

INFINERA Corp
Form 10-Q
August 08, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 1, 2017

or

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

For the transition period from _____ to _____

Commission file number: 001-33486

INFINERA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 77-0560433

State or other jurisdiction of incorporation or organization I.R.S. Employer Identification No.

140 Caspian Court Sunnyvale, CA 94089

Address of principal executive offices Zip Code
(408) 572-5200

Registrant's telephone number, including area code

Not Applicable

Former name, former address and former fiscal year, if changed since last report

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

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

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

Large accelerated filer Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of August 2, 2017, 148,204,671 shares of the registrant's Common Stock, \$0.001 par value, were issued and outstanding.

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FOR THE FISCAL QUARTER ENDED JULY 1, 2017
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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

INFINERA CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par values)

(Unaudited)

| | July 1, 2017 | December 31, 2016 |
|--|-----------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 119,820 | \$ 162,641 |
| Short-term investments | 137,929 | 141,697 |
| Short-term restricted cash | 1,423 | 8,490 |
| Accounts receivable, net of allowance for doubtful accounts of \$918 in 2017 and \$772 in 2016 | 123,903 | 150,370 |
| Inventory | 245,976 | 232,955 |
| Prepaid expenses and other current assets | 42,885 | 34,270 |
| Total current assets | 671,936 | 730,423 |
| Property, plant and equipment, net | 142,424 | 124,800 |
| Intangible assets | 102,933 | 108,475 |
| Goodwill | 189,989 | 176,760 |
| Long-term investments | 69,105 | 40,779 |
| Cost-method investment | 7,000 | 7,000 |
| Long-term restricted cash | 5,030 | 6,449 |
| Other non-current assets | 4,201 | 3,897 |
| Total assets | \$ 1,192,618 | \$ 1,198,583 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 80,684 | \$ 62,486 |
| Accrued expenses | 32,018 | 31,580 |
| Accrued compensation and related benefits | 43,625 | 46,637 |
| Short-term debt, net | 139,115 | — |
| Accrued warranty | 14,078 | 16,930 |
| Deferred revenue | 64,723 | 58,900 |
| Total current liabilities | 374,243 | 216,533 |
| Long-term debt, net | — | 133,586 |
| Accrued warranty, non-current | 18,322 | 23,412 |
| Deferred revenue, non-current | 23,723 | 19,362 |
| Deferred tax liability | 24,185 | 25,327 |
| Other long-term liabilities | 14,558 | 18,035 |
| Commitments and contingencies (Note 15) | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.001 par value | — | — |
| Authorized shares – 25,000 and no shares issued and outstanding | | |
| Common stock, \$0.001 par value | | |
| Authorized shares – 500,000 as of July 01, 2017 and December 31, 2016 | 148 | 145 |

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Issued and outstanding shares – 148,189 as of July 01, 2017 and 145,021 as of
December 31, 2016

| | | |
|--|-------------|-------------|
| Additional paid-in capital | 1,388,045 | 1,354,082 |
| Accumulated other comprehensive loss | (3,741) | (28,324) |
| Accumulated deficit | (646,865) | (563,575) |
| Total stockholders' equity | 737,587 | 762,328 |
| Total liabilities and stockholders' equity | \$1,192,618 | \$1,198,583 |

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

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INFINERA CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| Revenue: | | | | |
| Product | \$143,360 | \$227,532 | \$290,413 | \$443,614 |
| Services | 33,461 | 31,290 | 61,930 | 60,026 |
| Total revenue | 176,821 | 258,822 | 352,343 | 503,640 |
| Cost of revenue: | | | | |
| Cost of product | 100,302 | 122,438 | 199,634 | 240,500 |
| Cost of services | 11,687 | 12,638 | 23,821 | 23,056 |
| Total cost of revenue | 111,989 | 135,076 | 223,455 | 263,556 |
| Gross profit | 64,832 | 123,746 | 128,888 | 240,084 |
| Operating expenses: | | | | |
| Research and development | 57,377 | 59,541 | 112,460 | 113,686 |
| Sales and marketing | 29,397 | 30,465 | 58,838 | 60,474 |
| General and administrative | 18,563 | 17,658 | 35,922 | 34,971 |
| Total operating expenses | 105,337 | 107,664 | 207,220 | 209,131 |
| Income (loss) from operations | (40,505) | 16,082 | (78,332) | 30,953 |
| Other income (expense), net: | | | | |
| Interest income | 862 | 595 | 1,613 | 1,117 |
| Interest expense | (3,456) | (3,176) | (6,859) | (6,331) |
| Other gain (loss), net | (252) | (714) | (382) | (928) |
| Total other income (expense), net | (2,846) | (3,295) | (5,628) | (6,142) |
| Income (loss) before income taxes | (43,351) | 12,787 | (83,960) | 24,811 |
| Provision for (benefit from) income taxes | (512) | 1,475 | (670) | 1,691 |
| Net income (loss) | (42,839) | 11,312 | (83,290) | 23,120 |
| Less: Loss attributable to noncontrolling interest | — | (171) | — | (378) |
| Net income (loss) attributable to Infinera Corporation | \$(42,839) | \$11,483 | \$(83,290) | \$23,498 |
| Net income (loss) per common share attributable to Infinera Corporation: | | | | |
| Basic | \$(0.29) | \$0.08 | \$(0.57) | \$0.17 |
| Diluted | \$(0.29) | \$0.08 | \$(0.57) | \$0.16 |
| Weighted average shares used in computing net income (loss) per common share: | | | | |
| Basic | 147,538 | 142,396 | 146,662 | 141,600 |
| Diluted | 147,538 | 145,891 | 146,662 | 146,385 |

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

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INFINERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| Net income (loss) | \$(42,839) | \$11,312 | \$(83,290) | \$23,120 |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized gain (loss) on available-for-sale investments | 22 | 258 | (60 |) 639 |
| Foreign currency translation adjustment | 18,426 | (6,769 |) 24,643 | (3,499) |
| Net change in accumulated other comprehensive income (loss) | 18,448 | (6,511 |) 24,583 | (2,860) |
| Less: Comprehensive loss attributable to noncontrolling interest | — | (171 |) — | (378) |
| Comprehensive income (loss) attributable to Infinera Corporation | \$(24,391) | \$4,972 | \$(58,707) | \$20,638 |

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

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INFINERA CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Six Months Ended | |
|--|------------------|------------------|
| | July 1, 2017 | June 25, 2016 |
| Cash Flows from Operating Activities: | | |
| Net income (loss) | \$(83,290) | \$23,120 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 32,623 | 29,891 |
| Amortization of debt discount and issuance costs | 5,529 | 5,001 |
| Amortization of premium on investments | 234 | 733 |
| Impairment of intangible assets | 252 | — |
| Stock-based compensation expense | 23,257 | 18,980 |
| Other loss | 86 | 84 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 27,629 | (7,404) |
| Inventory | (12,700) | (31,304) |
| Prepaid expenses and other assets | (8,127) | (328) |
| Accounts payable | 16,927 | (7,339) |
| Accrued liabilities and other expenses | (4,392) | (5,528) |
| Deferred revenue | 10,065 | 10,129 |
| Accrued warranty | (8,111) | 2,165 |
| Net cash provided by (used in) operating activities | (18) | 38,200 |
| Cash Flows from Investing Activities: | | |
| Purchase of available-for-sale investments | (107,854) | (97,051) |
| Proceeds from sales of available-for-sale investments | 3,998 | — |
| Proceeds from maturities of investments | 79,003 | 91,714 |
| Purchase of property and equipment | (39,200) | (23,278) |
| Change in restricted cash | 2,974 | (60) |
| Net cash used in investing activities | (61,079) | (28,675) |
| Cash Flows from Financing Activities: | | |
| Security pledge to acquire noncontrolling interest | 5,596 | (24,942) |
| Acquisition of noncontrolling interest | (471) | — |
| Proceeds from issuance of common stock | 11,115 | 8,586 |
| Minimum tax withholding paid on behalf of employees for net share settlement | (823) | (3,082) |
| Net cash provided by (used in) financing activities | 15,417 | (19,438) |
| Effect of exchange rate changes on cash | 2,859 | (808) |
| Net change in cash and cash equivalents | (42,821) | (10,721) |
| Cash and cash equivalents at beginning of period | 162,641 | 149,101 |
| Cash and cash equivalents at end of period | \$119,820 | \$138,380 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid for income taxes, net of refunds | \$2,683 | \$3,237 |
| Cash paid for interest | \$1,316 | \$1,410 |
| Supplemental schedule of non-cash investing activities: | | |
| Transfer of inventory to fixed assets | \$2,087 | \$4,009 |

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

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INFINERA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

Infinera Corporation (the “Company”) prepared its interim condensed consolidated financial statements that accompany these notes in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”), consistent in all material respects with those applied in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

The Company has made certain estimates, assumptions and judgments that can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Significant estimates, assumptions and judgments made by management include revenue recognition, stock-based compensation, inventory valuation, accrued warranty, business combinations, fair value measurement of investments and accounting for income taxes. Other estimates, assumptions and judgments made by management include allowances for sales returns, allowances for doubtful accounts, useful life of intangible assets, property, plant and equipment, and fair value measurement of the liability component of the Company’s \$150.0 million in aggregate principal amount of 1.75% convertible senior notes due June 1, 2018 (the “Notes”). Management believes that the estimates and judgments upon which they rely are reasonable based upon information available to them at the time that these estimates and judgments are made. To the extent there are material differences between these estimates and actual results, the Company’s condensed consolidated financial statements will be affected.

The interim financial information is unaudited, but reflects all adjustments that are, in management’s opinion, necessary to provide a fair presentation of results for the interim periods presented. All adjustments are of a normal recurring nature. The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

The Company reclassified certain amounts reported in previous periods to conform to the current presentation. This interim information should be read in conjunction with the consolidated financial statements in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

To date, a few of the Company’s customers have accounted for a significant portion of its revenue. For the three months ended July 1, 2017, three customers individually accounted for 17%, 10% and 10% of the Company’s total revenue and for the corresponding period in 2016, two customers individually accounted for 15% and 11% of the Company’s total revenue, respectively. For the six months ended July 1, 2017, one customer individually accounted for 18% of the Company’s total revenue and for the corresponding period in 2016, three customers individually accounted for 16%, 13% and 12% of the Company’s total revenue, respectively.

There have been no material changes in the Company’s significant accounting policies for the six months ended July 1, 2017 as compared to those disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

2. Recent Accounting Pronouncements

In May 2017, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”), which amends the scope of modification accounting for share-based payment arrangements, and provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. This guidance is effective for the Company in its first quarter of fiscal 2018, with early adoption permitted. The Company does not expect the new guidance to have any material impact on its consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update 2017-04, “Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”). The guidance eliminates Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The same one-step impairment

test will be applied to goodwill at all reporting units, even those with zero or negative carrying amounts. Entities will

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be required to disclose the amount of goodwill at reporting units with zero or negative carrying amounts. ASU 2017-04 will be effective for the Company's annual or any interim goodwill impairment tests in its first quarter of fiscal 2020. The Company is currently evaluating the impact the adoption of ASU 2017-04 will have on its consolidated financial statements.

In November 2016, the FASB issued Accounting Standards Update 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash" ("ASU 2016-18"), which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. As such, restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and ending-of-period total amounts shown on the statement of cash flows. The Company is required to adopt ASU 2016-18 on a retrospective basis for fiscal years, and for interim periods within those fiscal years, beginning with its first quarter of fiscal 2018. Early adoption is permitted, including adoption in an interim period. Subsequent to the adoption of ASU 2016-18, the change in restricted cash would be excluded from the change in cash flows from investing and financing activities and included in the change in total cash, restricted cash and cash equivalents as reported in the statement of cash flows. The Company is currently evaluating the impact the adoption of ASU 2016-18 will have on its consolidated financial statements.

In August 2016, the FASB issued Accounting Standards Update 2016-15, "Statement of Cash Flows (Topic 320): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"), which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain transactions are presented and classified in the statement of cash flows. This guidance is effective for the Company in its first quarter of fiscal 2018 and will be applied on a retrospective basis. Early adoption is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-15 will have on its consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"), which requires measurement and recognition of expected credit losses for financial assets held. This guidance is effective for the Company in its first quarter of fiscal 2020 and early adoption is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-13 will have on its consolidated financial statements.

In May 2016, the FASB issued Accounting Standards Update 2016-11, "Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)" ("ASU 2016-11"), which rescinds various standards codified as part of Topic 605, Revenue Recognition in relation to the future adoption of Topic 606. These rescissions include changes to topics pertaining to revenue and expense recognition for freight services in process, accounting for shipping and handling fees and costs, and accounting for consideration given by a vendor to a customer. This guidance is effective for the Company in its first quarter of fiscal 2018 and early adoption is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-11 will have on its consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update 2016-02, "Leases (Topic 842)" ("ASU 2016-02"), which amends the existing accounting standards for leases. The new standard requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). For lessees, leases will continue to be classified as either operating or financing in the income statement. This guidance is effective for the Company in its first quarter of fiscal 2019 and early adoption is permitted. ASU 2016-02 is required to be applied with a modified retrospective approach and requires application of the new standard at the beginning of the earliest comparative period presented. The Company is currently evaluating the impact the adoption of ASU 2016-02 will have on its consolidated financial statements and expects to have increases in the assets and liabilities of its consolidated balance sheets.

In July 2015, the FASB issued Accounting Standards Update 2015-11, "Simplifying the Measurement of Inventory" ("ASU 2015-11"), to simplify the guidance on the subsequent measurement of inventory, excluding inventory measured using last-in, first-out or the retail inventory method. Under ASU 2015-11, inventory should be at the lower of cost and net realizable value. The Company adopted ASU 2015-11 during the first quarter of fiscal 2017. The Company's adoption of 2015-11 had no impact on the Company's financial position, results of operations or cash flows.

In May 2014, the FASB issued Accounting Standards Update 2014-09, “Revenue from Contracts from Customers (Topic 606)” (“ASU 2014-09”), which creates a single, joint revenue standard that is consistent across all

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industries and markets for companies that prepare their financial statements in accordance with U.S. GAAP. Under ASU 2014-09, an entity is required to recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to receive in exchange for those goods or services. In July 2015, the FASB decided to delay the effective date of the new revenue standard by one year. In April 2016, the FASB issued Accounting Standards Update 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which clarifies the implementation guidance on identifying performance obligations and licensing. In May 2016, the FASB issued Accounting Standards Update 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," which amends the guidance on collectability, noncash consideration, presentation of sales tax and transition. In December 2016, the FASB issued Accounting Standards Update 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers," to increase stakeholders' awareness of the proposals and to expedite improvements to ASU 2014-09. These standards will be effective for the Company's first quarter of 2018. The Company currently anticipates adopting the standard using the modified retrospective method as an adjustment to its opening balance of retained earnings. Prior periods will not be retrospectively adjusted.

The Company continues to evaluate the impact of the new accounting standards on our accounting policies, processes and system requirements, and has assigned internal resources in addition to the engagement of third party service providers to assist in this evaluation. In addition, the Company has made and will continue to make investments in systems and processes to enable timely and accurate reporting under the new standard. The Company is in the process of evaluating whether or not there will be a material impact on its consolidated financial statements.

3. Fair Value Measurements

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

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

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Prices or valuations that require management inputs that are both significant to the fair value measurement and unobservable.

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

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

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Certificates of Deposit

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

Commercial Paper

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

U.S. Agency Notes

The Company reviews trading activity and pricing for its U.S. agency notes as of the measurement date. When sufficient quoted pricing for identical securities is not available, the Company uses market pricing and other observable market inputs for similar securities obtained from a number of industry standard data providers. These inputs represent quoted prices for similar assets in active markets or these inputs have been derived from observable market data.

Corporate Bonds

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

Foreign Currency Exchange Forward Contracts

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

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

| | As of July 1, 2017 | | | As of December 31, 2016 | | |
|---|-----------------------------------|------------|------------|-----------------------------------|------------|------------|
| | Fair Value Measured Using Level 1 | Level 2 | Total | Fair Value Measured Using Level 1 | Level 2 | Total |
| Assets | | | | | | |
| Money market funds | \$34,179 | \$ — | \$ 34,179 | \$41,773 | \$ — | \$41,773 |
| Certificates of deposit | — | 240 | 240 | — | 1,881 | 1,881 |
| Commercial paper | — | 20,931 | 20,931 | — | 39,310 | 39,310 |
| Corporate bonds | — | 137,135 | 137,135 | — | 88,324 | 88,324 |
| U.S. agency notes | — | 12,780 | 12,780 | — | 11,759 | 11,759 |
| U.S. treasuries | 40,941 | — | 40,941 | 52,092 | — | 52,092 |
| Foreign currency exchange forward contracts | — | 11 | 11 | — | 187 | 187 |
| Total assets | \$75,120 | \$ 171,097 | \$ 246,217 | \$93,865 | \$ 141,461 | \$ 235,326 |
| Liabilities | | | | | | |
| Foreign currency exchange forward contracts | \$ — | \$ — | \$ — | \$ — | \$(71) | \$(71) |

During the three and six months ended July 1, 2017, there were no transfers of assets or liabilities between Level 1 and Level 2 of the fair value hierarchy. As of July 1, 2017 and December 31, 2016, none of the Company's existing securities were classified as Level 3 securities.

Cash, cash equivalents and investments were as follows (in thousands):

| | July 1, 2017 | | | |
|--|---------------|------------------------|-------------------------|------------|
| | Adjusted Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Cash | \$80,648 | \$ — | \$ — | \$ 80,648 |
| Money market funds | 34,179 | — | — | 34,179 |
| Commercial paper | 4,993 | — | — | 4,993 |
| Total cash and cash equivalents | \$119,820 | \$ — | \$ — | \$ 119,820 |
| Commercial paper | 15,945 | — | (7) | 15,938 |
| Corporate bonds | 84,814 | — | (100) | 84,714 |
| U.S. agency notes | 7,288 | — | (7) | 7,281 |
| U.S. treasuries | 30,050 | — | (54) | 29,996 |
| Total short-term investments | \$138,097 | \$ — | \$ (168) | \$ 137,929 |
| Certificates of deposit | 240 | — | — | 240 |
| Corporate bonds | 52,483 | 7 | (69) | 52,421 |
| U.S. agency notes | 5,510 | — | (11) | 5,499 |
| U.S. treasuries | 10,973 | — | (28) | 10,945 |
| Total long-term investments | \$69,206 | \$ 7 | \$ (108) | \$ 69,105 |
| Total cash, cash equivalents and investments | \$327,123 | \$ 7 | \$ (276) | \$ 326,854 |

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| | December 31, 2016 | | | |
|--|-------------------|------------|------------|------------|
| | Adjusted | Gross | Gross | Fair Value |
| | Amortized | Unrealized | Unrealized | |
| | Cost | Gains | Losses | |
| Cash | \$109,978 | \$ — | \$ — | \$ 109,978 |
| Money market funds | 41,773 | — | — | 41,773 |
| Commercial paper | 8,892 | — | (1) | 8,891 |
| U.S. agency notes | 1,999 | — | — | 1,999 |
| Total cash and cash equivalents | \$162,642 | \$ — | \$ (1) | \$ 162,641 |
| Certificates of deposit | 1,881 | — | — | 1,881 |
| Commercial paper | 30,425 | — | (6) | 30,419 |
| Corporate bonds | 63,097 | 1 | (59) | 63,039 |
| U.S. agency notes | 7,285 | — | (8) | 7,277 |
| U.S. treasuries | 39,093 | 9 | (21) | 39,081 |
| Total short-term investments | \$141,781 | \$ 10 | \$ (94) | \$ 141,697 |
| Corporate bonds | 25,374 | — | (89) | 25,285 |
| U.S. agency notes | 2,499 | — | (16) | 2,483 |
| U.S. treasuries | 13,032 | 2 | (23) | 13,011 |
| Total long-term investments | \$40,905 | \$ 2 | \$ (128) | \$ 40,779 |
| Total cash, cash equivalents and investments | \$345,328 | \$ 12 | \$ (223) | \$ 345,117 |

As of July 1, 2017, the Company's available-for-sale investments have a contractual maturity term of up to 23 months. Gross realized gains and losses on short-term and long-term investments were insignificant in all periods. The specific identification method is used to account for gains and losses on available-for-sale investments.

As of July 1, 2017, the Company had \$257.7 million of cash, cash equivalents and short-term investments, including \$49.6 million of cash and cash equivalents held by its foreign subsidiaries. The Company's cash in foreign locations is used for operational and investing activities in those locations, and the Company does not currently have the need or the intent to repatriate those funds to the United States.

4. Cost-method Investment

In 2016, the Company invested \$7.0 million in a privately-held company. In addition to the \$7.0 million investment, the transaction included a customer supply agreement and warrants to purchase up to \$10.0 million of additional shares of preferred stock. The warrants vest and become exercisable upon certain conditions being met.

As of July 1, 2017 and December 31, 2016, the Company's cost-method investment balance was \$7.0 million in both periods. This investment is accounted for as a cost-method investment as the Company owns less than 20% of the voting securities and does not have the ability to exercise significant influence over operating and financial policies of the entity. The Company's investment is carried at historical cost in its consolidated financial statements. The Company regularly evaluates the carrying value of its cost-method investment for impairment. If the Company believes that the carrying value of the cost basis investment is in excess of estimated fair value, the Company's policy is to record an impairment charge in other income (expense), net, in the accompanying condensed consolidated statements of operations to adjust the carrying value to estimated fair value, when the impairment is deemed other-than-temporary. As of July 1, 2017 and December 31, 2016, no event had occurred that would adversely affect the carrying value of this investment and thus no impairment charges have been recorded.

5. Derivative Instruments

Foreign Currency Exchange Forward Contracts

The Company transacts business in various foreign currencies and has international sales, cost of sales, and expenses denominated in foreign currencies, and carries foreign-currency-denominated monetary assets and liabilities, subjecting the Company to foreign currency risk. The Company's primary foreign currency risk management objective is to protect the U.S. dollar value of future cash flows and minimize the volatility of reported earnings. The Company utilizes foreign currency exchange forward contracts, primarily short term in nature.

The Company enters into foreign currency exchange forward contracts to manage its exposure to fluctuation in foreign exchange rates that arise from its euro and British pound denominated receivables and restricted cash balances. Gains and losses on these contracts are intended to offset the impact of foreign exchange rate fluctuations on the underlying foreign currency denominated accounts receivables and restricted cash, and therefore, do not subject the Company to material balance sheet risk.

The Company also enters into foreign currency exchange contracts to reduce the volatility of cash flows primarily related to forecasted revenues and expenses denominated in euros, British pound and Swedish kronor ("SEK"). The contracts are settled at maturity and at rates agreed to at inception of the contracts. The gains and losses on these foreign currency derivatives are recorded to the consolidated statement of operations line item, in the current period, to which the item that is being economically hedged is recorded.

For the three months ended July 1, 2017 and June 25, 2016, the before-tax effect of the foreign currency exchange forward contracts were a loss of \$1.5 million and a loss of \$0.1 million, respectively, and for the six months ended July 1, 2017 and June 25, 2016, the before-tax effect of the foreign currency exchange forward contracts were a loss of \$1.8 million and a loss of \$0.6 million, respectively. In each of these periods, the impact of the gross gains and losses were offset by foreign exchange rate fluctuations on the underlying foreign currency denominated amounts.

As of July 1, 2017, the Company did not designate foreign currency exchange forward contracts as hedges for accounting purposes and accordingly, changes in the fair value are recorded in the accompanying condensed consolidated statements of operations. These contracts were with one high-quality institutions and the Company consistently monitors the creditworthiness of the counterparties.

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

| | As of July 1, 2017 | | As of December 31, 2016 | | |
|--|-------------------------------|----------------------------------|-------------------------------|----------------------------------|---------------------------|
| | Gross Notional ⁽¹⁾ | Prepaid Expense and Other Assets | Gross Notional ⁽¹⁾ | Prepaid Expense and Other Assets | Other Accrued Liabilities |
| Foreign currency exchange forward contracts | | | | | |
| Related to euro denominated receivables | \$16,559 | \$ 11 | \$23,887 | \$ 137 | \$ (71) |
| Related to British pound denominated receivables | \$— | — | \$6,353 | 48 | — |
| Related to euro denominated restricted cash | \$240 | — | \$242 | 2 | — |
| | | \$ 11 | | \$ 187 | \$ (71) |

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

6. Goodwill and Intangible Assets

Goodwill

Goodwill is recorded when the purchase price of an acquisition exceeds the fair value of the net tangible and identified intangible assets acquired.

The following table presents details of the Company's goodwill during the six months ended July 1, 2017 (in thousands):

| | |
|--|-----------|
| Balance as of December 31, 2016 | \$176,760 |
| Foreign currency translation adjustments | 13,229 |
| Accumulated impairment loss | — |
| Balance as of July 1, 2017 | \$189,989 |

The gross carrying amount of goodwill may change due to the effects of foreign currency fluctuations as these assets are denominated in SEK.

Intangible Assets

The following tables present details of the Company's intangible assets as of July 1, 2017 and December 31, 2016 (in thousands, except for weighted-average):

| | July 1, 2017 | | | |
|---|-----------------------|--------------------------|---------------------|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted-Average Remaining Useful Life (In Years) |
| Intangible assets with finite lives: | | | | |
| Customer relationships | \$49,581 | \$ (11,476) | \$38,105 | 6.1 |
| Developed technology | 101,693 | (36,865) | 64,828 | 3.6 |
| Total intangible assets | \$151,274 | \$ (48,341) | \$102,933 | 4.6 |
| | December 31, 2016 | | | |
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Remaining Useful Life (In Years) |
| Intangible assets with finite lives: | | | | |
| Trade names | \$220 | \$ (220) | \$— | 0.0 |
| Customer relationships | 46,125 | (7,793) | 38,332 | 6.6 |
| Developed technology | 94,320 | (24,715) | 69,605 | 3.7 |
| Other intangible assets | 819 | (567) | 252 | 4.6 |
| Total intangible assets with finite lives | \$141,484 | \$ (33,295) | \$108,189 | 4.7 |
| In-process technology | 286 | — | 286 | |
| Total intangible assets | \$141,770 | \$ (33,295) | \$108,475 | |

The gross carrying amount of intangible assets and the related amortization expense of intangible assets may change due to the effects of foreign currency fluctuations as these assets are denominated in SEK. Amortization expense was \$6.6 million and \$12.9 million for the three and six months ended July 1, 2017, respectively, and was \$6.6 million and \$13.1 million for the three and six months ended, respectively, for the corresponding periods in 2016.

Intangible assets are carried at cost less accumulated amortization. Amortization expenses are recorded to the appropriate cost and expense categories. During the six months ended July 1, 2017, the Company recorded an impairment charge of \$0.3 million related to other intangible assets, which the Company has determined that the carrying value will not be recoverable. During the first quarter of 2017, the Company transferred \$0.3 million of its in-process technology to developed technology, which is being amortized over a useful life of five years.

The following table summarizes the Company's estimated future amortization expense of intangible assets with finite lives as of July 1, 2017 (in thousands):

| | Total | Fiscal Years Remainder of 2017 | 2018 | 2019 | 2020 | 2021 | 2022 and Thereafter |
|-----------------------------------|-----------|--------------------------------|----------|----------|----------|---------|---------------------|
| Total future amortization expense | \$102,933 | \$13,399 | \$26,797 | \$26,192 | \$19,114 | \$6,986 | \$10,445 |

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7. Balance Sheet Details

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

| | July 1, 2017 | December 31, 2016 |
|---|-----------------|----------------------|
| Inventory: | | |
| Raw materials | \$36,709 | \$33,158 |
| Work in process | 91,620 | 74,533 |
| Finished goods | 117,647 | 125,264 |
| Total inventory | \$245,976 | \$232,955 |
| Property, plant and equipment, net: | | |
| Computer hardware | \$13,548 | \$12,775 |
| Computer software ⁽¹⁾ | 31,928 | 26,779 |
| Laboratory and manufacturing equipment | 236,275 | 222,311 |
| Land and building | 12,347 | — |
| Furniture and fixtures | 2,228 | 2,075 |
| Leasehold improvements | 38,235 | 42,267 |
| Construction in progress | 37,794 | 33,633 |
| Subtotal | \$372,355 | \$339,840 |
| Less accumulated depreciation and amortization | (229,931) | (215,040) |
| Total property, plant and equipment, net | \$142,424 | \$124,800 |
| Accrued expenses: | | |
| Loss contingency related to non-cancelable purchase commitments | \$7,290 | \$5,555 |
| Professional and other consulting fees | 4,189 | 4,955 |
| Taxes payable | 2,925 | 2,384 |
| Royalties | 5,501 | 5,375 |
| Other accrued expenses | 12,113 | 13,311 |
| Total accrued expenses | \$32,018 | \$31,580 |

Included in computer software at July 1, 2017 and December 31, 2016 were \$11.4 million and \$9.1 million,

⁽¹⁾ respectively, related to enterprise resource planning (“ERP”) systems that the Company implemented. The unamortized ERP costs at July 1, 2017 and December 31, 2016 were \$5.5 million and \$4.0 million, respectively.

8. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss includes certain changes in equity that are excluded from net income. The following table sets forth the changes in accumulated other comprehensive loss by component for the six months ended July 1, 2017 (in thousands):

| | Unrealized Gain (Loss) on Other Available-for-Sale Securities | Foreign Currency Translation | Accumulated Tax Effect | Total |
|--|--|------------------------------------|---------------------------|------------|
| Balance at December 31, 2016 | \$ (209) | \$ (27,236) | \$ (879) | \$(28,324) |
| Net current-period other comprehensive income (loss) | (60) | 24,643 | — | 24,583 |
| Balance at July 1, 2017 | \$ (269) | \$ (2,593) | \$ (879) | \$(3,741) |

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

Basic net income (loss) per common share is computed by dividing net income (loss) attributable to Infinera Corporation by the weighted average number of common shares outstanding during the period. Diluted net income (loss) attributable to Infinera Corporation per common share is computed using net income (loss) attributable to Infinera Corporation and the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the assumed exercise of outstanding stock options, assumed release of outstanding restricted stock units (“RSUs”) and performance stock units (“PSUs”), and assumed issuance of common stock under the Company's 2007 Employee Stock Purchase Plan (“ESPP”) using the treasury stock method.

Potentially dilutive common shares also include the assumed conversion of the Notes from the conversion spread (as discussed in Note 10, “Convertible Senior Notes”). The Company includes the common shares underlying PSUs in the calculation of diluted net income per share only when they become contingently issuable. In net loss periods, these potentially diluted common shares have been excluded from the diluted net loss calculation. The dilutive impact of the Notes (as defined in Note 10, “Convertible Senior Notes”) was based on the difference between the Company's average stock price during the period and the conversion price of the Notes. Upon conversion of the Notes, it is the Company's intention to pay cash equal to the lesser of the aggregate principal amount or the conversion value of the Notes being converted, therefore, only the conversion spread relating to the Notes would be included in the Company's diluted earnings per share calculation unless their effect is anti-dilutive.

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| Numerator: | | | | |
| Net income (loss) attributable to Infinera Corporation | \$(42,839) | \$11,483 | \$(83,290) | \$23,498 |
| Denominator: | | | | |
| Basic weighted average common shares outstanding | 147,538 | 142,396 | 146,662 | 141,600 |
| Effect of dilutive securities: | | | | |
| Employee equity plans | — | 2,775 | — | 3,299 |
| Assumed conversion of convertible senior notes from conversion spread | — | 720 | — | 1,486 |
| Diluted weighted average common shares outstanding | 147,538 | 145,891 | 146,662 | 146,385 |
| Net income (loss) per common share attributable to Infinera Corporation | | | | |
| Basic | \$(0.29) | \$0.08 | (0.57) | \$0.17 |
| Diluted | \$(0.29) | \$0.08 | (0.57) | \$0.16 |

The Company incurred net losses during the three and six months ended July 1, 2017, and as a result, potential common shares from stock options, RSUs, PSUs, assumed release of outstanding stock under the ESPP and assumed conversion of the Notes from the conversion spread were not included in the diluted shares used to calculate net loss per share, as their inclusion would have been anti-dilutive.

During the three and six months ended June 25, 2016, the Company included the dilutive effects of the Notes in the calculation of diluted net income per common share as the applicable average market price was above the conversion price of the Notes. The effects of certain potentially outstanding shares were not included in the calculation of diluted net income per share for the three and six months ended June 25, 2016 because their effect were anti-dilutive under the treasury stock method or the performance condition of the award had not been met.

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The following sets forth the potentially dilutive shares excluded from the computation of the diluted net income (loss) per share because their effect was anti-dilutive (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---------------|--------------------------|---------------------|---------------------|---------------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| Stock options | 1,407 | 13 | 1,521 | 11 |
| RSUs | 6,500 | 2,663 | 7,137 | 1,721 |
| PSUs | 1,464 | 846 | 1,439 | 594 |
| ESPP shares | 892 | — | 923 | 291 |
| Total | 10,263 | 3,522 | 11,020 | 2,617 |

10. Convertible Senior Notes

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

As a result of the Notes maturing on June 1, 2018, the net carrying amount of \$139.1 million was reclassified from long-term debt to short-term debt in the Company's condensed consolidated balance sheets during the three months ended July 1, 2017.

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

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

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

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

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

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

•

at any time on or after December 1, 2017 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their Notes at any time, regardless of the foregoing circumstances. If the Company undergoes a fundamental change as defined in the Indenture governing the Notes, holders may require the Company to repurchase for cash all or any portion of their Notes at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest to, but excluding,

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the fundamental change repurchase date. In addition, upon the occurrence of a “make-whole fundamental change” (as defined in the Indenture), the Company may, in certain circumstances, increase the conversion rate by a number of additional shares for a holder that elects to convert its Notes in connection with such make-whole fundamental change.

The net carrying amounts of the debt obligation were as follows (in thousands):

| | July 1, 2017 | December 31, 2016 |
|--|-----------------|----------------------|
| Principal | \$150,000 | \$150,000 |
| Unamortized discount ⁽¹⁾ | (10,023) | (15,114) |
| Unamortized issuance cost ⁽¹⁾ | (862) | (1,300) |
| Net carrying amount | \$139,115 | \$133,586 |

⁽¹⁾ Unamortized debt conversion discount and issuance costs will be amortized over the remaining life of the Notes, which is approximately 11 months.

As of July 1, 2017 and December 31, 2016, the carrying amount of the equity component of the Notes was \$43.3 million.

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

In accounting for the issuance costs of \$5.5 million related to the Notes, the Company allocated the total amount incurred to the liability and equity components of the Notes based on their relative values. Issuance costs attributable to the liability component were initially recorded as other non-current assets and will be amortized to interest expense over the term of the Notes. Accounting Standards Update 2015-03, “Simplifying the Presentation of Debt Issuance Costs” (“ASU 2015-03”) requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. The Company adopted ASU 2015-03 during the first quarter of 2016. The December 31, 2016 balance sheet was retrospectively adjusted to reclassify \$2.1 million from other non-current assets to a reduction of the Notes payable liability.

The issuance costs attributable to the equity component were netted with the equity component in stockholders’ equity. Additionally, the Company initially recorded a deferred tax liability of \$17.0 million in connection with the issuance of the Notes, and a corresponding reduction in valuation allowance. The impact of both was recorded to stockholders’ equity.

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

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

| | Three Months Ended | | Six Months Ended | |
|-------------------------------------|-----------------------|---------------------|---------------------|---------------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| Contractual interest expense | \$656 | \$656 | \$1,313 | \$1,313 |
| Amortization of debt issuance costs | 222 | 201 | 437 | 396 |

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| | | | | |
|-------------------------------|---------|---------|---------|---------|
| Amortization of debt discount | 2,577 | 2,331 | 5,091 | 4,605 |
| Total interest expense | \$3,455 | \$3,188 | \$6,841 | \$6,314 |

The coupon rate is 1.75%. For the three and six months ended July 1, 2017 and June 25, 2016, the debt discount and debt issuance costs are amortized, using an annual effective interest rate of 10.23%, to interest expense over the term of the Notes.

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As of July 1, 2017, the fair value of the Notes was \$160.9 million. The fair value was determined based on the quoted bid price of the Notes in an over-the-counter market on June 30, 2017. The Notes are classified as Level 2 of the fair value hierarchy.

During the three months ended July 1, 2017, the closing price of the Company's common stock did not meet the conversion criteria; therefore, holders of the Notes may not convert their Notes during the third quarter of 2017. Should the closing price conditions be met during the 30 consecutive trading days prior to the end of the third quarter of 2017 or a future quarter, the Notes will be convertible at their holders' option during the immediately following quarter. Based on the closing price of the Company's common stock of \$10.67 on June 30, 2017 (the last trading day of the fiscal quarter), the if-converted value of the Notes did not exceed their principal amount.

11. Stockholders' Equity

Stock-based Compensation Plans

The Company has stock-based compensation plans pursuant to which the Company has granted stock options, RSUs and PSUs. The Company also has an ESPP for all eligible employees.

In February 2016, the Company's board of directors adopted the 2016 Equity Incentive Plan ("2016 Plan") and the Company's stockholders approved the 2016 Plan in May 2016. In May 2017, the Company's stockholders approved an amendment to the 2016 Plan to increase the number of shares authorized for issuance under the 2016 Plan by 6.4 million shares. As of July 1, 2017, the Company has reserved a total of 13.9 million shares of common stock for issuance of stock options, RSUs and PSUs to employees, non-employees, consultants and members of the Company's board of directors, pursuant to the 2016 Plan, plus any shares subject to awards granted under the Company's 2007 Equity Incentive Plan (the "2007 Plan") that, after the effective date of the 2016 Plan, expire, are forfeited or otherwise terminate without having been exercised in full to the extent such awards were exercisable, and shares issued pursuant to awards granted under the 2007 Plan that, after the effective date of the 2016 Plan, are forfeited to or repurchased by the Company due to failure to vest. The 2016 Plan has a maximum term of 10 years from the date of adoption, or it can be earlier terminated by the Company's board of directors. The 2007 Plan was canceled; however, it continues to govern outstanding grants under the 2007 Plan.

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

| | Number of Stock Options | Weighted-Average Exercise Price Per Share | Aggregate Intrinsic Value |
|----------------------------------|-------------------------------|--|---------------------------------|
| Outstanding at December 31, 2016 | 1,655 | \$ 8.30 | \$ 965 |
| Stock options granted | — | \$ — | |
| Stock options exercised | (196) | \$ 7.78 | \$ 373 |
| Stock options canceled | (52) | \$ 12.87 | |
| Outstanding at July 1, 2017 | 1,407 | \$ 8.20 | \$ 3,620 |
| Exercisable at July 1, 2017 | 1,403 | \$ 8.20 | \$ 3,614 |

| | Number of Restricted Stock Units | Weighted- Average Grant Date Fair Value Per Share | Aggregate Intrinsic Value |
|----------------------------------|--|---|---------------------------------|
| Outstanding at December 31, 2016 | 5,293 | \$ 14.10 | \$ 44,939 |
| RSUs granted | 3,191 | \$ 10.51 | |
| RSUs released | (1,860) | \$ 13.66 | \$ 17,848 |
| RSUs canceled | (124) | \$ 14.96 | |
| Outstanding at July 1, 2017 | 6,500 | \$ 12.45 | \$ 69,359 |

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| | Number of Performance Stock Units | Weighted- Average Grant Date Fair Value Per Share | Aggregate Intrinsic Value |
|----------------------------------|---|---|---------------------------------|
| Outstanding at December 31, 2016 | 904 | \$ 14.13 | \$ 7,672 |
| PSUs granted | 916 | \$ 16.36 | |
| PSUs released | — | \$ — | \$ — |
| PSUs canceled | (356) | \$ 11.55 | |
| Outstanding at July 1, 2017 | 1,464 | \$ 16.16 | \$ 15,618 |
| Expected to vest at July 1, 2017 | 997 | | \$ 10,642 |

The aggregate intrinsic value of unexercised stock options is calculated as the difference between the closing price of the Company's common stock of \$10.67 at June 30, 2017 (the last trading day of the fiscal quarter) and the exercise prices of the underlying stock options. The aggregate intrinsic value of the stock options that have been exercised is calculated as the difference between the fair market value of the common stock at the date of exercise and the exercise price of the underlying stock options.

The aggregate intrinsic value of unreleased RSUs and unreleased PSUs is calculated using the closing price of the Company's common stock of \$10.67 at June 30, 2017 (the last trading day of the fiscal quarter). The aggregate intrinsic value of RSUs and PSUs released is calculated using the fair market value of the common stock at the date of release.

The following table presents total stock-based compensation cost for instruments granted but not yet amortized, net of estimated forfeitures, of the Company's equity compensation plans as of July 1, 2017. These costs are expected to be amortized on a straight-line basis over the following weighted-average periods (in thousands, except for weighted-average period):

| | Unrecognized Compensation Expense, Net | Weighted- Average Period (in years) |
|---------------|--|---|
| Stock options | \$ 12 | 0.5 |
| RSUs | \$ 68,948 | 2.8 |
| PSUs | \$ 15,643 | 1.8 |

Employee Stock Options

The Company did not grant any stock options during the three and six months ended July 1, 2017. Amortization of stock-based compensation related to stock options in the three and six months ended July 1, 2017 and June 25, 2016 was insignificant in both periods.

Employee Stock Purchase Plan

The fair value of the shares was estimated at the date of grant using the following assumptions (expense amounts in thousands):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|---------------|------------------|---------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| Employee Stock Purchase Plan | | | | |
| Volatility | 51% | 56% | 51% | 56% |
| Risk-free interest rate | 0.81% | 0.52% | 0.81% | 0.52% |
| Expected life | 0.5 years | 0.5 years | 0.5 years | 0.5 years |
| Estimated fair value | \$3.46 | \$4.53 | \$3.46 | \$4.53 |
| Total stock-based compensation expense | \$1,392 | \$1,247 | \$3,073 | \$2,489 |

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Restricted Stock Units

During the three and six months ended July 1, 2017, the Company granted RSUs to employees to receive 0.3 million shares and 3.2 million shares of the Company's common stock. All RSUs awarded are subject to each individual's continued service to the Company through each applicable vesting date. The Company accounted for the fair value of the RSUs using the closing market price of the Company's common stock on the date of grant. Amortization of stock-based compensation related to RSUs in the three and six months ended July 1, 2017 was approximately \$8.4 million and \$16.0 million, respectively, and was \$7.7 million and \$13.8 million in the three and six months ended June 25, 2016, respectively.

Performance Stock Units

Pursuant to the 2007 Plan and the 2016 Plan, the Company has granted PSUs to certain of the Company's executive officers, senior management and employees. All PSUs awarded are subject to each individual's continued service to the Company through each applicable vesting date and if the performance metrics are not met within the time limits specified in the award agreements, the PSUs will be canceled.

PSUs granted to the Company's executive officers and senior management under the 2007 Plan during the first quarter of 2015 and 2016 are based on the total stockholder return ("TSR") of the Company's common stock price as compared to the TSR of the S&P North American Technology Multimedia Networking Index ("SPGIIPTR") over the span of one year, two years and three years. The number of shares to be issued upon vesting of these PSUs range from zero to two times the target number of PSUs granted depending on the Company's performance against the SPGIIPTR.

PSUs granted to the Company's executive officers and senior management under the 2016 Plan during the first quarter of 2017 are based on the TSR of the Company's common stock price relative to the TSR of the individual companies listed in the SPGIIPTR over the span of one year, two years and three years. The number of shares to be issued upon vesting of these PSUs range from zero to two times the target number of PSUs granted depending on the Company's performance against the individual companies listed in the SPGIIPTR.

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

| | 2017 | 2016 | 2015 |
|--|-------------------|-------------------|-------------------|
| Index | SPGIIPTR | SPGIIPTR | SPGIIPTR |
| Index volatility | 33% - 34% | 18% | 18% - 19% |
| Infinera volatility | 55% - 56% | 55% | 48% |
| Risk-free interest rate | 1.41% - 1.63% | 0.95% - 1.07% | 0.97% - 1.10% |
| Correlation with index/index component | 0.10 - 0.49 | 0.58 - 0.59 | 0.52 |
| Estimated fair value | \$15.23 - \$17.35 | \$10.31 - \$16.62 | \$18.08 - \$19.29 |

In addition, certain other PSUs granted to the Company's executive officers, senior management and certain employees will only vest upon the achievement of specific financial or operational performance criteria.

The following table summarizes by grant year, the Company's PSU activity for the six months ended July 1, 2017 (in thousands):

| | Total Number of Performance Stock Units | Grant Year | | | |
|----------------------------------|--|------------|------|-------|------|
| | | 2014 | 2015 | 2016 | 2017 |
| Outstanding at December 31, 2016 | 904 | 123 | 148 | 633 | — |
| PSUs granted | 916 | — | — | — | 916 |
| PSUs released | — | — | — | — | — |
| PSUs canceled | (356) | (102) | (60) | (194) | — |
| Outstanding at July 1, 2017 | 1,464 | 21 | 88 | 439 | 916 |

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Amortization of stock-based compensation related to PSUs in the three and six months ended July 1, 2017 was approximately \$2.8 million and \$4.6 million, respectively, and was \$2.3 million and \$3.2 million in the three and six months ended June 25, 2016, respectively.

Stock-Based Compensation

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

| | July 1, December 2017 31, 2016 | | Three Months Ended July 1, June 25, 2017 2016 | | Six Months Ended July 1, June 25, 2017 2016 | |
|--|-----------------------------------|----------|--|----------|--|--|
| Stock-based compensation effects in inventory | \$5,383 | \$ 4,911 | | | | |
| Stock-based compensation effects included in net income (loss) before income taxes | | | | | | |
| Cost of revenue | \$834 | \$746 | \$1,558 | \$1,419 | | |
| Research and development | 4,184 | 3,904 | 7,964 | 6,225 | | |
| Sales and marketing | 3,273 | 2,945 | 5,999 | 5,180 | | |
| General and administration | 2,852 | 2,486 | 5,392 | 4,385 | | |
| | \$11,143 | \$10,081 | \$20,913 | \$17,209 | | |
| Cost of revenue – amortization from balance sheet ⁽¹⁾ | 1,237 | 912 | 2,344 | 1,771 | | |
| Total stock-based compensation expense | \$12,380 | \$10,993 | \$23,257 | \$18,980 | | |

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

12. Income Taxes

Benefit from income taxes for the three and six months ended July 1, 2017 was \$0.5 million and \$0.7 million, respectively, on pre-tax loss of \$43.4 million and \$84.0 million, respectively. This compared to a tax provision of \$1.5 million and \$1.7 million, respectively, on pre-tax income of \$12.8 million and \$24.8 million for the three and six months ended June 25, 2016, respectively. The results for the three and six months ended July 1, 2017 include approximately \$6.6 million and \$13.3 million, respectively, of purchase accounting amortization and other charges related to the acquisition of Transmode AB, which occurred in 2015, with a corresponding tax benefit of approximately \$1.5 million and \$2.9 million, respectively. Exclusive of this tax benefit, provision for income taxes otherwise decreased by approximately \$2.1 million and \$2.6 million, respectively, during the three and six months ended July 1, 2017 compared to June 25, 2016, as a result of an operating loss in the United States and lower foreign income tax of our Swedish operations, offset by higher foreign taxes related to an increase in spending in certain of the Company's cost-plus foreign subsidiaries.

In all periods, the tax expense and benefit projected in the Company's effective tax rate assumptions primarily represents foreign taxes of the Company's overseas subsidiaries compensated on a cost-plus basis, as well as the results of our Swedish operations, inclusive of purchase accounting amortization and other charges for the three and six months ended July 1, 2017.

The Company must assess the likelihood that some portion or all of its deferred tax assets will be recovered from future taxable income within the respective jurisdictions. In the past, the Company established a valuation allowance against its deferred tax assets as it determined that its ability to recover the value of these assets did not meet the "more-likely-than-not" standard. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management

judgment is required on an on-going basis to determine whether it needs to maintain the valuation allowance recorded against its net deferred tax assets. The Company must consider all positive and negative evidence, including its forecasts of taxable income over the applicable carryforward periods, its current financial performance, its market environment and other factors in evaluating the need for a valuation allowance

against its net U.S. deferred tax assets. At July 1, 2017, the Company does not believe that it is more-likely-than-not that it would be able to utilize its deferred tax assets in the foreseeable future. Accordingly, the domestic net deferred tax assets continued to be fully reserved with a valuation allowance. To the extent that the Company determines that deferred tax assets are realizable on a more-likely-than-not basis, and adjustment is needed, that adjustment will be recorded in the period that the determination is made and would generally decrease the valuation allowance and record a corresponding benefit to earnings.

13. Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the Company's Chief Executive Officer ("CEO"). The Company's CEO reviews financial information presented on a consolidated basis, accompanied by information about revenue by geographic region for purposes of allocating resources and evaluating financial performance. The Company has one business activity as a provider of optical transport networking equipment, software and services. Accordingly, the Company is considered to be in a single reporting segment and operating unit structure.

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

Revenue

| | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|---------------|------------------|---------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| United States | \$112,196 | \$166,710 | \$211,976 | \$341,225 |
| Other Americas | 2,971 | 11,267 | 9,006 | 14,526 |
| Europe, Middle East and Africa | 47,910 | 64,570 | 105,323 | 124,446 |
| Asia Pacific | 13,744 | 16,275 | 26,038 | 23,443 |
| Total revenue | \$176,821 | \$258,822 | \$352,343 | \$503,640 |

Property, plant and equipment, net

| | July 1, 2017 | December 31, 2016 |
|--|--------------|-------------------|
| United States | \$134,920 | \$117,715 |
| Other Americas | 307 | 218 |
| Europe, Middle East and Africa | 3,795 | 3,822 |
| Asia Pacific | 3,402 | 3,045 |
| Total property, plant and equipment, net | \$142,424 | \$124,800 |

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14. Guarantees

Product Warranties

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

| | Three Months Ended | | Six Months Ended | |
|-----------------------------------|--------------------|---------------|------------------|---------------|
| | July 1, 2017 | June 25, 2016 | July 1, 2017 | June 25, 2016 |
| Beginning balance | \$35,980 | \$39,999 | \$40,342 | \$38,844 |
| Charges to operations | 5,022 | 7,308 | 9,681 | 14,062 |
| Utilization | (3,901) | (3,702) | (7,289) | (8,689) |
| Change in estimate ⁽¹⁾ | (4,701) | (2,616) | (10,334) | (3,228) |
| Balance at the end of the period | \$32,400 | \$40,989 | \$32,400 | \$40,989 |

The Company records product warranty liabilities based on the latest quality and cost information available as of the date the revenue is recorded. The changes in estimate shown here are due to changes in overall actual failure rates, the mix of new versus used units related to replacement of failed units, and changes in the estimated cost of repair. As the Company's products mature over time, failure rates and repair costs generally decline leading to favorable changes in warranty reserves. In addition, during the first quarter of 2017, due to product quality improvements, the Company revised certain estimates used in calculating its product warranties that resulted in a one-time reduction to the warranty accrual of \$2.2 million.

Letters of Credit and Bank Guarantees

The Company had \$5.8 million of standby letters of credit and bank guarantees outstanding as of July 1, 2017 that consisted of \$2.7 million related to customer performance guarantees, \$1.9 million related to property leases, and \$1.2 million related to value added tax and customs' licenses. The Company had \$8.7 million of standby letters of credit and bank guarantees outstanding as of December 31, 2016 that consisted of \$4.5 million related to property leases, \$3.1 million related to customer performance guarantees and \$1.1 million related to a value added tax license. As of July 1, 2017 and December 31, 2016, the Company had a line of credit for approximately \$1.6 million and \$1.1 million, respectively, to support the issuance of letters of credit, of which zero and \$0.3 million had been issued and outstanding, respectively. The Company has pledged approximately \$4.9 million and \$4.5 million of assets of a subsidiary to secure this line of credit and other obligations as of July 1, 2017 and December 31, 2016, respectively.

15. Litigation and Contingencies

Legal Matters

On November 23, 2016, Oyster Optics, LLC ("Oyster Optics") filed a complaint against the Company in the United States District Court for the Eastern District of Texas. The complaint asserts U.S. Patent Nos. 6,469,816, 6,476,952, 6,594,055, 7,099,592, 7,620,327, 8,374,511 and 8,913,898 (collectively, the "Oyster Optics patents in suit"). The complaint seeks unspecified damages and a permanent injunction. The Company believes that it does not infringe any valid and enforceable claim of the Oyster Optics patents in suit, and intends to defend this action vigorously. The Company filed its answer to Oyster Optics on February 3, 2017. The Court has set a trial date for June 2018. The Company is currently unable to predict the outcome of this litigation and therefore cannot reasonably estimate the possible loss or range of loss, if any, arising from this matter.

On March 24, 2017, Core Optical Technologies, LLC ("Core Optical") filed a complaint against the Company in the United States District Court for the Central District of California. The complaint asserts U.S. Patent No. 6,782,211 (the "Core Optical patent in suit"). The complaint seeks unspecified damages and a permanent injunction. The Company believes that it does not infringe any valid and enforceable claim of the Core Optical patent in suit, and intends to defend this action vigorously. Because this action is in the early stages, the Company is unable to predict the outcome of this litigation at this time and therefore cannot reasonably estimate the possible loss or range of loss, if any, arising from this matter.

In addition to the matters described above, the Company is subject to various legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not

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determinable, the Company does not expect that the ultimate costs to resolve these matters will have a material effect on its consolidated financial position, results of operations or cash flows.

Loss Contingencies

The Company is subject to the possibility of various losses arising in the ordinary course of business. These may relate to disputes, litigation and other legal actions. In the preparation of its quarterly and annual financial statements, the Company considers the likelihood of loss or the incurrence of a liability, including whether it is probable, reasonably possible or remote that a liability has been incurred, as well as the Company's ability to reasonably estimate the amount of loss, in determining loss contingencies. In accordance with U.S. GAAP, an estimated loss contingency is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company regularly evaluates current information to determine whether any accruals should be adjusted and whether new accruals are required. As of July 1, 2017, the Company has accrued the estimated liabilities associated with certain loss contingencies.

Intellectual Property Indemnification

The Company has agreed to indemnify certain customers for claims made against the Company's products, where such claims allege infringement of third party intellectual property rights, including, but not limited to, patents, registered trademarks and/or copyrights. Under the aforementioned indemnification clauses, the Company may be obligated to defend the customer and pay for the damages awarded against the customer under an infringement claim as well as the customer's attorneys' fees and costs. The Company's indemnification obligations generally do not expire after termination or expiration of the agreement containing the indemnification obligation. In certain cases, there are limits on and exceptions to the Company's potential liability for indemnification. Although historically the Company has not made significant payments under these indemnification obligations, the Company cannot estimate the amount of potential future payments, if any, that it might be required to make as a result of these agreements. The maximum potential amount of any future payments that the Company could be required to make under these indemnification obligations could be significant.

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

This Quarterly Report on Form 10-Q contains “forward-looking statements” that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include our expectations regarding revenue, gross margin, expenses, cash flows and other financial items; any statements of the plans, strategies and objectives of management for future operations and personnel; factors that may affect our operating results; anticipated customer activity; statements concerning new products or services, including new product features and delivery dates; statements related to capital expenditures; statements related to future economic conditions, performance, market growth or our sales cycle; statements related to our convertible senior notes; statements related to the effects of litigation on our financial position, results of operations or cash flows; statements as to industry trends and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” or “will,” and similar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled “Risk Factors” included in Part II, Item 1A. of this Quarterly Report on Form 10-Q and in our other SEC filings, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 filed on February 23, 2017. Such forward-looking statements speak only as of the date of this report. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements. You should review these risk factors for more a complete understanding of the risks associated with an investment in our securities. The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q.

Overview

We provide optical transport networking equipment, software and services to telecommunications service providers, internet content providers (“ICPs”), cable providers, wholesale and enterprise carriers, research and education institutions, enterprise customers, and government entities across the globe. Optical transport networks are deployed by customers facing significant demand for optical bandwidth prompted by increased use of high-speed internet access, mobile broadband, cloud-based services, high-definition video streaming services, virtual and augmented reality, the Internet of Things (IoT) and business Ethernet services. Our end-to-end packet-optical portfolio is designed to be managed with a single network management system.

Historically, we had focused on the long-haul portion of the optical transport market and a large portion of our revenue continues to be derived from long-haul customers. Over the past few years, we have evolved from focusing entirely on the long-haul and subsea markets with the DTN-X Family of products to offering an end-to-end suite of solutions that spans long-haul, subsea, data center interconnect (“DCI”) and metro.

In late 2014, we increased our addressable markets by introducing the Cloud Xpress platform for the DCI market to address a growing need for optical interconnections between data centers. Since its initial introduction, we have steadily increased our revenue contribution from Cloud Xpress, in particular with ICPs. During the second quarter of 2017, we released the follow-on to our initial Cloud Xpress with the Cloud Xpress 2, offering 1.2 terabits per second of line-side capacity in a single unit form factor. Going forward, we anticipate many of our large customers will transition to this new platform.

In the second half of 2015, we entered the metro market with the acquisition of Transmode AB, a leader in metro packet-optical applications. Entering into the metro market expanded our addressable market, in particular with existing long-haul customers that also invest in metro networks. This enabled us to deliver to our customers an end-to-end portfolio of solutions. We continue to expand our suite of metro solutions by both enhancing our XTM-Series solutions and utilizing our optical engines to deliver XT and XTC solutions.

In the second half of 2016, we announced our next-generation suite of technologies, the Infinite Capacity Engine (“ICE”), which delivers a family of multi-terabit opto-electronic subsystems powered by our fourth-generation photonic

integrated circuits (“PIC”) and next-generation FlexCoherent DSP. ICE is a family of different subsystems that can be customized for different network applications across our end-to-end product portfolio.

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Our goal is to be the preeminent provider of optical transport networking systems to telecommunications service providers, ICPs, cable providers, wholesale and enterprise carriers, research and education institutions, enterprise customers, and government entities across the globe. Our financial success in 2017 will be largely dependent on the timing of delivery and customer adoption of our next-generation products in each of our end markets. Success will also depend on the continued acceptance of our existing products, growth of communications traffic and the proliferation of next-generation bandwidth-intensive services, which are expected to drive the need for increased levels of bandwidth.

In the short-term, our quarterly revenue results may be volatile and could be impacted by several factors, including delivery and market acceptance of our next-generation products, customer consolidation, competitive solutions and pricing strategies, general economic and market conditions, and the timing of customer network deployments. We continue to expect variability with our gross margins in 2017 as we make strategic investments to win and preserve business in advance of bringing our new products to market. Gross margins could also remain suppressed for the remainder of 2017 as we bring our next-generation ICE products to market, attributable to manufacturing PIC yields being lower initially and increasing as we ramp production. Additionally, given our current revenue levels and the necessity to invest in current and future opportunities, we anticipate that research and development expenses will remain at elevated levels as a percentage of revenue throughout 2017.

Over a longer period of time, we believe that our efforts and investments in expanding the markets we serve, delivering new products and technologies on a faster cadence, and diversifying our customer base will enable us to grow revenue and improve profitability. Moreover, we plan to further leverage our vertically-integrated manufacturing model, which combined with the introduction of additional purpose-built products, selling incremental bandwidth capacity into deployed networks, and prudent expense management, can result in improved profitability and cash flow.

Over time, we have broadened our customer base across multiple customer verticals and geographies, with several customers capable of spending significantly in a given quarter. However, in a period where multiple key customers slow spend, our business may be harmed if our customers make an acquisition or are acquired, do not generate as much revenue as we forecast, stop purchasing from us or substantially reduce their orders to us. In particular, over the past several quarters, we have been impacted by the consolidation of several key customers. Such consolidation could reduce the number of customers that generate a significant percentage of revenue and may increase the risks relating to dependence on a small number of customers. For the three months ended July 1, 2017, three customers individually accounted for 17%, 10% and 10% of our total revenue and for the corresponding period in 2016, two customers individually accounted for 15% and 11% of our total revenue, respectively. For the six months ended July 1, 2017, one customer individually accounted for 18% of our total revenue and for the corresponding period in 2016, three customers individually accounted for 16%, 13% and 12% of our total revenue, respectively.

We are headquartered in Sunnyvale, California, with employees located throughout the Americas, Europe, Middle East and Africa, and the Asia Pacific region. We primarily sell our products through our direct sales force but also sell indirectly through channel partners. We derived 94% of our revenue from direct sales to customers during each of the three and six months ended July 1, 2017, respectively, and 96% of our revenue for each of the three and six months ended June 25, 2016, respectively, with the remainder attributable to channel-driven sales.

Critical Accounting Policies and Estimates

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

An accounting policy is deemed to be critical if it requires a significant accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably

could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements. Management believes that there have been no significant changes during the three months ended July 1, 2017 to the items that we disclosed as our critical accounting policies and

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estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

Results of Operations

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

| | Three Months Ended | | June 25, 2016 | | Change | % Change |
|-----------------------|--------------------|--------------------|---------------|--------------------|-------------|----------|
| | July 1, 2017 | | | | | |
| | Amount | % of total revenue | Amount | % of total revenue | | |
| Revenue: | | | | | | |
| Product | \$143,360 | 81 % | \$227,532 | 88 % | \$(84,172) | (37) % |
| Services | 33,461 | 19 % | 31,290 | 12 % | 2,171 | 7 % |
| Total revenue | \$176,821 | 100 % | \$258,822 | 100 % | \$(82,001) | (32) % |
| Cost of revenue: | | | | | | |
| Product | \$100,302 | 57 % | \$122,438 | 47 % | \$(22,136) | (18) % |
| Services | 11,687 | 6 % | 12,638 | 5 % | (951) | (8) % |
| Total cost of revenue | \$111,989 | 63 % | \$135,076 | 52 % | \$(23,087) | (17) % |
| Gross profit | \$64,832 | 36.7 % | \$123,746 | 47.8 % | \$(58,914) | (48) % |
| | | | | | | |
| | Six Months Ended | | June 25, 2016 | | Change | % Change |
| | July 1, 2017 | | | | | |
| | Amount | % of total revenue | Amount | % of total revenue | | |
| Revenue: | | | | | | |
| Product | \$290,413 | 82 % | \$443,614 | 88 % | \$(153,201) | (35) % |
| Services | 61,930 | 18 % | 60,026 | 12 % | 1,904 | 3 % |
| Total revenue | \$352,343 | 100 % | \$503,640 | 100 % | \$(151,297) | (30) % |
| Cost of revenue: | | | | | | |
| Product | \$199,634 | 56 % | \$240,500 | 48 % | \$(40,866) | (17) % |
| Services | 23,821 | 7 % | 23,056 | 4 % | 765 | 3 % |
| Total cost of revenue | \$223,455 | 63 % | \$263,556 | 52 % | \$(40,101) | (15) % |
| Gross profit | \$128,888 | 36.6 % | \$240,084 | 47.7 % | \$(111,196) | (46) % |

Revenue

Total product revenue decreased by \$84.2 million, or 37%, during the three months ended July 1, 2017 compared to the corresponding period in 2016. Total product revenue decreased by \$153.2 million, or 35%, during the six months ended July 1, 2017 compared to the corresponding period in 2016. These decreases were primarily attributable to effects of customer consolidation on pricing and demand, changes in certain large customers' buying patterns, and a slowdown in customer spend as we begin to transition to our next-generation of products.

Total services revenue increased by \$2.2 million, or 7%, during the three months ended July 1, 2017 compared to the corresponding period in 2016. Total service revenue increased by \$1.9 million, or 3%, during the six months ended July 1, 2017 compared to the corresponding period in 2016. The increases during the three and six month periods were attributable to continued growth in on-going support services as a result of a larger installed base of customer networks.

We currently expect that total revenue will grow marginally in the third quarter of 2017, as compared to the second quarter of 2017, driven by opportunities with traditional service providers, cable operators and ICPs, as we begin to bring new products to market. Growth opportunities over the next few quarters will be largely dependent on the introduction and acceptance of our new products.

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

| | Three Months Ended | | | | | |
|---------------------------------|--------------------|--------------------|-----------|--------------------|-------------|----------|
| | July 1, 2017 | | | June 25, 2016 | | |
| | Amount | % of total revenue | Amount | % of total revenue | Change | % Change |
| Total revenue by geography: | | | | | | |
| Domestic | \$112,196 | 63 % | \$166,710 | 64 % | \$(54,514) | (33)% |
| International | 64,625 | 37 % | 92,112 | 36 % | (27,487) | (30)% |
| | \$176,821 | 100 % | \$258,822 | 100 % | \$(82,001) | (32)% |
| Total revenue by sales channel: | | | | | | |
| Direct | \$166,826 | 94 % | \$247,459 | 96 % | \$(80,633) | (33)% |
| Indirect | 9,995 | 6 % | 11,363 | 4 % | (1,368) | (12)% |
| | \$176,821 | 100 % | \$258,822 | 100 % | \$(82,001) | (32)% |
| | Six Months Ended | | | | | |
| | July 1, 2017 | | | June 25, 2016 | | |
| | Amount | % of total revenue | Amount | % of total revenue | Change | % Change |
| Total revenue by geography: | | | | | | |
| Domestic | \$211,976 | 60 % | \$341,225 | 68 % | \$(129,249) | (38)% |
| International | 140,367 | 40 % | 162,415 | 32 % | (22,048) | (14)% |
| | \$352,343 | 100 % | \$503,640 | 100 % | \$(151,297) | (30)% |
| Total revenue by sales channel: | | | | | | |
| Direct | \$332,772 | 94 % | \$482,410 | 96 % | \$(149,638) | (31)% |
| Indirect | 19,571 | 6 % | 21,230 | 4 % | (1,659) | (8)% |
| | \$352,343 | 100 % | \$503,640 | 100 % | \$(151,297) | (30)% |

Domestic revenue decreased by \$54.5 million, or 33%, during the three months ended July 1, 2017 compared to the corresponding period in 2016. Domestic revenue decreased by \$129.2 million, or 38%, during the six months ended July 1, 2017 compared to the corresponding period in 2016. The decreases were primarily attributable to the effects of customer consolidation, and changes in certain large customers' buying patterns as we transition to our next-generation of products.

International revenue decreased by \$27.5 million, or 30%, during the three months ended July 1, 2017 compared to the corresponding period in 2016. International revenue decreased by \$22.0 million, or 14%, during the six months ended July 1, 2017 compared to the corresponding period in 2016. The decreases were primarily attributable to lower sales from our Europe, Middle East and Africa ("EMEA") and Other Americas regions, resulting from changes in certain large customers' buying patterns, slowdown in customer spend for our subsea products as we transition to our next-generation of products, and a challenging pricing environment, particularly in the EMEA region.

Cost of Revenue and Gross Margin

Gross margin was 36.7% during the three months ended July 1, 2017, down from 47.8% in the corresponding period in 2016 and decreased to 36.6% during the six months ended July 1, 2017, down from 47.7% in the corresponding period of 2016. This decline was driven by the effects of customer consolidation on revenue, changes in customer mix, strategic investments to win and preserve business as we bring our new products to market and ongoing competitive pricing pressure. Lower manufacturing levels during the three and six months ended July 1, 2017 compared to the corresponding periods in 2016 also reduced the benefits of our vertically integrated operating model. Additionally, during the first quarter of 2017, due to product quality improvements, we revised certain estimates used in calculating our product warranties, which resulted in a one-time reduction to our warranty cost of \$2.2 million.

We currently expect that gross margin in the third quarter of 2017 will decline moderately as compared to the second quarter of 2017, attributable to the high cost of our next-generation production units that we anticipate

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selling during the quarter as these units were manufactured before our manufacturing yields and unit volumes had sufficiently ramped. We also anticipate incurring significant costs as we fulfill our commitments made in previous quarters to bridge customers to our new products.

Operating Expenses

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

| | Three Months Ended | | | | | | Change | % Change |
|----------------------------|--------------------|--------------------|--|-----------------------|--------------------|-------------|--------|----------|
| | July 1, 2017 | | | June 25, 2016 | | | | |
| | Amount | % of total revenue | | Amount | % of total revenue | | | |
| Operating expenses: | | | | | | | | |
| Research and development | \$57,377 | 32 % | | \$59,541 | 23 % | \$ (2,164) | (4) % | |
| Sales and marketing | 29,397 | 17 % | | 30,465 | 12 % | (1,068) | (4) % | |
| General and administrative | 18,563 | 10 % | | 17,658 | 7 % | 905 | 5 % | |
| Total operating expenses | \$105,337 | 59 % | | \$ 107,664 | 42 % | \$ (2,327) | (2) % | |

| | Six Months Ended | | | | | | Change | % Change |
|----------------------------|------------------|--------------------|--|---------------|--------------------|-------------|--------|----------|
| | July 1, 2017 | | | June 25, 2016 | | | | |
| | Amount | % of total revenue | | Amount | % of total revenue | | | |
| Operating expenses: | | | | | | | | |
| Research and development | \$112,460 | 32 % | | \$113,686 | 23 % | \$ (1,226) | (1) % | |
| Sales and marketing | 58,838 | 17 % | | 60,474 | 12 % | (1,636) | (3) % | |
| General and administrative | 35,922 | 10 % | | 34,971 | 7 % | 951 | 3 % | |
| Total operating expenses | \$207,220 | 59 % | | \$209,131 | 42 % | \$ (1,911) | (1) % | |

Research and Development Expenses

Research and development expenses decreased by \$2.2 million, or 4%, during the three months ended July 1, 2017 and decreased by \$1.2 million, or 1%, during the six months ended July 1, 2017, compared to the corresponding period in 2016. The decreases during the three and six month periods were primarily due to lower spending on prototype, other engineering materials and related resources of \$3.5 million and \$6.6 million, respectively, as we shift manufacturing activities from the development stage to production. Additionally, during the three and six months ended July 1, 2017, we incurred lower incremental outside professional services costs of \$0.5 million and \$0.8 million, respectively, and lower discretionary spending of \$0.5 million and \$0.8 million, respectively. These decreases during the three and six months ended July 1, 2017 were offset by higher personnel costs of \$2.3 million and \$7.0 million, respectively, as a result of incremental headcount to support our next-generation products.

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Sales and Marketing Expenses

Sales and marketing expenses decreased by \$1.1 million, or 4%, during the three months ended July 1, 2017, and decreased by \$1.6 million, or 3%, during the six months ended July 1, 2017, compared to the corresponding period in 2016. The decreases during the three and six month periods were primarily driven by lower sales commissions of \$0.5 million and \$1.4 million, respectively, professional services costs of \$0.4 million and \$0.8 million, respectively, and travel related costs of \$0.3 million and \$0.9 million, respectively. Additionally, during the three months ended July 1, 2017, we incurred lower discretionary spending of \$0.2 million. These decreases during the three and six months ended July 1, 2017 were offset by higher personnel costs of \$0.3 million and \$1.5 million, respectively, due to incremental headcount to support our next-generation products and the expansion of our business into new markets and customer verticals.

General and Administrative Expenses

General and administrative expenses increased \$0.9 million, or 5%, during the three months ended July 1, 2017, and increased by \$1.0 million, or 3%, during the six months ended July 1, 2017, compared to the corresponding period in 2016. The increases during the three and six month periods were primarily due to higher personnel costs of \$0.8 million and \$1.8 million, respectively, due to incremental headcount to support the business. Additionally, during the three months ended July 1, 2017, we incurred higher discretionary spending of \$0.1 million and in the six months ended July 1, 2017, the increase offset by lower professional services costs of \$0.8 million.

Other Income (Expense), Net

| | Three Months Ended | | | | Six Months Ended | | | |
|-----------------------------------|--------------------|------------------|--------|-------------|------------------|------------------|--------|-------------|
| | July 1, 2017 | June 25, 2016 | Change | % Change | July 1, 2017 | June 25, 2016 | Change | % Change |
| | (In thousands) | | | | | | | |
| Interest income | \$862 | \$595 | \$267 | 45 % | \$1,613 | \$1,117 | \$496 | 44 % |
| Interest expense | (3,456) | (3,176) | (280) | 9 % | (6,859) | (6,331) | (528) | 8 % |
| Other gain (loss), net | (252) | (714) | 462 | (65)% | (382) | (928) | 546 | (59)% |
| Total other income (expense), net | \$(2,846) | \$(3,295) | \$449 | (14)% | \$(5,628) | \$(6,142) | \$514 | (8)% |

Interest income for three and six months ended July 1, 2017 increased by \$0.3 million and \$0.5 million, respectively, due to a higher return on investments. Interest expense for the three and six months ended July 1, 2017 increased by \$0.3 million and \$0.5 million, respectively, mainly due to an increase of amortization of discount and issuance costs related to the \$150.0 million in aggregate principal amount of 1.75% convertible senior notes due June 1, 2018 (the "Notes"). The change in other gain (loss), net, during the three and six months ended July 1, 2017 compared to the corresponding period in 2016 was primarily due to reduced losses from foreign exchange related transactions.

Income Tax Provision

Benefit from income taxes during the three and six months ended July 1, 2017 was \$0.5 million and \$0.7 million, respectively, on pre-tax loss of \$43.4 million and \$84.0 million, respectively. This compares to a tax provision of \$1.5 million and \$1.7 million, respectively, on pre-tax income of \$12.8 million and \$24.8 million, respectively, during the three and six months ended June 25, 2016. The results for the three and six months ended July 1, 2017 include approximately \$6.6 million and \$13.3 million, respectively, of purchase accounting amortization and other charges related to the acquisition of Transmode AB, with a corresponding tax benefit of approximately \$1.5 million and \$2.9 million, respectively. Exclusive of this tax benefit, provision for income taxes otherwise decreased by approximately \$2.1 million and \$2.6 million, respectively, during the three and six months ended July 1, 2017 compared to June 25, 2016, as a result of an operating loss in the United States and lower foreign income tax of our Swedish operations, offset by higher foreign taxes related to an increase in spending in certain of our cost-plus foreign subsidiaries. In all periods, the tax expense and benefit projected in our effective tax rate assumptions primarily represents foreign taxes of our overseas subsidiaries compensated on a cost-plus basis, as well as the results of our Swedish operations, inclusive of purchase accounting amortization and other charges for the three and six months ended July 1, 2017.

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Liquidity and Capital Resources

Six Months Ended
July 1, June 25,
2017 2016

(In thousands)

Net cash flow provided by (used in):

| | | |
|----------------------|------------|------------|
| Operating activities | \$(18) | \$38,200 |
| Investing activities | \$(61,079) | \$(28,675) |
| Financing activities | \$15,417 | \$(19,438) |

July 1, December
2017 31, 2016

(In thousands)

| | | |
|-------------------------------------|-----------|-----------|
| Cash and cash equivalents | \$119,820 | \$162,641 |
| Short and long-term investments | 207,034 | 182,476 |
| Short and long-term restricted cash | 6,453 | 14,939 |
| | \$333,307 | \$360,056 |

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

Operating Activities

Net cash used in operating activities during the six months ended July 1, 2017 was not significant as compared to net cash provided by operating activities of \$38.2 million for the corresponding period in 2016.

Net loss adjusted for non-cash items was \$21.3 million during the six months ended July 1, 2017 compared to net income adjusted for non-cash items of \$77.8 million for the corresponding period in 2016.

Net cash used to fund working capital was \$21.3 million during the six months ended July 1, 2017. Accounts receivable decreased by \$27.6 million as our revenue levels decreased significantly during the six months ended July 1, 2017. Accounts payable increased by \$16.9 million primarily reflecting increased inventory purchases and timing of payments during the period. Accrued liabilities and other expenses decreased \$4.4 million primarily due to reduced levels of compensation related accruals and the corporate bonus payout during the six months ended July 1, 2017. Deferred revenue increased \$10.1 million attributable to commercial arrangements with customers to transition to new products and continued growth in on-going support services, which are typically contracted on an annual or multi-year basis. Accrued warranty decreased \$8.1 million primarily due to changes in estimated repair and replacement costs, along with improved failure rates.

Net cash used to fund working capital was \$39.6 million during the six months ended June 25, 2016. Inventory increased by \$31.3 million as a result of stocking more components due to longer lead times with suppliers and building up PIC die bank inventory to meet future demand. Accounts payable decreased by \$7.3 million primarily reflecting timing of purchases and payments during the period. Deferred revenue increased \$10.1 million due to higher on-going support services as we continued to grow our installed base.

Investing Activities

Net cash used in investing activities during the six months ended July 1, 2017 was \$61.1 million as compared to net cash provided by of \$28.7 million in the corresponding period in 2016. Investing activities during the six months ended July 1, 2017 included net usage of \$24.9 million associated with purchases, maturities and sales of investments and capital expenditures of \$39.2 million, of which \$12.4 million was due to our purchase of our module manufacturing facility in Pennsylvania in May 2017. Investing activities during the six months ended June 25, 2016 included net usage of \$5.3 million associated with purchases, maturities and sales of investments, offset by capital

expenditures of \$23.3 million.

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Financing Activities

Net cash provided by financing activities during the six months ended July 1, 2017 was \$15.4 million compared to net cash used by financing activities of \$19.4 million in the corresponding period of 2016. Financing activities during the six months ended July 1, 2017 included \$5.6 million in cash released from the security pledge maintained during the period to acquire the remaining 4.2% of Transmode AB shares not tendered in the initial acquisition offer.

Additionally, both periods included net proceeds from the issuance of shares under our 2007 Employee Stock Purchase Plan (“ESPP”). These proceeds were offset by the minimum tax withholdings paid on behalf of certain employees for net share settlements of restricted stock units.

Liquidity

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

In May 2013, we issued the Notes, which will mature on June 1, 2018, unless earlier purchased by us or converted. Interest is payable semi-annually in arrears on June 1 and December 1 of each year, commencing December 1, 2013. The net proceeds from the Notes issuance were approximately \$144.5 million and were intended to be used for working capital and other general corporate purposes.

Due to the upcoming maturity of the Notes on June 1, 2018, the outstanding principal amount was reclassified from long-term debt to short-term debt in our condensed consolidated balance sheets during the three months ended July 1, 2017.

During the three months ended July 1, 2017, the closing price of our common stock did not meet the conversion criteria; therefore, holders of the Notes may not convert their Notes during the second quarter of 2017. Any conversion of the Notes prior to their maturity or acceleration of the repayment of the Notes could have a material adverse effect on our cash flows, business, results of operations and financial condition, if we choose to settle the amounts in cash. Should the closing price conditions be met during the 30 consecutive trading days prior to the end of the second quarter of 2017 or a future quarter, the Notes will be convertible at their holders’ option during the immediately following quarter. Under current market conditions, we do not expect the Notes will be converted in the short-term, even if the conversion criteria is met. Holders may also convert their Notes at any time on or after December 1, 2017 until the close of business on the second scheduled trading day immediately preceding the maturity date.

Upon conversion, it is our intention to pay cash equal to the lesser of the aggregate principal amount or the conversion value of the Notes. For any remaining conversion obligation, we intend to pay cash, shares of common stock or a combination of cash and shares of common stock, at our election. As of July 1, 2017, short-term debt, net, was \$139.1 million, which represents the liability component of the \$150.0 million principal balance, net of \$10.9 million of unamortized debt discount and debt issuance costs. The debt discount and debt issuance costs are currently being amortized over the remaining term until maturity of the Notes on June 1, 2018. To the extent that the holders of the Notes request conversion during an early conversion window, we may require funds for repayment of such Notes prior to their maturity date.

As of July 1, 2017, contractual obligations related to the Notes are payments of \$1.3 million due in the remainder of 2017 and \$151.3 million due in 2018. These amounts represent principal and interest cash payments over the term of the Notes. Any future redemption, conversion or refinancing of the Notes could impact the amount or timing of our cash payments. For more information regarding the Notes, see Note 10, “Convertible Senior Notes” to the Notes to Consolidated Financial Statements.

During the six months ended July 1, 2017, in association with the compulsory acquisition proceedings in accordance with Swedish law, we paid \$0.5 million to the minority shareholders of Transmode AB based on the final determination of the arbitration tribunal. We were also required to pay the litigation costs of the minority shareholders and compensation of the arbitrators. During the period, we maintained a security pledge of

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approximately \$5.2 million while all proceedings finalized. As of July 1, 2017, all funds from the pledged account were returned to a non-pledged account.

As of July 1, 2017, we had \$257.7 million of cash, cash equivalents, and short-term investments, including \$49.6 million of cash and cash equivalents held by our foreign subsidiaries. Our cash in foreign locations is used primarily for operational activities in those locations, and we do not currently have the need or the intent to repatriate those funds to the United States. Our policy with respect to undistributed foreign subsidiaries' earnings is to consider those earnings to be indefinitely reinvested. If we were to repatriate these funds, we would be required to accrue and pay U.S. taxes on such amounts, however, due to our significant net operating loss carryforward position for both federal and state tax purposes, as well as the full valuation allowance provided against our U.S. and state net deferred tax assets, we would currently be able to offset any such tax obligations in their entirety. However, foreign withholding taxes may be applicable.

Contractual Obligations

In May 2017, we purchased a module manufacturing facility and the associated land that we had previously leased. This operating lease was terminated without penalty. As a result of the purchase, our future minimum operating lease payments decreased by \$12.6 million.

As of July 1, 2017, repayment of the Notes of \$152.6 million, including interest, is due within one year on June 1, 2018.

Off-Balance Sheet Arrangements

As of July 1, 2017, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

For a discussion of our exposure to market risk, see "Quantitative and Qualitative Disclosures About Market Risk" in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. There have been no material changes to our market risk during the six months ended July 1, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the three months ended July 1, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On November 23, 2016, Oyster Optics, LLC (“Oyster Optics”) filed a complaint against us in the United States District Court for the Eastern District of Texas. The complaint asserts U.S. Patent Nos. 6,469,816, 6,476,952, 6,594,055, 7,099,592, 7,620,327, 8,374,511 and 8,913,898 (collectively, the “Oyster Optics patents in suit”). The complaint seeks unspecified damages and a permanent injunction. We believe that we do not infringe any valid and enforceable claim of the Oyster Optics patents in suit, and intend to defend this action vigorously. We filed our answer to Oyster Optics on February 3, 2017. The Court has set a trial for June 2018. We are currently unable to predict the outcome of this litigation and therefore cannot reasonably estimate the possible loss or range of loss, if any, arising from this matter.

On March 24, 2017, Core Optical Technologies, LLC (“Core Optical”) filed a complaint against us in the United States District Court for the Central District of California. The complaint asserts U.S. Patent No. 6,782,211 (the “Core Optical patent in suit”). The complaint seeks unspecified damages and a permanent injunction. We believe that we do not infringe any valid and enforceable claim of the Core Optical patent in suit, and intend to defend this action vigorously. Because this action is in the early stages, we are unable to predict the outcome of this litigation at this time and therefore cannot reasonably estimate the possible loss or range of loss, if any, arising from this matter.

In addition to the matters described above, we are subject to various legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material effect on our consolidated financial position, results of operations or cash flows.

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Item 1A. Risk Factors

Investing in our securities involves a high degree of risk and a description of the risks and uncertainties associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risks and uncertainties associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. You should carefully consider such risks and uncertainties, together with the other information contained in this report, our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 and in our other public filings. Because of the following factors, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods. If any of such risks and uncertainties actually occurs, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this report and in our other public filings, which could cause the market price of our common stock to decline, perhaps significantly.

Our quarterly results may vary significantly from period to period, which could make our future results difficult to predict and could cause our operating results to fall below investor or analyst expectations.

Our quarterly results, in particular, our revenue, gross margins, operating expenses, operating margins and net income (loss), have historically varied from period to period and may continue to do so in the future. As a result, comparing our operating results on a period-to-period basis may not be meaningful. Our budgeted expense levels are based, in large part, on our expectations of future revenue and the development efforts associated with that future revenue.

Given the relatively fixed nature of our operating costs including those relating to our personnel and facilities, particularly for our engineering personnel, any substantial adjustment to our expenses to account for lower levels of revenue will be difficult to execute and may take significant time. Consequently, if our revenue does not meet projected levels in the short-term, our inventory levels, gross margin and operating expenses would be high relative to revenue, resulting in potential operating losses. For example, in the fourth quarter of 2016, and the first and second quarters of 2017, we had operating losses of \$45.9 million, \$37.8 million and \$40.5 million, respectively, largely as a result of lower revenue and gross margins.

Factors that may contribute to fluctuations in our quarterly results, many of which are outside our control and may be difficult to predict, include:

- fluctuations in demand, sales cycles and prices for products and services, including discounts given in response to competitive pricing pressures, as well as the timing of purchases by our key customers;
- changes in customers’ budgets for optical transport network equipment purchases and changes or variability in their purchasing cycles;
- fluctuations in our customer, product or geographic mix, including the impact of new customer deployments, which typically carry lower gross margins, and increased customer consolidation, which may affect our ability to grow revenue;
- the timing and acceptance of our new product releases and our competitors’ new product releases;
- how quickly, or at all, the markets in which we operate adopt our solutions;
- order cancellations or reductions or delays in delivery schedules by our customers;
- our ability to control costs, including our operating expenses and the costs and availability of components we purchase for our products;
- our ability to maintain volumes and yields on products manufactured in our internal manufacturing facilities;
- any significant changes in the competitive dynamics of our market, including any new entrants, new technologies or customer or competitor consolidation;
- readiness of customer sites for installation of our products as well as the availability of third party suppliers to provide contract engineering and installation services for us;
- the timing of recognizing revenue in any given quarter, including the impact of revenue recognition standards and any future changes in U.S. GAAP or new interpretations of existing accounting rules;

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the impact of a significant natural disaster, such as an earthquake, severe weather, or tsunami or other flooding, as well as interruptions or shortages in the supply of utilities such as water and electricity, in a key location such as our Northern California facilities, which is located near major earthquake fault lines and in a designated flood zone; and general economic conditions in domestic and international markets.

Many factors affecting our results of operations are beyond our control and make it difficult to predict our results for a particular quarter or to accurately predict future revenue beyond a one-quarter time horizon. If our revenue or operating results do not meet the expectations of investors or securities analysts or fall below any guidance we provide to the market, the price of our common stock may decline substantially.

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

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

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

completion of product development, including the development and completion of our next-generation PICs and specialized ASICs, and the completion of associated module development, including modules developed by third parties;

the qualification and multiple sourcing of critical components;

validation of manufacturing methods and processes;

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

validation of software; and

establishment of systems integration and systems test validation requirements.

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

Increased consolidation among our customers in the communications networking industry could adversely affect our business, financial condition and results of operations.

We have seen increased consolidation in the communications networking industry over the past year. For example, during 2016, Charter Communications completed its acquisition of Time Warner Cable, Inc. and Altice completed its acquisition of Cablevision, and during the first quarter of 2017, Verizon completed its acquisition of XO Communications. In addition, in 2016, CenturyLink announced its intent to acquire Level 3 Communications with the deal expected to close in the second half of 2017. Customer consolidation can lead to changes in buying patterns, a slowdown in spending, redeployment of existing equipment or re-architecture of parts of an existing network or future networks, as the combined companies evaluate the needs of the combined business. Moreover, the significant

purchasing power of these large companies could increase pricing and competitive pressures for us,

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including the potential for decreases in our average selling prices. If one of our customers is acquired by another company that does not rely on us to provide it with products or relies on another provider of similar products, we may lose that customer's business. Such consolidation may further reduce the number of customers that generate a significant percentage of our revenue and may exacerbate the risks relating to dependence on a small number of customers. Any of the foregoing results could adversely affect our business, financial condition and results of operations.

Our ability to increase our revenue will depend upon continued growth of demand by consumers and businesses for additional network capacity and on the level and timing of capital spending by our customers.

Our future success depends on factors that increase the amount of data transmitted over communications networks and the growth of optical transport networks to meet the increased demand for optical capacity. These factors include the growth of mobile, video and cloud-based services, increased broadband connectivity and the continuing adoption of high-capacity, revenue-generating services. If demand for such bandwidth does not continue, or slows down, the market for optical transport networking equipment may not continue to grow and our product sales would be negatively impacted.

In addition, demand for our products depends on the level and timing of capital spending in optical networks by service providers as they construct, expand and upgrade the capacity of their optical networks. Capital spending is cyclical in our industry and spending by customers can change on short notice. Any future decisions by our customers to reduce capital spending, whether caused by lower customer demand or weakening economic conditions, changes in government regulations relating to telecommunications and data networks, customer consolidation or other reasons, could have a material adverse effect on our business, results of operations and financial condition.

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

A relatively small number of customers account for a large percentage of our revenue from period to period. For example, for the first quarter of 2017, our top five customers accounted for approximately 45% of our total revenue, for the second quarter of 2017, our top five customers accounted for approximately 47% of our total revenue, and for the fiscal year 2016, our top five customers accounted for approximately 46% of our total revenue. Our business will likely be harmed if any of our key customers make an acquisition or are acquired, do not generate as much revenue as we forecast, stop purchasing from us, delay anticipated product purchases, or substantially reduce their orders to us. In addition, our business will be harmed if we fail to maintain our competitive advantage with our key customers. We continue to expect a relatively small number of customers to continue to account for a large percentage of revenue from period to period. However, customer consolidation could reduce the number of key customers that generate a significant percentage of our revenue and may increase the risks relating to dependence on a small number of customers.

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

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

Our gross margin fluctuates from period-to-period and varies by customer and by product. Over the past eight fiscal quarters, our gross margin has ranged from 36.1% to 47.8%. Our gross margin is likely to continue to fluctuate and will be affected by a number of factors, including:

- the mix in any period of the types of customers purchasing our products as well as the product mix;

the timing of deploying solutions powered by our next generation technologies, which are often lower margin initially, as per unit production costs for initial units tend to be higher and experience more variability in production yields;

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- the pace at which we deploy solutions powered by our next generation technologies, which could lead to higher excess or obsolete inventory;
- significant new deployments to existing and new customers, often with a higher portion of lower margin common equipment as we deploy network footprint;
- volume of units manufactured in our PIC facility;
- pricing and commercial terms designed to secure long-term customer relationships;
- the volume of Infinera Instant Bandwidth- and Instant Network-enabled solutions sold, and capacity licenses activated;
- price discounts negotiated by our customers;
- charges for excess or obsolete inventory;
- changes in the price or availability of components for our products;
- changes in our manufacturing costs, including fluctuations in yields and production volumes; and
- changes in warranty related costs.

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

Aggressive business tactics by our competitors may harm our business.

The markets in which we compete are extremely competitive and this often results in aggressive business tactics by our competitors, including:

- aggressively pricing their optical transport products and other portfolio products, including offering significant one-time discounts and guaranteed future price decreases;
- offering optical products at a substantial discount or for free when bundled together with broader technology purchases, such as router or wireless equipment purchases;
- providing financing, marketing and advertising assistance to customers;
- influencing customer requirements to emphasize different product capabilities, which better suit their products; and
- repurchasing our equipment from existing customers.

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

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

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

The markets in which we compete are highly competitive and we may not be able to compete effectively.

Competition in the optical transport networking equipment market is intense, and we expect such competition to increase. Our main competitors include WDM suppliers, such as ADVA, Ciena, Cisco, Coriant, Huawei, Nokia and ZTE. In addition, there are several smaller but established companies that offer one or more products that compete with our offerings.

Competition in the markets we serve is based on any one or a combination of the following factors:

- price and other commercial terms;
- functionality;
- form factor or density;
- power consumption;
- heat dissipation;
- customer qualification testing;
- existing business and customer relationships;
- the ability of products and services to meet customers' immediate and future network requirements;
- installation and operational simplicity;
- service and support;
- security and encryption requirements;
- scalability and investment protection; and
- product lead times.

In addition to the current competitors, other companies have, or may in the future develop, products that are or could be competitive with our products. We also expect to encounter further consolidation in the markets in which we compete. Consolidation among our competitors could lead to a changing competitive landscape, capabilities and market share, which could harm our results of operations.

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

We also compete with low-cost producers that can increase pricing pressure on us and a number of smaller companies that provide competition for a specific product, customer segment or geographic market. In addition, we

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may also face increased competition from system and component companies that develop products based on off-the-shelf hardware that offers the latest commercially available technologies. Due to the narrower focus of their efforts, these competitors may achieve commercial availability of their products more quickly than we can and may provide attractive alternatives to our customers.

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

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

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

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

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

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

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

Many of our customers are large service providers that have substantial purchasing power and leverage in negotiating contractual arrangements with us. Our customers have and may continue to seek advantageous pricing, payment and other commercial terms. We have and may continue to agree to unfavorable commercial terms with these customers, including the potential of reducing the average selling price of our products, increasing cost of

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sales or agreeing to extended payment terms in response to these commercial requirements or competitive pricing pressures. To maintain acceptable operating results, we will need to comply with these commercial terms, develop and introduce new products and product enhancements on a timely basis, and continue to reduce our costs.

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

We currently purchase several key components for our products from sole or limited sources. In particular, we rely on our own production of certain components of our products, such as PICs, and on third parties, including sole source and limited source suppliers, for certain of the components of our products, including ASICs, field-programmable gate arrays, processors, and other semiconductor and optical components. We have increased our reliance on third parties to develop and manufacture components for certain products, some of which require custom development. We purchase most of these components on a purchase order basis and only have some long-term contracts with these sole source or limited source suppliers. If any of our sole source or limited source suppliers suffer from capacity constraints, lower than expected yields, deployment delays, work stoppages or any other reduction or disruption in output, they may be unable to meet our delivery schedule which could result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships. Further, our suppliers could enter into exclusive arrangements with our competitors, refuse to sell their products or components to us at commercially reasonable prices or at all, go out of business or discontinue their relationships with us. We may be unable to develop alternative sources for these components.

The loss of a source of supply, or lack of sufficient availability of key components, could require us to redesign products that use such components, which could result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships. In addition, if we do not receive critical components for our products in a timely manner, we will be unable to deliver those components to our contract manufacturer in a timely manner and would, therefore, be unable to meet our prospective customers' product delivery requirements. In the past, we have experienced delivery delays because of lack of availability of components or reliability issues with components that we were purchasing. In addition, some of our suppliers have gone out of business, merged with another supplier, or limited their supply of components to us, which may cause us to experience longer than normal lead times and supply delays. We may in the future experience a shortage of certain components as a result of our own manufacturing issues, manufacturing issues at our suppliers or contract manufacturers, capacity problems experienced by our suppliers or contract manufacturers, strong demand in the industry for such components, or other disruptions in our supply chain. In addition, global macroeconomic conditions are likely to continue to create pressure on us and our suppliers to accurately project overall component demand and manufacturing capacity. These supplier disruptions may continue to occur in the future, which could limit our ability to produce our products and cause us to fail to meet a customer's delivery requirements. Any failure to meet our customers' product delivery requirements could harm our reputation and our customer relationships, either of which would harm our business and operating results.

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

We generate forecasts of future demand for our products several months prior to the scheduled delivery to our prospective customers. This requires us to make significant investments before we know if corresponding revenue will be recognized. Lead times for materials and components, including ASICs, that we need to order for the manufacture of our products vary significantly and depend on factors such as the specific supplier, contract terms and demand for each component at a given time. In the past, we have experienced lengthening in lead times for certain components. If the lead times for components are lengthened, we may be required to purchase increased levels of such components to satisfy our delivery commitments to our customers. In addition, we must manage our inventory to ensure we continue to meet our commitments as we introduce new products or make enhancements to our existing products.

If we overestimate market demand for our products and, as a result, increase our inventory in anticipation of customer orders that do not materialize, we will have excess inventory, which could result in increased risk of obsolescence and significant inventory write-downs. Furthermore, this will result in reduced production volumes and our fixed costs will be spread across fewer units, increasing our per unit costs. If we underestimate demand for our products, we will

have inadequate inventory, which could slow down or interrupt the manufacturing of our products and result in delays in shipments and our ability to recognize revenue. In addition, we may be unable to meet our supply commitments to customers, which could result in a loss of certain customer opportunities or a breach of our customer agreements resulting in payment of damages.

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

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

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

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

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

Our products can have a lengthy sales cycle, which can extend from six to twelve months and may take even longer for larger prospective customers. Our prospective customers conduct significant evaluation, testing, implementation and acceptance procedures before they purchase our products. We incur substantial sales and marketing expenses and expend significant management effort during this time, regardless of whether we make a sale.

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

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

The development and production of products with high technology content is complicated and often involves problems with software, components and manufacturing methods. Complex hardware and software systems, such as our products, can often contain undetected errors when first introduced or as new versions are released. In addition, errors associated with components we purchase from third parties, including customized components, may be difficult to resolve. We have experienced issues in the past in connection with our products, including failures due to the receipt of faulty components from our suppliers. In addition, performance issues can be heightened during periods where we are developing and introducing multiple new products to the market, as any performance issues we encounter in one technology or product could impact the performance or timing of delivery of other products. Our products may suffer degradation of performance and reliability over time.

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

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• reduced orders from existing customers;
• declining interest from potential customers;
• delays in our ability to recognize revenue or in collecting accounts receivables;
• costs associated with fixing hardware or software defects or replacing products;
• high service and warranty expenses;
• delays in shipments;
• high inventory excess and obsolescence expense;
• high levels of product returns;
• diversion of our engineering personnel from our product development efforts; and
• payment of liquidated damages, performance guarantees or similar penalties.

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

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

In recent years, we have substantially grown our employee base and expanded our product portfolio, and if we do not effectively manage any future growth or are unable to improve our systems, processes and controls, our operating results may be adversely affected.

In recent years, our employee headcount and number of product offerings have increased significantly. For example, from the end of fiscal 2014 to the end of fiscal 2016, our headcount increased from 1,495 to 2,240 employees. The growth and expansion of our product and service offerings places a continuous significant strain on our management, and operational and financial resources. To manage any future growth effectively, we must continue to improve and expand our information technology and financial infrastructure, our operating and administrative systems, and our ability to manage headcount and retain key talent.

We may not be able to successfully scale improvements to our enterprise resource planning system or implement or scale improvements to our other systems, processes and controls in an efficient or timely manner, or in a manner that does not negatively affect our operating results. In addition, our existing systems, processes and controls may not prevent or detect all errors, omissions or fraud. We may experience difficulties in managing improvements to our systems, processes and controls, or in connection with third-party software, which could disrupt existing customer relationships, cause us to lose customers, or increase our technical support costs. Our failure to improve our systems, processes and controls, or their failure to operate in the intended manner, may result in our inability to manage the growth of our business and to accurately forecast our revenue, expenses and earnings, or to prevent certain losses. Failure to manage any future growth effectively could result in increased costs, negatively impact our customers' satisfaction with our products and services, and harm our operating results.

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

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

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

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

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, many leading companies in the optical transport networking industry, including our competitors, have extensive patent portfolios with respect to optical transport networking technology. In addition, patent holding companies seek to monetize patents they have purchased or otherwise obtained. We expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps occur. From time to time, third parties may assert exclusive patent, copyright, trademark and other intellectual property rights to technologies and related standards that are important to our business or seek to invalidate the proprietary rights that we hold. Competitors or other third parties have, and may continue to assert claims or initiate litigation or other proceedings against us or our manufacturers, suppliers or customers alleging infringement of their proprietary rights, or seeking to invalidate our proprietary rights, with respect to our products and technology. In addition, we have had certain patent licenses with third parties that have not been renewed, and if we cannot successfully renew these licenses, we could face claims of infringement. In the event that we are unsuccessful in defending against any such claims, or any resulting lawsuit or proceedings, we could incur liability for damages and/or have valuable proprietary rights invalidated.

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

parties. If any of these claims succeed, we may be forced to pay damages on behalf of our customers or sales partners, which could have an adverse effect on our business, financial condition and operating results.

We may also be required to indemnify some customers under our contracts if a third party alleges, or a court finds, that our products have infringed upon the proprietary rights of other parties. From time to time, we have agreed to indemnify certain customers for claims made against our products, where such claims allege infringement of third party intellectual property rights, including, but not limited to, patents, registered trademarks and/or

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copyrights. If we are required to make a significant payment under any of our indemnification obligations, our result of operations may be harmed.

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

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

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

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

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

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

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

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

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

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

Our debt obligations may adversely affect our ability to raise additional capital and will be a burden on our future cash resources, particularly if we elect to settle these obligations in cash upon conversion or upon maturity or required repurchase.

In May 2013, we issued the Notes, which will mature on June 1, 2018, unless earlier repurchased by us or converted. The degree to which we are leveraged could have important consequences, including, but not limited to, the following:

- our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, litigation, general corporate or other purposes may be limited; and
- a substantial portion of our future cash balance may be dedicated to the payment of the principal of our indebtedness as we have stated the intention to pay the principal amount of the Notes in cash upon conversion or when otherwise due, such that we would not have those funds available for use in our business.

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

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

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

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The fundamental change provisions of the Notes may delay or prevent an otherwise beneficial takeover attempt of us. If a fundamental change, such as an acquisition of our company, occurs prior to the maturity of the Notes, holders of the Notes will have the right, at their option, to require us to repurchase all or a portion of their Notes. In addition, if such fundamental change also constitutes a make-whole fundamental change, the conversion rate for the Notes may be increased upon conversion of the Notes in connection with such make-whole fundamental change. Any increase in the conversion rate will be determined based on the date on which the make-whole fundamental change occurs or becomes effective and the price paid (or deemed paid) per share of our common stock in such transaction. Any such increase will be dilutive to our existing stockholders. Our obligation to repurchase Notes or increase the conversion rate upon the occurrence of a make-whole fundamental change may, in certain circumstances, delay or prevent a takeover of us that might otherwise be beneficial to our stockholders.

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

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

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

Sales of our products into international markets are an important part of our business. During fiscal 2016 and 2015, we derived approximately 38% and 32%, respectively, of our revenue from customers outside of the United States. We expect that significant management attention and financial resources will be required for our international activities over the foreseeable future as we continue to expand our international presence. In some countries, our success in selling our products and growing revenue will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements for international sales of our products could impact our ability to maintain or increase international market demand for our products. In addition, many of the companies we compete against internationally have greater name recognition and a more substantial sales and marketing presence.

We have sales and support personnel in numerous countries worldwide. In addition, we have established development centers in Canada, China, India and Sweden. There is no assurance that our reliance upon development resources in international locations will enable us to achieve meaningful cost reductions or greater resource efficiency.

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

- greater difficulty in collecting accounts receivable and longer collection periods;
- difficulties of managing and staffing international offices, and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- political, social and economic instability, including wars, terrorism, political unrest, boycotts, curtailment of trade and other business restrictions;
- tariff and trade barriers and other regulatory requirements or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- less effective protection of intellectual property than is afforded to us in the United States or other developed countries;
- local laws and practices that favor local companies, including business practices that we are prohibited from engaging in by the Foreign Corrupt Practices Act and other anti-corruption laws and regulations;
- potentially adverse tax consequences; and

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effects of changes in currency exchange rates, particularly relative increases in the exchange rate of the U.S. dollar versus other currencies that could negatively affect our financial results and cash flows.

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

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

As we continue to expand our business globally, our success will depend, in large part, on our ability to effectively anticipate and manage these and other risks and expenses associated with our international operations. For example, political instability and uncertainty in the European Union and, in particular, the United Kingdom's pending exit from the E.U. (Brexit) as well as other countries potentially choosing to exit the E.U., could slow economic growth in the region, affect foreign exchange rates, and could further discourage near-term economic activity, including our customers delaying purchases of our products. Our failure to manage any of these risks successfully could harm our international operations and reduce our international sales, and business generally, adversely affecting our business, operating results and financial condition.

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

A portion of our sales and expenses stem from countries outside of the United States, and are in currencies other than U.S. dollars, and therefore subject to foreign currency fluctuation. Accordingly, fluctuations in foreign currency rates could have a material impact on our financial results in future periods. We may enter into other financial contracts to reduce the impact of foreign currency fluctuations. We currently enter into foreign currency exchange forward contracts to reduce the impact of foreign currency fluctuations on accounts receivable. These forward contracts reduce the impact of currency exchange rate movements on certain transactions, but do not cover all foreign-denominated transactions and therefore do not entirely eliminate the impact of fluctuations in exchange rates that could negatively affect our results of operations and financial condition.

Our effective tax rate may increase or fluctuate, which could increase our income tax expense and reduce our net income.

Our effective tax rate can be adversely affected by several factors, many of which are outside of our control, including:

- changes in the valuation of our deferred tax assets and liabilities, and in deferred tax valuation allowances;
- changes in the relative proportions of revenue and income before taxes in the various jurisdictions in which we operate that have differing statutory tax rates;
- changing tax laws, regulations, rates and interpretations in multiple jurisdictions in which we operate;
- changes in accounting and tax treatment of equity-based compensation;
- changes to the financial accounting rules for income taxes; and
- the resolution of issues arising from tax audits.

The international tax environment continues to change as a result of both coordinated actions by governments and unilateral measures designed by individual countries, both intended to tackle concerns over base erosion and profit shifting (“BEPS”) and perceived international tax avoidance techniques. The recommendations of the BEPS Project led by the Organization for Economic Cooperation and Development are involved in much of the coordinated activity,

although the timing and methods of implementation vary. Additionally, comprehensive U.S. tax

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reform has been stated to be a priority for the U.S. Congress and the new administration. Such changes in tax laws or their interpretation, if adopted, could adversely affect our effective tax rates and our results.

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

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

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

We may make strategic acquisitions of businesses, technologies and other assets. For example, we completed the acquisition of Transmode AB in August 2015. If we are not able to achieve the anticipated strategic benefits of such acquisitions, it could adversely affect our business, financial condition and results of operations. In addition, the market price of our common stock could be adversely affected if the integration or the anticipated financial and strategic benefits of such acquisitions are not realized as rapidly as, or to the extent anticipated by investors and analysts.

The expansion of our business through acquisitions allows us to complement our technological capabilities and address new markets. In the event of any future acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or they may be viewed negatively by customers, financial markets or investors and we could:

- issue stock that would dilute our current stockholders' percentage ownership;
- incur debt and assume other liabilities;
- use a substantial portion of our cash resources; or
- incur amortization expenses related to other intangible assets and/or incur large and immediate write-offs.

Acquisitions can result in adverse tax consequences, warranty or product liability exposure related to acquired assets, additional stock-based compensation expense, and write-up of acquired inventory to fair value. In addition, we may record goodwill and other purchased intangible assets in connection with an acquisition and incur impairment charges in the future. If our actual results, or the plans and estimates used in future impairment analyses, are less favorable than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges.

Acquisitions also involve numerous risks that could disrupt our ongoing business and distract our management team, including:

- problems integrating the acquired operations, technologies or products with our own;
- diversion of management's attention from our core business;
- adverse impact on overall company operating results;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering new markets; and
- loss of key employees.

Our failure to adequately manage the risks associated with an acquisition could have an adverse effect on our business, financial condition and operating results.

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

Our manufacturing operations use substances that are regulated by various federal, state and international laws governing health, safety and the environment, including the Waste Electrical and Electronic Equipment Directive, Directive on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment, and the Registration, Evaluation, Authorization, and Restriction of Chemicals regulations adopted by the

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European Union. If we experience a problem with complying with these regulations, it could cause an interruption or delay in our manufacturing operations or could cause us to incur liabilities for any costs related to health, safety or environmental remediation. We could also be subject to liability if we do not handle these substances in compliance with safety standards for storage and transportation and applicable laws. If we experience a problem or fail to comply with such safety standards, our business, financial condition and operating results may be harmed.

We are subject to governmental regulations that could adversely affect our business.

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

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

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

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

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

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

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

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

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law, which apply to us, may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our amended and restated certificate of incorporation and amended and restated bylaws:

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

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

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

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

- prevent stockholders from calling special meetings; and

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

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Item 6. Exhibits

Exhibit No. Description

| | |
|-------------|---|
| <u>10.1</u> | <u>Infinera Corporation 2016 Equity Incentive Plan, as amended, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (No. 001-33486) filed with the SEC on May 30, 2017.</u> |
| <u>31.1</u> | <u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>31.2</u> | <u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>32.1</u> | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

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

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SIGNATURES

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

Infinera Corporation

By: /s/ BRAD D. FELLER
Brad D. Feller
Chief Financial Officer
(Duly Authorized Officer and Principal
Financial Officer)

Date: August 8, 2017