are valued using observable inputs to quoted market prices, benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. These investments include: government agencies, corporate bonds and commercial paper. Please see note 8 for additional details regarding fair value of our investments.

The Company did not hold financial assets and liabilities which were valued using unobservable inputs as of August 2, 2009.

### ***Inventories***

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

The Company permanently writes down the cost of inventory that the Company specifically identifies and considers obsolete or excessive to fulfill future sales estimates. The Company defines obsolete inventory as inventory that will no longer be used in the manufacturing process. Excess inventory is generally defined as inventory in excess of projected usage and is determined using management's best estimate of future demand, based upon information then available to the Company. The Company also considers: (1) parts and subassemblies that can be used in alternative finished products, (2) parts and subassemblies that are likely to be engineered out of the Company's products, and (3) known design changes which would reduce the Company's ability to use the inventory as planned.

In quantifying the amount of excess inventory, the Company assumes that the last twelve months of demand is generally indicative of the demand for the next twelve months. Inventory on hand that is in excess of that demand is written down. Obligations to purchase inventory acquired by subcontractors based on forecasts provided by the Company are recognized at the time such obligations arise.

### ***Property and Equipment***

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, generally three years to seven years except for buildings, which are depreciated over twenty-five years. Land is carried at acquisition cost and not depreciated. Leased land is depreciated over the life of the lease.

### ***Goodwill and Other Intangible Assets***

Goodwill, purchased technology, and other intangible assets result from acquisitions accounted for under the purchase method. Amortization of purchased technology and other intangibles has been provided on a straight-line basis over periods ranging from three to seven years. The amortization of goodwill ceased with the adoption of SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ), beginning in the first quarter of fiscal 2003. Goodwill is assessed for impairment annually or more frequently when an event occurs or circumstances change between annual tests that would more likely than not reduce the fair value of the reporting unit below its carrying value. Intangible assets with finite lives are amortized over their estimated useful lives.

### ***Accounting for the Impairment of Long-Lived Assets***

The Company periodically evaluates whether changes have occurred to long-lived assets that would require revision of the remaining estimated useful life of the assets or render them not recoverable. If such circumstances arise, the Company uses an estimate of the undiscounted value of expected future operating cash flows to determine whether the long-lived assets are impaired. If the aggregate undiscounted cash flows are less than the carrying amount

of the assets, the resulting impairment charge to be recorded is calculated based on the excess of the carrying value of the assets over the fair value of such assets, with the fair value determined based on an estimate of discounted future cash flows.

**Table of Contents*****Stock-Based Compensation Expense***

The Company accounts for stock-based compensation in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123R ), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors including employee stock options and employee stock purchases under the Company's Employee Stock Purchase Plan based on estimated fair values. SFAS 123R requires companies to estimate the fair value of stock-based payment awards on the date of grant using an option pricing model. The Company uses the Black-Scholes option pricing model to determine the fair value of stock based awards under SFAS 123R. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statements of operations.

Stock-based compensation expense recognized in the Company's condensed consolidated statements of operations for the three months ended August 2, 2009 and August 3, 2008 included compensation expense for stock-based payment awards granted prior to, but not yet vested as of, the adoption of SFAS 123R, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, and compensation expense for the stock-based payment awards granted subsequent to April 30, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Compensation expense for expected-to-vest stock-based awards that were granted on or prior to April 30, 2006 was valued under the multiple-option approach and will continue to be amortized using the accelerated attribution method. Subsequent to April 30, 2006, compensation expense for expected-to-vest stock-based awards is valued under the single-option approach and amortized on a straight-line basis, net of estimated forfeitures.

***Computation of Net Income (Loss) Per Share***

Basic and diluted net income (loss) per share is presented in accordance with SFAS No. 128, *Earnings Per Share*, for all periods presented. Basic net income (loss) per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from options and warrants (under the treasury stock method) and convertible notes (on an as-if-converted basis) outstanding during the period.

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share amounts):

	<b>Three Months Ended</b>	
	<b>August</b>	<b>August 3,</b>
	<b>2,</b>	<b>2008</b>
	<b>2009</b>	
Numerator:		
Net income (loss) from continuing operations	\$ (11,116)	\$ 2,942
Net income (loss) from discontinued operations	\$ 37,079	\$ (125)
Denominator for basic net income (loss) per share from continuing operations and basic net income (loss) per share from discontinued operations		
Weighted-average shares outstanding basic	481,444	310,133
Effect of dilutive securities:		
Weighted-average shares outstanding employee stock options	6,911	1,481
Weighted-average warrants outstanding	256	
Conversion of convertible subordinated notes	13,495	
Weighted-average shares outstanding diluted	502,106	311,614

Denominator for diluted net income (loss) per share:		
From continuing operations	481,444	311,614
From discontinued operations	502,106	310,133
Basic net income (loss) per share		
From continuing operations	(0.02)	0.01
From discontinued operations	\$ 0.08	\$ (0.00)
Diluted net income (loss) per share		
From continuing operations	\$ (0.02)	\$ 0.01
From discontinued operations	\$ 0.07	\$ (0.00)

**Table of Contents**

The following table presents common stock equivalents related to potentially dilutive securities excluded from the calculation of diluted net income (loss) per share from continuing operations because they are anti-dilutive (in thousands):

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>
Employee stock options	6,911	
Conversion of convertible subordinated notes	13,495	30,167
Warrants assumed in acquisition	256	21
	20,662	30,188

***Comprehensive Income (Loss)***

SFAS No. 130, *Reporting Comprehensive Income* ( SFAS 130 ), establishes rules for reporting and display of comprehensive income or loss and its components. SFAS 130 requires unrealized gains or losses on the Company's available-for-sale securities and foreign currency translation adjustments to be included in comprehensive income (loss).

The components of comprehensive income for the three months ended August 2, 2009 and August 3, 2008 were as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>
Net income	\$ 25,963	\$ 2,817
Foreign currency translation adjustment, net of income taxes	3,876	(1,953)
Change in unrealized gain (loss) on securities, net of reclassification adjustments for realized loss, net of income taxes	14	(850)
Comprehensive income	\$ 29,853	\$ 14

The components of accumulated other comprehensive income, net of taxes, were as follows (in thousands):

	<b>August 2, 2009</b>	<b>April 30, 2009</b>
Net unrealized losses on available-for-sale securities	\$ (7)	\$ (21)
Cumulative translation adjustment	6,559	2,683
Accumulated other comprehensive income	\$ 6,552	\$ 2,662

***Income Taxes***

The Company uses the liability method to account for income taxes as required by SFAS No. 109, *Accounting for Income Taxes* ( SFAS 109 ). As part of the process of preparing its consolidated financial statements, the Company is required to estimate income taxes in each of the jurisdictions in which it operates. This process involves determining our income tax expense together with calculating the deferred income tax expense related to temporary differences resulting from the differing treatment of items for tax and accounting purposes, such as deferred revenue or deductibility of certain intangible assets. These temporary differences result in deferred tax assets or liabilities, which



are included within the consolidated balance sheets.

The Company records a valuation allowance to reduce its deferred tax assets to an amount that it estimates is more likely than not to be realized. The Company considers estimated future taxable income and prudent tax planning strategies in determining the need for a valuation allowance. When the Company determines that it is more likely than not that some or all of its tax attributes will be realizable by either refundable income taxes or future taxable income, the valuation allowance will be reduced and the related tax impact will be recorded to the provision in that quarter. Likewise, should the Company determine that it is not likely to realize all or part of its deferred tax assets in the future, an increase to the valuation allowance would be recorded to the income tax provision in the period such determination was made.

**Table of Contents*****Recent Adoption of New Accounting Standards***

In May 2008, the FASB issued FSP APB 14-1 which specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The Company adopted this pronouncement in the first quarter of fiscal 2010. See Note 11 for the impact of the adoption of FSP APB 14-1 on the Company's financial position and results of operations.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 requires an entity to recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet. For nonrecognized subsequent events that must be disclosed to keep the financial statements from being misleading, an entity will be required to disclose the nature of the event as well as an estimate of its financial effect, or a statement that such an estimate cannot be made. In addition, SFAS 165 requires an entity to disclose the date through which subsequent events have been evaluated. SFAS No. 165 is effective for the Company beginning in the first quarter of fiscal 2010 and is required to be applied prospectively. The implementation of this standard did not have any impact on the financial statements of the Company. Subsequent events through the filing date of this Form 10-Q report have been evaluated for disclosure and recognition.

In April 2009, the FASB issued SFAS No. 107-1 and Accounting Principle Board (APB) Opinion No. 28-1 (APB No. 28-1), *Interim Disclosures About Fair Value of Financial Instruments* (SFAS No. 107-1 and APB No. 28-1). SFAS No. 107-1 and APB No. 28-1 require fair value disclosures in both interim as well as annual financial statements in order to provide more timely information about the effects of current market conditions on financial instruments. SFAS No. 107-1 and APB No. 28-1 are effective for interim and annual periods ending after June 15, 2009. The Company adopted these standards as of May 1, 2009. As SFAS No. 107-1 and APB No. 28-1 relate specifically to disclosures, these standards had no impact on the Company's financial condition, results of operations or cash flows. See note 25 for further discussion.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51* (SFAS 160). SFAS 160 addresses the accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. FAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of this standard had no impact on the Company's financial condition, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations the Company engages in subsequent to May 1, 2009 will be accounted for in accordance with SFAS 141R. The Company expects FAS No. 141R will have an impact on its consolidated financial statements but the nature and magnitude of the specific effects will depend upon the nature, terms and size of any acquisitions it may consummate after the effective date. There were no business combinations consummated in the first quarter of fiscal 2010 by the Company.

***Pending Adoption of New Accounting Standards***

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a Replacement of FASB Statement No. 162* (SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular

topic in one place. The Codification is effective for interim and annual periods ending after September 15, 2009, and as of the effective date, all existing accounting standard documents will be superseded. The Codification is effective for the Company in the second quarter of fiscal 2010, and accordingly, its Quarterly Report on Form 10-Q for the quarter ending November 1, 2009 and all subsequent public filings will reference the Codification as the sole source of authoritative literature. The codification will not have an impact on the Company's financial condition, results of operations or cash flows.

**Table of Contents**

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* ( SFAS 167 ). SFAS 167 modifies how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. SFAS 167 clarifies that the determination of whether a company is required to consolidate an entity is based on, among other things, the entity's purpose and design and the company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. SFAS 167 requires an ongoing reassessment of whether a company is the primary beneficiary of a variable interest entity. SFAS 167 also requires additional disclosures about a company's involvement in variable interest entities and any significant changes in risk exposure due to that involvement. SFAS 167 is effective for fiscal years beginning after November 15, 2009. The Company has not completed its assessment of the impact SFAS 167 will have on its financial condition, results of operations or cash flows.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets* ( SFAS 166 ), an amendment of SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The FASB's objective in issuing this Statement is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. This Statement must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This Statement must be applied to transfers occurring on or after the effective date. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 166 on its consolidated results of operations and financial condition.

**3. Discontinued Operations**

During the three months ended August 2, 2009, the Company completed the sale of substantially all of the assets of its Network Tools Division to JDSU. The Company received \$40.6 million in cash and recorded a net gain on sale of the business of \$36.1 million before income taxes, which is included in income from discontinued operations, net of tax, in the Company's condensed consolidated statements of operations. In accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, the operating results of this business, through the date of its disposition and for all applicable prior periods are reported as discontinued operations in the condensed consolidated financial statements for the period ending August 2, 2009. The assets and liabilities related to this business, have been classified as discontinued operations in the consolidated financial statements for all periods presented. As a result, the prior period comparative financial statements have been restated to exclude assets, liabilities and results of operations related to the discontinued operations. In accordance with SFAS No. 95, *Statement of Cash Flows*, the Company has elected not to separately disclose the cash flows associated with the discontinued operations in the consolidated statements of cash flow.

The following table summarizes results from discontinued operations (in thousands):

	<b>Three Months Ended</b>	
	<b>August</b>	<b>August 3,</b>
	<b>2,</b>	<b>2008</b>
	<b>2009</b>	
Net revenue	\$ 6,753	\$ 12,938
Gross profit	4,892	8,633
Income (loss) from discontinued operations	1,026	(125)
Gain on sale of discontinued operations	36,053	
Income (loss) from discontinued operations	\$ 37,079	\$ (125)

**Table of Contents**

The following table summarizes assets and liabilities classified as discontinued operations (in thousands):

	<b>April 30, 2009</b>
<b>ASSETS</b>	
Current assets:	
Prepaid expenses	\$ 327
Inventories	4,536
Total current assets	4,863
Purchased technology, net	\$ 204
Other intangible assets, net	889
Property, plant and improvements, net	2,434
Total assets of discontinued operations	\$ 8,390
<b>LIABILITIES</b>	
Current liabilities:	
Warranty accrual	200
Deferred revenue	3,610
Total liabilities of discontinued operations	\$ 3,810

The following table summarizes the gain on sale of discontinued operations (in thousands) :

Gross proceeds from sale	\$ 40,683
Assets sold	
Inventory	(4,814)
Property and equipment	(2,295)
Intangibles	(845)
Liabilities transferred	
Deferred Revenue	3,102
Other accruals	312
Other charges	(90)
	\$ 36,053

The Company has entered into a transition services agreement with the buyer of the Network Tools business. The Company evaluated the agreement for continuing cash flows and concluded that the cash flows from continuation of activities are not expected to extend beyond one year. Under this agreement, the Company will provide manufacturing services to the buyer for a period which is not expected to be more than one year. The buyer will reimburse the Company for material costs plus 10% for the first six months, plus 12% for the first three months of any extension and plus 15% for the second three months of any extension. The buyer will also pay the Company a fixed fee of \$50,000 per month to cover manufacturing overhead and direct labor costs. Under the agreement, the buyer will also pay a fixed fee for leasing the Company's facilities and a service fee for the use of the Company's information technology, communication services and employee services. The duration for which these services will be provided is not expected to be more than three to six months.

**4. Inventories**

Inventories consist of the following (in thousands):

	<b>August 2, 2009</b>	<b>April 30, 2009</b>
Raw materials	\$ 34,707	\$ 36,153
Work-in-process	40,442	36,042
Finished goods	33,537	35,569
Total inventories	\$ 108,686	\$ 107,764

**Table of Contents**

During the three months ended August 2, 2009 and August 3, 2008, the Company recorded charges of \$9.2 million and \$2.6 million, respectively, for excess and obsolete inventory, and sold inventory that was written-off in previous periods with an approximate cost of \$2.7 million and \$1.8 million, respectively. As a result, cost of revenue associated with the sale of this inventory was zero.

**5. Property and Equipment**

Property and equipment consist of the following (in thousands):

	<b>August 2, 2009</b>	<b>April 30, 2009</b>
Buildings	\$ 7,549	\$ 7,416
Computer equipment	33,741	33,232
Office equipment, furniture and fixtures	3,791	3,739
Machinery and equipment	158,361	154,505
Leasehold improvements	17,800	17,246
Construction-in-process	404	445
 Total	 221,646	 216,583
Accumulated depreciation and amortization	(142,154)	(134,977)
 Property, equipment and improvements (net)	 \$ 79,492	 \$ 81,606

**6. Sale-leaseback and Impairment of Tangible Assets**

During the quarter ended January 31, 2005, the Company recorded an impairment charge of \$18.8 million to write down the carrying value of one of its corporate office facilities located in Sunnyvale, California upon entering into a sale-leaseback agreement. The property was written down to its appraised value, which was based on the work of an independent appraiser in conjunction with the sale-leaseback agreement. Due to retention by the Company of an option to acquire the leased properties at fair value at the end of the fifth year of the lease, the sale-leaseback transaction was recorded in the Company's quarter ended April 30, 2005 as a financing transaction under which the sale would not be recorded until the option expired or was otherwise terminated.

During the first quarter of fiscal 2009, the Company amended the sale-leaseback agreement with the landlord to immediately terminate the Company's option to acquire the leased properties. Accordingly, the Company finalized the sale of the property by disposing of the remaining net book value of its corporate office facility in Sunnyvale, California and the corresponding value of the land resulting in a loss on disposal of approximately \$12.2 million. This loss was offset by the reduction in the carrying value of the financing liability and other related accounts by approximately \$11.9 million, resulting in the recognition of a net loss on the sale of this property of approximately \$343,000 during the three months ended August 3, 2008. As of August 3, 2008, the carrying value of the property and the financing liability had been reduced to zero.

**7. Intangible Assets**

The following table reflects intangible assets subject to amortization as of August 2, 2009 and April 30, 2009 (in thousands):

**Table of Contents**

	<b>August 2, 2009</b>		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	\$ 75,937	\$ (60,670)	\$ 15,267
Purchased trade name	1,172	(1,080)	92
Purchased customer relationships	15,970	(3,335)	12,635
Purchased patent	375		375
Totals	\$ 93,454	\$ (65,085)	\$ 28,369

	<b>April 30, 2009</b>		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	\$ 75,936	\$ (59,478)	\$ 16,458
Purchased trade name	1,172	(805)	367
Purchased customer relationships	15,970	(2,909)	13,061
Totals	\$ 93,078	\$ (63,192)	\$ 29,886

Estimated remaining amortization expense for each of the next five fiscal years ending April 30, is as follows (in thousands):

Year	Amount
2010	\$ 4,931
2011	6,190
2012	5,373
2013	3,961
2014 and beyond	7,914
total	\$ 28,369



**Table of Contents****8. Investments*****Available-for-Sale Investments***

The following table presents the summary of the Company's available-for-sale investments measured at fair value on a recurring basis as of August 2, 2009 (in thousands):

Assets Measured at Fair Value on a Recurring Basis	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other		Total
		Observable Remaining Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash equivalents and available-for-sale investments:				
Money market funds	\$ 40	\$	\$	\$ 40
Mortgage-backed debt		92		92
Total cash equivalents, and available-for-sale investments	\$ 40	\$ 92	\$	\$ 132
Cash				60,287
Total cash, cash equivalents and available-for-sale investments				\$ 60,419
Reported as:				
Cash and cash equivalents				\$ 60,327
Short-term available-for-sale investments				92
Long-term available-for-sale investments				
Total cash, cash equivalents, and available-for-sale investments				\$ 60,419

The following table presents the summary of the Company's available-for-sale investments measured at fair value on a recurring basis as of April 30, 2009 (in thousands):

Assets Measured at Fair Value on a Recurring Basis	Quoted Prices in Active Markets For Identical Assets	Significant Other		Total
		Observable Remaining Inputs	Significant Unobservable Inputs	

Edgar Filing: FINISAR CORP - Form 10-Q

	(Level 1)	(Level 2)	(Level 3)
Cash equivalents, and available-for-sales investments:			
Money market funds	\$ 25	\$	\$ 25
Mortgage-backed debt		92	92
Total cash equivalents and available-for-sales investments	\$ 25	\$ 92	\$ 117
Cash			37,104
Total cash, cash equivalents, and available-for-sales investments			\$ 37,221
Reported as:			
Cash and cash equivalents			\$ 37,129
Short-term available-for-sale investments			92
Long-term available-for-sale investments			
Total cash, cash equivalents, and available-for-sales investments			\$ 37,221

**Table of Contents**

The following is a summary of the Company's available-for-sale investments by contractual maturity (in thousands):

	<b>August 2, 2009</b>		<b>April 30, 2009</b>	
	<b>Amortized Cost</b>	<b>Market Value</b>	<b>Amortized Cost</b>	<b>Market Value</b>
Mature in less than one year	\$ 99	\$ 92	\$ 113	\$ 92

The gross realized gains and losses for the three months ended August 2, 2009 and August 3, 2008 were immaterial. Realized gains and losses were calculated based on the specific identification method.

***Sale of an Available-for-Sale Equity Security***

During fiscal 2008, the Company granted an option to a third party to acquire 3.8 million shares of stock of a publicly-held company held by the Company. The Company determined that this option should be accounted for under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which requires the Company to calculate the fair value of the option at the end of each reporting period, upon the exercise of the option or at the time the option expires and recognize the change in fair value through other income (expense), net. As of April 30, 2008, the Company had recorded a current liability of \$1.1 million related to the fair value of this option.

During the first quarter of fiscal 2009, the third party did not exercise its option to purchase any of the shares and the option expired. Accordingly, the Company reduced the carrying value of the option liability to zero and recorded \$1.1 million of other income during the three months ended August 3, 2008 and also recorded a \$735,000 loss as the Company determined that the carrying value of these shares was other than temporarily impaired.

**9. Minority Investments**

The carrying value of minority investments at August 2, 2009 and April 30, 2009 is \$14.3 million, respectively and comprises of the Company's minority investment in four privately held companies accounted for under the cost method.

During the first quarter of fiscal 2009, the Company completed the sale of a product line to a third party in exchange for an 11% equity interest in the acquiring company in the form of preferred stock and a note convertible into preferred stock. This sale of product line was related to its Network Tools Division which was sold to JDS Uniphase in the first quarter of fiscal 2010 and accounted as discontinued operations. For accounting purposes, no value had been placed on the equity interest due to the uncertainty in the recoverability of this investment and note. The sale included the transfer of certain assets and liabilities and the retention of certain obligations related to the sale of the product line resulting in a net loss of approximately \$919,000 which was included in operating expenses. In the first quarter of fiscal 2010, the Company sold the note and all of the preferred stock back to the buyer of the product line for \$1.2 million in cash and recorded the \$1.2 million as income from discontinued operations.

**10. Other Accrued Liabilities**

Accrued liabilities consist of the following (in thousands):

	<b>August 2, 2009</b>	<b>April 30, 2009</b>
Warranty accrual (Note 16)	\$ 6,410	\$ 6,413
Other liabilities	18,692	24,100
Total	\$ 25,102	\$ 30,513

**Table of Contents****11. Convertible Debt**

The Company's convertible subordinated and convertible senior subordinated note balances as of August 2, 2009 and April 30, 2009 were as follows (in thousands):

Description	Carrying Amount	Interest Rate	Due in Fiscal year
<b>As of August 2, 2009</b>			
Convertible subordinated notes	\$ 50,000	2.50%	2011
Convertible senior subordinated notes	92,000	2.50%	2011
Unamortized debt discount	(6,510)		
Convertible senior subordinated notes, net	85,490		
Total	\$ 135,490		
<b>As of April 30, 2009</b>			
Convertible subordinated notes	\$ 50,000	2.50%	2011
Convertible senior subordinated notes	92,000	2.50%	2011
Unamortized debt discount	(7,745)		
Convertible senior subordinated notes, net	84,255		
Total	\$ 134,255		

As discussed in Note 2, the Company adopted the provisions of FSP APB 14-1 in the first quarter of fiscal 2010. FSP APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. The separation of the conversion option creates an original issue discount in the bond component which is to be accreted as interest expense over the term of the instrument using the interest method, resulting in an increase in interest expense and a decrease in net income and earnings per share. The provisions of this FSP apply to the Company's \$92 million aggregate principal amount of 2.5% Convertible Senior Subordinated Notes due 2010 and the Company has accounted for the debt and equity components of the notes to reflect the estimated nonconvertible debt borrowing rate at the date of issuance of 8.59%. FSP APB 14-1 requires retrospective application to all periods presented. Accordingly, prior period balances have been restated to effectively record a debt discount equal to the fair value of the equity component and an increase to paid-in capital for the fair value of the equity component as of the date of issuance of the underlying notes. Prior period balances have also been adjusted to provide for the amortization of the debt discount through interest expense (non-cash interest cost).

FSP APB 14-1 also requires the debt issuance costs to be allocated to the equity component based on the percentage split between the liability and equity component of the debt. Accordingly, the Company has allocated \$700,000 of the total debt issuance costs of \$1.9 million to the equity component. The remaining \$1.2 million of debt issuance cost will continue to be amortized over the expected life of the debt on a straight line basis. Prior period amounts of amortization of debt issuance costs have been adjusted accordingly.

The following table reflects the Company's previously reported amounts, along with the adjusted amounts reflecting the adoption of FSP APB 14-1.

**Table of Contents**

<b><i>Condensed Consolidated Statement of Operations (Unaudited)</i></b>	As reported	As Adjusted	Effect of Change
	(in thousands, except per share data)		
<b>Three Months Ended August 3, 2008</b>			
Interest expense	\$ 4,008	\$ 5,243	\$ 1,235
Income (loss) from continuing operations	4,131	2,942	(1,189)
Net Income (loss)	4,006	2,817	(1,189)
Income (loss) per share from continuing operations:			
Basic	0.01	0.01	0.00
Diluted	0.01	0.01	0.00

***Condensed Consolidated Balance Sheet (Unaudited)*****As of April 30, 2009**

Other assets	\$ 2,897	\$ 2,584	\$ (313)
Convertible notes	142,000	134,255	(7,745)
Additional paid in capital	1,811,298	1,830,807	19,509
Accumulated deficit	(1,699,648)	(1,711,725)	(12,077)

Interest (cash interest cost) on the 2.5% Convertible Senior Subordinated Notes is payable semiannually on April 15 and October 15. The notes become convertible, at the option of the holder, upon the Company's common stock reaching \$4.92 for a period of time at a conversion price of \$3.28 per share, which is equal to a rate of approximately 304.9055 shares of Finisar common stock per \$1,000 principal amount of the notes. The conversion price is subject to adjustment. The notes contain a net share settlement feature which requires that, upon conversion of the notes into common stock of the Company, Finisar will pay holders in cash for up to the principal amount of the converted notes and that any amounts in excess of the cash amount will be settled in shares of Finisar common stock. At August 2, 2009, the if-converted value of the Convertible Senior Subordinated Notes did not exceed the principal balance.

At August 2, 2009, the \$6.5 million unamortized debt discount had a remaining amortization period of approximately 14 months. On August 11, 2009 the Company repurchased \$14.4 million principal amount of 2.5% Convertible Senior Subordinated Notes under exchange offers which commenced on July 16, 2009. See Note 26 for additional details regarding these exchange offers.

The following table provides additional information about the Company's Convertible Senior Subordinated Notes that may be settled for cash (in thousands):

	<b>August 2, 2009</b>	<b>April 30, 2009</b>
Carrying amount of the equity component	\$19,509	\$19,509
Effective interest rate on liability component	8.59%	8.59%

The following table presents the associated interest expense related to the Company's Convertible Senior Subordinated Notes that may be settled in cash, which consists of both the contractual interest coupon (cash interest cost) and amortization of the discount on the liability (non-cash interest cost) (in thousands):

**Table of Contents**

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>
Non-cash interest cost	\$ 1,235	\$ 1,235
Cash interest cost	601	660
	<b>\$ 1,836</b>	<b>\$ 1,895</b>

The Company's Convertible Subordinated and Convertible Senior Subordinated Notes are due in fiscal 2011.

**12. Long-term Debt**

In December 2005, the Company entered into a note and security agreement with a financial institution. Under this agreement, the Company borrowed \$9.9 million at an interest rate of 5.9% per annum. The note is payable in 60 equal monthly installments beginning in January 2006 and is secured by certain property and equipment of the Company. At August 2, 2009, the remaining principal balance outstanding under this note was \$3.2 million. At April 30, 2009, the remaining principal balance outstanding under this note was \$3.7 million. As of August 2, 2009, the Company recorded \$2.2 million of this debt, as Current portion of long-term debt and recorded the remaining \$1.0 million as Long-term debt, net of current portion on the consolidated balance sheet. As of April 30, 2009, the Company recorded \$2.1 million of this debt, as Current portion of long-term debt and recorded the remaining \$1.6 million as Long-term debt, net of current portion.

In July 2008, the Company's Malaysian subsidiary entered into two separate loan agreements with a Malaysian bank. Under these agreements, the Company's Malaysian subsidiary borrowed a total of \$20 million at an initial interest rate of 5.05% per annum. The first loan is payable in 20 equal quarterly installments of \$750,000 beginning in January 2009, and the second loan is payable in 20 equal quarterly installments of \$250,000 beginning in October 2008. Both loans are secured by certain property of the Company's Malaysian subsidiary, guaranteed by the Company and subject to certain covenants. The Company was in compliance with all covenants associated with these loans as of August 2, 2009 and April 30, 2009. At August 2, 2009, the principal balance outstanding under these loans was \$16.7 million. As of August 2, 2009, the Company recorded \$4.0 million of this debt, as Current portion of long-term debt and recorded the remaining \$12.7 million as Long-term debt, net of current portion on the consolidated balance sheet. At April 30, 2009, the principal balance outstanding under these loans was \$17.7 million. As of April 30, 2009, the Company recorded \$4.0 million of this debt, as Current portion of long-term debt and recorded the remaining \$13.7 million as Long-term debt, net of current portion on the consolidated balance sheet.

**13. Revolving Line of Credit Agreement**

On March 14, 2008, the Company entered into a revolving line of credit agreement with Silicon Valley Bank which, as previously amended, was further amended on July 15, 2009. The amended credit facility allows for advances in the aggregate amount of \$25 million subject to certain restrictions and limitations. Borrowings under this line are collateralized by substantially all of the Company's assets except its intellectual property rights and bear interest, at the Company's option, at either the bank's prime rate plus 0.5% or LIBOR plus 3%. The maturity date is July 15, 2010. The facility is subject to financial covenants including an adjusted quick ratio covenant and an EBITDA covenant which are tested as of the last day of each month. The Company was in compliance with all covenants associated with this facility as of August 2, 2009 and April 30, 2009. There were no outstanding borrowings under this revolving line of credit at August 2, 2009 or April 30, 2009.

**14. Letter of Credit Reimbursement Agreement**

In April 2005, the Company entered into a letter of credit reimbursement agreement with Silicon Valley Bank. Several amendments were made to the agreement subsequently. The last amendment was on April 30, 2009. Under the terms of the amended agreement, Silicon Valley Bank will provide to the Company, through October 24, 2009 a \$4.0 million letter of credit facility covering existing letters of credit issued by Silicon Valley Bank and any other

letters of credit that may be required by the Company. The cost related to the credit facility consisted of the bank's out of pocket expenses associated with the credit facility. The credit facility is unsecured but includes a negative pledge that requires that the Company will not create a security interest in any of its assets in favor of a subsequent creditor without the approval of Silicon Valley Bank. Outstanding letters of credit secured under this agreement at August 2, 2009 and April 30, 2009 totaled \$3.4 million and \$3.4 million, respectively.

**Table of Contents****15. Non-recourse Accounts Receivable Purchase Agreement**

On October 28, 2004, the Company entered into an non-recourse accounts receivable purchase agreement with Silicon Valley Bank. Several amendments were subsequently made to the agreement. The last amendment was on October 28, 2008. Under the terms of the amended agreement, the Company may sell to Silicon Valley Bank, through October 24, 2009 up to \$16 million of qualifying receivables whereby all right, title and interest in the Company's invoices are purchased by Silicon Valley Bank. In these non-recourse sales, the Company removes sold receivables from its books and records no liability related to the sale, as the Company has assessed that the sales should be accounted for as true sales in accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The discount interest for the facility is based on the number of days in the discount period multiplied by Silicon Valley Bank's prime rate plus 0.25% and a non-refundable administrative fee of 0.25% of the face amount of each invoice.

During the three months ended August 2, 2009, the Company did not sell any receivables under the facility. During the three months ended August 3, 2008, the Company sold receivables totaling \$5.2 million, respectively, under this facility.

**16. Warranty**

The Company generally offers a one-year limited warranty for its products. The specific terms and conditions of these warranties vary depending upon the product sold. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs based on revenue recognized. Factors that affect the Company's warranty liability include the historical and anticipated rates of warranty claims. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company's warranty liability during the following period were as follows (in thousands):

	<b>Three Months Ended August 2, 2009</b>
Beginning balance at April 30, 2009	\$ 6,413
Additions during the period based on product sold	899
Settlements	(481)
Changes in liability for pre-existing warranties, including expirations	(421)
Ending balance at August 2, 2009	\$ 6,410

**17. Stockholders' Equity*****Employee Stock Purchase Plan***

The Company has an Employee Stock Purchase Plan, which includes its sub-plan, the International Employee Stock Purchase Plan (together the Purchase Plan), under which 16,750,000 shares of the Company's common stock have been reserved for issuance. The Purchase Plan permits eligible employees to purchase Finisar common stock through payroll deductions, which may not exceed 20% of the employee's total compensation. Stock may be purchased under the plan at a price equal to 85% of the fair market value of Finisar common stock on either the first or the last day of the offering period, whichever is lower. During the three months ended August 2, 2009, the Company issued 6,412,146 shares under the Purchase Plan. During the three months ended August 2, 2008, the Company issued 1,947,944 shares under the Purchase Plan. At August 2, 2009, 1,627,625 shares were available for issuance under the Purchase Plan.

***Employee Stock Option Plans***

In September 1999, Finisar's 1999 Stock Option Plan was adopted by the board of directors and approved by the stockholders. An amendment and restatement of the 1999 Stock Option Plan, including renaming it the 2005 Stock Incentive Plan (the 2005 Plan), was approved by the board of directors in September 2005 and by the stockholders in October 2005. A total of 21,000,000 shares of common stock were initially reserved for issuance under the 2005 Plan. The share reserve automatically increases on May 1 of each calendar year by a number of shares equal to 5% of the



number of shares of Finisar's common stock issued and outstanding as of the immediately preceding April 30, subject to certain restrictions on the aggregate maximum number of shares that may be issued pursuant to incentive stock options. The types of stock-based awards available under the 2005 Plan include stock options, stock appreciation rights, restricted stock units ( RSUs ) and other stock-based awards which vest upon the attainment of designated performance goals or the satisfaction of specified service requirements or, in the case of certain RSUs or other stock-based awards, become payable upon the expiration of a designated time period following such vesting events. Options generally vest over five years and have a maximum term of 10 years. As of August 2, 2009, there were no shares subject to repurchase.

**Table of Contents**

A summary of activity under the Company's employee stock option plans is as follows:

Options for Common Stock	Stock-based awards available for Grant	Number of Shares	Options Outstanding		
	Number of Shares		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value(1) (\$000 s)
<b>Balance at April 30, 2009</b>	28,292,066	77,450,473	\$1.83		
Increase in authorized shares	23,874,603				
Options granted	(244,000)	244,000	\$0.64		
RSUs granted	(57,726)				
Options exercised		(271,752)	\$0.38		
RSUs canceled	947,917				
Options canceled	4,806,792	(4,806,792)	\$1.66		
<b>Balance at August 2, 2009</b>	57,619,652	72,615,929	\$1.85	6.49	\$6,249

(1) Represents the difference between the exercise price and the value of Finisar common stock at August 2, 2009

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of \$0.64 as of August 2, 2009, which would have been received by the option holders had all option holders exercised their options as of that date. The weighted-average remaining contractual life of options exercisable is 5.46 years.

**Restricted Stock Units**

A summary of the changes in RSUs outstanding under the Company's employee stock plans during first quarter of fiscal 2010 is as follows:

	Shares	Weighted- Average Grant
		Date Fair Value
Nonvested at April 30, 2009	11,053,092	\$ 0.67
Granted	57,726	\$ 0.64
Vested	(2,846,600)	\$ 0.62
Forfeited	(947,917)	\$ 0.56
Nonvested at August 2, 2009	7,316,301	\$ 0.70

During the first quarter of fiscal 2010 and first quarter of fiscal 2009, the Company issued 57,726 and 60,214 RSUs, respectively, under the 2005 Plan. Typically, vesting of RSUs occurs over one to four years and is subject to the employee's continuing service to the Company. The compensation expense related to these awards of \$36,945 and

\$96,878 for first quarter fiscal 2009 and first quarter of fiscal 2010, respectively, was determined using the fair market value of the Company's common stock on the date of the grant and is recognized using a straight line method over the awards' vesting period.

The aggregate intrinsic value of RSUs outstanding at August 2, 2009 was \$4.7 million.

As of August 2, 2009, the Company had \$3.0 million of unrecognized compensation expense, net of estimated forfeitures, related to RSUs grants. These expenses are expected to be recognized over a weighted-average period of 15 months.

***Valuation and Expense Information Under SFAS 123R***

The following table summarizes stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123R for the three months ended August 2, 2009 and August 3, 2008 which was reflected in the Company's operating results (in thousands):

25

---

**Table of Contents**

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>
	(unaudited, in thousands)	
Cost of revenues	\$ 1,032	\$ 821
Research and development	1,521	860
Sales and marketing	578	327
General and administrative	1,040	515
Total	\$ 4,171	\$ 2,523

The total stock-based compensation capitalized as part of inventory as of August 2, 2009 was \$672,000.

As of August 2, 2009, total compensation cost related to unvested stock options not yet recognized was approximately \$13.7 million which is expected to be recognized over the next 29 months.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes single option pricing model with the following weighted-average assumptions:

	<b>Employee Stock Option Plans</b>		<b>Employee Stock Purchase Plan</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>	<b>August 2, 2009</b>	<b>August 3, 2008</b>
Weighted average fair value per share	\$ 0.43	\$ 0.99	\$ 0.21	\$ 0.51
Expected term (in years)	5.16	5.14	0.75	0.74
Volatility	84%	72%	102%	58%
Risk-free interest rate	2.57%	3.23%	4.50%	3.29%
Dividend yield	0.00%	0.00%	0.00%	0.00%

***Accuracy of Fair Value Estimates***

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and the stock price volatility. The assumptions listed above represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Company's recorded stock-based compensation expense could have been materially different from that depicted above. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the Company's actual forfeiture rate is materially different from the estimate, stock-based compensation expense could be materially different.

***Acceleration of Vesting of Certain Options and RSUs***

During the first quarter of fiscal 2010, the Company partially accelerated certain outstanding options and restricted stock units held by the employees of the Network Tools Division the assets of which were sold to JDSU during the quarter. This acceleration of vesting was treated as a modification of the award in accordance with SFAS 123R. Incremental stock compensation expense of \$99,000 was recorded in loss from discontinued operations.

***Extension of Stock Option Exercise Periods for Former Employees***

As more fully described in Note 22, Pending Litigation- Stock option Derivative, the Company could not issue shares of its common stock under its registration statements on Form S-8 during the period in which it was not current in its obligations to file periodic reports under the Securities Exchange Act of 1934 ( "34 Act" ) due to the pending investigation into its historical stock option grant practices. As a result, during parts of 2006 and 2007, vested options held by certain former employees of the Company could not be exercised until the completion of the Company's stock option investigation and the Company's report filings under the "34 Act had been made current. As a result, the

Company extended the expiration date of these stock options to June 30, 2008. This extension was treated as a modification of the award in accordance with SFAS 123R. As a result of the extension, the fair value related to these stock options had been reclassified to current liabilities subsequent to the modification and was subject to mark-to-market accounting each reporting period until the earlier of the final settlement or June 30, 2008. The remaining accrued balance for these stock options as of April 30, 2008 was approximately \$341,000.

During the first quarter of fiscal 2009, the Company recognized a benefit of approximately \$332,000 as a result of a decrease in the fair value of these options on June 30, 2008. The remaining accrued balance of \$9,000 related to these stock options was reclassified to equity as of August 3, 2008. These transactions represented the final settlement of these options.

## **Table of Contents**

### **18. Income Taxes**

The Company recorded a provision for income taxes of \$159,000 and \$746,000, respectively, for the three months ended August 2, 2009 and August 3, 2008. The provision for income tax expense for the three months ended August 3, 2008 includes non-cash charges of \$551,000 for deferred tax liabilities that were recorded for tax amortization of goodwill for which no financial statement amortization has occurred under generally accepted accounting principles. The \$159,000 provision for income tax expense for the three months ended August 2, 2009 includes minimum state taxes and foreign income taxes arising in certain foreign jurisdictions in which the Company conducts business.

The Company records a valuation allowance against its deferred tax assets for each period in which management concludes that it is more likely than not that the deferred tax assets will not be realized. Realization of the Company's net deferred tax assets is dependent upon future taxable income the amount and timing of which are uncertain. Accordingly, the Company's net deferred tax assets as of August 3, 2008 have been fully offset by a valuation allowance.

A portion of the valuation allowance for deferred tax assets at August 2, 2009 relates to the tax benefits of stock option deductions the tax benefit of which will be credited to paid-in capital if and when realized, and thereafter, income tax expense.

Utilization of the Company's net operating loss and tax credit carryforwards may be subject to a substantial annual limitation due to the ownership change limitations set forth by Internal Revenue Code Section 382 and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss and tax credit carryforwards before utilization.

The Company's total gross unrecognized tax benefits as of April 30, 2009 and August 2, 2009 were \$12.5 million. There was no change in the uncertain tax position. Excluding the effects of recorded valuation allowances for deferred tax assets, \$10.5 million of the unrecognized tax benefits would favorably impact the effective tax rate in future periods if recognized.

Due to the Company's taxable loss position since inception, all tax years are subject to examination in the U.S. and state jurisdictions. The Company is also subject to examination in various foreign jurisdictions, none of which were individually material. It is the Company's belief that no significant changes in the unrecognized tax benefit positions will occur within 12 months of April 30, 2010.

The Company records interest and penalties related to unrecognized tax benefits in income tax expense. At August 2, 2009, there were no accrued interest or penalties related to uncertain tax positions. The Company recorded no interest or penalties for the quarter ended August 2, 2009.

On May 1, 2009, the Company adopted the provisions of FSP APB-14-1 on a retrospective basis which requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability and equity components of the instrument. As a result of the adoption of FSP APB 14-1, the Company has separately accounted for the liability and equity components of its 2.5% Convertible Senior Subordinated Notes due 2010. The Company calculated the value of the conversion component of the debt and recorded this value as a component of equity and a corresponding debt discount. The debt discount, which is a reduction to the carrying value of the debt, will be amortized as additional non-cash interest expense over the term of the original note. The retrospective application of this pronouncement affects all periods presented. There are no income tax benefits related to the non-cash interest expense over the term of the original note due to the valuation allowances for deferred tax assets

### **19. Segments**

Prior to first quarter of fiscal 2010, the Company's Chief Executive Officer and Chairman of the Board viewed the business as having two principal operating segments, consisting of optical subsystems and components, and network performance test systems. After the sale of the assets of the Network Tools Division to JDSU in the first quarter of fiscal 2010, the Company has one reportable segment consisting of optical subsystems and components.

Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for SANs and LANs and MAN applications. Optical subsystems also include multiplexers, de-multiplexers and optical add/drop modules for use in MAN applications. Optical components consist primarily of packaged lasers and photo-detectors which are incorporated in transceivers, primarily for LAN and SAN applications.



**Table of Contents****20. Geographic Information**

The following is a summary of operations within geographic areas based on the location of the entity purchasing the Company's products (in thousands):

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>
Revenues from sales to unaffiliated customers:		
United States	\$ 49,001	\$ 25,764
Malaysia	22,361	27,341
China	17,022	15,427
Rest of the world	40,341	47,242
	<b>\$ 128,725</b>	<b>\$ 115,774</b>

Revenues generated in the United States are all from sales to customers located in the United States.

The following is a summary of long-lived assets of continuing operations within geographic areas based on the location of the assets (in thousands):

	<b>August 2, 2009</b>	<b>April 30, 2009</b>
Long-lived assets		
United States	\$ 77,773	\$ 83,119
Malaysia	28,504	28,067
Rest of the world	18,300	17,180
	<b>\$ 124,577</b>	<b>\$ 128,366</b>

**21. Restructuring Charges**

During the second quarter of fiscal 2006, the Company consolidated its Sunnyvale facilities into one building and permanently exited a portion of its Scotts Valley facility. As a result of these activities, the Company recorded restructuring charges of approximately \$3.1 million. These restructuring charges included \$290,000 of miscellaneous costs required to effect the closures and approximately \$2.8 million of non-cancelable facility lease payments. Of the \$3.1 million in restructuring charges, \$1.9 million related to the Company's optical subsystems and components segment and \$1.2 million related to discontinued operations. During the first quarter of fiscal 2009, the Company recorded additional restructuring charges of \$600,000 for lease payments for the remaining portion of the Scotts Valley facility that had been used for a product line of our discontinued operations which was sold in first quarter of fiscal 2009. See Note 9 for additional details regarding the sale of this product line.

As of August 2, 2009 and April 30, 2009, \$700,000 and \$900,000, respectively, of committed facilities payments related to restructuring activities remained accrued all of which is expected to be fully utilized by the end of fiscal 2011.

**22. Pending Litigation*****Stock Option Derivative Litigation***

On November 30, 2006, the Company announced that it had undertaken a voluntary review of its historical stock option grant practices subsequent to its initial public offering in November 1999. The review was initiated by senior management, and preliminary results of the review were discussed with the Audit Committee of the Company's board of directors. Based on the preliminary results of the review, senior management concluded, and the Audit Committee agreed, that it was likely that the measurement dates for certain stock option grants differed from the recorded grant



dates for such awards and that the Company would likely need to restate its historical financial statements to record non-cash charges for compensation expense relating to some past stock option grants. The Audit Committee thereafter conducted a further investigation and engaged independent legal counsel and financial advisors to assist in that investigation. The Audit Committee concluded that measurement dates for certain option grants differed from the recorded grant dates for such awards. The Company's management, in conjunction with the Audit Committee, conducted a further review to finalize

**Table of Contents**

revised measurement dates and determine the appropriate accounting adjustments to its historical financial statements. The announcement of the investigation resulted in delays in filing the Company's quarterly reports on Form 10-Q for the quarters ended October 29, 2006, January 28, 2007, and January 27, 2008, and the Company's annual report on Form 10-K for the fiscal year ended April 30, 2007. On December 4, 2007, the Company filed all four of these reports which included revised financial statements.

Following the Company's announcement on November 30, 2006 that the Audit Committee of the board of directors had voluntarily commenced an investigation of the Company's historical stock option grant practices, the Company was named as a nominal defendant in several shareholder derivative cases. These cases have been consolidated into two proceedings pending in federal and state courts in California. The federal court cases have been consolidated in the United States District Court for the Northern District of California. The state court cases have been consolidated in the Superior Court of California for the County of Santa Clara. The plaintiffs in all cases have alleged that certain of the Company's current or former officers and directors caused the Company to grant stock options at less than fair market value, contrary to the Company's public statements (including its financial statements), and that, as a result, those officers and directors are liable to the Company. No specific amount of damages has been alleged, and by the nature of the lawsuits, no damages will be alleged against the Company. On May 22, 2007, the state court granted the Company's motion to stay the state court action pending resolution of the consolidated federal court action. On June 12, 2007, the plaintiffs in the federal court case filed an amended complaint to reflect the results of the stock option investigation announced by the Audit Committee in June 2007. On August 28, 2007, the Company and the individual defendants filed motions to dismiss the complaint. On January 11, 2008, the Court granted the motions to dismiss, with leave to amend. On May 12, 2008, the plaintiffs filed an amended complaint. The Company and the individual defendants filed motions to dismiss the amended complaint on July 1, 2008. The Court's ruling on the motions remains pending.

***505 Patent Litigation******DirecTV Litigation***

On April 4, 2005, the Company filed an action for patent infringement in the United States District Court for the Eastern District of Texas against the DirecTV Group, Inc., DirecTV Holdings, LLC, DirecTV Enterprises, LLC, DirecTV Operations, LLC, DirecTV, Inc., and Hughes Network Systems, Inc. (collectively, DirecTV). The lawsuit involves the Company's U.S. Patent No. 5,404,505, or the 505 patent, which relates to technology used in information transmission systems to provide access to a large database of information. On June 23, 2006, following a jury trial, the jury returned a verdict that the Company's patent had been willfully infringed and awarded the Company damages of \$78,920,250. In a post-trial hearing held on July 6, 2006, the Court determined that, due to DirecTV's willful infringement, those damages would be enhanced by an additional \$25 million. Further, the Court awarded the Company pre-judgment interest on the jury's verdict and court costs in the aggregate amount of approximately \$13.5 million. The Court denied the Company's motion for injunctive relief, but ordered DirecTV to pay a compulsory ongoing license fee to the Company at the rate of \$1.60 per set-top box activated by or on behalf of DirecTV for the period beginning June 16, 2006 through the duration of the patent, which expires in April 2012.

DirecTV appealed to the United States Court of Appeals for the Federal Circuit. In its appeal, DirecTV raised issues related to claim construction, infringement, invalidity, willful infringement and enhanced damages. The Company cross-appealed raising issues related to the denial of the Company's motion for a permanent injunction, the trial court's refusal to enhance future damages for willfulness and the trial court's determination that some of the asserted patent claims are invalid. The appeals were consolidated.

On April 18, 2008, the appeals court issued its decision affirming in part, reversing in part, and remanding the case for further proceedings before the trial court in Texas. Specifically, the appeals court ruled that the lower court's interpretation of some of the patent claim terms was too broad and issued its own, narrower interpretation of those terms. The appeals court also determined that one of the seven patent claims (Claim 16) found infringed by the jury was invalid, that DirecTV's infringement of the 505 patent was not willful, and that the trial court did not err in its determination that various claims of the 505 patent were invalid for indefiniteness. As a result, the judgment, including the compulsory license, was vacated and the case was remanded to the trial court to reconsider infringement and validity of the six remaining patent claims and releasing to DirecTV the escrow funds it had deposited.

On July 11, 2008, the United States District Court for the Northern District of California issued an order in the Comcast lawsuit described below in which it held that one of the claims of the 505 patent, Claim 25, is invalid. The order in the Comcast lawsuit also, in effect, ruled invalid a related claim, Claim 24, which is one of the six remaining claims of the 505 patent that were returned to the trial court for retrial in the DirecTV lawsuit.

On December 1, 2008, both parties filed motions for summary judgment on the issue of validity in the trial court. On May 19, 2009, the Court granted DirecTV's motions for summary judgment and entered final judgment in the case in favor of DirecTV. The Company is appealing this ruling.

## **Table of Contents**

### *EchoStar Litigation*

On July 10, 2006, EchoStar Satellite LLC, EchoStar Technologies Corporation and NagraStar LLC (collectively, EchoStar ), filed an action against the Company in the United States District Court for the District of Delaware seeking a declaration that EchoStar does not infringe, and has not infringed, any valid claim of the Company s 505 patent. The 505 patent is the same patent that is in dispute in the DirecTV lawsuit. On December 4, 2007, the Court approved the parties stipulation to stay the case pending issuance of the Federal Circuit s mandate in the DirecTV case. This stay expired when the mandate of the Federal Circuit issued in the DirecTV case on April 18, 2008. The Court has yet to set a case schedule.

### *Requests for Re-Examination of the 505 Patent*

Four requests for re-examination of the Company s 505 patent have been filed with the PTO. The 505 patent is the patent that is in dispute in the DirecTV and EchoStar lawsuits. The PTO has granted each of these requests, and these proceedings have been combined into a single re-examination. During the re-examination, some or all of the claims in the 505 patent could be invalidated or revised to narrow their scope, either of which could have a material adverse impact on the Company s position in the related 505 lawsuits.

### *Securities Class Action*

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased the Company s common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants the Company, Jerry S. Rawls, its President and Chief Executive Officer, Frank H. Levinson, its former Chairman of the Board and Chief Technical Officer, Stephen K. Workman, its Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for the Company s initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as subsequently amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934, on the grounds that the prospectuses incorporated in the registration statements for the offerings failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of the Company s stock sold in the offerings and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of the Company s stock sold in the offerings to those customers in exchange for which the customers agreed to purchase additional shares of the Company s stock in the aftermarket at pre-determined prices. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, the Court denied defendants motion to dismiss the complaint.

In July 2004, the Company and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs would dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers would have been required to pay the amount, if any, by which \$1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs failed to recover \$1 billion and payment was required under the guaranty, the Company would have been responsible to pay its pro rata portion of the shortfall, up to the amount of the self-insured retention under its insurance policy, which could have been up to \$2 million. The Court gave preliminary approval to the settlement in February 2005. Before the Court issued a final decision on the settlement, on December 5, 2006, the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, the parties withdrew the settlement.

In February 2009, the parties reached an understanding regarding the principal elements of a settlement, subject to formal documentation and Court approval. On June 10, 2009, the Court granted preliminary approval of the settlement and on September 10, 2009 took the settlement under advisement pending final approval of the settlement terms.

Under the new proposed settlement, the underwriter defendants will pay a total of \$486 million, and the issuer defendants and their insurers will pay a total of \$100 million to settle all of the cases. On August 25, 2009, the Company funded approximately \$327,000 with respect to its pro rata share of the issuers' contribution to the settlement and certain costs. This amount was accrued in the financial statements for the quarter ended August 2, 2009 and recorded as operating expense.

***Section 16(b) Lawsuit***

A lawsuit was filed on October 3, 2007 in the United States District Court for the Western District of Washington by Vanessa Simmonds, a purported holder of the Company's common stock against two investment banking firms that served as underwriters for the initial public offering of the Company's common stock in November 1999. None of the Company's officers, directors or employees were named as defendants in the complaint. On February 28, 2008, the plaintiff filed an amended complaint. The complaint, as amended, alleges that: (i) the defendants, other underwriters of the offering, and unspecified officers, directors and the

**Table of Contents**

Company's principal shareholders constituted a group that owned in excess of 10% of the Company's outstanding common stock between November 11, 1999 and November 20, 2000; (ii) the defendants were therefore subject to the short swing prohibitions of Section 16(b) of the Securities Exchange Act of 1934; and (iii) the defendants engaged in purchases and sales, or sales and purchases, of the Company's common stock within periods of less than six months in violation of the provisions of Section 16(b). The complaint seeks disgorgement of all profits allegedly received by the defendants, with interest and attorneys fees, for transactions in violation of Section 16(b). The Company, as the statutory beneficiary of any potential Section 16(b) recovery, is named as a nominal defendant in the complaint.

This case is one of 54 lawsuits containing similar allegations relating to initial public offerings of technology company issuers, which were coordinated (but not consolidated) by the Court. On July 25, 2008, the real defendants in all 54 cases filed a consolidated motion to dismiss, and a majority of the nominal defendants (including the Company) filed a consolidated motion to dismiss, the amended complaints. On March 19, 2009, the Court dismissed the amended complaints naming the nominal defendants that had moved to dismiss, without prejudice, because the plaintiff had not properly demanded action by their respective boards of directors before filing suit; and dismissed the amended complaints naming nominal defendants that had not moved to dismiss, with prejudice, finding the claims time-barred by the applicable statute of limitation. Also on March 19, 2009, the Court entered judgment against the plaintiff in all 54 cases. The plaintiff has appealed the order and judgments. The real defendants have cross-appealed the dismissal of certain amended complaints without prejudice, contending that dismissal should have been with prejudice because those amended complaints are barred by the applicable statute of limitation.

***JDSU/Emcore Patent Litigation***

Litigation is pending with JDS Uniphase Corporation and Emcore Corporation with respect to certain cable television transmission products acquired in connection with the Company's acquisition of Optium Corporation. On September 11, 2006, JDSU and Emcore filed a complaint in the United States District Court for the Western District of Pennsylvania alleging that the Company's 1550 nm HFC externally modulated transmitter used in cable television applications, in addition to possibly products as yet unidentified, infringes on two U.S. patents. On March 14, 2007, JDSU and Emcore filed a second complaint in the United States District Court for the Western District of Pennsylvania alleging that the Company's 1550 nm HFC quadrature amplitude modulated transmitter used in cable television applications, in addition to possibly products as yet unidentified, infringes on another U.S. patent. The plaintiffs are seeking for the court to declare that Optium has willfully infringed on such patents and to be awarded up to three times the amount of any compensatory damages found, if any, plus any other damages and costs incurred. The Company has answered both of these complaints denying that it has infringed any of the asserted patents and asserting that those patents are invalid. On December 10, 2007, the Company filed a complaint in the United States District Court for the Western District of Pennsylvania seeking a declaration that the patents asserted against the Company's HFC externally modulated transmitter are unenforceable due to inequitable conduct committed by the patent applicants and/or the attorneys or agents during prosecution.

On February 18, 2009, the Court granted JDSU's and Emcore's motion for summary judgment dismissing the Company's declaratory judgment action on inequitable conduct. The Company has appealed this ruling. The court has consolidated the remaining two actions and has scheduled a single trial to begin October 19, 2009. The Company is unable to determine the ultimate outcome of this litigation.

***Export Compliance***

During mid-2007, Optium became aware that certain of its analog RF over fiber products may, depending on end use and customization, be subject to the International Traffic in Arms Regulations, or ITAR. Accordingly, Optium filed a detailed voluntary disclosure with the United States Department of State describing the details of possible inadvertent ITAR violations with respect to the export of a limited number of certain prototype products, as well as related technical data and defense services. Optium may have also made unauthorized transfers of ITAR-restricted technical data and defense services to foreign persons in the workplace. Additional information has been provided upon request to the Department of State with respect to this matter. In late 2008, a grand jury subpoena from the office of the U.S. Attorney for the Eastern District of Pennsylvania was received requesting documents from 2005 through the present referring to, relating to or involving the subject matter of the above referenced voluntary disclosure and export activities.

While the Department of State encourages voluntary disclosures and generally affords parties mitigating credit under such circumstances, the Company nevertheless could be subject to continued investigation and potential regulatory consequences ranging from a no-action letter, government oversight of facilities and export transactions, monetary penalties, and in extreme cases, debarment from government contracting, denial of export privileges and criminal sanctions, any of which would adversely affect the Company's results of operations and cash flow. The Department of State and U.S. Attorney inquiries may require the Company to expend significant management time and incur significant legal and other expenses. The Company cannot predict how long it will take or how much more time and resources it will have to expend to resolve these government inquiries, nor can it predict the outcome of these inquiries.

**Table of Contents*****Other Litigation***

In the ordinary course of business, the Company is a party to litigation, claims and assessments in addition to those described above. Based on information currently available, management does not believe the impact of these other matters will have a material adverse effect on its business, financial condition, results of operations or cash flows of the Company.

**23. Guarantees and Indemnifications**

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligations it assumes under that guarantee. As permitted under Delaware law and in accordance with the Company's Bylaws, the Company indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The Company may terminate the indemnification agreements with its officers and directors upon 90 days written notice, but termination will not affect claims for indemnification relating to events occurring prior to the effective date of termination. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that may enable it to recover a portion of any future amounts paid.

The Company enters into indemnification obligations under its agreements with other companies in its ordinary course of business, including agreements with customers, business partners, and insurers. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities or the use of the Company's products. These indemnification provisions generally survive termination of the underlying agreement. In some cases, the maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited.

The Company believes the fair value of these indemnification agreements are not material. Accordingly, the Company has not recorded any liabilities for these agreements as of August 2, 2009. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements and payments under the loans are expected to be paid when due.

During the first quarter of fiscal 2009, the Company's Malaysian subsidiary entered into loan agreements with a Malaysian bank (see Note 12. Long-Term Debt) for which the Company has provided corporate guarantees. The Company guaranteed loan payments of up to \$23.1 million in the event of non-payment by its Malaysian subsidiary. These guarantees are effective during the term of these loans. The principal balance of this loan outstanding as of August 2, 2009, was \$16.7 million.

**24. Related Party Transactions**

Frank H. Levinson, the Company's former Chairman of the Board and Chief Technical Officer and a member of the Company's board of directors until August 29, 2008, is a member of the board of directors of Fabrinet, Inc., a privately held contract manufacturer. In June 2000, the Company entered into a volume supply agreement, at rates which the Company believes to be market, with Fabrinet under which Fabrinet serves as a contract manufacturer for the Company. In addition, Fabrinet purchases certain products from the Company. The Company recorded purchases of \$21.6 million from Fabrinet during the three months ended August 3, 2008 and Fabrinet purchased products from the Company totaling to \$13.0 million during the same period.

During the three months ended August 2, 2009, the Company paid a sales and marketing consultant, who is the brother of the Chief Executive Officer of the Company, \$36,700 in cash compensation.

Amounts paid to related parties represented values considered by management to be fair and reasonable, reflective of an arm's length transaction.

**25. Fair Value of Financial Instruments**

The following disclosure of the estimated fair value of financial instruments presents amounts that have been determined using available market information and appropriate valuation methodologies. The estimated fair values of the Company's financial instruments as of August 2, 2009 are as follows (dollars in thousands):





**Table of Contents**

	<b>August 2, 2009</b>	
	Carrying Amount	Fair value
Financial assets:		
Cash and cash equivalents	\$ 60,327	\$ 60,327
Short-term available-for-sale investments	92	92
Financial liabilities:		
Convertible notes	135,490	123,540
Long-term debt	19,910	19,910
Totals	\$ 215,819	\$ 203,869

*Cash and cash equivalents* The fair value of cash and cash equivalents approximates its carrying value.

*Short-term available-for-sale investments* The fair value of short-term available-for-sale investments approximates its carrying value.

*Convertible notes* The fair value of convertible notes is estimated using the price from the repurchase transaction that the Company completed during August 2009.

*Long-term debt* The fair value of long-term debt approximates its carrying value.

The Company has not estimated the fair value of its minority investments as it is not practicable to estimate the fair value of these investments because of the lack of a quoted market price and the inability to estimate fair value without incurring excessive costs. As of August 2, 2009, the carrying value of its minority investments is \$14.3 million which represents the original cost of the investment, which management believes is not impaired as of August 2, 2009.

## **26. Subsequent Events**

### ***Settlement of Exchange Offer***

On July 9, 2009, the Company announced that it had commenced separate concurrent Modified Dutch Auction tender offers (each an Exchange Offer and together, the Exchange Offers) to exchange shares of its common stock and cash for an aggregate of up to \$95 million principal amount of the following series of its outstanding convertible notes (the Notes):

2.50% Convertible Subordinated Notes due 2010 (the Subordinated Notes); and

2.50% Convertible Senior Subordinated Notes due 2010 (the Senior Subordinated Notes)

The Company offered to exchange up to an aggregate of \$37.5 million principal amount, or 75%, of the outstanding Subordinated Notes and an aggregate of \$57.5 million principal amount, or 62.5%, of the outstanding Senior Subordinated Notes.

Under the Exchange offers, as amended, for each \$1,000 principal amount of Notes, tendering holders were entitled to receive consideration with a value not greater than \$870 nor less than \$820 (the Exchange Consideration), with such value determined by a Modified Dutch Auction procedure, plus accrued and unpaid interest to, but excluding, the settlement date, payable in cash. A separate Modified Dutch Auction procedure was conducted for each of the Exchange Offers. A Modified Dutch Auction tender offer allows holders of the Notes to indicate the principal amount of Notes that such holders desire to tender and the consideration within the specified range at which they wish to tender such Notes. The mix of Exchange Consideration consisted of (i) \$525 in cash, and (ii) a number of shares of common stock with a value equal to the Exchange Consideration minus \$525 (the Equity Consideration). The number of shares of common stock representing the Equity Consideration to be received by holders as part of Exchange Consideration was determined on the basis of the trading price of the common stock during a 5-trading day VWAP period (the 5-day VWAP) starting on July 13 and ending on July 17, 2009.

The Exchange Offers expired on Thursday, August 6, 2009. On August 11, 2009, the Company announced the final results of the Exchange. The Company exchanged \$47,504,000 aggregate principal amount of the Notes. The

Company issued approximately 28.3 million shares of common stock and paid out approximately \$24.9 million in cash..

**Table of Contents**

The Company accepted for exchange the following approximate principal amount of each series of Notes:

- (i) \$33,100,000, or 66.2%, of the \$50,000,000 aggregate outstanding principal amount of Subordinated Notes; and
- (ii) \$14,404,000, or approximately 15.7%, of the \$92,000,000 aggregate outstanding principal amount of Senior Subordinated Notes.

***Repurchase of Senior Subordinated Notes***

On September 8, 2009, the Company repurchased \$15.2 million principal amount of its Senior Subordinated Notes in a privately negotiated transaction. For each \$1,000 principal amount of the Notes, the Company paid \$952 in cash, for a total purchase price of \$14.5 million plus accrued interest of \$154,000.

After the repurchase and the settlement of the Exchange Offers discussed above, approximately \$79.3 million aggregate principal amount of Notes remained outstanding.

## **Table of Contents**

### **Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*** **Forward-Looking Statements**

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ substantially from those anticipated in these forward-looking statements as a result of many factors, including those referred to in Part II, Item 1A. Risk Factors below. The following discussion should be read together with our condensed consolidated financial statements and related notes thereto included elsewhere in this report.

#### **Business Overview**

We are a leading provider of optical subsystems and components that connect short-distance local area networks, or LANs, and storage area networks, or SANs, and longer distance metropolitan area networks, or MANs and wide area networks, or WANs. Our optical subsystems consist primarily of transmitters, receivers, transceivers and transponders which provide the fundamental optical-electrical interface for connecting the equipment used in building these networks. These products rely on the use of semiconductor lasers and photodetectors in conjunction with integrated circuit design and novel packaging technology to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable at speeds ranging from less than 1Gbps to 40Gbps, using a wide range of network protocols and physical configurations over distances of 70 meters to 200 kilometers. We supply optical transceivers and transponders that allow point-to-point communications on a fiber using a single specified wavelength or, bundled with multiplexing technologies, can be used to supply multi-gigabit bandwidth over several wavelengths on the same fiber. We also provide products for dynamically switching network traffic from one optical wavelength to another across multiple wavelengths known as reconfigurable optical add/drop multiplexers, or ROADMs. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers for LAN and SAN applications and passive optical components used in building MANs. Our manufacturing operations are vertically integrated and we utilize internal sources for many of the key components used in making our products including lasers, photodetectors and integrated circuits, or ICs, designed by our own internal IC engineering teams. We also have internal assembly and test capabilities that make use of internally designed equipment for the automated testing of our optical subsystems and components.

We sell our optical products to manufacturers of storage systems, networking equipment and telecommunication equipment or their contract manufacturers, such as Alcatel-Lucent, Brocade, Cisco Systems, EMC, Emulex, Ericsson, Hewlett-Packard Company, Huawei, IBM, Juniper, Qlogic, Siemens and Tellabs. These customers, in turn, sell their systems to businesses and to wireline and wireless telecommunications service providers and cable TV operators, collectively referred to as carriers.

#### **Recent Developments**

##### ***Combination with Optium Corporation***

On August 29, 2008, we completed a business combination with Optium Corporation, a leading designer and manufacturer of high performance optical subsystems for use in telecommunications and cable TV network systems, through the merger of Optium with a wholly-owned subsidiary of Finisar. We believe that the combination of the two companies created the world's largest supplier of optical components, modules and subsystems for the communications industry and will leverage Finisar's leadership position in the storage and data networking sectors of the industry and Optium's leadership position in the telecommunications and CATV sectors to create a more competitive industry participant. In addition, as a result of the combination, we expect to realize cost synergies related to operating expenses and manufacturing costs resulting from (1) the transfer of production to lower cost locations, (2) improved purchasing power associated with being a larger company and (3) cost synergies associated with the integration of components into product designs previously purchased in the open market by Optium. At the closing of the merger, we issued 160,808,659 shares of Finisar common stock, valued at approximately \$242.8 million, in exchange for all of the outstanding common stock of Optium.

We have accounted for the combination using the purchase method of accounting and as a result have included the operating results of Optium in our consolidated financial results since the August 29, 2008 consummation date. The Optium results are included in our optical subsystems and components segment.

##### ***Sale of Network Tools Division***

In the first quarter of fiscal 2010, we sold substantially all of the assets of our Network Tools Division to JDSU for \$40.6 million in cash. We recorded a net gain on sale of the business of \$36.1 million before income taxes, which is included in income from discontinued operations, net of income tax, in our condensed consolidated statements of operations. In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, the assets and liabilities, results of operations and cash flows related to the business, have been classified as discontinued operations in the condensed consolidated financial statements for all periods presented.

**Table of Contents****Critical Accounting Policies**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make judgments, estimates and assumptions in the preparation of our consolidated financial statements and accompanying notes. Actual results could differ from those estimates. We believe there have been no significant changes in our critical accounting policies as discussed in our Annual Report on Form 10-K for the year ended April 30, 2009 other than the adoption of FSP APB14-1 (see Note 1 to condensed consolidated financial statements).

**Results of Operations**

The following table sets forth certain statement of operations data as a percentage of revenues for the periods indicated:

	<b>Three Months Ended</b>	
	<b>August 2, 2009</b>	<b>August 3, 2008</b>
	<b>(Unaudited)</b>	
Revenues	100.0%	100.0%
Cost of revenues	76.2	64.0
Amortization of acquired developed technology	1.0	0.8
Gross profit	22.8	35.2
Operating expenses:		
Research and development	16.4	15.0
Sales and marketing	5.3	5.9
General and administrative	7.5	7.4
Amortization of purchased intangibles	0.5	0.1
Total operating expenses	29.7	28.4
Income (loss) from operations	(6.9)	6.8
Interest income	0.0	0.8
Interest expense	(1.9)	(4.5)
Other income (expense), net	0.2	0.1
Income (loss) before income taxes	(8.6)	3.2
Provision for income taxes	0.1	0.7
Income (loss) from continuing operations	(8.7)	2.5
Income (loss) from discontinued operations, net of taxes	28.8	(0.1)
Net income	20.1	2.4

**Revenues.** Revenues from continuing operations increased \$13.0 million, or 11.2%, to \$128.7 million in the quarter ended August 2, 2009 compared to \$115.8 million in the quarter ended August 3, 2008. The increase was due to the inclusion of \$28.8 million revenues from Optium's operations, consisting of \$14.1 million in sales of Metro/Telecom products with speeds of 10 Gbs and higher, \$11.0 million in sales of ROADM products and \$3.7 million in sales of CATV products. Revenue from pre-merger Finisar products decreased \$15.9 million, or 13.7%, to \$99.9 million

compared to \$115.8 million in the quarter ended August 3, 2008. While this decrease was primarily due to the global recession, sales of products with speeds of 10 Gbs and higher increased while sales of products with speeds of less than 10 Gbs declined. Sales of LAN and SAN products with speeds of less than 10 Gbs decreased \$12.0 million, or 26.1%, to \$34.0 million while sales of LAN and SAN products with speeds of 10 Gbs and higher increased \$3.1 million, or 30.8%, to \$13.1 million. Sales of Metro/Telecom products with speeds of less than 10 Gbs decreased \$7.0 million, or 23.1%, to 23.4 million while sales of Metro/Telecom products with speeds of 10 Gbs and higher increased \$2.1 million, or 9.4%, to \$24.3 million. Sales of components decreased \$2.3 million, or 32.9%, to \$4.8 million. Combined sales of Metro/Telecom products with speeds of 10 Gbs and higher increased \$16.2 million, or 73.1%, to \$38.4 million.

*Amortization of Acquired Developed Technology.* Amortization of acquired developed technology related to continuing operations, a component of cost of revenues, increased \$343,000, or 40.4%, in the quarter ended August 2, 2009 to \$1.2 million compared to \$850,000 in the quarter ended August 3, 2008. The increase was primarily due to the addition of \$605,000 related to the Optium merger offset by full amortization during fiscal 2009 of the assets associated with the Kodeos acquisition.

*Gross Profit.* Gross profit from continuing operations decreased \$11.4 million, or 27.9%, to \$29.4 million in the quarter ended August 2, 2009 compared to \$40.8 million in the quarter ended August 3, 2008. Gross profit as a percentage of revenue was 22.8% in the quarter ended August 2, 2009 compared to 35.2% in the quarter ended August 3, 2008. We recorded charges of \$9.2 million for obsolete and excess inventory in the quarter ended August 2, 2009 compared to \$2.6 million in the quarter ended August 3, 2008. We sold inventory that was written-off in previous periods resulting in a benefit of \$2.7 million in the quarter ended August 2, 2009 and \$1.8 million in the quarter ended August 3, 2008. As a result, we recognized a net charge of \$6.5 million in the quarter ended August 2, 2009 compared to \$800,000 in the quarter ended August 3, 2008. Manufacturing overhead includes stock-based compensation charges of \$1.0 million in the quarter ended August 2, 2009 and \$821,000 in the quarter ended August 3, 2008. Excluding



**Table of Contents**

amortization of acquired developed technology, the net impact of excess and obsolete inventory charges and stock-based compensation charges, gross profit would have been \$38.1 million, or 29.6% of revenue, in the quarter ended August 2, 2009 compared to \$43.3 million, or 37.4% of revenue in the quarter ended August 3, 2008. The decrease in adjusted gross profit margin resulted from many factors including lower manufacturing volume, reduced pricing on our slower speed products, lower yield rates on our higher speed components and sales of certain lower margin products acquired in the Optium merger. Manufacturing overhead costs, including those related to Optium's operations, increased by 3.2% compared to the combined increase in revenue of 11.2% suggesting that we have achieved some manufacturing cost synergies as a result of the Optium merger.

*Research and Development Expenses.* Research and development expenses of continuing operations increased \$3.6 million, or 20.9%, to \$21.0 million in the quarter ended August 2, 2009 compared to \$17.4 million in the quarter ended August 3, 2008. The increase was due to Optium merger. Included in research and development expenses were stock-based compensation charges of \$1.5 million in the quarter ended August 2, 2009 and \$860,000 in the quarter ended August 3, 2008. Research and development expenses as a percent of revenues increased to 16.4% in the quarter ended August 2, 2009 compared to 15.0% in the quarter ended August 3, 2008.

*Sales and Marketing Expenses.* Sales and marketing expenses of continuing operations decreased \$57,000, or 0.8%, to \$6.8 million in the quarter ended August 2, 2009 compared to \$6.9 million in the quarter ended August 3, 2008. The decrease in sales and marketing expenses in spite of an increase in sales of 11.2% was primarily due to cost savings derived from modifications to our sales commission plan structure which reduced commissions expense. Included in sales and marketing expenses were stock-based compensation charges of \$578,000 in the quarter ended August 2, 2009 and \$327,000 in the quarter ended August 3, 2008. Sales and marketing expenses as a percent of revenues decreased to 5.3% in the quarter ended August 2, 2009 compared to 5.9% in the quarter ended August 3, 2008.

*General and Administrative Expenses.* General and administrative expenses of continuing operations increased \$1.2 million, or 13.6%, to \$9.7 million in the quarter ended August 2, 2009 compared to \$8.5 million in the quarter ended August 3, 2008. The increase was primarily due to personnel related costs due to the Optium merger. Included in general and administrative expenses were stock-based compensation charges of \$1.0 million in the quarter ended August 2, 2009 and \$515,000 in the quarter ended August 3, 2008. General and administrative expenses as a percent of revenues increased slightly to 7.5% of revenues in the quarter August 2, 2009 compared to 7.4% in the quarter ended August 3, 2008.

*Amortization of Purchased Intangibles.* Amortization of purchased intangibles increased \$572,000, or 443.4%, to \$701,000 in the quarter ended August 2, 2009 compared to \$129,000 in the quarter ended August 3, 2008. The increase was primarily due to the Optium merger.

*Interest Income.* Interest income decreased \$958,000, or 99.0%, to \$10,000 in the quarter ended August 2, 2009 compared to \$968,000 in the quarter ended August 3, 2008. The decrease was primarily due to a decrease in our cash balances related to the purchase and repayment of \$100.3 million of our convertible subordinated notes in the second half of fiscal 2009.

*Interest Expense.* Interest expense decreased \$2.8 million, or 53.6%, to \$2.4 million in the quarter ended August 2, 2009 compared to \$5.2 million in the quarter ended August 3, 2008. The decrease was primarily related to the purchase and repayment of \$100.3 million of our convertible subordinated notes in the second half of fiscal 2009. Interest expense for the quarter ended August 2, 2009 included \$927,000 related to our convertible subordinated notes due in 2010, \$262,000 related to other various debt instruments and a non-cash charge of \$1.2 million due to the adoption of FSP APB 14-1 which requires us to separately account for the liability (debt) and equity (conversion option) components of our 2.5% senior subordinated convertible notes that may be settled in cash (or other assets) on conversion in a manner that reflects our non-convertible debt borrowing rate. The separation of conversion option creates an original issue discount in the bond component which is to be accreted as interest expense over the term of the instrument using the interest method, resulting in an increase in interest expense. Interest expense for the quarter ended August 3, 2008 included \$2.2 million related to our convertible subordinated notes due in 2008 and 2010, \$626,000 related to other various debt instruments, a non-cash charge of \$1.2 million related to the adoption of FSP APB 14-1 and a non-cash charge of \$1.1 million to amortize the beneficial conversion feature of the notes due in

2008.

*Other Income (Expense), Net.* Other income was \$253,000 in the quarter ended August 2, 2009 compared to \$103,000 in the quarter ended August 3, 2008. Other expense in both periods primarily consisted of subordinated loan costs offset by gains on the sale of certain equity investments.

*Provision for Income Taxes.* We recorded income tax provisions of \$159,000 and \$746,000, respectively, for the quarters ended August 2, 2009 and August 3, 2008. The income tax provision for the quarter ended August 2, 2009 primarily represents current minimum foreign income taxes arising in certain jurisdictions in which we conduct business. The income tax provision for the quarter ended August 3, 2008 included a non-cash charge of \$551,000 for deferred tax liabilities that were recorded for tax amortization of goodwill for which no financial statement amortization has occurred under U.S. GAAP and current tax expense of \$195,000 for minimum federal and state and foreign taxes arising in certain jurisdictions in which we conduct business. Due to the uncertainty regarding the timing and extent of our future profitability, we have recorded a valuation allowance to offset our deferred tax assets which represent future income tax benefits associated with our operating losses. There can be no assurance that our deferred tax assets subject to the valuation allowance will ever be realized.

**Table of Contents**

*Income from Discontinued Operation, Net of Taxes.* As discussed above, on July 15, 2009, we completed the sale of certain assets related to our Network Tools Division to JDSU for \$40.6 million in cash. In accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the results of operations of our Network Tools Division business unit through July 15, 2009, have been classified and reported as discontinued operations. Income from discontinued operations for the quarter ended August 2, 2009 was \$37.1 million, including a gain on the sale of the business unit of \$36.1 million compared to a loss of \$125,000 in the quarter ended August 3, 2008. The loss in the quarter ended August 3, 2008 was primarily attributable to a charge of \$919,000 related to the sale of a product line.

**Liquidity and Capital Resources*****Cash Flows From Operating Activities***

Net cash used by operating activities was \$16.5 million in the quarter ended August 2, 2009, compared to net cash provided by operating activities of \$3.3 million in the quarter ended August 3, 2008. Cash used by operating activities in the quarter ended August 2, 2009 was due to our net loss as adjusted to exclude depreciation, amortization and other non-cash related items in the income statement totaling to \$15.7 million and changes in working capital requirements which were primarily related to a increase in accounts receivable and a decrease in other accrued liabilities. Accounts receivable increased by \$17.6 million primarily due to no sales of accounts receivable under our non-recourse accounts receivable purchase agreement with Silicon Valley Bank during the first quarter of fiscal 2010 compared to \$5.2 million sold in the first quarter of fiscal 2009. Other accrued liabilities decreased by \$5.7 million mainly due to repayment of \$5.7 million to Silicon Valley Bank which was borrowed against the line of credit available under the non-recourse accounts receivable purchase agreement. Net cash provided by operating activities in the quarter ended August 3, 2008 was due to our net income as adjusted to exclude depreciation, amortization and other non-cash related items in the income statement totaling \$14.5 million and changes in working capital requirements which were primarily related to increases in accounts receivable, inventories and accounts payable.

***Cash Flows From Investing Activities***

Net cash provided by investing activities totaled \$38.8 million in the quarter ended August 2, 2009 compared to \$3.2 million in the quarter ended August 3, 2008. Net cash provided by investing activities in the quarter ended August 2, 2009 was primarily due to the \$40.7 cash received from sale the assets of our Network Tools Division to JDSU on July 15, 2009. We also received \$1.2 million cash from the sale of a product line made in the first quarter of fiscal 2009 which was recorded as a gain from sales of a product line in the first quarter of fiscal 2010. This gain was partially offset by \$3.2 million of expenditures for capital equipment. Net cash provided by investing activities in the quarter ended August 3, 2008 was primarily related to the net maturities of available-for-sale investments offset by purchases of equipment to support production expansion.

***Cash Flows From Financing Activities***

Net cash provided by financing activities totaled to \$875,000 in the quarter ended August 2, 2009 compared to \$10.6 million in the quarter ended August 3, 2008. Cash provided by financing activities for the quarter ended August 2, 2009 primarily reflected proceeds from the exercise of stock options and purchases under our stock purchase plan totaling \$2.4 million, partially offset by repayments of borrowings totaling \$1.5 million. Cash provided by financing activities for the quarter ended August 3, 2008 primarily reflected proceeds of \$20 million from bank borrowings and proceeds from the exercise of stock options and purchases under our stock purchase plan totaling \$3.1 million, partially offset by repayments of borrowings of \$12.5 million.

***Cash Requirements***

Our anticipated cash requirements for the next 12 months are primarily to fund:

Operations

Research and development

Debt repayments

Restructuring payments

Capital expenditures

At August 2, 2009, we had contractual obligations of \$218 million as shown in the following table (in thousands):

38

---

**Table of Contents**

Contractual Obligations	Total	Payments Due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Short-term debt	\$ 6,173	\$ 6,173	\$	\$	\$
Long-term debt	13,737		8,987	4,750	
Convertible debt	142,000		142,000		
Interest on debt	6,617	4,623	1,772	222	
Operating leases	48,370	7,851	11,073	8,066	21,380
Purchase obligations	657	657			
Total contractual obligations	\$ 217,554	\$ 19,304	\$ 163,832	\$ 13,038	\$ 21,380

At August 2, 2009, total long-term debt and convertible debt was \$161.9 million, compared to \$163.4 million at April 30, 2009.

Long-term debt consists of a note payable to a financial institution under which we borrowed \$9.9 million in December 2005. At August 2, 2009, the remaining principal balance outstanding under this note was \$3.2 million. This note is payable in 60 equal monthly installments beginning in January 2006 and is secured by certain property and equipment. Long-term debt also includes borrowings made by our Malaysian subsidiary under two separate loan agreements entered by them with a Malaysian bank in July 2008. The first loan is payable in 20 equal quarterly installments of \$750,000 beginning in January 2009 and the second loan is payable in 20 equal quarterly installments of \$250,000 beginning in October 2008. Both loans are secured by certain property of our Malaysian subsidiary, guaranteed by us and subject to certain covenants. We were in compliance with all covenants associated with these loans as of August 2, 2009. At August 2, 2009, the principal balance outstanding under these loans was \$16.7 million.

Convertible debt consists of a series of convertible subordinated notes in the aggregate principal amount of \$50.0 million due October 15, 2010 and a series of convertible senior subordinated notes in the aggregate principal amount of \$92.0 million due October 15, 2010. The notes are convertible by the holders at any time prior to maturity into shares of Finisar common stock at specified conversion prices. The notes are redeemable by us, in whole or in part. Aggregate annual interest payments on both series of notes are approximately \$3.6 million. On August 11, 2009, we exchanged \$47,504,000 aggregate principal amount of the notes under exchange offers which commenced on July 9, 2009. We settled \$33,100,000, or 66.2%, of the \$50,000,000 aggregate outstanding principal amount of 2<sup>1</sup>/<sub>2</sub>% Convertible Subordinated Notes due 2010; and \$14,404,000, or approximately 15.7%, of the \$92,000,000 aggregate outstanding principal amount of 2<sup>1</sup>/<sub>2</sub>% Convertible Senior Subordinated Notes due 2010. On September 8, 2009, we repurchased \$15.2 million principal amount of our Senior Subordinated Notes in a privately negotiated transaction. For each \$1,000 principal amount of the Notes, we paid \$952 in cash, for a total purchase price of \$14.5 million plus accrued interest of \$154,000. After the repurchase and the settlement of the Exchange Offers discussed above, approximately \$79.3 million aggregate principal amount of notes remained outstanding.

Interest on debt consists of the scheduled interest payments on our short-term, long-term, and convertible debt.

Operating lease obligations consist primarily of base rents for facilities we occupy at various locations.

Purchase obligations consist of standby repurchase obligations and are related to materials purchased and held by subcontractors on our behalf to fulfill the subcontractors' purchase order obligations at their facilities. Our repurchase obligations of \$657,000 have been expensed and recorded on the balance sheet as non-cancelable purchase obligations as of August 2, 2009.

***Sources of liquidity***

At August 2, 2009, our principal sources of liquidity consisted of \$60.4 million of cash, cash equivalents and available-for-sale investments and an aggregate of \$45 million available under various credit facilities with Silicon

Valley Bank subject to certain restrictions and limitations.

*Available Credit Facilities*

On March 14, 2008, we entered into a revolving line of credit agreement with Silicon Valley Bank. Under the terms of the agreement, the bank provided a \$50 million revolving line of credit that was available to us through March 13, 2009. On October 28, 2008, this agreement was amended to decrease the amount available under the revolving line to \$45 million, subject to certain restrictions and limitations and to extend the term of the credit facility through July 15, 2010. On July 15, 2009, this agreement was amended further to decrease the amount available under the revolving line to \$25 million. Borrowings under this line are collateralized by substantially all of our assets except our intellectual property rights and bear interest, at our option, at either the bank's prime rate plus 0.5% or LIBOR plus 3.0%. The facility is subject to financial covenants including an adjusted quick ratio covenant and an EBITDA covenant which are tested as of the last day of each month.. There were no outstanding borrowings under this revolving line of credit at August 2, 2009.

## **Table of Contents**

On April 29, 2005, we entered into a letter of credit reimbursement agreement with Silicon Valley Bank. There have been several amendments to this agreement, the latest being on April 30, 2009. Under the terms of the latest amended agreement, Silicon Valley Bank will provide to the Company, through October 24, 2009 a \$4.0 million letter of credit facility covering existing letters of credit issued by Silicon Valley Bank and any other letters of credit that we may require. Outstanding letters of credit secured under this agreement at August 2, 2009 totaled \$3.4 million.

On October 24, 2004, we entered into a non-recourse accounts receivable purchase agreement with Silicon Valley Bank. There have been several amendments to this agreement, the latest being on October 28, 2008. Under the terms of the amended agreement, we may sell to Silicon Valley Bank, through October 24, 2009 up to \$16 million of qualifying receivables whereby all right, title and interest in the Company's invoices are purchased by Silicon Valley Bank. During the three months ended August 2, 2009 and August 3, 2008, the Company sold receivables totaling \$0 million, and \$5.2 million, respectively, under this facility.

We believe that our existing balances of cash, cash equivalents and short-term investments, together with the cash expected to be generated from our future operations, will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may however require additional financing to fund our operations in the future and we will require additional financing to repay all of our remaining convertible subordinated notes which mature in October 2010. A significant contraction in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, our business, financial condition and results of operations will be adversely affected.

### **Off-Balance-Sheet Arrangements**

At August 2, 2009 and April 30, 2009, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

**Table of Contents****Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. We place our investments with high credit issuers in short-term securities with maturities ranging from overnight up to 36 months or have characteristics of such short-term investments. The average maturity of the portfolio will not exceed 18 months. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity. We have no investments denominated in foreign country currencies and therefore our investments are not subject to foreign exchange risk.

We invest in equity instruments of privately held companies for business and strategic purposes. These investments are included in other long-term assets and are accounted for under the cost method when our ownership interest is less than 20% and we do not have the ability to exercise significant influence. For entities in which we hold greater than a 20% ownership interest, or where we have the ability to exercise significant influence, we use the equity method. For these non-quoted investments, our policy is to regularly review the assumptions underlying the operating performance and cash flow forecasts in assessing the carrying values. We identify and record impairment losses when events and circumstances indicate that such assets are impaired. If our investment in a privately-held company becomes marketable equity securities upon the company's completion of an initial public offering or its acquisition by another company, our investment would be subject to significant fluctuations in fair market value due to the volatility of the stock market.

There has been no material change in our interest rate exposure since April 30, 2009.

**Item 4. *Controls and Procedures*****Evaluation of Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

**Changes in Internal Control Over Financial Reporting**

Cycle counting of parts in inventory is an important financial control process that is conducted at all of our primary manufacturing facilities throughout the fiscal year. During the quarter ended February 1, 2009, the cycle counting process at our Ipoh, Malaysia manufacturing facility was discontinued as a result of discrepancies noted between the actual physical location of a number of parts compared to their location as indicated by our management information systems. Because of the failure of this control, we augmented our inventory procedures shortly after the end of the quarter to include physical inventory counts covering a substantial portion of the inventory held at this site in order to verify quantities on hand at each period end. We evaluated the cause of discrepancies in the cycle counting process at the Ipoh facility, made appropriate operational and system changes and restarted the cycle count process for finished goods during the quarter ended April 30, 2009. Additional improvements to our inventory systems and controls at our Ipoh facility were made during the quarter ended August 2, 2009. We will continue to augment the process with additional physical inventory counts as warranted until the cycle count process is fully operational once again. Other than these changes in inventory procedures, there were no changes in our internal control over financial reporting during the quarter ended August 2, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****Item 1. *Legal Proceedings***

Reference is made to Part I, Item I, Financial Statements Note 22. Pending Litigation for a description of pending legal proceedings, including material developments in certain of those proceedings during the quarter ended August 2, 2009.

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

OUR FUTURE PERFORMANCE IS SUBJECT TO A VARIETY OF RISKS, INCLUDING THOSE DESCRIBED BELOW. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCUR, OUR BUSINESS COULD



BE HARMED AND THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE. YOU SHOULD ALSO REFER TO THE OTHER INFORMATION CONTAINED IN THIS REPORT, INCLUDING OUR CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES. THE RISK FACTORS DESCRIBED BELOW DO NOT CONTAIN ANY MATERIAL CHANGES FROM THOSE PREVIOUSLY DISCLOSED IN ITEM 1A OF OUR ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED APRIL 30, 2009.

**Table of Contents**

***We may have insufficient cash flow to meet our debt service obligations, including payments due on our subordinated convertible notes.***

We will be required to generate cash sufficient to conduct our business operations and pay our indebtedness and other liabilities, including all amounts due on our outstanding 21/2% convertible senior subordinated notes due October 15, 2010 totaling \$77.6 million as of August 2, 2009 and our 21/2% convertible subordinated notes due October 15, 2010 totaling \$16.9 million

Our existing balances of cash, cash equivalents and short-term investments are not sufficient to repay these notes, and we may not be able to cover our future debt service obligations from our operating cash flow. We have recently implemented a series of cost control measures, but these measures alone will not be sufficient to generate the cash necessary to repay our outstanding notes. Our ability to meet our future debt service obligations will depend upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. Accordingly, we cannot assure you that we will be able to make required principal and interest payments on the notes due in 2010.

***We may not be able to obtain additional capital in the future, and failure to do so may harm our business.***

We believe that our existing balances of cash, cash equivalents and short-term investments together with the cash expected to be generated from future operations and borrowings under our bank credit facility will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may, however, require additional financing to fund our operations in the future or to repay the principal of our outstanding convertible subordinated notes which mature in October 2010. Due to the unpredictable nature of the capital markets, particularly in the technology sector, we cannot assure you that we will be able to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, we could be required to significantly reduce or restructure our business operations. If we do raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders.

***We expect that our revenues and profitability will be adversely affected following our recently completed sale of our network performance test systems business.***

On July 15, 2009, we completed the sale of substantially all of the assets of our Network Tools Division (excluding accounts receivable and payable) to JDSU for \$40.6 million in cash. As a result of this transaction, we no longer offer network performance test products. These products accounted for \$37.3 million, \$38.6 million and \$44.2 million in revenues during fiscal 2007, 2008 and 2009, respectively. Gross profit and operating profit margins on sales of network performance test products have generally been higher than on our optical subsystem and component products. Accordingly, we expect that our revenues and profitability will be adversely affected following the sale unless and until we are able to achieve significant growth in our optical subsystems and components business.

***Our quarterly revenues and operating results fluctuate due to a variety of factors, which may result in volatility or a decline in the price of our stock.***

Our quarterly operating results have varied significantly due to a number of factors, including:

- fluctuation in demand for our products;

- the timing of new product introductions or enhancements by us and our competitors;

- the level of market acceptance of new and enhanced versions of our products;

- the timing or cancellation of large customer orders;

- the length and variability of the sales cycle for our products;

- pricing policy changes by us and our competitors and suppliers;

the availability of development funding and the timing of development revenue;

changes in the mix of products sold;

increased competition in product lines, and competitive pricing pressures; and

the evolving and unpredictable nature of the markets for products incorporating our optical components and subsystems.

## **Table of Contents**

We expect that our operating results will continue to fluctuate in the future as a result of these factors and a variety of other factors, including:

fluctuations in manufacturing yields;

the emergence of new industry standards;

failure to anticipate changing customer product requirements;

the loss or gain of important customers;

product obsolescence; and

the amount of research and development expenses associated with new product introductions.

Our operating results could also be harmed by:

the continuation or worsening of the current global economic slowdown or economic conditions in various geographic areas where we or our customers do business;

acts of terrorism and international conflicts or crises;

other conditions affecting the timing of customer orders; or

a downturn in the markets for our customers' products, particularly the data storage and networking and telecommunications components markets.

We may experience a delay in generating or recognizing revenues for a number of reasons. Orders at the beginning of each quarter typically represent a small percentage of expected revenues for that quarter and are generally cancelable with minimal notice. Accordingly, we depend on obtaining orders during each quarter for shipment in that quarter to achieve our revenue objectives. Failure to ship these products by the end of a quarter may adversely affect our operating results. Furthermore, our customer agreements typically provide that the customer may delay scheduled delivery dates and cancel orders within specified timeframes without significant penalty. Because we base our operating expenses on anticipated revenue trends and a high percentage of our expenses are fixed in the short term, any delay in generating or recognizing forecasted revenues could significantly harm our business. It is likely that in some future quarters our operating results will again decrease from the previous quarter or fall below the expectations of securities analysts and investors. In this event, it is likely that the trading price of our common stock would significantly decline.

As a result of these factors, our operating results may vary significantly from quarter to quarter. Accordingly, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indications of future performance. Any shortfall in revenues or net income from levels expected by the investment community could cause a decline in the trading price of our stock.

***We may lose sales if our suppliers or independent contractors fail to meet our needs or go out of business.***

We currently purchase a number of key components used in the manufacture of our products from single or limited sources, and we rely on several independent contract manufacturers to supply us with certain key subassemblies, including lasers, modulators, and printed circuit boards. We depend on these sources to meet our production needs. Moreover, we depend on the quality of the components and subassemblies that they supply to us, over which we have limited control. Several of our suppliers are or may become financially unstable as the result of current global market conditions. In addition, we have encountered shortages and delays in obtaining components in the past and expect to encounter additional shortages and delays in the future. Recently, many of our suppliers have extended lead times for many of their products as the result of significantly reducing capacity in light of the global slowdown in demand. This reduction in capacity has reduced the ability of many suppliers to respond to increases in demand. If we cannot supply products due to a lack of components, or are unable to redesign products with other components in a timely manner, our business will be significantly harmed. We generally have no long-term contracts with any of our component

suppliers or contract manufacturers. As a result, a supplier or contract manufacturer can discontinue supplying components or subassemblies to us without penalty. If a supplier were to discontinue supplying a key component or cease operations, our business may be harmed by the resulting product manufacturing and delivery delays. We are also subject to potential delays in the development by our suppliers of key components which may affect our ability to introduce new products. Similarly, disruptions in the services provided by our contract manufacturers or the transition to other suppliers of these services could lead to supply chain problems or delays in the delivery of our products. These problems or delays could damage our relationships with our customers and adversely affect our business.

**Table of Contents**

We use rolling forecasts based on anticipated product orders to determine our component and subassembly requirements. Lead times for materials and components that we order vary significantly and depend on factors such as specific supplier requirements, contract terms and current market demand for particular components. If we overestimate our component requirements, we may have excess inventory, which would increase our costs. If we underestimate our component requirements, we may have inadequate inventory, which could interrupt our manufacturing and delay delivery of our products to our customers. Any of these occurrences could significantly harm our business.

***If we are unable to realize anticipated cost savings from the transfer of certain manufacturing operations to our overseas locations and increased use of internally-manufactured components our results of operations could be harmed.***

As part of our cost of goods sold cost reduction initiatives planned for the next several quarters, we expect to realize significant cost savings through (i) the transfer of certain product manufacturing operations to lower cost off-shore locations and (ii) product engineering changes to enable the broader use of internally-manufactured components. The transfer of production to overseas locations may be more difficult and costly than we currently anticipate, which could result in increased transfer costs and time delays. Further, following transfer, we may experience lower manufacturing yields than those historically achieved in our U.S. manufacturing locations. In addition, the engineering changes required for the use of internally-manufactured components may be more technically-challenging than we anticipate and customer acceptance of such changes could be delayed. If we fail to achieve the planned product manufacturing transfer and increase in internally-manufactured component use within our currently anticipated time frame, or if our manufacturing yields decrease as a result, our actual cost savings will be less than anticipated and our results of operations could be harmed.

***Failure to accurately forecast our revenues could result in additional charges for obsolete or excess inventories or non-cancellable purchase commitments.***

We base many of our operating decisions, and enter into purchase commitments, on the basis of anticipated revenue trends which are highly unpredictable. Some of our purchase commitments are not cancelable, and in some cases we are required to recognize a charge representing the amount of material or capital equipment purchased or ordered which exceeds our actual requirements. In the past, we have sometimes experienced significant growth followed by a significant decrease in customer demand such as occurred in fiscal 2001, when revenues increased by 181% followed by a decrease of 22% in fiscal 2002. Based on projected revenue trends during these periods, we acquired inventories and entered into purchase commitments in order to meet anticipated increases in demand for our products which did not materialize. As a result, we recorded significant charges for obsolete and excess inventories and non-cancelable purchase commitments which contributed to substantial operating losses in fiscal 2002. Should revenues in future periods again fall substantially below our expectations, or should we fail again to accurately forecast changes in demand mix, we could be required to record additional charges for obsolete or excess inventories or non-cancelable purchase commitments.

***If we encounter sustained yield problems or other delays in the production or delivery of our internally-manufactured components or in the final assembly and test of our transceiver products, we may lose sales and damage our customer relationships.***

Our manufacturing operations are highly vertically integrated. In order to reduce our manufacturing costs, we have acquired a number of companies, and business units of other companies, that manufacture optical components incorporated in our optical subsystem products and have developed our own facilities for the final assembly and testing of our products. For example, we design and manufacture many critical components including all of the short wavelength VCSEL lasers incorporated in transceivers used for LAN/SAN applications at our wafer fabrication facility in Allen, Texas and manufacture a portion of our internal requirements for longer wavelength lasers at our wafer fabrication facility in Fremont, California. We assemble and test most of our transceiver products at our facility in Ipoh, Malaysia. As a result of this vertical integration, we have become increasingly dependent on our internal production capabilities. The manufacture of critical components, including the fabrication of wafers, and the assembly and testing of our products, involve highly complex processes. For example, minute levels of contaminants in the manufacturing environment, difficulties in the fabrication process or other factors can cause a substantial portion of

the components on a wafer to be nonfunctional. These problems may be difficult to detect at an early stage of the manufacturing process and often are time-consuming and expensive to correct. From time to time, we have experienced problems achieving acceptable yields at our wafer fabrication facilities, resulting in delays in the availability of components. Moreover, an increase in the rejection rate of products during the quality control process before, during or after manufacture, results in lower yields and margins. In addition, changes in manufacturing processes required as a result of changes in product specifications, changing customer needs and the introduction of new product lines have historically significantly reduced our manufacturing yields, resulting in low or negative margins on those products. Poor manufacturing yields over a prolonged period of time could adversely affect our ability to deliver our subsystem products to our customers and could also affect our sale of components to customers in the merchant market. Our inability to supply components to meet our internal needs could harm our relationships with customers and have an adverse effect on our business.

***We are dependent on widespread market acceptance of our optical subsystems and components, and our revenues will decline if the markets for these products do not expand as expected.***

**Table of Contents**

We derive all of our revenue from sales of our optical subsystems and components. Accordingly, widespread acceptance of these products is critical to our future success. If the market does not continue to accept our optical subsystems and components, our revenues will decline significantly. Our future success ultimately depends on the continued growth of the communications industry and, in particular, the continued expansion of global information networks, particularly those directly or indirectly dependent upon a fiber optics infrastructure. As part of that growth, we are relying on increasing demand for voice, video and other data delivered over high-bandwidth network systems as well as commitments by network systems vendors to invest in the expansion of the global information network. As network usage and bandwidth demand increase, so does the need for advanced optical networks to provide the required bandwidth. Without network and bandwidth growth, the need for optical subsystems and components, and hence our future growth as a manufacturer of these products, and systems that test these products, will be jeopardized, and our business would be significantly harmed.

Many of these factors are beyond our control. In addition, in order to achieve widespread market acceptance, we must differentiate ourselves from our competition through product offerings and brand name recognition. We cannot assure you that we will be successful in making this differentiation or achieving widespread acceptance of our products. Failure of our existing or future products to maintain and achieve widespread levels of market acceptance will significantly impair our revenue growth.

***We depend on large purchases from a few significant customers, and any loss, cancellation, reduction or delay in purchases by these customers could harm our business.***

A small number of customers have consistently accounted for a significant portion of our revenues. For example, sales to our top five customers represented 42% of our revenues in first quarter of fiscal 2010 and 46% of its revenues in fiscal 2009. Our success will depend on our continued ability to develop and manage relationships with our major customers. Although we are attempting to expand our customer base, we expect that significant customer concentration will continue for the foreseeable future. We may not be able to offset any decline in revenues from our existing major customers with revenues from new customers, and our quarterly results may be volatile because we are dependent on large orders from these customers that may be reduced or delayed.

The markets in which we have historically sold our optical subsystems and components products are dominated by a relatively small number of systems manufacturers, thereby limiting the number of our potential customers. Recent consolidation of portions of our customer base, including telecommunications systems manufacturers and potential future consolidation, may have a material adverse impact on our business. Our dependence on large orders from a relatively small number of customers makes our relationship with each customer critically important to our business. We cannot assure you that we will be able to retain our largest customers, that we will be able to attract additional customers or that our customers will be successful in selling their products that incorporate our products. We have in the past experienced delays and reductions in orders from some of our major customers. In addition, our customers have in the past sought price concessions from us, and we expect that they will continue to do so in the future. Cost reduction measures that we have implemented over the past several years, and additional action we may take to reduce costs, may adversely affect our ability to introduce new and improved products which may, in turn, adversely affect our relationships with some of our key customers. Further, some of our customers may in the future shift their purchases of products from us to our competitors or to joint ventures between these customers and our competitors. The loss of one or more of our largest customers, any reduction or delay in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may make could significantly harm our business.

***Because we do not have long-term contracts with our customers, our customers may cease purchasing our products at any time if we fail to meet our customers' needs.***

Typically, we do not have long-term contracts with our customers. As a result, our agreements with our customers do not provide any assurance of future sales. Accordingly:

our customers can stop purchasing our products at any time without penalty;

our customers are free to purchase products from our competitors; and



our customers are not required to make minimum purchases.

Sales are typically made pursuant to inventory hub arrangements under which customers may draw down inventory to satisfy their demand as needed or pursuant to individual purchase orders, often with extremely short lead times. If we are unable to fulfill these orders in a timely manner, it is likely that we will lose sales and customers. If our major customers stop purchasing our products for any reason, our business and results of operations would be harmed.

***The markets for our products are subject to rapid technological change, and to compete effectively we must continually introduce new products that achieve market acceptance.***

The markets for our products are characterized by rapid technological change, frequent new product introductions, substantial capital investment, changes in customer requirements and evolving industry standards with respect to the protocols used in data communications, telecommunications and cable TV networks. Our future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address these changes as well as current and potential

## Table of Contents

customer requirements. For example, the market for optical subsystems is currently characterized by a trend toward the adoption of pluggable modules and subsystems that do not require customized interconnections and by the development of more complex and integrated optical subsystems. We expect that new technologies will emerge as competition and the need for higher and more cost-effective bandwidth increases. The introduction of new and enhanced products may cause our customers to defer or cancel orders for existing products. In addition, a slowdown in demand for existing products ahead of a new product introduction could result in a write-down in the value of inventory on hand related to existing products. We have in the past experienced a slowdown in demand for existing products and delays in new product development and such delays may occur in the future. To the extent customers defer or cancel orders for existing products due to a slowdown in demand or in the expectation of a new product release or if there is any delay in development or introduction of our new products or enhancements of our products, our operating results would suffer. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, or to license these technologies from third parties. Product development delays may result from numerous factors, including:

changing product specifications and customer requirements;

unanticipated engineering complexities;

expense reduction measures we have implemented, and others we may implement, to conserve our cash and attempt to achieve and sustain profitability;

difficulties in hiring and retaining necessary technical personnel;

difficulties in reallocating engineering resources and overcoming resource limitations; and

changing market or competitive product requirements.

The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation and highly skilled engineering and development personnel, as well as the accurate anticipation of technological and market trends. The introduction of new products also requires significant investment to ramp up production capacity, for which benefit will not be realized if customer demand does not develop as expected. Ramping of production capacity also entails risks of delays which can limit our ability to realize the full benefit of the new product introduction. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product announcements by competitors, technological changes or emerging industry standards. Any failure to respond to technological change would significantly harm our business.

***Continued competition in our markets may lead to an accelerated reduction in our prices, revenues and market share.***

The end markets for optical products have experienced significant industry consolidation during the past few years while the industry that supplies these customers has not. As a result, the markets for optical subsystems and components are highly competitive. Our current competitors include a number of domestic and international companies, many of which have substantially greater financial, technical, marketing and distribution resources and brand name recognition than we have. We may not be able to compete successfully against either current or future competitors. Companies competing with us may introduce products that are competitively priced, have increased performance or functionality, or incorporate technological advances and may be able to react quicker to changing customer requirements and expectations. There is also the risk that network systems vendors may re-enter the subsystem market and begin to manufacture the optical subsystems incorporated in their network systems. Increased competition could result in significant price erosion, reduced revenue, lower margins or loss of market share, any of which would significantly harm our business. For optical subsystems, we compete primarily with Avago Technologies, Capella Intelligent Subsystems, CoAdna Photonics, Emcore, Fujitsu Computer Systems, JDS Uniphase,

Opnext, Oplink, StrataLight Communications, Sumitomo, and a number of smaller vendors. BKtel, Emcore, Olson Technology and Yagi Antenna are our main competitors with respect to our cable TV products. Our competitors continue to introduce improved products and we will have to do the same to remain competitive.

***Decreases in average selling prices of our products may reduce our gross margins.***

The market for optical subsystems is characterized by declining average selling prices resulting from factors such as increased competition, overcapacity, the introduction of new products and increased unit volumes as manufacturers continue to deploy network and storage systems. We have in the past experienced, and in the future may experience, substantial period-to-period fluctuations in operating results due to declining average selling prices. We anticipate that average selling prices will decrease in the future in response to product introductions by competitors or us, or by other factors, including pricing pressures from significant customers. Therefore, in order to achieve and sustain profitable operations, we must continue to develop and introduce on a timely basis new products that incorporate features that can be sold at higher average selling prices. Failure to do so could cause our revenues and gross margins to decline, which would result in additional operating losses and significantly harm our business.

## **Table of Contents**

We may be unable to reduce the cost of our products sufficiently to enable us to compete with others. Our cost reduction efforts may not allow us to keep pace with competitive pricing pressures and could adversely affect our margins. In order to remain competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes. We may not be successful in redesigning our products or delivering our products to market in a timely manner. We cannot assure you that any redesign will result in sufficient cost reductions to allow us to reduce the price of our products to remain competitive or improve our gross margins.

### ***Shifts in our product mix may result in declines in gross margins.***

Our optical products sold for longer distance MAN and telecom applications typically have higher gross margins than our products for shorter distance LAN or SAN applications. Gross margins on individual products fluctuate over the product's life cycle. Our overall gross margins have fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices for older products and our ability to reduce product costs, and these fluctuations are expected to continue in the future.

### ***Our customers often evaluate our products for long and variable periods, which causes the timing of our revenues and results of operations to be unpredictable.***

The period of time between our initial contact with a customer and the receipt of an actual purchase order may span a year or more. During this time, customers may perform, or require us to perform, extensive and lengthy evaluation and testing of our products before purchasing and using the products in their equipment. These products often take substantial time to develop because of their complexity and because customer specifications sometimes change during the development cycle. Our customers do not typically share information on the duration or magnitude of these qualification procedures. The length of these qualification processes also may vary substantially by product and customer, and, thus, cause our results of operations to be unpredictable. While our potential customers are qualifying our products and before they place an order with us, we may incur substantial research and development and sales and marketing expenses and expend significant management effort. Even after incurring such costs we ultimately may not sell any products to such potential customers. In addition, these qualification processes often make it difficult to obtain new customers, as customers are reluctant to expend the resources necessary to qualify a new supplier if they have one or more existing qualified sources. Once our products have been qualified, the agreements that we enter into with our customers typically contain no minimum purchase commitments. Failure of our customers to incorporate our products into their systems would significantly harm our business.

### ***We will lose sales if we are unable to obtain government authorization to export certain of our products, and we would be subject to legal and regulatory consequences if we do not comply with applicable export control laws and regulations.***

Exports of certain of our products are subject to export controls imposed by the U.S. Government and administered by the United States Departments of State and Commerce. In certain instances, these regulations may require pre-shipment authorization from the administering department. For products subject to the Export Administration Regulations, or EAR, administered by the Department of Commerce's Bureau of Industry and Security, the requirement for a license is dependent on the type and end use of the product, the final destination, the identity of the end user and whether a license exception might apply. Virtually all exports of products subject to the International Traffic in Arms Regulations, or ITAR, administered by the Department of State's Directorate of Defense Trade Controls, require a license. Certain of our fiber optics products are subject to EAR and certain of our RF over fiber products, as well as certain products developed with government funding, are currently subject to ITAR. Products developed and manufactured in our foreign locations are subject to export controls of the applicable foreign nation.

Given the current global political climate, obtaining export licenses can be difficult and time-consuming. Failure to obtain export licenses for these shipments could significantly reduce our revenue and materially adversely affect our business, financial condition and results of operations. Compliance with U.S. Government regulations may also subject us to additional fees and costs. The absence of comparable restrictions on competitors in other countries may adversely affect our competitive position.

During mid-2007, Optium became aware that certain of its analog RF over fiber products may, depending on end use and customization, be subject to ITAR. Accordingly, Optium filed a detailed voluntary disclosure with the United States Department of State describing the details of possible inadvertent ITAR violations with respect to the export of

a limited number of certain prototype products, as well as related technical data and defense services. Optium may have also made unauthorized transfers of ITAR-restricted technical data and defense services to foreign persons in the workplace. Additional information has been provided upon request to the Department of State with respect to this matter. In late 2008, a grand jury subpoena from the office of the U.S. Attorney for the Eastern District of Pennsylvania was received requesting documents from 2005 through the present referring to, relating to or involving the subject matter of the above referenced voluntary disclosure and export activities.

While the Department of State encourages voluntary disclosures and generally affords parties mitigating credit under such circumstances, we nevertheless could be subject to continued investigation and potential regulatory consequences ranging from a no-action letter, government oversight of facilities and export transactions, monetary penalties, and in extreme cases, debarment from government contracting, denial of export privileges and criminal sanctions, any of which would adversely affect our results of operations and cash flow. The Department of State and U.S. Attorney inquiries may require us to expend significant management time and incur significant legal and other expenses. We cannot predict how long it will take or how much more time and resources we will have to expend to resolve these government inquiries, nor can we predict the outcome of these inquiries.

**Table of Contents**

***We depend on facilities located outside of the United States to manufacture a substantial portion of our products, which subjects us to additional risks.***

In addition to our principal manufacturing facility in Malaysia, we operate smaller facilities in Australia, China, Israel and Singapore. We also rely on several contract manufacturers located in Asia for our supply of key subassemblies. Each of these facilities and manufacturers subjects us to additional risks associated with international manufacturing, including:

unexpected changes in regulatory requirements;

legal uncertainties regarding liability, tariffs and other trade barriers;

inadequate protection of intellectual property in some countries;

greater incidence of shipping delays;

greater difficulty in overseeing manufacturing operations;

greater difficulty in hiring talent needed to oversee manufacturing operations;

potential political and economic instability; and

the outbreak of infectious diseases such as the H1N1 influenza virus and/or severe acute respiratory syndrome, or SARS, which could result in travel restrictions or the closure of our facilities or the facilities of our customers and suppliers.

Any of these factors could significantly impair our ability to source our contract manufacturing requirements internationally.

***Our future operating results may be subject to volatility as a result of exposure to foreign exchange risks.***

We are exposed to foreign exchange risks. Foreign currency fluctuations may affect both our revenues and our costs and expenses and significantly affect our operating results. Prices for our products are currently denominated in U.S. dollars for sales to our customers throughout the world. If there is a significant devaluation of the currency in a specific country relative to the dollar, the prices of our products will increase relative to that country's currency, our products may be less competitive in that country and our revenues may be adversely affected.

Although we price our products in U.S. dollars, portions of both our cost of revenues and operating expenses are incurred in foreign currencies, principally the Malaysian ringgit, the Chinese yuan, the Australian dollar and the Israeli shekel. As a result, we bear the risk that the rate of inflation in one or more countries will exceed the rate of the devaluation of that country's currency in relation to the U.S. dollar, which would increase our costs as expressed in U.S. dollars. To date, we have not engaged in currency hedging transactions to decrease the risk of financial exposure from fluctuations in foreign exchange rates.

***Our business and future operating results are subject to a wide range of uncertainties arising out of the continuing threat of terrorist attacks and ongoing military actions in the Middle East.***

Like other U.S. companies, our business and operating results are subject to uncertainties arising out of the continuing threat of terrorist attacks on the United States and ongoing military actions in the Middle East, including the economic consequences of the war in Iraq or additional terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. In particular, due to these uncertainties we are subject to:

increased risks related to the operations of our manufacturing facilities in Malaysia;

greater risks of disruption in the operations of our China, Singapore and Israeli facilities and our Asian contract manufacturers and more frequent instances of shipping delays; and

the risk that future tightening of immigration controls may adversely affect the residence status of non-U.S. engineers and other key technical employees in our U.S. facilities or our ability to hire new non-U.S. employees in such facilities.

***Past and future acquisitions could be difficult to integrate, disrupt our business, dilute stockholder value and harm our operating results.***

In addition to our recent combination with Optium, we have completed the acquisition of ten privately-held companies and certain businesses and assets from six other companies since October 2000. We continue to review opportunities to acquire other businesses, product lines or technologies that would complement our current products, expand the breadth of our markets or enhance our technical capabilities, or that may otherwise offer growth opportunities, and we from time to time make proposals and offers, and take other steps, to acquire businesses, products and technologies.

## Table of Contents

The Optium merger and several of our other past acquisitions have been material, and acquisitions that we may complete in the future may be material. In 13 of our 17 acquisitions, we issued common stock or notes convertible into common stock as all or a portion of the consideration. The issuance of common stock or other equity securities by us in any future transaction would dilute our stockholders' percentage ownership.

Other risks associated with acquiring the operations of other companies include:

problems assimilating the purchased operations, technologies or products;

unanticipated costs associated with the acquisition;

diversion of management's attention from our core business;

adverse effects on existing business relationships with suppliers and customers;

risks associated with entering markets in which we have no or limited prior experience; and

potential loss of key employees of purchased organizations.

Not all of our past acquisitions have been successful. In the past, we have subsequently sold some of the assets acquired in prior acquisitions, discontinued product lines and closed acquired facilities. As a result of these activities, we incurred significant restructuring charges and charges for the write-down of assets associated with those acquisitions. Through fiscal 2009, we have written off all of the goodwill associated with past acquisitions. We cannot assure you that we will be successful in overcoming problems encountered in connection with more recently completed acquisitions or potential future acquisitions, and our inability to do so could significantly harm our business. In addition, to the extent that the economic benefits associated with any of our completed or future acquisitions diminish in the future, we may be required to record additional write downs of goodwill, intangible assets or other assets associated with such acquisitions, which would adversely affect our operating results.

***We have made and may continue to make strategic investments which may not be successful, may result in the loss of all or part of our invested capital and may adversely affect our operating results.***

Through the first quarter of fiscal 2010, we made minority equity investments in early-stage technology companies, totaling approximately \$56 million. Our investments in these early stage companies were primarily motivated by our desire to gain early access to new technology. We intend to review additional opportunities to make strategic equity investments in pre-public companies where we believe such investments will provide us with opportunities to gain access to important technologies or otherwise enhance important commercial relationships. We have little or no influence over the early-stage companies in which we have made or may make these strategic, minority equity investments. Each of these investments in pre-public companies involves a high degree of risk. We may not be successful in achieving the financial, technological or commercial advantage upon which any given investment is premised, and failure by the early-stage company to achieve its own business objectives or to raise capital needed on acceptable economic terms could result in a loss of all or part of our invested capital. In fiscal 2003, we wrote off \$12.0 million in two investments which became impaired. In fiscal 2004, we wrote off \$1.6 million in two additional investments, and in fiscal 2005, we wrote off \$10.0 million in another investment. During fiscal 2006, we reclassified \$4.2 million of an investment associated with the Infineon acquisition to goodwill as the investment was deemed to have no value. During fiscal 2009, we wrote off \$1.2 million for another investment that became impaired. We may be required to write off all or a portion of the \$14.3 million in such investments remaining on our balance sheet as of August 2, 2009 in future periods.

***Because of competition for technical personnel, we may not be able to recruit or retain necessary personnel.***

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, technical, sales and marketing, finance and manufacturing personnel. In particular, we may need to increase the number of technical staff members with experience in high-speed networking applications as we further develop our product lines. Competition for these highly skilled employees in our industry is intense. In making employment decisions, particularly in the high-technology industries, job candidates often consider the value of the



equity they are to receive in connection with their employment. Therefore, significant volatility in the price of our common stock may adversely affect our ability to attract or retain technical personnel. Furthermore, changes to accounting principles generally accepted in the United States relating to the expensing of stock options may limit our ability to grant the sizes or types of stock awards that job candidates may require to accept employment with us. Our failure to attract and retain these qualified employees could significantly harm our business. The loss of the services of any of our qualified employees, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel could hinder the development and introduction of and negatively impact our ability to sell our products. In addition, employees may leave our company and subsequently compete against us. Moreover, companies in our industry whose employees accept positions with competitors frequently

## **Table of Contents**

claim that their competitors have engaged in unfair hiring practices. We have been subject to claims of this type and may be subject to such claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation. We could incur substantial costs in defending ourselves against these claims, regardless of their merits.

### ***Our failure to protect our intellectual property may significantly harm our business.***

Our success and ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements to establish and protect our proprietary rights. We license certain of our proprietary technology, including our digital diagnostics technology, to customers who include current and potential competitors, and we rely largely on provisions of our licensing agreements to protect our intellectual property rights in this technology. Although a number of patents have been issued to us, we have obtained a number of other patents as a result of our acquisitions, and we have filed applications for additional patents, we cannot assure you that any patents will issue as a result of pending patent applications or that our issued patents will be upheld. Additionally, significant technology used in our product lines is not the subject of any patent protection, and we may be unable to obtain patent protection on such technology in the future. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of a competitive advantage and decreased revenues.

Despite our efforts to protect our proprietary rights, existing patent, copyright, trademark and trade secret laws afford only limited protection. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may not be able to prevent misappropriation of our technology or deter others from developing similar technology. Furthermore, policing the unauthorized use of our products is difficult and expensive. We are currently engaged in pending litigation to enforce certain of our patents, and additional litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. In connection with the pending litigation, substantial management time has been, and will continue to be, expended. In addition, we have incurred, and we expect to continue to incur, substantial legal expenses in connection with these pending lawsuits. These costs and this diversion of resources could significantly harm our business.

### ***Claims that we infringe third-party intellectual property rights could result in significant expenses or restrictions on our ability to sell our products.***

The networking industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We have been involved in the past as a defendant in patent infringement lawsuits, and are currently defending a patent infringement lawsuit filed against Optium by JDS Uniphase Corporation and Emcore Corporation. From time to time, other parties may assert patent, copyright, trademark and other intellectual property rights to technologies and in various jurisdictions that are important to our business. Any claims asserting that our products infringe or may infringe proprietary rights of third parties, if determined adversely to us, could significantly harm our business. Any claims, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could significantly harm our business. In addition, our agreements with our customers typically require us to indemnify our customers from any expense or liability resulting from claimed infringement of third party intellectual property rights. In the event a claim against us was successful and we could not obtain a license to the relevant technology on acceptable terms or license a substitute technology or redesign our products to avoid infringement, our business would be significantly harmed.

Numerous patents in our industry are held by others, including academic institutions and competitors. Optical subsystem suppliers may seek to gain a competitive advantage or other third parties may seek an economic return on their intellectual property portfolios by making infringement claims against us. In the future, we may need to obtain license rights to patents or other intellectual property held by others to the extent necessary for our business. Unless we are able to obtain those licenses on commercially reasonable terms, patents or other intellectual property held by others could inhibit our development of new products. Licenses granting us the right to use third party technology may

not be available on commercially reasonable terms, if at all. Generally, a license, if granted, would include payments of up-front fees, ongoing royalties or both. These payments or other terms could have a significant adverse impact on our operating results.

***Our products may contain defects that may cause us to incur significant costs, divert our attention from product development efforts and result in a loss of customers.***

Our products are complex and defects may be found from time to time. Networking products frequently contain undetected software or hardware defects when first introduced or as new versions are released. In addition, our products are often embedded in or deployed in conjunction with our customers' products which incorporate a variety of components produced by third parties. As a result, when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relation problems or loss of customers, all of which would harm our business.

**Table of Contents*****We are subject to pending shareholder derivative legal proceedings.***

We have been named as a nominal defendant in several purported shareholder derivative lawsuits concerning the granting of stock options. These cases have been consolidated into two proceedings pending in federal and state courts in California. The plaintiffs in all of these cases have alleged that certain current or former officers and directors of Finisar caused it to grant stock options at less than fair market value, contrary to our public statements (including statements in our financial statements), and that, as a result, those officers and directors are liable to Finisar. No specific amount of damages has been alleged and, by the nature of the lawsuits no damages will be alleged, against Finisar. On May 22, 2007, the state court granted our motion to stay the state court action pending resolution of the consolidated federal court action. On August 28, 2007, we and the individual defendants filed motions to dismiss the complaint which were granted on January 11, 2008. On May 12, 2008, the plaintiffs filed a further amended complaint in the federal court action. On July 1, 2008, we and the individual defendants filed motions to dismiss the amended complaint. We cannot predict whether these actions are likely to result in any material recovery by, or expense to, us. We expect to continue to incur legal fees in responding to these lawsuits, including expenses for the reimbursement of legal fees of present and former officers and directors under indemnification obligations. The expense of defending such litigation may be significant. The amount of time to resolve these and any additional lawsuits is unpredictable and these actions may divert management's attention from the day-to-day operations of our business, which could adversely affect our business, results of operations and cash flows.

***Our business and future operating results may be adversely affected by events outside our control.***

Our business and operating results are vulnerable to events outside of our control, such as earthquakes, fire, power loss, telecommunications failures and uncertainties arising out of terrorist attacks in the United States and overseas. Our corporate headquarters and a portion of our manufacturing operations are located in California. California in particular has been vulnerable to natural disasters, such as earthquakes, fires and floods, and other risks which at times have disrupted the local economy and posed physical risks to our property. We are also dependent on communications links with our overseas manufacturing locations and would be significantly harmed if these links were interrupted for any significant length of time. We presently do not have adequate redundant, multiple site capacity if any of these events were to occur, nor can we be certain that the insurance we maintain against these events would be adequate.

***The conversion of our outstanding convertible subordinated notes would result in substantial dilution to our current stockholders.***

After the settlement of our exchange offer on August 11, 2009 we have outstanding 21/2% convertible senior subordinated notes due 2010 in the principal amount of \$77.6 million and 21/2% convertible subordinated notes due 2010 in the principal amount of \$16.9 million. The \$16.9 million in principal amount of our 21/2% notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of our common stock at a conversion price of \$3.705 per share. The \$77.6 million in principal amount of our 21/2% senior notes are convertible at a conversion price of \$3.28, with the underlying principal payable in cash, upon the trading price of our common stock reaching \$4.92 for a period of time. An aggregate of approximately 12,448,000 shares of common stock would be issued upon the conversion of all outstanding convertible subordinated notes at these exchange rates, which would dilute the voting power and ownership percentage of our existing stockholders. We have previously entered into privately negotiated transactions with certain holders of our convertible subordinated notes for the repurchase of notes in exchange for a greater number of shares of our common stock than would have been issued had the principal amount of the notes been converted at the original conversion rate specified in the notes, thus resulting in more dilution. We may enter into similar transactions in the future and, if we do so, there will be additional dilution to the voting power and percentage ownership of our existing stockholders.

***Delaware law, our charter documents and our stockholder rights plan contain provisions that could discourage or prevent a potential takeover, even if such a transaction would be beneficial to our stockholders.***

Some provisions of our certificate of incorporation and bylaws, as well as provisions of Delaware law, may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable. These include provisions:

- authorizing the board of directors to issue additional preferred stock;

prohibiting cumulative voting in the election of directors;

limiting the persons who may call special meetings of stockholders;

prohibiting stockholder actions by written consent;

creating a classified board of directors pursuant to which our directors are elected for staggered three-year terms;

permitting the board of directors to increase the size of the board and to fill vacancies;

requiring a super-majority vote of our stockholders to amend our bylaws and certain provisions of our certificate of incorporation; and

## **Table of Contents**

establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law which limit the right of a corporation to engage in a business combination with a holder of 15% or more of the corporation's outstanding voting securities, or certain affiliated persons.

In addition, in September 2002, our board of directors adopted a stockholder rights plan under which our stockholders received one share purchase right for each share of our common stock held by them. Subject to certain exceptions, the rights become exercisable when a person or group (other than certain exempt persons) acquires, or announces its intention to commence a tender or exchange offer upon completion of which such person or group would acquire, 20% or more of our common stock without prior board approval. Should such an event occur, then, unless the rights are redeemed or have expired, our stockholders, other than the acquirer, will be entitled to purchase shares of our common stock at a 50% discount from its then-Current Market Price (as defined) or, in the case of certain business combinations, purchase the common stock of the acquirer at a 50% discount.

Although we believe that these charter and bylaw provisions, provisions of Delaware law and our stockholder rights plan provide an opportunity for the board to assure that our stockholders realize full value for their investment, they could have the effect of delaying or preventing a change of control, even under circumstances that some stockholders may consider beneficial.

***We do not currently intend to pay dividends on Finisar common stock and, consequently, a stockholder's ability to achieve a return on such stockholder's investment will depend on appreciation in the price of the common stock.***

We have never declared or paid any cash dividends on Finisar common stock and we do not currently intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. Therefore, a stockholder is not likely to receive any dividends on such stockholder's common stock for the foreseeable future.

***Our stock price has been and is likely to continue to be volatile.***

The trading price of our common stock has been and is likely to continue to be subject to large fluctuations. Our stock price may increase or decrease in response to a number of events and factors, including:

trends in our industry and the markets in which we operate;

changes in the market price of the products we sell;

changes in financial estimates and recommendations by securities analysts;

acquisitions and financings;

quarterly variations in our operating results;

the operating and stock price performance of other companies that investors in our common stock may deem comparable; and

purchases or sales of blocks of our common stock.

Part of this volatility is attributable to the current state of the stock market, in which wide price swings are common. This volatility may adversely affect the prices of our common stock regardless of our operating performance. If any of the foregoing occurs, our stock price could fall and we may be exposed to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

**Table of Contents**

**Item 6. *Exhibits***

The exhibits listed in the Exhibit Index are filed as part of this report (see page 56).

53

---

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

**FINISAR CORPORATION**

By: /s/ JERRY S. RAWLS

Jerry S. Rawls

*Chairman of the Board (Co-Principal Executive Officer)*

By: /s/ EITAN GERTEL

Eitan Gertel

*Chief Executive officer (Co-Principal Executive Officer)*

By: /s/ STEPHEN K. WORKMAN

Stephen K. Workman

*Senior Vice President, Finance and Chief Financial Officer*

Dated: September 11, 2009



**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
10.1	Fourth Loan Modification Agreement dated as of July 15, 2009 by and between Silicon Valley Bank and Finisar Corporation
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.3	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.3	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002