

CIENA CORP  
Form 10-Q  
March 05, 2010

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549  
FORM 10-Q**

(Mark one)

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

**For the quarterly period ended January 31, 2010**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 0-21969**

**Ciena Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**23-2725311**

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

**1201 Winterson Road, Linthicum, MD**

(Address of Principal Executive Offices)

**21090**

(Zip Code)

**(410) 865-8500**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

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

Smaller reporting  
company ☐

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

**Class**

**Outstanding at February 26, 2010**

common stock, \$.01 par value

92,570,585

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**CIENA CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)  
(unaudited)

	Quarter Ended January 31,	
	2009	2010
Revenue:		
Products	\$ 139,717	\$ 149,054
Services	27,683	26,822
Total revenue	167,400	175,876
Cost of goods sold:		
Products	76,367	76,669
Services	19,190	19,047
Total cost of goods sold	95,557	95,716
Gross profit	71,843	80,160
Operating expenses:		
Research and development	46,700	50,033
Selling and marketing	33,819	34,237
General and administrative	11,585	12,763
Acquisition and integration costs		27,031
Amortization of intangible assets	6,404	5,981
Restructuring costs	76	(21)
Total operating expenses	98,584	130,024
Loss from operations	(26,741)	(49,864)
Interest and other income (loss), net	4,660	(773)
Interest expense	(1,844)	(1,828)
Loss on cost method investments	(565)	
Loss before income taxes	(24,490)	(52,465)
Provision for income taxes	341	868
Net loss	\$ (24,831)	\$ (53,333)
Basic net loss per common share	\$ (0.27)	\$ (0.58)
Diluted net loss per potential common share	\$ (0.27)	\$ (0.58)
Weighted average basic common shares outstanding	90,620	92,321

Weighted average dilutive potential common shares outstanding	90,620	92,321
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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**CIENA CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share data)  
(unaudited)

	October 31, 2009	January 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 485,705	\$ 573,180
Short-term investments	563,183	428,409
Accounts receivable, net	118,251	105,624
Inventories	88,086	95,431
Prepaid expenses and other	50,537	75,423
Total current assets	1,305,762	1,278,067
Long-term investments	8,031	8,048
Equipment, furniture and fixtures, net	61,868	64,351
Other intangible assets, net	60,820	53,433
Other long-term assets	67,902	77,208
Total assets	\$ 1,504,383	\$ 1,481,107
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 53,104	\$ 76,211
Accrued liabilities	103,349	97,560
Restructuring liabilities	1,811	1,566
Income tax payable		1,306
Deferred revenue	40,565	43,722
Total current liabilities	198,829	220,365
Long-term deferred revenue	35,368	37,177
Long-term restructuring liabilities	7,794	7,184
Other long-term obligations	8,554	8,330
Convertible notes payable	798,000	798,000
Total liabilities	1,048,545	1,071,056
Commitments and contingencies		
Stockholders' equity:		
Preferred stock — par value \$0.01; 20,000,000 shares authorized; zero shares issued and outstanding		
Common stock — par value \$0.01; 290,000,000 shares authorized; 92,038,360 and 92,566,178 shares issued and outstanding	920	926
Additional paid-in capital	5,665,028	5,673,387
Accumulated other comprehensive income	1,223	404

Accumulated deficit	(5,211,333)	(5,264,666)
Total stockholders' equity	455,838	410,051
Total liabilities and stockholders' equity	\$ 1,504,383	\$ 1,481,107

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

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**CIENA CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(unaudited)

	Three Months Ended January 31,	
	2009	2010
Cash flows from operating activities:		
Net loss	\$ (24,831)	\$ (53,333)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of (discount) premium on marketable securities	(863)	365
Loss on cost method investments	565	
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	5,097	5,871
Share-based compensation costs	8,494	8,282
Amortization of intangible assets	8,055	7,631
Provision for inventory excess and obsolescence	6,548	950
Provision for warranty	2,541	3,060
Other	271	471
Changes in assets and liabilities:		
Accounts receivable	7,922	12,627
Inventories	(4,379)	(8,295)
Prepaid expenses and other	(147)	9,204
Accounts payable, accruals and other obligations	(8,781)	11,366
Income taxes payable	1,162	1,306
Deferred revenue	(2,533)	4,966
Net cash provided by (used in) operating activities	(879)	4,471
Cash flows from investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(6,140)	(7,009)
Restricted cash	(84)	(5,520)
Purchase of available for sale securities	(195,538)	(63,591)
Proceeds from maturities of available for sale securities	186,853	179,739
Proceeds from sales of available for sale securities		18,000
Deposit on pending business acquisition		(38,450)
Net cash provided by (used in) investing activities	(14,909)	83,169
Cash flows from financing activities:		
Proceeds from issuance of common stock and warrants	58	83
Net cash provided by financing activities	58	83
Effect of exchange rate changes on cash and cash equivalents	46	(248)
Net increase (decrease) in cash and cash equivalents	(15,730)	87,723
Cash and cash equivalents at beginning of period	550,669	485,705

Cash and cash equivalents at end of period	\$ 534,985	\$ 573,180
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**Supplemental disclosure of cash flow information**

Cash paid (refunded) during the period for:

Interest	\$ 2,188	\$ 2,560
Income taxes, net	\$ (695)	\$ 736

**Non-cash investing and financing activities**

Purchase of equipment in accounts payable	\$ 641	\$ 3,294
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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

**(1) INTERIM FINANCIAL STATEMENTS**

The interim financial statements included herein for Ciena Corporation ( Ciena ) have been prepared by Ciena, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, financial statements included in this report reflect all normal recurring adjustments that Ciena considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial position of Ciena at the date of the interim balance sheets. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The October 31, 2009 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. However, Ciena believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with Ciena's audited consolidated financial statements and notes thereto included in Ciena's annual report on Form 10-K for the fiscal year ended October 31, 2009.

Ciena has a 52 or 53 week fiscal year, which ends on the Saturday nearest to the last day of October of each year. For purposes of financial statement presentation, each fiscal year is described as having ended on October 31, and each fiscal quarter is described as having ended on January 31, April 30 and July 31 of each fiscal year.

During the first quarter of 2010, Ciena recorded an adjustment to reduce its warranty liability and cost of goods sold by \$3.3 million, to correct an overstatement of warranty expenses related to prior periods. The adjustment related to an error in the methodology of computing the annual failure rate used to calculate the warranty accrual. There was no tax impact as a result of this adjustment. Ciena believes this adjustment is not material to its financial statements for prior annual or interim periods, the first quarter of 2010 or the expected annual results for 2010.

Ciena performed an evaluation of events that have occurred subsequent to the end of its fiscal period through the date that the condensed consolidated financial statements were issued. As of the date of the filing of this Form 10-Q, there have been no subsequent events that occurred during such period that would require disclosure in this Form 10-Q or would be required to be recognized in the condensed consolidated financial statements.

**(2) SIGNIFICANT ACCOUNTING POLICIES**

*Use of Estimates*

The preparation of the financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Estimates are used for bad debts, valuation of inventories and investments, recoverability of intangible assets, other long-lived assets and goodwill, income taxes, warranty obligations, restructuring liabilities, derivatives and contingencies and litigation. Ciena bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results may differ materially from management's estimates.

*Cash and Cash Equivalents*

Ciena considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. Restricted cash collateralizing letters of credits are included in other current assets and other long-term assets depending upon the duration of the restriction.

*Investments*

Ciena's investments are principally in marketable debt securities. These investments are classified as available-for-sale and are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income. Ciena recognizes losses when it determines that declines in the fair value of its investments, below their cost basis, are other-than-temporary. In determining whether a decline in fair value is other-than-temporary, Ciena considers various factors including market price (when available), investment ratings, the financial condition and near-term prospects of the investee, the length of time and the extent to which the fair value

has been less than Ciena's cost basis, and its intent and ability to hold the investment until maturity or for a period of time sufficient to allow for any anticipated recovery in market value. Ciena considers all marketable debt securities that it expects to convert to cash within one year or less to be short-term investments. All others are considered long-term investments.

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### *Inventories*

Inventories are stated at the lower of cost or market, with cost computed using standard cost, which approximates actual cost on a first-in, first-out basis. Ciena records a provision for excess and obsolete inventory when an impairment has been identified.

### *Equipment, Furniture and Fixtures*

Equipment, furniture and fixtures are recorded at cost. Depreciation and amortization are computed using the straight-line method over useful lives of two years to five years for equipment, furniture and fixtures and the shorter of useful life or lease term for leasehold improvements. Upon a triggering event or changes in circumstances, a review of the fair value of our equipment, furniture and fixtures is performed and an impairment loss is recognized only if the carrying amount of the asset or asset group is determined to not be recoverable and exceeds its fair value. An impairment loss is measured as the amount by which the carrying amount of the asset or asset group exceeds its fair value.

Qualifying internal use software and website development costs incurred during the application development stage that consist primarily of outside services and purchased software license costs, are capitalized and amortized straight-line over the estimated useful life.

### *Goodwill and Other Intangible Assets*

Ciena has recorded goodwill and intangible assets as a result of several acquisitions. Ciena tests the reporting unit's goodwill for impairment on an annual basis, which Ciena has determined to be the last business day of its fiscal September each year. Testing is required between annual tests if events occur or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. Ciena operates its business and tests its goodwill for impairment as a single reporting unit.

Finite-lived intangible assets are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the economic lives of the respective assets, generally three to seven years, which approximates the use of intangible assets. Upon a triggering event or changes in circumstances, a review of the fair value of our finite-lived intangible assets is performed. Impairments of finite-lived intangible assets are recognized only if the carrying amount of the asset or asset group is determined to not be recoverable and exceeds its fair value. Upon a triggering event or changes in circumstances, a review of the fair value of our finite-lived intangible assets is performed and an impairment loss is measured as the amount by which the carrying amount of the asset or asset group exceeds its fair value.

### *Minority Equity Investments*

Ciena has certain minority equity investments in privately held technology companies that are classified as other assets. These investments are carried at cost because Ciena owns less than 20% of the voting equity and does not have the ability to exercise significant influence over these companies. These investments involve a high degree of risk as the markets for the technologies or products manufactured by these companies are usually early stage at the time of Ciena's investment and such markets may never be significant. Ciena could lose its entire investment in some or all of these companies. Ciena monitors these investments for impairment and makes appropriate reductions in carrying values when necessary.

### *Concentrations*

Substantially all of Ciena's cash and cash equivalents and short-term and long-term investments in marketable debt securities are maintained at three major U.S. financial institutions. The majority of Ciena's cash equivalents consist of money market funds. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and, therefore, management believes that they bear minimal risk.

Historically, a large percentage of Ciena's revenue has been the result of sales to a small number of communications service providers. Consolidation among Ciena's customers has increased this concentration. Consequently, Ciena's accounts receivable are concentrated among these customers. See Notes 7 and 17 below.

Additionally, Ciena's access to certain materials or components is dependent upon sole or limited source suppliers. The inability of any supplier to fulfill Ciena's supply requirements could affect future results. Ciena relies on a small number of contract manufacturers, principally in China and Thailand, to perform the majority of the manufacturing for

its products. If Ciena cannot effectively manage these manufacturers and forecast future demand, or if they fail to deliver products or components on time, Ciena's business and results of operations may suffer.

**Table of Contents***Revenue Recognition*

Ciena recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and evidence of customer acceptance, when applicable, are used to verify delivery. Ciena assesses whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. Ciena assesses collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are to be performed.

Some of Ciena's communications networking equipment is integrated with software that is essential to the functionality of the equipment. Software revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. In instances where final acceptance of the product is specified by the customer, revenue is deferred until all acceptance criteria have been met.

Arrangements with customers may include multiple deliverables, including any combination of equipment, services and software. If multiple element arrangements include software or software-related elements that are essential to the equipment, Ciena allocates the arrangement fee to be allocated to those separate units of accounting. Multiple element arrangements that include software are separated into more than one unit of accounting if the functionality of the delivered element(s) is not dependent on the undelivered element(s), there is vendor-specific objective evidence of the fair value of the undelivered element(s), and general revenue recognition criteria related to the delivered element(s) have been met. The amount of product and services revenue recognized is affected by Ciena's judgments as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence of fair value exists. Changes to the elements in an arrangement and Ciena's ability to establish vendor-specific objective evidence for those elements could affect the timing of revenue recognition. For all other deliverables, Ciena separates the elements into more than one unit of accounting if the delivered element(s) have value to the customer on a stand-alone basis, objective and reliable evidence of fair value exists for the undelivered element(s), and delivery of the undelivered element(s) is probable and substantially in Ciena's control. Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or using the residual method if objective evidence of fair value does not exist for the delivered element(s). The revenue recognition criteria described above are applied to each separate unit of accounting. If these criteria are not met, revenue is deferred until the criteria are met or the last element has been delivered.

*Warranty Accruals*

Ciena provides for the estimated costs to fulfill customer warranty obligations upon the recognition of the related revenue. Estimated warranty costs include estimates for material costs, technical support labor costs and associated overhead. The warranty liability is included in cost of goods sold and determined based upon actual warranty cost experience, estimates of component failure rates and management's industry experience. Ciena's sales contracts do not permit the right of return of product by the customer after the product has been accepted.

*Accounts Receivable, Net*

Ciena's allowance for doubtful accounts is based on its assessment, on a specific identification basis, of the collectibility of customer accounts. Ciena performs ongoing credit evaluations of its customers and generally has not required collateral or other forms of security from its customers. In determining the appropriate balance for Ciena's allowance for doubtful accounts, management considers each individual customer account receivable in order to determine collectibility. In doing so, management considers creditworthiness, payment history, account activity and communication with such customer. If a customer's financial condition changes, Ciena may be required to record an allowance for doubtful accounts, which would negatively affect its results of operations.

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### *Research and Development*

Ciena charges all research and development costs to expense as incurred. Types of expense incurred in research and development include employee compensation, prototype, consulting, depreciation, facility costs and information technologies.

### *Advertising Costs*

Ciena expenses all advertising costs as incurred.

### *Legal Costs*

Ciena expenses legal costs associated with litigation defense as incurred.

### *Share-Based Compensation Expense*

Ciena measures and recognizes compensation expense for share-based awards based on estimated fair values on the date of grant. Ciena estimates the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This model is affected by Ciena's stock price as well as estimates regarding a number of variables including expected stock price volatility over the expected term of the award and projected employee stock option exercise behaviors. Ciena estimates the fair value of each share-based award based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense to its consolidated statement of operations for those options or shares that are expected ultimately to vest. Ciena uses two attribution methods to record expense, the straight-line method for grants with service-based vesting and the graded-vesting method, which considers each performance period or tranche separately, for all other awards. See Note 15 below.

### *Income Taxes*

Ciena accounts for income taxes using an asset and liability approach that recognizes deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases, and for operating loss and tax credit carry forwards. In estimating future tax consequences, Ciena considers all expected future events other than the enactment of changes in tax laws or rates. Valuation allowances are provided, if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Ciena adopted the accounting guidance on uncertainty related to income tax positions at the beginning of fiscal 2008. The total amount of unrecognized tax benefits increased by \$0.1 million during the first quarter of fiscal 2010 to \$7.5 million, which includes \$1.2 million of interest and some minor penalties. Ciena classified interest and penalties related to uncertain tax positions as a component of income tax expense. All of the uncertain tax positions, if recognized, would decrease the effective income tax rate.

In the ordinary course of business, transactions occur for which the ultimate outcome may be uncertain. In addition, tax authorities periodically audit Ciena's income tax returns. These audits examine significant tax filing positions, including the timing and amounts of deductions and the allocation of income tax expenses among tax jurisdictions. Ciena's major tax jurisdictions include the United States, United Kingdom, Canada and India, with open tax years beginning with fiscal years 2006, 2004, 2005 and 2007, respectively. However, limited adjustments can be made to Federal tax returns in earlier years in order to reduce net operating loss carryforwards.

Ciena has not provided U.S. deferred income taxes on the cumulative unremitted earnings of its non-U.S. affiliates as it plans to permanently reinvest cumulative unremitted foreign earnings outside the U.S. and it is not practicable to determine the unrecognized deferred income taxes. These cumulative unremitted foreign earnings relate to ongoing operations in foreign jurisdictions and are required to fund foreign operations, capital expenditures, and any expansion requirements.

Ciena recognizes windfall tax benefits associated with the exercise of stock options or release of restricted stock units directly to stockholders' equity only when realized. A windfall tax benefit occurs when the actual tax benefit realized by Ciena upon an employee's disposition of a share-based award exceeds the deferred tax asset, if any, associated with the award that Ciena had recorded. When assessing whether a tax benefit relating to share-based compensation has been realized, Ciena follows the tax law with-and-without method. Under the with-and-without method, the windfall is considered realized and recognized for financial statement purposes only when an incremental benefit is provided after considering all other tax benefits including Ciena's net operating losses. The with-and-without method results in the windfall from share-based compensation awards always being effectively the last tax benefit to

be considered. Consequently, the windfall attributable to share-based compensation will not be considered realized in instances where Ciena's net operating loss carryover (that is unrelated to windfalls) is sufficient to offset the current year's taxable income before considering the effects of current-year windfalls.

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### *Loss Contingencies*

Ciena 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. Ciena considers the likelihood of loss or the incurrence of a liability, as well as Ciena's ability to reasonably estimate the amount of loss, in determining loss contingencies. 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. Ciena regularly evaluates current information available to it to determine whether any accruals should be adjusted and whether new accruals are required.

### *Fair Value of Financial Instruments*

The carrying value of Ciena's cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximates fair market value due to the relatively short period of time to maturity. The fair value of investments in marketable debt securities is determined using quoted market prices for those securities or similar financial instruments. For information related to the fair value of Ciena's convertible notes, see Note 6 below.

Fair value for the measurement of financial assets and liabilities is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. Ciena utilizes a valuation hierarchy for disclosure of the inputs for fair value measurement. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 inputs are quoted prices for identical or similar assets or liabilities in less active markets or model-derived valuations in which significant inputs are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 inputs are unobservable inputs based on Ciena's assumptions used to measure assets and liabilities at fair value.

By distinguishing between inputs that are observable in the marketplace, and therefore more objective, and those that are unobservable and therefore more subjective, the hierarchy is designed to indicate the relative reliability of the fair value measurements. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

### *Restructuring*

Ciena has previously taken actions to align its workforce, facilities and operating costs with perceived market opportunities and business conditions. Ciena implements these restructuring plans and incurs the associated liability concurrently. Generally accepted accounting principles require that a liability for the cost associated with an exit or disposal activity be recognized in the period in which the liability is incurred, except for one-time employee termination benefits related to a service period of more than 60 days, which are accrued over the service period.

### *Foreign Currency*

Some of Ciena's foreign branch offices and subsidiaries use the U.S. dollar as their functional currency, because Ciena, as the U.S. parent entity, exclusively funds the operations of these branch offices and subsidiaries with U.S. dollars. For those subsidiaries using the local currency as their functional currency, assets and liabilities are translated at exchange rates in effect at the balance sheet date, and the statement of operations is translated at a monthly average rate. Resulting translation adjustments are recorded directly to a separate component of stockholders' equity. Where the U.S. dollar is the functional currency of foreign branch offices or subsidiaries, re-measurement adjustments are recorded in other income. The net gain (loss) on foreign currency re-measurement and exchange rate changes is immaterial for separate financial statement presentation.

**Table of Contents***Derivatives*

Occasionally, Ciena uses foreign currency forward contracts to hedge certain forecasted foreign currency transactions relating to operating expenses. These derivatives, designated as cash flow hedges, have maturities of less than one year and permit net settlement.

At the inception of the cash flow hedge and on an ongoing basis, Ciena assesses the hedging relationship to determine its effectiveness in offsetting changes in cash flows attributable to the hedged risk during the hedge period. The effective portion of the hedging instrument's net gain or loss is initially reported as a component of accumulated other comprehensive income (loss), and upon occurrence of the forecasted transaction, is subsequently reclassified into the operating expense line item to which the hedged transaction relates. Any net gain or loss associated with the ineffectiveness of the hedging instrument is reported in interest and other income, net. See Note 13 below.

*Computation of Basic Net Income (Loss) per Common Share and Diluted Net Income (Loss) per Dilutive Potential Common Share*

Ciena calculates basic earnings per share (EPS) by dividing earnings attributable to common stock by the weighted-average number of common shares outstanding for the period. Diluted EPS includes the potential dilution of common stock equivalent shares that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. Ciena uses a dual presentation of basic and diluted EPS on the face of its income statement. A reconciliation of the numerator and denominator used for the basic and diluted EPS computations is set forth in Note 14.

*Software Development Costs*

Generally accepted accounting principles require the capitalization of certain software development costs incurred subsequent to the date technological feasibility is established and prior to the date the product is generally available for sale. The capitalized cost is then amortized straight-line over the estimated life of the product. Ciena defines technological feasibility as being attained at the time a working model is completed. To date, the period between Ciena achieving technological feasibility and the general availability of such software has been short, and software development costs qualifying for capitalization have been insignificant. Accordingly, Ciena has not capitalized any software development costs.

*Segment Reporting*

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. Ciena's chief operating decision maker is its chief executive officer, who reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. Ciena has one business activity, and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Accordingly, Ciena considers its business to be in a single reportable segment.

*Newly Issued Accounting Standards*

In January 2010, the FASB amended the accounting standards for fair value measurement and disclosures. The amended guidance requires disclosures regarding the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers. It also requires separate presentation of purchases, sales, issuances and settlements of Level 3 fair value measurements. The guidance is effective for interim and annual reporting periods beginning after December 15, 2009, with the exception of the additional Level 3 disclosures which are effective for fiscal years beginning after December 15, 2010. Ciena believes this new guidance will not have a material impact on its financial condition, results of operations and cash flows.

In October 2009, the FASB amended the accounting standards for revenue recognition with multiple deliverables. The amended guidance allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence or third-party evidence is unavailable. Additionally, it eliminates the residual method of revenue recognition in accounting for multiple deliverable arrangements. The guidance is effective for fiscal years beginning on or after June 15, 2010, early adoption is permitted. Ciena is currently evaluating the impact this new guidance could have on its financial condition, results of operations and cash flows.

In October 2009, the FASB amended the accounting standards for revenue arrangements with software elements. The amended guidance modifies the scope of the software revenue recognition guidance to exclude tangible products that contain both software and non-software components that function together to deliver the product's essential functionality. The pronouncement is effective for fiscal years beginning on or after June 15, 2010, early adoption is permitted. This guidance must be adopted in the same period an entity adopts the amended revenue arrangements with multiple deliverables guidance described above. Ciena is currently evaluating the impact this new guidance could have on its financial condition, results of operations and cash flows.

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**(3) BUSINESS COMBINATIONS**

*Pending Acquisition of Nortel Metro Ethernet Networks ( MEN ) Assets*

On November 23, 2009 Ciena announced that it had been selected as the successful bidder in the auction of substantially all of the optical networking and carrier Ethernet assets of Nortel's MEN business. In accordance with the definitive purchase agreements, as amended, Ciena has agreed to pay \$530 million in cash and issue \$239 million in aggregate principal amount of 6% Senior Convertible notes due 2017 ( Notes ) for a total consideration of \$769 million for the assets. Ciena expects this pending transaction to close in the first calendar quarter of 2010.

The Notes to be issued at closing will bear interest at the rate of 6.0% per annum, payable semi-annually, commencing six months after the date of issuance. The interest rate is subject to an upward adjustment, up to a maximum of 8% per annum, in the event that the volume weighted average price of Ciena's common stock price over the measurement period immediately preceding closing is less than \$13.17 per share. The Notes mature on June 15, 2017.

The terms of the Notes to be issued will be substantially similar to Ciena's outstanding series of 0.875% senior convertible notes due 2017. The Notes will be senior unsecured obligations of Ciena and will rank equally with all of Ciena's other senior unsecured debt and senior to all of Ciena's future subordinated debt. The Notes will be structurally subordinated to all present and future debt and other obligations of Ciena's subsidiaries and will be effectively subordinated to all of Ciena's present and future secured debt to the extent of the value of the collateral securing such debt.

Following issuance, the Notes may be converted prior to maturity (unless earlier redeemed by Ciena) at the option of the holder into shares of Ciena common stock at the initial conversion rate of 60.7441 shares of Ciena common stock per \$1,000 in principal amount of Notes, which is equal to an initial conversion price of approximately \$16.4625 per share, subject to customary adjustments. Assuming the full conversion of the aggregate principal amount, the Notes are convertible into approximately 14.5 million shares of Ciena common stock, subject to customary adjustments.

Ciena is required to prepare and file a shelf registration statement on Form S-3 for purposes of registering the resale of the Notes, and the common stock underlying the Notes, by the later of thirty days following the closing or sixty days following Ciena's receipt from Nortel of certain financial statements required in connection with the filing and effectiveness of the registration statement. Ciena's failure to timely file the registration statement, and certain withdrawals or suspensions thereof, would result in liquidated damages of 0.25% to 0.50% per annum of the aggregate principal amount of the Notes, depending upon the duration of the registration default. Ciena has also granted certain demand registration rights requiring it to register and certain piggyback registration rights that afford the holders an opportunity to participate in certain registered offerings by Ciena.

Prior to closing, Ciena may elect to replace some or all of the Notes with cash equal to 102% of the face amount of such Notes replaced, provided that the volume weighted average price of Ciena's common stock is less than \$17.00 per share over the ten trading days prior to the date Ciena makes such election, or, if such volume weighted average price of Ciena's common stock is equal to or greater than \$17.00 per share, with cash in the principal amount equal to the greater of 105% of the face amount of the Notes to be replaced or 95% of the fair value of the Notes to be replaced as of the date of the election. In the event that it completes any capital raising transaction prior to the closing, Ciena will be required to use the net proceeds of the capital raising transaction to make the election described above and, if such transaction involves the issuance of convertible securities, the price used to determine the value of Ciena's common stock for the purposes of calculating the cost of the Notes replaced or redeemed will be the closing price per share prior to the time when such offering is priced, instead of the volume weighted average price as described in the preceding sentence.

After the closing, but prior to the effectiveness of the shelf registration statement above, Ciena has the right to redeem the Notes if they have been issued, with cash in the principal amount equal to the greater of 105% of the face amount of the Notes or 95% of the fair value of the Notes and any accrued and unpaid interest since the date of issue. Ciena must offer to use the net proceeds of any capital raising transaction completed during the above described period to redeem the Notes at the applicable redemption price above.

If Ciena undergoes a fundamental change, as defined in the proposed indenture and subject to certain exceptions, the holders have the right to require Ciena to repurchase for cash any or all of their Notes at a purchase price equal to 100% of the principal amount, plus accrued and unpaid interest, if any, to the repurchase date. If a holder elects to convert the Notes in connection with a qualified fundamental change, Ciena will in certain circumstances increase the conversion rate by a specified number of additional shares, depending upon the price paid per share of Ciena common stock in such fundamental change transaction.

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On November 25, 2009, Ciena deposited in escrow approximately \$38.5 million in cash pending the closing of the transaction. Upon closing, Ciena will receive a credit for the amount of the deposit against the aggregate cash consideration to be paid to the sellers. The deposit is subject to forfeiture in the event that all of the conditions to closing are satisfied and Ciena does not consummate the transaction and the sellers terminate the asset purchase agreement, pertaining principally to the North American assets, as a result of Ciena's material breach of its obligations under that agreement. If this agreement is terminated for any other reason, the deposit will be returned to Ciena.

Given the structure of the transaction as an asset carve-out from Nortel, Ciena expects that the transaction will result in a costly and complex integration with a number of operational risks. Ciena expects to incur acquisition and integration costs of approximately \$180 million, with the majority of these costs to be incurred in the first 12 months following the completion of the transaction. This estimate principally reflects expense associated with equipment and information technology costs, transaction expense, and consulting and third party service fees associated with integration. This amount does not give effect to any expense related to, among other things, facilities restructuring or inventory obsolescence charges. As a result, the integration expense Ciena incurs and recognizes for financial statement purposes could be significantly higher. As of January 31, 2010, Ciena has incurred \$27.0 million in transaction, consulting and third party service fees and \$2.3 million primarily related to purchases of capitalized information technology equipment. In addition to these integration costs, Ciena also expects to incur significant transition services expense, and Ciena will rely upon an affiliate of Nortel to perform certain operational functions during an interim period following closing not to exceed two years.

If the closing does not take place on or before April 30, 2010, the applicable asset sale agreements may be terminated by either party. Ciena has been granted early termination of the antitrust waiting periods under the Hart-Scott-Rodino Act and the Canadian Competition Act. On December 2, 2009, the bankruptcy courts in the U.S. and Canada approved the asset sale agreement relating to Ciena's acquisition of substantially all of the North American, Caribbean and Latin American and Asian optical networking and carrier Ethernet assets of Nortel's MEN business. Completion of the transaction remains subject to information and consultation with employee representatives and employees in certain international jurisdictions and customary closing conditions.

**(4) RESTRUCTURING COSTS**

The following table sets forth the activity and balance of the restructuring liability accounts for the three months ended January 31, 2010 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2009	\$ 170	\$ 9,435	\$ 9,605
Additional liability recorded	(21)		(21)
Cash payments	(82)	(752)	(834)
Balance at January 31, 2010	\$ 67	\$ 8,683	\$ 8,750
Current restructuring liabilities	\$ 67	\$ 1,499	\$ 1,566
Non-current restructuring liabilities	\$	\$ 7,184	\$ 7,184

The following table sets forth the activity and balance of the restructuring liability accounts for the three months ended January 31, 2009 (in thousands):

	Consolidation of excess facilities
Balance at October 31, 2008	\$ 4,225

Additional liability recorded	76
Cash payments	(1,287)
Balance at January 31, 2009	\$ 3,014
Current restructuring liabilities	\$ 611
Non-current restructuring liabilities	\$ 2,403

**Table of Contents****(5) MARKETABLE SECURITIES**

As of the dates indicated, short-term and long-term investments are comprised of the following (in thousands):

	Amortized Cost	January 31, 2010		Estimated Fair Value
		Gross Unrealized	Gross Unrealized	
		Gains	Losses	
U.S. government obligations	\$ 435,991	\$ 273	\$	\$ 436,264
Publicly traded equity securities	193			193
	\$ 436,184	\$ 273	\$	\$ 436,457
Included in short-term investments	428,205	204		428,409
Included in long-term investments	7,979	69		8,048
	\$ 436,184	\$ 273	\$	\$ 436,457

  

	Amortized Cost	October 31, 2009		Estimated Fair Value
		Gross Unrealized	Gross Unrealized	
		Gains	Losses	
U.S. government obligations	\$ 570,505	\$ 460	\$ 2	\$ 570,963
Publicly traded equity securities	251			251
	\$ 570,756	\$ 460	\$ 2	\$ 571,214
Included in short-term investments	562,781	404	\$ 2	563,183
Included in long-term investments	7,975	56		8,031
	\$ 570,756	\$ 460	\$ 2	\$ 571,214

Gross unrealized losses related to marketable debt investments, included in short-term and long-term investments, were primarily due to changes in interest rates. Ciena's management determined that the gross unrealized losses at October 31, 2009 were temporary in nature because Ciena had the ability and intent to hold these investments until a recovery of fair value, which may be maturity. As of the dates indicated, gross unrealized losses were as follows (in thousands):

	January 31, 2010					
	Unrealized Losses Less Than 12 Months		Unrealized Losses 12 Months or Greater		Total	
	Gross Unrealized	Fair Value	Gross Unrealized	Fair Value	Gross Unrealized	Fair Value
	Losses		Losses		Losses	
U.S. government obligations	\$	\$	\$	\$	\$	\$

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	\$	\$	\$	\$	\$	\$
	Unrealized Losses Less Than 12 Months		October 31, 2009 Unrealized Losses 12 Months or Greater		Total	
	Gross Unrealized		Gross Unrealized		Gross Unrealized	
	Losses	Fair Value	Losses	Fair Value	Losses	Fair Value
U.S. government obligations	\$ 2	\$ 37,744	\$	\$	\$ 2	\$ 37,744
	\$ 2	\$ 37,744	\$	\$	\$ 2	\$ 37,744

The following table summarizes final legal maturities of debt investments at January 31, 2010 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than one year	\$ 428,012	\$ 428,216
Due in 1-2 years	7,979	8,048
	\$ 435,991	\$ 436,264

**Table of Contents****(6) FAIR VALUE MEASUREMENTS**

As of the dates indicated, the following table summarizes the fair value of assets that are recorded at fair value on a recurring basis (in thousands):

	January 31, 2010			
Assets:	Level 1	Level 2	Level 3	Total
U.S. government obligations	\$	\$ 436,264	\$	\$ 436,264
Publicly traded equity securities	193			193
Total assets measured at fair value	\$ 193	\$ 436,264	\$	\$ 436,457

Ciena's Level 1 assets include corporate equity securities publicly traded on major exchanges that are valued using quoted prices in active markets. Ciena's Level 2 investments include U.S. government obligations. These investments are valued using observable inputs such as quoted market prices, benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. Investments are held by a custodian who obtains investment prices from a third party pricing provider that uses standard inputs to models which vary by asset class.

As of January 31, 2010, Ciena did not hold financial assets or liabilities recorded at fair value based on Level 3 inputs.

As of the date indicated, the assets and liabilities above were presented on Ciena's Condensed Consolidated Balance Sheet as follows (in thousands):

	January 31, 2010			
Assets:	Level 1	Level 2	Level 3	Total
Short-term investments	\$ 193	\$ 428,216	\$	\$ 428,409
Long-term investments		8,048		8,048
Total assets measured at fair value	\$ 193	\$ 436,264	\$	\$ 436,457

At January 31, 2010, the fair value of the outstanding \$500.0 million of 0.875% convertible senior notes and \$298.0 million of 0.25% convertible senior notes was \$335.0 million and \$245.2 million, respectively. Fair value is based on the quoted market price for the notes on the date above.

**(7) ACCOUNTS RECEIVABLE**

As of October 31, 2009 one customer accounted for 10.7% of net accounts receivable, and as of January 31, 2010 two customers in aggregate accounted for 22.6% of net accounts receivable.

Ciena's allowance for doubtful accounts receivable is based on management's assessment, on a specific identification basis, of the collectibility of customer accounts. As of October 31, 2009 and January 31, 2010, allowance for doubtful accounts was \$0.1 million.

**(8) INVENTORIES**

As of the dates indicated, inventories are comprised of the following (in thousands):

	October 31, 2009	January 31, 2010
Raw materials	\$ 19,694	\$ 18,256
Work-in-process	1,480	2,255
Finished goods	90,914	98,264

	112,088	118,775
Provision for excess and obsolescence	(24,002)	(23,344)
	\$ 88,086	\$ 95,431

Ciena writes down its inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value, based on assumptions about future demand and market conditions. During the first three months of fiscal 2010, Ciena recorded a provision for excess and obsolete inventory of \$1.0 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory relate to disposal activities. The following table summarizes the activity in Ciena's reserve for excess and obsolete inventory for the period indicated (in thousands):

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	Inventory Reserve
Reserve balance as of October 31, 2009	\$ 24,002
Provision for excess for obsolescence	950
Actual inventory disposed	(1,608)
Reserve balance as of January 31, 2010	\$ 23,344

During the first three months of fiscal 2009, Ciena recorded a provision for excess and obsolete inventory of \$6.5 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory relate to disposal activities. The following table summarizes the activity in Ciena's reserve for excess and obsolete inventory for the period indicated (in thousands):

	Inventory Reserve
Reserve balance as of October 31, 2008	\$ 23,257
Provision for excess and obsolescence	6,548
Actual inventory disposed	(5,155)
Reserve balance as of January 31, 2009	\$ 24,650

**(9) PREPAID EXPENSES AND OTHER**

As of the dates indicated, prepaid expenses and other are comprised of the following (in thousands):

	October 31, 2009	January 31, 2010
Interest receivable	\$ 993	\$ 814
Prepaid VAT and other taxes	14,527	16,857
Deferred deployment expense	4,242	4,647
Prepaid expenses	8,869	8,401
Deposit on pending business acquisition		38,450
Capitalized acquisition costs	12,473	
Restricted cash	7,477	5,371
Other non-trade receivables	1,956	883
	\$ 50,537	\$ 75,423

Capitalized acquisition costs at October 31, 2009 include direct costs related to Ciena's pending acquisition of the optical networking and carrier Ethernet assets of Nortel's MEN business. In the first quarter of fiscal 2010, Ciena adopted newly issued accounting guidance related to business combinations, which required the full amount of these capitalized acquisition costs to be expensed in the Condensed Consolidated Statement of Operations. The deposit on pending business acquisition represents the initial payment of \$38.5 million related to Ciena's pending acquisition of the optical networking and carrier Ethernet assets of Nortel's MEN business. See Note 3 above.

**(10) EQUIPMENT, FURNITURE AND FIXTURES**

As of the dates indicated, equipment, furniture and fixtures are comprised of the following (in thousands):

October 31, 2009	January 31, 2010
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Equipment, furniture and fixtures	\$ 293,093	\$ 299,908
Leasehold improvements	45,761	45,002
	338,854	344,910
Accumulated depreciation and amortization	(276,986)	(280,559)
	\$ 61,868	\$ 64,351

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Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements was \$5.1 million and \$5.9 million for the first three months of fiscal 2009 and 2010, respectively.

**(11) OTHER INTANGIBLE ASSETS**

As of the dates indicated, other intangible assets are comprised of the following (in thousands):

		October 31, 2009	Net		January 31, 2010	Net
	Gross Intangible	Accumulated Amortization	Intangible	Gross Intangible	Accumulated Amortization	Intangible
Developed technology	\$ 185,833	\$ (147,504)	\$ 38,329	\$ 185,833	\$ (152,316)	\$ 33,517
Patents and licenses	47,370	(42,811)	4,559	47,615	(43,800)	3,815
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	60,981	(43,049)	17,932	60,981	(44,880)	16,101
	\$ 294,184		\$ 60,820	\$ 294,429		\$ 53,433

The aggregate amortization expense of other intangible assets was \$8.1 million and \$7.6 million for the first three months of fiscal 2009 and 2010, respectively. Expected future amortization of other intangible assets for the fiscal years indicated is as follows (in thousands):

	Period ended October 31,
2010 (remaining nine months)	\$ 20,309
2011	13,933
2012	9,555
2013	7,230
2014	2,406
	\$ 53,433

**(12) OTHER BALANCE SHEET DETAILS**

As of the dates indicated, other long-term assets are comprised of the following (in thousands):

	October 31, 2009	January 31, 2010
Maintenance spares inventory, net	\$ 31,994	\$ 34,586
Deferred debt issuance costs, net	12,832	12,258
Investments in privately held companies	907	907
Restricted cash	18,792	26,419
Other	3,377	3,038
	\$ 67,902	\$ 77,208

Deferred debt issuance costs are amortized using the straight line method which approximates the effect of the effective interest rate method on the maturity of the related debt. Amortization of debt issuance costs, which is included in interest expense, was \$0.6 million during the first three months of fiscal 2009 and fiscal 2010.

As of the dates indicated, accrued liabilities are comprised of the following (in thousands):

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	October 31, 2009	January 31, 2010
Warranty	\$ 40,196	\$ 38,437
Compensation, payroll related tax and benefits	20,025	17,824
Vacation	11,508	11,782
Interest payable	2,045	738
Other	29,575	28,779
	\$ 103,349	\$ 97,560

The following table summarizes the activity in Ciena's accrued warranty for the fiscal periods indicated (in thousands):

Three months ended	Beginning			Balance at end of period
January 31,	Balance	Provisions	Settlements	
2009	\$37,258	2,541	(3,692)	\$36,107
2010	\$40,196	3,060	(4,819)	\$38,437

As of the dates indicated, deferred revenue is comprised of the following (in thousands):

	October 31, 2009	January 31, 2010
Products	\$ 11,998	\$ 15,536
Services	63,935	65,363
	75,933	80,899
Less current portion	(40,565)	(43,722)
Long-term deferred revenue	\$ 35,368	\$ 37,177

**(13) DERIVATIVES**

Ciena uses foreign currency forward contracts to reduce variability in non-U.S. dollar denominated operating expenses. Ciena uses these derivatives to partially offset its market exposure to fluctuations in certain foreign currencies. These derivatives are designated as cash flow hedges and have maturities of less than one year. These forward contracts are not designed to provide foreign currency protection over the long-term. Ciena considers several factors, including offsetting exposures, significance of exposures, costs associated with entering into a particular instrument, and potential effectiveness when designing its hedging activities.

The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and, upon occurrence of the forecasted transaction, is subsequently reclassified into the operating expense line item to which the hedged transaction relates. Ciena records the ineffective portion of the hedging instruments in interest and other income, net. As of October 31, 2009 and January 31, 2010, there were no foreign currency forward contracts outstanding and Ciena did not enter into any foreign currency forward contracts during the first three months of fiscal 2010.

Ciena's foreign currency forward contracts are classified as follows:

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	Reclassified to Condensed Consolidated Statement of Operations (Effective Portion) Quarter Ended January 31,	
Line Item in Condensed Consolidated Statement of Operations	2009	2010
Research and development	\$ 40	\$
Selling and marketing	165	
	\$ 205	\$
	Recognized in Other Comprehensive Income (Loss) Quarter Ended January 31,	
Line Item in Condensed Consolidated Balance Sheet	2009	2010
Accumulated other comprehensive income (loss)	\$ (2,295)	\$
	\$ (2,295)	\$
	Ineffective Portion Quarter Ended January 31,	
Line Item in Condensed Consolidated Statement of Operations	2009	2010
Interest and other income, net	\$	\$
	\$	\$

**(14) EARNINGS (LOSS) PER SHARE CALCULATION**

The following table (in thousands except per share amounts) is a reconciliation of the numerator and denominator of the basic net income (loss) per common share ( Basic EPS ) and the diluted net income (loss) per potential common share ( Diluted EPS ). Basic EPS is computed using the weighted average number of common shares outstanding. Diluted EPS is computed using the weighted average number of (i) common shares outstanding, (ii) shares issuable upon vesting of restricted stock units, (iii) shares issuable upon exercise of outstanding stock options, employee stock purchase plan options and warrants using the treasury stock method; and (iv) shares underlying the 0.25% and 0.875% convertible senior notes.

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<b>Numerator</b>	Quarter Ended January 31,	
	2009	2010
Net loss	\$ (24,831)	\$ (53,333)
Add: Interest expense for 0.250% convertible senior notes		
Add: Interest expense for 0.875% convertible senior notes		
Net loss used to calculate diluted EPS.	\$ (24,831)	\$ (53,333)

<b>Denominator</b>	Quarter Ended January 31,	
	2009	2010
Basic weighted average shares outstanding	90,620	92,321
Add: Shares underlying outstanding stock options, employees stock purchase plan options, warrants and restricted stock		
Add: Shares underlying 0.250% convertible senior notes		
Add: Shares underlying 0.875% convertible senior notes		
Dilutive weighted average shares outstanding	90,620	92,321

<b>EPS</b>	Quarter Ended January 31,	
	2009	2010
Basic EPS	\$ (0.27)	\$ (0.58)
Diluted EPS	\$ (0.27)	\$ (0.58)

***Explanation of Shares Excluded due to Anti-Dilutive Effect***

For the quarters ended January 31, 2009 and January 31, 2010, the weighted average number of shares set forth in the table below, underlying outstanding stock options, employee stock purchase plan options, restricted stock units, and warrants, is considered anti-dilutive because Ciena incurred a net loss. In addition, the shares, representing the weighted average number of shares issuable upon conversion of Ciena's 0.25% convertible senior notes and Ciena's 0.875% convertible senior notes, are considered anti-dilutive because the related interest expense on a per common share if converted basis exceeds Basic EPS for the period.

The following table summarizes the shares excluded from the calculation of the denominator for Basic and Diluted EPS due to their anti-dilutive effect for the periods indicated (in thousands):

	Quarter Ended January 31,	
	2009	2010
<b>Shares Excluded from EPS Denominator due to Anti-dilutive Effect</b>		
Shares underlying stock options, restricted stock units and warrants	8,052	7,494
0.250% convertible senior notes	7,539	7,539
0.875% convertible senior notes	13,108	13,108
Total excluded due to anti-dilutive effect	28,699	28,141

**(15) SHARE-BASED COMPENSATION EXPENSE**

Ciena makes equity awards under its 2008 Omnibus Incentive Plan ( 2008 Plan ) and 2003 Employee Stock Purchase Plan ( ESPP ). These plans were approved by shareholders and are described in Ciena's annual report on Form

10-K.

*2008 Plan*

Ciena has previously granted stock options and restricted stock units under the 2008 Plan. As of January 31, 2010, there were approximately 1.2 million shares authorized and remaining available for issuance thereunder.

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**Table of Contents***Stock Options*

Outstanding stock option awards to employees are generally subject to service-based vesting restrictions and vest incrementally over a four-year period. The following table is a summary of Ciena's stock option activity for the periods indicated (shares in thousands):

	Shares Underlying Options	Weighted Average Exercise Price
Balance as of October 31, 2009	5,538	\$ 45.80
Granted	80	12.33
Exercised	(40)	2.29
Canceled	(184)	76.69
Balance as of January 31, 2010	5,394	\$ 44.57

The total intrinsic value of options exercised during the first three months of fiscal 2009 and fiscal 2010, was \$0.2 million and \$0.3 million, respectively. The weighted average fair values of each stock option granted by Ciena during the first three months of fiscal 2009 and fiscal 2010 were \$4.43 and \$6.91, respectively.

The following table summarizes information with respect to stock options outstanding at January 31, 2010, based on Ciena's closing stock price of \$12.75 per share on the last trading day of Ciena's first fiscal quarter of 2010 (shares and intrinsic value in thousands):

Options Outstanding at January 31, 2010					Vested Options at January 31, 2010				
Range of Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	
\$ 0.01- \$ 16.52	961	6.95	\$ 10.97	\$ 3,124	647	5.85	\$ 11.66	\$ 2,104	
\$16.53- \$ 17.43	549	5.75	17.21		501	5.48	17.21		
\$17.44- \$ 22.96	460	5.13	21.77		411	4.77	21.89		
\$22.97- \$ 31.71	1,493	4.95	29.42		1,280	4.51	29.62		
\$31.72- \$ 46.90	897	6.23	39.44		645	5.60	40.07		
\$46.91- \$ 73.78	462	2.85	59.07		462	2.85	59.07		
\$73.79- \$1,046.50	572	1.56	181.35		572	1.56	181.35		
\$ 0.01- \$1,046.50	5,394	5.07	\$ 44.57	\$ 3,124	4,518	4.44	\$ 48.70	\$ 2,104	

*Assumptions for Option-Based Awards*

Ciena recognizes the fair value of service-based options as share-based compensation expense on a straight-line basis over the requisite service period. Ciena estimates the fair value of each option award on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions:

	Quarter Ended January 31,	
	2009	2010
Expected volatility	65.0%	61.9%

Risk-free interest rate.	1.7 - 2.2%	2.4 - 2.9%
Expected life (years)	5.2 - 5.3	5.3 - 5.5
Expected dividend yield	0.0%	0.0%

Ciena considered the implied volatility and historical volatility of its stock price in determining its expected volatility, and, finding both to be equally reliable, determined that a combination of both would result in the best estimate of expected volatility.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the expected term of Ciena's employee stock options.

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The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding. Ciena gathered detailed historical information about specific exercise behavior of its grantees, which it used to determine the expected term.

The dividend yield assumption is based on Ciena's history of not making dividends and its expectation of future dividend payouts.

Because share-based compensation expense is recognized only for those awards that are ultimately expected to vest, the amount of share-based compensation expense recognized reflects a reduction for estimated forfeitures. Ciena estimates forfeitures at the time of grant and revises those estimates in subsequent periods based upon new or changed information. Ciena relies upon historical experience in establishing forfeiture rates. If actual forfeitures differ from current estimates, total unrecognized share-based compensation expense will be adjusted for future changes in estimated forfeitures.

*Restricted Stock Units*

A restricted stock unit is a stock award that entitles the holder to receive shares of Ciena common stock as the unit vests. Ciena's outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. Awards subject to service-based conditions typically vest in increments over a three to four year period. Awards with performance-based vesting conditions require the achievement of certain operational, financial or other performance criteria or targets as a condition of vesting, or acceleration of vesting, of such awards.

Ciena's outstanding restricted stock units include performance-accelerated restricted stock units (PARS), which vest in full four years after the date of grant (assuming that the grantee is still employed by Ciena at that time). Under the PARS, the Compensation Committee may establish performance targets which, if satisfied, provide for the acceleration of vesting of that portion of the award designated by the Compensation Committee. As a result, the grantee may have the opportunity, subject to satisfaction of performance conditions, to vest as to the entire award prior to the expiration of the four-year period above. Ciena recognizes the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon Ciena's determination of whether it is probable that the performance targets will be achieved. At each reporting period, Ciena reassesses the probability of achieving the performance targets and the performance period required to meet those targets.

The aggregate intrinsic value of Ciena's restricted stock units is based on Ciena's closing stock price on the last trading day of each period as indicated. The following table is a summary of Ciena's restricted stock unit activity for the periods indicated, with the aggregate intrinsic value of the balance outstanding at the end of each period, based on Ciena's closing stock price on the last trading day of the relevant period (shares and aggregate intrinsic value in thousands):

	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Balance as of October 31, 2009	3,716	\$ 14.67	\$ 43,591
Granted	1,389		
Vested	(488)		
Canceled or forfeited	(29)		
Balance as of January 31, 2010	4,588	\$ 13.16	\$ 58,503

The total fair value of restricted stock units that vested and were converted into common stock during the first three months fiscal 2009 and fiscal 2010 was \$1.2 million and \$5.4 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first three months of fiscal 2009 and fiscal 2010 was \$6.94 and \$11.01, respectively.

*Assumptions for Restricted Stock Unit Awards*

The fair value of each restricted stock unit award is estimated using the intrinsic value method, which is based on the closing price on the date of grant. Share-based expense for service-based restricted stock unit awards is recognized, net of estimated forfeitures, ratably over the vesting period on a straight-line basis.

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Share-based expense for performance-based restricted stock unit awards, net of estimated forfeitures, is recognized ratably over the performance period based upon Ciena's determination of whether it is probable that the performance targets will be achieved. At each reporting period, Ciena reassesses the probability of achieving the performance targets and the performance period required to meet those targets. The estimation of whether the performance targets will be achieved involves judgment, and the estimate of expense is revised periodically based on the probability of achieving the performance targets. Revisions are reflected in the period in which the estimate is changed. If any performance goals are not met, no compensation cost is ultimately recognized against that goal and, to the extent previously recognized, compensation cost is reversed.

*2010 Inducement Equity Award Plan*

On December 8, 2009, the Compensation Committee of the Ciena Board of Directors approved the 2010 Inducement Equity Award Plan (the "2010 Plan"). The 2010 Plan is intended to enhance Ciena's ability to attract and retain certain key employees to be transferred to Ciena in connection with its pending acquisition of Nortel's Metro Ethernet Networks (MEN) assets. The 2010 Plan authorizes issuance of restricted stock or restricted stock units representing up to 2.3 million shares of Ciena common stock. The 2010 Plan will terminate automatically one year following the closing date of the pending acquisition of the Nortel assets described above. Upon termination, any shares that remain available for issuance under the 2010 Plan shall cease to be available thereunder and shall not be available for issuance under any other existing Ciena equity incentive plan.

*2003 Employee Stock Purchase Plan*

The ESPP is a non-compensatory and issuances thereunder do not result in share-based compensation expense. The following table is a summary of ESPP activity and shares available for issuance for the periods indicated (shares in thousands):

	ESPP shares available for issuance
Balance as of October 31, 2009	3,469
Evergreen provision	102
Balance as of January 31, 2010	3,571

*Share-Based Compensation Expense for Periods Reported*

The following table summarizes share-based compensation expense for the periods indicated (in thousands):

	Quarter Ended January 31,	
	2009	2010
Product costs	\$ 713	\$ 379
Service costs	397	430
Share-based compensation expense included in cost of sales	1,110	809
Research and development	2,566	2,387
Sales and marketing	2,703	2,458
General and administrative	2,419	2,576
Share-based compensation expense included in operating expense	7,688	7,421
Share-based compensation expense capitalized in inventory, net	(304)	52

Total share-based compensation	\$ 8,494	\$ 8,282
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As of January 31, 2010, total unrecognized compensation expense was: (i) \$10.5 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 1.0 year; and (ii) \$52.8 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.4 years.

**Table of Contents****(16) COMPREHENSIVE LOSS**

The components of comprehensive loss were as follows (in thousands):

	Quarter Ended January 31,	
	2009	2010
Net loss	\$ (24,831)	\$ (53,333)
Change in unrealized gain (loss) on available-for-sale securities, net of tax	1,766	(186)
Change in unrealized loss on derivative instruments, net of tax	(2,090)	
Change in accumulated translation adjustments	(244)	(633)
Total comprehensive loss	\$ (25,399)	\$ (54,152)

**(17) ENTITY WIDE DISCLOSURES**

The following table reflects Ciena's geographic distribution of revenue based on the location of the purchaser, with any country accounting for greater than 10% of total revenue in the period specifically identified. Revenue attributable to geographic regions outside of the United States and the United Kingdom is reflected as Other International revenue. For the periods below, Ciena's geographic distribution of revenue was as follows (in thousands, except percentage data):

	Quarter Ended January 31,			
	2009	% *	2010	% *
United States	\$ 98,947	59.1	\$ 123,912	70.4
United Kingdom	26,717	16.0	18,590	10.6
Other International	41,736	24.9	33,374	19.0
Total	\$ 167,400	100.0	\$ 175,876	100.0

\* Denotes % of total revenue

The following table reflects Ciena's geographic distribution of equipment, furniture and fixtures, with any country attributable for greater than 10% of total equipment, furniture and fixtures specifically identified. Equipment, furniture and fixtures attributable to geographic regions outside of the United States are reflected as International. For the periods below, Ciena's geographic distribution of equipment, furniture and fixtures was as follows (in thousands, except percentage data):

	October 31,		January 31,	
	2009	% *	2010	% *
United States	\$ 47,875	77.4	\$ 48,780	75.8
International	13,993	22.6	15,571	24.2
Total	\$ 61,868	100.0	\$ 64,351	100.0

\* Denotes % of total equipment, furniture and fixtures

For the periods below, Ciena's distribution of revenue was as follows (in thousands, except percentage data):

	2009	Quarter Ended January 31, % *	2010	% *
Optical service delivery	\$ 130,191	77.8	\$ 108,615	61.8
Carrier Ethernet service delivery	9,526	5.7	40,439	22.9
Global network services	27,683	16.5	26,822	15.3
Total	\$ 167,400	100.0	\$ 175,876	100.0

\* Denotes % of  
total revenue

For the periods below, customers accounting for at least 10% of Ciena's revenue were as follows (in thousands, except percentage data):

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	2009	Quarter Ended January 31, % *	2010	% *
Company A	\$ 32,556	19.4	\$ 42,515	24.2
Company B	18,877	11.3	n/a	
Company C	16,938	10.1	n/a	
Total	\$ 68,371	40.8	\$ 42,515	24.2

n/a Denotes revenue representing less than 10% of total revenue for the period

\* Denotes % of total revenue

**(18) CONTINGENCIES***Foreign Tax Contingencies*

Ciena has received assessment notices from the Mexican tax authorities asserting deficiencies in payments between 2001 and 2005 related primarily to income taxes and import taxes and duties. Ciena has filed judicial petitions appealing these assessments. As of October 31, 2009 and January 31, 2010, Ciena had accrued liabilities of \$1.1 million and \$1.2 million, respectively, related to these contingencies, which are reported as a component of other current accrued liabilities. As of January 31, 2010, Ciena estimates that it could be exposed to possible losses of up to \$5.8 million, for which it has not accrued liabilities. Ciena has not accrued the additional income tax liabilities because it does not believe that such losses are more likely than not to be incurred. Ciena has not accrued the additional import taxes and duties because it does not believe the incurrence of such losses are probable. Ciena continues to evaluate the likelihood of probable and reasonably possible losses, if any, related to these assessments. As a result, future increases or decreases to accrued liabilities may be necessary and will be recorded in the period when such amounts are estimable and more likely than not (for income taxes) or probable (for non-income taxes).

*Litigation*

On May 29, 2008, Graywire, LLC filed a complaint in the United States District Court for the Northern District of Georgia against Ciena and four other defendants, alleging, among other things, that certain of the parties' products infringe U.S. Patent 6,542,673 (the '673 Patent'), relating to an identifier system and components for optical assemblies. The complaint, which seeks injunctive relief and damages, was served upon Ciena on January 20, 2009. Ciena filed an answer to the complaint and counterclaims against Graywire on March 26, 2009, and an amended answer and counterclaims on April 17, 2009. On April 27, 2009, Ciena and certain other defendants filed an application for *inter partes* reexamination of the '673 Patent with the U.S. Patent and Trademark Office (the PTO). On the same date, Ciena and the other defendants filed a motion to stay the case pending reexamination of all of the patents-in-suit. On July 17, 2009, the district court granted the defendants' motion to stay the case. On July 23, 2009, the PTO granted the defendants' application for reexamination with respect to certain claims of the '673 Patent. Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously in the event the stay of the case is lifted.

As a result of our June 2002 merger with ONI Systems Corp., Ciena became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI's initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI's registration statement and by engaging in manipulative practices to

artificially inflate ONI's stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters' alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and all of these actions have been included in a single coordinated proceeding. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena's Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 22, 2009. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation, the ultimate outcome of the matter is uncertain.

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

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

*Some of the statements contained, or incorporated by reference, in this quarterly report discuss future events or expectations, contain projections of results of operations or financial condition, changes in the markets for our products and services, or state other forward-looking information. Ciena's forward-looking information is based on various factors and was derived using numerous assumptions. In some cases, you can identify these forward-looking statements by words like may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continue or the negative of those words and other comparable words. You should be aware that these statements only reflect our current predictions and beliefs. These statements are subject to known and unknown risks, uncertainties and other factors, and actual events or results may differ materially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly in Item 1A Risk Factors of Part II of this report below. You should review these risk factors and the rest of this quarterly report in combination with the more detailed description of our business and management's discussion and analysis of financial condition in our annual report on Form 10-K, which we filed with the Securities and Exchange Commission on December 22, 2009, for a more complete understanding of the risks associated with an investment in Ciena's securities. Ciena undertakes no obligation to revise or update any forward-looking statements.*

**Overview**

We are a provider of communications networking equipment, software and services that support the transport, switching, aggregation and management of voice, video and data traffic. Our optical service delivery and carrier Ethernet service delivery products are used, individually or as part of an integrated solution, in networks operated by communications service providers, cable operators, governments and enterprises around the globe.

We are a network specialist targeting the transition of disparate, legacy communications networks to converged, next-generation architectures, better able to handle increased traffic and deliver more efficiently a broader mix of high-bandwidth communications services. Our products, with their embedded network element software and our unified service and transport management, enable service providers to efficiently and cost-effectively deliver critical enterprise and consumer-oriented communication services. Together with our professional support and consulting services, our product offerings seek to offer solutions that address the business challenges and network needs of our customers. Our customers face an increasingly challenging and rapidly changing environment that requires them to quickly adapt their business strategies and deliver new, revenue-creating services. By improving network productivity and automation, reducing operating costs and providing the flexibility to enable new and integrated service offerings, our equipment, software and services solutions create business and operational value for our customers.

Our quarterly reports on Form 10-Q, annual reports on Form 10-K and current reports on Form 8-K filed with the SEC are available through the SEC's website at [www.sec.gov](http://www.sec.gov) or free of charge on our website as soon as reasonably practicable after we file these documents. We routinely post the reports above, recent news and announcements, financial results and other important information about Ciena on our website at [www.ciena.com](http://www.ciena.com).

***Pending Acquisition of Nortel Metro Ethernet Networks (MEN) Assets***

We believe that our pending acquisition of substantially all of the optical networking and carrier Ethernet assets of Nortel's Metro Ethernet Networks business (MEN) will accelerate the execution of our corporate and research and development strategies, and will create a leader in next-generation, converged optical Ethernet networks. We expect this pending transaction to close in the first calendar quarter of 2010.

Following our emergence as the winning bidder in the bankruptcy auction, we agreed to acquire substantially all of the optical networking and carrier Ethernet assets of Nortel's MEN business for \$530 million in cash and \$239 million in aggregate principal amount of 6% Senior Convertible notes due 2017. The terms of the notes to be issued upon closing are set forth in Note 3 of the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report. Nortel's product and technology assets to be acquired include:

long-haul optical transport portfolio;

metro optical Ethernet switching and transport solutions;

Ethernet transport, aggregation and switching technology;

multiservice SONET/SDH product families;

network management software products; and

network implementation and support services.

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The pending acquisition encompasses a business that is a leading provider of next-generation, 40G and 100G optical transport technology with a significant, global installed base. The acquired transport technology allows network operators to upgrade their existing 10G networks to 40G capability, quadrupling capacity without the need for new fiber deployments or complex network re-engineering. In addition to transport capability, the optical platforms acquired include traffic switching and aggregation capability for traditional protocols such as SONET/SDH as well as newer packet protocols such as Ethernet. A suite of software products used to manage networks built from these technologies is also part of the transaction.

We believe that the transaction provides an opportunity to significantly transform Ciena and strengthen our position as a leader in next-generation, converged optical Ethernet networking. We believe that the additional resources, expanded geographic reach, new and broader customer relationships, and deeper portfolio of complementary network solutions derived from the transaction will augment Ciena's growth. We also expect that the transaction will add scale, enable operating model synergies and provide an opportunity to optimize our research and development investment. We expect these benefits of the transaction will help Ciena to better compete with traditional, larger network vendors.

Due to the relative scale of its operations, upon closing, the incorporation of the MEN assets will significantly transform Ciena's business and will materially affect our operations, financial results and liquidity, which may make period to period comparisons difficult. By way of example, we expect our revenue and operating expense to significantly increase following the closing. The assets to be acquired generated approximately \$798 million in the first nine months of Nortel's fiscal 2009. The global scale of our operations will increase significantly as a result of this transaction. Upon the closing we will hire approximately 2,000 Nortel employees, nearly doubling our headcount and expanding the global presence of Ciena's team of network specialists.

Given the structure of the transaction as an asset carve-out from Nortel, we expect that the transaction will result in a costly and complex integration with a number of operational risks. We expect to incur acquisition and integration costs of approximately \$180 million, with the majority of these costs to be incurred in the first 12 months following the completion of the transaction. This estimate principally reflects expense associated with equipment and information technology costs, transaction expense, and consulting and third party service fees associated with integration. This amount does not give effect to any expense related to, among other things, facilities restructuring or inventory obsolescence charges. As a result, the integration expense we incur and recognize for financial statement purposes could be significantly higher. As of January 31, 2010, we have incurred \$27.0 million in transaction, consulting and third party service fees and \$2.3 million primarily related to purchases of capitalized information technology equipment. Any material delays or unanticipated additional expense may harm our business and results of operations. In addition to these integration costs, we also expect to incur significant transition services expense, and we will rely upon an affiliate of Nortel to perform certain operational functions on our behalf during an interim period following closing not to exceed two years.

As a result of the acquisition and the accounting for the transaction, we may also record goodwill and expect to record intangible assets that will be amortized over their useful lives. Under purchase accounting rules, we also expect to revalue the acquired finished goods inventory to fair value at the time of the acquisition. This revaluation may increase marketable inventory carrying value and adversely affect our product gross margin in the near term.

If the closing does not take place on or before April 30, 2010, the applicable asset sale agreements may be terminated by either party. Ciena has been granted early termination of the antitrust waiting periods under the Hart-Scott-Rodino Act and the Canadian Competition Act and has received approval of the transaction under the Investment Canada Act. On December 2, 2009, the bankruptcy courts in the U.S. and Canada approved the asset sale agreement relating to Ciena's acquisition of substantially all of the North American, Caribbean and Latin American and Asian optical networking and carrier Ethernet assets of Nortel's MEN business. Completion of the transaction remains subject to information and consultation with employee representatives and employees in certain international jurisdictions and customary closing conditions.

As a result of the aggregate consideration to be paid as described above, we will incur significant additional indebtedness and will materially reduce our existing cash balance. Except where specifically indicated, the discussion in this Management's Discussion and Analysis of Financial Condition and Results of Operations does not give effect to the possible consummation of this pending transaction and the effect on our results of operations.

*Effect of Decline in Market Conditions*

Our results of operations for the first quarter of fiscal 2010 reflect the sustained weakness and uncertainty presented by the global market conditions. In recent quarters, our business has experienced the effects of cautious spending by our largest customers, as they have sought to conserve capital, reduce debt or address uncertainties or changes in their own business models brought on by these broader market challenges. As a result, we have experienced lower demand, lengthening sales cycles, customer delays in network build-outs, slowing deployments and deferral of new technology adoption. We have also experienced an increasingly competitive marketplace and a heightened customer focus on pricing and return on investment. While we have started to see some indications that conditions in North America may be improving, we remain uncertain as to how long these unfavorable macroeconomic and industry conditions will persist and the magnitude of their effects on our business and results of operations.

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### *Financial Results*

Revenue for the first quarter of fiscal 2010 was \$175.9 million, representing a 0.2% sequential decrease from \$176.3 million in the fourth quarter of fiscal 2009 and a 5.1% increase from \$167.4 million in the first quarter of fiscal 2009. Additional revenue-related details include:

Product revenue for the first quarter of fiscal 2010 reflects a \$10.9 million sequential decrease in optical service delivery revenue, primarily reflecting decreased sales of core transport products, and a \$10.9 million sequential increase in carrier Ethernet service delivery revenue, principally related to sales of switching and aggregation products in support of wireless backhaul deployments;

Revenue from the U.S. for the first quarter of fiscal 2010 was \$123.9 million, a slight decrease from \$124.7 million in the fourth quarter of fiscal 2009 and an increase from \$98.9 million in the first quarter of fiscal 2009;

International revenue for the first quarter of fiscal 2010 was \$52.0 million, a slight increase from \$51.6 million in the fourth quarter of 2009 and a decrease from \$68.5 million in the first quarter of fiscal 2009;

As a percentage of revenue, international revenue was 29.6% during the first quarter of fiscal 2010, roughly flat with 29.2% in the fourth quarter of fiscal 2009 and down from 40.9% in the first quarter of fiscal 2009; and

For the first quarter of fiscal 2010, one customer accounted for 24.2% of revenue. This compares to one customer that accounted for 18.5% of revenue in the fourth quarter of fiscal 2009.

Gross margin for the first quarter of fiscal 2010 was 45.6%, up from 44.0% in the fourth quarter of fiscal 2009, and 42.9% in the first quarter of fiscal 2009.

Operating expense for the first quarter of fiscal 2010 was \$130.0 million, an increase from \$104.2 million in the fourth quarter of fiscal 2009 and \$98.6 million for the first quarter of fiscal 2009. First quarter fiscal 2010 operating expense includes \$27.0 million in acquisition and integration related costs related to the pending acquisition of Nortel's MEN business. We expect operating expense, particularly the portions attributable to acquisition and integration related expense and research and development expense, to increase from the first quarter of fiscal 2010 as we continue to integrate the Nortel MEN assets and fund strategic technology initiatives including:

Data-optimized switching solutions and evolution of our CoreDirector family and 5400 family of reconfigurable switching solutions;

Extending and increasing capacity of our converged optical transport service delivery portfolio, including 100G transport technologies and capabilities;

Expanding our carrier Ethernet service delivery portfolio, including larger Ethernet aggregation switches; and

Extending the value of our network management software platform across our product portfolio.

Our loss from operations for the first quarter of fiscal 2010 was \$49.9 million. This compares to a \$26.6 million loss from operations during the fourth quarter of fiscal 2009 and a \$26.7 million loss from operations for the first quarter of fiscal 2009. Our net loss for the first quarter of fiscal 2010 was \$53.3 million, or \$0.58 per share. This compares to a net loss of \$26.7 million, or \$0.29 per share, for the fourth quarter of fiscal 2009.

We generated \$4.5 million in cash from operations during the first quarter of fiscal 2010, consisting of a use of cash of \$26.7 million from net income (adjusted for non-cash charges) and cash generated of \$31.2 million from changes in working capital. This compares with cash generated from operations of \$1.9 million in the fourth quarter of fiscal 2009, consisting of \$4.8 million in cash generated from net income (adjusted for non-cash charges) and a use of cash of \$2.9 million from changes in working capital.

At January 31, 2010, we had \$573.2 million in cash and cash equivalents and \$428.2 million of short-term investments in marketable debt securities.

As of January 31, 2010, headcount was 2,197, an increase from 2,163 at October 31, 2009 and a decrease from 2,238 at January 31, 2009.

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### **Results of Operations**

#### *Revenue*

We derive revenue from sales of our products and services, which we discuss in the following three major groupings:

1. *Optical Service Delivery*. Included in product revenue, this revenue grouping reflects sales of our transport and switching products and legacy data networking products and related software. This revenue grouping was previously referred to as our converged Ethernet infrastructure products.
2. *Carrier Ethernet Service Delivery*. Included in product revenue, this revenue grouping reflects sales of our service delivery and aggregation switches, broadband access products, and the related software.
3. *Global Network Services*. Included in services revenue are sales of installation, deployment, maintenance support, consulting and training activities.

A sizable portion of our revenue continues to come from sales to a small number of communications service providers. As a result, our revenues are closely tied to the prospects, performance, and financial condition of our largest customers and are significantly affected by market-wide changes, including reductions in enterprise and consumer spending, that affect the businesses and level of infrastructure-related spending by communications service providers. Our contracts do not have terms that obligate these customers to purchase any minimum or specific amounts of equipment or services. Because their spending may be unpredictable and sporadic, and their purchases may result in the recognition or deferral of significant amounts of revenue in a given quarter, our revenue can fluctuate on a quarterly basis. Our concentration of revenue increases the risk of quarterly fluctuations in revenue and operating results and can exacerbate our exposure to reductions in spending or changes in network strategy involving one or more of our significant customers. In particular, some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce the number of vendors from which they purchase equipment.

Given current market conditions and the effect of lower demand in prior periods, as well as changes in the mix of our revenue toward products with shorter customer lead times, the percentage of our quarterly revenue relating to orders placed in that quarter has increased in comparison to prior fiscal years. Lower levels of backlog orders and an increase in the percentage of quarterly revenue relating to orders placed in that quarter could result in more variability and less predictability in our quarterly results.

#### *Cost of Goods Sold*

Product cost of goods sold consists primarily of amounts paid to third-party contract manufacturers, component costs, direct compensation costs and overhead, shipping and logistics costs associated with manufacturing-related operations, warranty and other contractual obligations, royalties, license fees, amortization of intangible assets, cost of excess and obsolete inventory and, when applicable, estimated losses on committed customer contracts.

Services cost of goods sold consists primarily of direct and third-party costs, including personnel costs, associated with provision of services including installation, deployment, maintenance support, consulting and training activities, and, when applicable, estimated losses on committed customer contracts.

#### *Gross Margin*

Gross margin continues to be susceptible to quarterly fluctuation due to a number of factors. Product gross margin can vary significantly depending upon the mix of products and customers in a given fiscal quarter. Gross margin can also be affected by volume of orders, our ability to drive product cost reductions, geographic mix, the level of pricing pressure we encounter, our introduction of new products or entry into new markets, charges for excess and obsolete inventory and changes in warranty costs.

Service gross margin can be affected by the mix of customers and services, particularly the mix between deployment and maintenance services, geographic mix and the timing and extent of any investments in internal resources to support this business.

#### *Operating Expense*

Research and development expense primarily consists of salaries and related employee expense (including share-based compensation expense), prototype costs relating to design, development, testing of our products, and third-party consulting costs.

Sales and marketing expense primarily consists of salaries, commissions and related employee expense (including share-based compensation expense), and sales and marketing support expense, including travel, demonstration units, trade show expense, and third-party consulting costs.

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General and administrative expense primarily consists of salaries and related employee expense (including share-based compensation expense), and costs for third-party consulting and other services.

Amortization of intangible assets primarily reflects purchased technology and customer relationships, from our acquisitions.

***Quarter ended January 31, 2009 compared to the quarter ended January 31, 2010******Revenue, cost of goods sold and gross profit***

The table below (in thousands, except percentage data) sets forth the changes in revenue, cost of goods sold and gross profit for the periods indicated:

	2009	Quarter Ended January 31, % *	2010	% *	Increase (decrease)	%**
Revenues:						
Products	\$ 139,717	83.5	\$ 149,054	84.7	\$ 9,337	6.7
Services	27,683	16.5	26,822	15.3	(861)	(3.1)
Total revenue	167,400	100.0	175,876	100.0	8,476	5.1
Costs:						
Products	76,367	45.6	76,669	43.6	302	0.4
Services	19,190	11.5	19,047	10.8	(143)	(0.7)
Total cost of goods sold	95,557	57.1	95,716	54.4	159	0.2
Gross profit	\$ 71,843	42.9	\$ 80,160	45.6	\$ 8,317	11.6

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

The table below (in thousands, except percentage data) sets forth the changes in product revenue, product cost of goods sold and product gross profit for the periods indicated:

	2009	Quarter Ended January 31, % *	2010	% *	Increase (decrease)	%**
Product revenue	\$ 139,717	100.0	\$ 149,054	100.0	\$ 9,337	6.7
Product cost of goods sold	76,367	54.7	76,669	51.4	302	0.4
Product gross profit	\$ 63,350	45.3	\$ 72,385	48.6	\$ 9,035	14.3

\* Denotes % of product revenue

\*\* Denotes % change from 2009 to 2010

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The table below (in thousands, except percentage data) sets forth the changes in services revenue, services cost of goods sold and services gross profit for the periods indicated:

	2009	Quarter Ended January 31, %*	2010	%*	Increase (decrease)	%**
Services revenue	\$ 27,683	100.0	\$ 26,822	100.0	\$ (861)	(3.1)
Services cost of goods sold	19,190	69.3	19,047	71.0	(143)	(0.7)
Services gross profit	\$ 8,493	30.7	\$ 7,775	29.0	\$ (718)	(8.5)

\* Denotes % of  
services revenue

\*\* Denotes %  
change from  
2009 to 2010

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The table below (in thousands, except percentage data) sets forth the changes in distribution of revenue for the periods indicated:

	2009	Quarter Ended January 31, % *	2010	% *	Increase (decrease)	%**
Optical service delivery	\$ 130,191	77.8	\$ 108,615	61.8	\$ (21,576)	(16.6)
Carrier Ethernet service delivery	9,526	5.7	40,439	22.9	30,913	324.5
Global network services	27,683	16.5	26,822	15.3	(861)	(3.1)
Total	\$ 167,400	100.0	\$ 175,876	100.0	\$ 8,476	5.1

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

Revenue from sales to customers based outside of the United States is reflected as International in the geographic distribution of revenue below. The table below (in thousands, except percentage data) sets forth the changes in geographic distribution of revenue for the periods indicated:

	2009	Quarter Ended January 31, % *	2010	% *	Increase (decrease)	%**
United States	\$ 98,947	59.1	\$ 123,912	70.4	\$ 24,965	25.2
International	68,453	40.9	51,964	29.6	(16,489)	(24.1)
Total	\$ 167,400	100.0	\$ 175,876	100.0	\$ 8,476	5.1

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

Certain customers each accounted for at least 10% of our revenue for the periods indicated (in thousands, except percentage data) as follows:

	2009	Quarter Ended January 31, % *	2010	% *
Company A	\$ 32,556	19.4	\$ 42,515	24.2
Company B	18,877	11.3	n/a	
Company C	16,938	10.1	n/a	
Total	\$ 68,371	40.8	\$ 42,515	24.2

n/a Denotes revenue  
recognized less  
than 10% of  
total revenue for  
the period

\* Denotes % of  
total revenue

*Revenue*

**Product revenue** increased primarily due to a \$30.9 million increase in sales of our carrier Ethernet service delivery products primarily reflecting a \$31.6 million increase in sales of our switching and aggregation products. This increase was partially offset by a \$21.6 million decrease in sales of our optical service delivery products. Lower optical service delivery revenue reflects decreases of \$21.3 million in sales of core switching products, \$2.8 million in sales of core transport products, and \$2.1 million in sales of legacy data networking and metro transport products. These decreases were partially offset by an increase of \$4.6 million in sales of our CN 4200 FlexSelect Advanced Service Platform.

**Services revenue** decreased primarily due to a \$1.9 million decrease in deployment services.

**United States revenue** increased primarily due to a \$30.1 million increase in sales of our carrier Ethernet service delivery products primarily reflecting a \$30.9 million increase in sales of our switching and aggregation products. This increase was partially offset by a \$6.7 million decrease in sales of our optical service delivery products. Lower optical service delivery revenue reflects decreases of \$16.0 million in sales of core switching products and \$1.4 million in sales of legacy data networking and metro transport products. These decreases were partially offset by increases of \$8.1 million in sales of CN 4200 and \$2.6 million in sales of core transport products. In addition, U.S revenue benefited from a \$1.5 million increase in services revenue.

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**International revenue** decreased primarily due to a \$14.9 million decrease in sales of our optical service delivery products. This reflects a decrease of \$5.5 million in sales of core transport products, \$5.3 million in sales of core switching products, and \$3.5 million in sales of CN 4200. In addition, services revenue decreased \$2.4 million primarily related to a \$2.0 million decrease in deployment services. These decreases were partially offset by an increase of \$0.8 million in sales of carrier Ethernet service delivery products.

*Gross profit*

**Gross profit as a percentage of revenue** increased due to lower charges related to excess and obsolete inventory partially offset by unfavorable product mix.

**Gross profit on products as a percentage of product revenue** increased, benefitting from lower charges related to excess and obsolete inventory. The first quarter of fiscal 2009 reflected higher than typical charges relating to excess and obsolete inventory. Gross profit for the first quarter of 2010 reflects an immaterial adjustment to reduce cost of goods sold by \$3.3 million to correct warranty expenses related to prior periods. These improvements were partially offset by a less favorable product mix in the first quarter of fiscal 2010. See Note 1 for more information regarding the immaterial adjustment to warranty expense in the first quarter of fiscal 2010.

**Gross profit on services as a percentage of services revenue** decreased slightly due to higher costs related to deployment services.

*Operating expense*

The table below (in thousands, except percentage data) sets forth the changes in operating expense for the periods indicated:

	2009	Quarter Ended January 31, % *	2010	% *	Increase (decrease)	%**
Research and development	\$ 46,700	27.9	\$ 50,033	28.4	\$ 3,333	7.1
Selling and marketing	33,819	20.2	34,237	19.5	418	1.2
General and administrative	11,585	6.9	12,763	7.3	1,178	10.2
Acquisition and integration costs			27,031	15.4	27,031	100.0
Amortization of intangible assets	6,404	3.8	5,981	3.4	(423)	(6.6)
Restructuring costs	76	0.0	(21)	0.0	(97)	(127.6)
Total operating expense	\$ 98,584	58.8	\$ 130,024	74.0	\$ 31,440	31.9

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

**Research and development** expense benefited by \$0.8 million in favorable foreign exchange rates, primarily due to the strengthening of the U.S. dollar in relation to the Canadian dollar. The resulting \$3.3 million change primarily reflects increases of \$2.3 million in prototype expense related to the development initiatives described above, \$0.8 million in professional services and fees, \$0.3 million in depreciation expense and \$0.3 million in facilities and information systems expenses. These increases were partially offset by a decrease of \$0.5 million in employee compensation and related costs.

**Selling and marketing** expense was negatively affected by \$0.6 million in foreign exchange rates primarily due to the weakening of the U.S. dollar in relation to the Euro. The resulting \$0.4 million change primarily reflects increases of \$0.9 million in employee compensation and related costs, \$0.3 million in travel-related expenditures. These increases were partially offset by decreases of \$0.5 million in marketing program costs and \$0.2 million in facilities and information systems expenses.

**General and administrative** expense was negatively affected by \$0.1 million in foreign exchange rates primarily due to the weakening of the U.S. dollar in relation to the Euro. The resulting \$1.2 million net change primarily reflects increases of \$0.6 million in consulting service expense, \$0.2 million in employee compensation and related costs, \$0.2 million in facilities and information systems expenses, and \$0.1 million in travel-related expenditures.

**Acquisition and integration costs** were related to the pending acquisition of the optical and carrier Ethernet assets of Nortel's Metro Ethernet Networks (MEN) business as described above. As of January 31, 2010, we have incurred \$27.0 million in transaction, consulting and third party service fees, which were expensed in the Condensed Consolidated Statement of Operations. We also purchased \$2.3 million in capitalized equipment, primarily related to information technology, which is included in the Condensed Consolidated Balance Sheet.

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**Amortization of intangible assets** decreased due to certain intangible assets reaching their useful life and becoming fully amortized prior to the first quarter of fiscal 2010.

**Restructuring costs** decreased by \$0.1 million due to reduced one-time termination benefits.

*Other items*

The table below (in thousands, except percentage data) sets forth the changes in other items for the periods indicated:

	2009	Quarter Ended January 31,			Increase (decrease)	
		% *	2010	% *		%**
Interest and other income (loss), net	\$4,660	2.8	\$ (773)	(0.4)	\$(5,433)	(116.6)
Interest expense	\$1,844	1.1	\$1,828	1.0	\$ (16)	(0.9)
Loss on cost method investments	\$ 565	0.3	\$		\$ (565)	(100.0)
Provision for income taxes	\$ 341	0.2	\$ 868	0.5	\$ 527	154.5

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

**Interest and other income (loss), net** decreased as a result of a \$4.9 million decrease in interest income due to lower interest rates and a \$0.5 million increase of other losses related to foreign currency re-measurements.

**Interest expense** remained relatively unchanged.

**Loss on cost method investments** was primarily due to a decline in value of our investment in a privately held technology company that was determined to be other-than-temporary.

**Provision for income taxes** increased primarily due to increased foreign income tax and the elimination of refundable federal tax credits, which expired on December 31, 2009.

**Liquidity and Capital Resources**

At January 31, 2010, our principal sources of liquidity were cash and cash equivalents, and short-term investments. During the second quarter of fiscal 2009, we reallocated our previous short and long-term investments principally into U.S. treasuries. As a result, at January 31, 2010, all short-term investments principally represent U.S. treasuries. The following table summarizes our cash and cash equivalents and investments (in thousands):

	October 31, 2009	January 31, 2010	Increase (decrease)
Cash and cash equivalents	\$ 485,705	\$ 573,180	\$ 87,475
Short-term investments in marketable debt securities	563,183	428,409	(134,774)
Long-term investments in marketable debt securities	8,031	8,048	17
Total cash and cash equivalents and investments in marketable debt securities	\$ 1,056,919	\$ 1,009,637	\$ (47,282)

The decrease in total cash and cash equivalents, and investments during the first three months of fiscal 2010 was primarily related to our initial deposit of \$38.5 million related to the pending acquisition of Nortel's MEN business.

These amounts were slightly offset by \$4.5 million of cash generated from operating activities described in

Operating Activities below. Cash generated from operating activities reflects payments of approximately \$11.4 million related to acquisition and integration activities. See Note 3 above for more information regarding the pending acquisition and its effect on our cash and debt position. Based on past performance and current expectations, we believe that our cash and cash equivalents, investments and cash generated from operations will satisfy our working capital needs, capital expenditures, and other liquidity requirements associated with our existing operations through at least the next 12 months.

The following sections review the significant activities that had an impact on our cash during the first three months of fiscal 2010.

**Table of Contents*****Operating Activities***

The following tables set forth (in thousands) components of our cash generated from operating activities during the period:

*Net loss*

	Three Months Ended January 31, 2010
Net loss	\$ (53,333)

Our net loss during the first three months of fiscal 2010 included the significant non-cash items summarized in the following table (in thousands):

	Three Months Ended January 31, 2010
Depreciation of equipment, furniture and fixtures; and amortization of leasehold improvements	\$ 5,871
Share-based compensation costs	8,282
Amortization of intangible assets	7,631
Provision for inventory excess and obsolescence	950
Provision for warranty	3,060
Total significant non-cash charges	\$ 25,794

*Accounts Receivable, Net*

Cash provided by accounts receivable, net of allowance for doubtful accounts, during the first three months of fiscal 2010 was \$12.6 million. Our days sales outstanding (DSOs) decreased from 70 days for the first three months of fiscal 2009 to 54 days for the first three months of fiscal 2010. Our DSOs decreased due to lower incidence of customer payment delays.

The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2009 through the end of the first quarter of fiscal 2010:

	October 31, 2009	January 31, 2010	Increase (decrease)
Accounts receivable, net	\$ 118,251	\$ 105,624	\$ (12,627)

*Inventory*

Cash consumed by inventory during the first three months of fiscal 2010 was \$8.3 million. Our inventory turns decreased slightly from 3.3 turns during the first three months of fiscal 2009 to 3.2 turns for the first three months of fiscal 2010.

During the first three months of fiscal 2010, changes in inventory reflect a \$1.0 million reduction related to a non-cash provision for excess and obsolescence. The following table sets forth (in thousands) changes to the components of our inventory from the end of fiscal 2009 through the end of the first quarter of fiscal 2010:

October 31, 2009	January 31, 2010	Increase (decrease)
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Raw materials	\$ 19,694	\$ 18,256	\$ (1,438)
Work-in-process	1,480	2,255	775
Finished goods	90,914	98,264	7,350
Gross inventory	112,088	118,775	6,687
Provision for inventory excess and obsolescence	(24,002)	(23,344)	658
Inventory	\$ 88,086	\$ 95,431	\$ 7,345

*Accounts payable, accruals and other obligations*

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Cash generated in operations related to accounts payable, accruals and other obligations during the first three months of fiscal 2010 was \$11.4 million.

During the first three months of fiscal 2010, we had non-operating cash accounts payable increases of \$1.8 million related to equipment purchases. Changes in accrued liabilities reflect non-cash provisions of \$3.1 million related to warranties. The following table sets forth (in thousands) changes in our accounts payable, accruals and other obligations from the end of fiscal 2009 through the end of the first quarter of fiscal 2010:

	October 31, 2009	January 31, 2010	Increase (decrease)
Accounts payable	\$ 53,104	\$ 76,211	\$ 23,107
Accrued liabilities	103,349	97,560	(5,789)
Restructuring liabilities	9,605	8,750	(855)
Other long-term obligations	8,554	8,330	(224)
Accounts payable, accruals and other obligations	\$ 174,612	\$ 190,851	\$ 16,239

*Interest Payable on Convertible Notes*

Interest on our outstanding 0.25% convertible senior notes, due May 1, 2013, is payable on May 1 and November 1 of each year. We paid \$0.4 million in interest on our 0.25% convertible notes during the first three months of fiscal 2010.

Interest on our outstanding 0.875% convertible senior notes, due June 15, 2017, is payable on June 15 and December 15 of each year. We paid \$2.2 million in interest on our 0.875% convertible notes during the first three months of fiscal 2010.

The indentures governing our outstanding convertible notes do not contain any financial covenants. The indentures provide for customary events of default, including payment defaults, breaches of covenants, failure to pay certain judgments and certain events of bankruptcy, insolvency and reorganization. If an event of default occurs and is continuing, the principal amount of the notes, plus accrued and unpaid interest, if any, may be declared immediately due and payable. These amounts automatically become due and payable if an event of default relating to certain events of bankruptcy, insolvency or reorganization occurs.

The following table reflects (in thousands) the balance of interest payable and the change in this balance from the end of fiscal 2009 through the end of the first quarter of fiscal 2010:

	October 31, 2009	January 31, 2010	Increase (decrease)
Accrued interest payable	\$ 2,045	\$ 738	\$ (1,307)

*Deferred revenue*

Deferred revenue increased by \$5.0 million during the first three months of fiscal 2010. Product deferred revenue represents payments received in advance of shipment and payments received in advance of our ability to recognize revenue. Services deferred revenue is related to payment for service contracts that will be recognized over the contract term. The following table reflects (in thousands) the balance of deferred revenue and the change in this balance from the end of fiscal 2009 through the end of the first quarter of fiscal 2010:

	October 31, 2009	January 31, 2010	Increase (decrease)
Products	\$ 11,998	\$ 15,536	\$ 3,538
Services	63,935	65,363	1,428

Total deferred revenue	\$ 75,933	\$ 80,899	\$ 4,966
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***Investing Activities***

During the first three months of fiscal 2010, we had net sales and maturities of approximately \$197.7 million of available for sale securities. Investing activities also include our initial deposit of \$38.5 million related to the pending acquisition of Nortel's MEN business. Investing activities also included the payment of approximately \$7.0 million in equipment purchases. We also purchased an additional \$3.3 million of equipment which was included in accounts payable. Of the \$3.3 million included in accounts payable, \$2.3 million was related to the acquisition. Purchases of equipment in accounts payable increased by \$1.8 million from the end of fiscal 2009.

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**Table of Contents****Contractual Obligations**

On November 23, 2009 we announced that we had been selected as the successful bidder in the auction of substantially all of the optical networking and carrier Ethernet assets of Nortel's MEN business. In accordance with the definitive purchase agreements, as amended, we have agreed to pay \$530 million in cash and issue \$239 million in aggregate principal amount of 6% Senior Convertible notes due in 2017 for a total consideration of \$769 million for the assets. See Note 3 to our Condensed Consolidated Financial Statements above for more information regarding the pending acquisition of substantially all of the optical networking and carrier Ethernet assets of Nortel's MEN business and the terms of the notes.

During the first three months of fiscal 2010, we did not experience material changes, outside of the ordinary course of business, in our contractual obligations from those reported in our annual report on Form 10-K for the fiscal year ended October 31, 2009. The following is a summary of our future minimum payments under contractual obligations as of January 31, 2010 (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Interest due on convertible notes	\$ 35,420	\$ 5,120	\$ 10,240	\$ 9,122	\$ 10,938
Principal due at maturity on convertible notes	798,000			298,000	500,000
Operating leases (1)	59,138	14,856	22,139	13,889	8,254
Purchase obligations (2)	99,013	99,013			
Total (3)	\$ 991,571	\$ 118,989	\$ 32,379	\$ 321,011	\$ 519,192

(1) The amount for operating leases above does not include insurance, taxes, maintenance and other costs required by the applicable operating lease. These costs are variable and are not expected to have a material impact.

(2) Purchase obligations relate to purchase order commitments to our contract manufacturers and component

suppliers for inventory. In certain instances, we are permitted to cancel, reschedule or adjust these orders. Consequently, only a portion of the amount reported above relates to firm, non-cancelable and unconditional obligations.

- (3) As of January 31, 2010, we also had approximately \$6.2 million of other long-term obligations in our condensed consolidated balance sheet for unrecognized tax positions that are not included in this table because the periods of cash settlement with the respective tax authority cannot be reasonably estimated.

Some of our commercial commitments, including some of the future minimum payments set forth above, are secured by standby letters of credit. The following is a summary of our commercial commitments secured by standby letters of credit by commitment expiration date as of January 31, 2010 (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Standby letters of credit	\$ 24,936	\$ 22,832	\$ 1,400	\$ 704	\$

**Off-Balance Sheet Arrangements**

We do not engage in any off-balance sheet financing arrangements. In particular, we do not have any equity interests in so-called limited purpose entities, which include special purpose entities (SPEs) and structured finance entities.

**Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expense, and related disclosure of contingent assets and liabilities. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. On an ongoing basis, we reevaluate our estimates, including those related to bad debts, inventories, investments, intangible assets, goodwill, income taxes, warranty obligations, restructuring, derivatives and hedging, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Among other things, these estimates form the basis for 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. To the extent that there are material differences between our estimates and actual results, our consolidated financial statements will be affected.

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We believe that the following critical accounting policies reflect those areas where significant judgments and estimates are used in the preparation of our consolidated financial statements.

***Revenue Recognition***

We recognize revenue when it is realized or realizable and earned. We consider revenue to be realized or realizable and earned when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery. We assess whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. We assess collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are to be performed.

Some of our communications networking equipment is integrated with software that is essential to the functionality of the equipment. Software revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. In instances where final acceptance of the product is specified by the customer, revenue is deferred until all acceptance criteria have been met.

Arrangements with customers may include multiple deliverables, including any combination of equipment, services and software. If multiple element arrangements include software or software-related elements that are essential to the equipment, we allocate the arrangement fee to those separate units of accounting. Multiple element arrangements that include software are separated into more than one unit of accounting if the functionality of the delivered element(s) is not dependent on the undelivered element(s), there is vendor-specific objective evidence of the fair value of the undelivered element(s), and general revenue recognition criteria related to the delivered element(s) have been met. The amount of product and services revenue recognized is affected by our judgments as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence of fair value exists. Changes to the elements in an arrangement and our ability to establish vendor-specific objective evidence for those elements could affect the timing of revenue recognition. For all other deliverables, we separate the elements into more than one unit of accounting if the delivered element(s) have value to the customer on a stand-alone basis, objective and reliable evidence of fair value exists for the undelivered element(s), and delivery of the undelivered element(s) is probable and substantially within our control. Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or using the residual method if objective evidence of fair value does not exist for the delivered element(s). The revenue recognition criteria described above are applied to each separate unit of accounting. If these criteria are not met, revenue is deferred until the criteria are met or the last element has been delivered.

Our total deferred revenue for products was \$12.0 million and \$15.5 million as of October 31, 2009 and January 31, 2010, respectively. Our services revenue is deferred and recognized ratably over the period during which the services are to be performed. Our total deferred revenue for services was \$63.9 million and \$65.4 million as of October 31, 2009 and January 31, 2010, respectively.

***Share-Based Compensation***

We measure and recognize compensation expense for share-based awards based on estimated fair values on the date of grant. We estimate the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This option pricing model requires that we make several estimates, including the option's expected life and the price volatility of the underlying stock. The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding. Because we considered our options to be plain vanilla, we calculated the expected term using the simplified method for fiscal 2007. Options are considered to be plain vanilla if they have the following basic characteristics: they are granted at-the-money; exercisability is conditioned upon service through the vesting date; termination of service prior to vesting results in forfeiture; there is a limited exercise period following termination of service; and the options are non-transferable and non-hedgeable. Beginning in fiscal 2008 we gathered more detailed historical information about specific exercise

behavior of our grantees, which we used to determine expected term. We considered the implied volatility and historical volatility of our stock price in determining our expected volatility, and, finding both to be equally reliable, determined that a combination of both measures would result in the best estimate of expected volatility. We recognize the estimated fair value of option-based awards, net of estimated forfeitures, as share-based compensation expense on a straight-line basis over the requisite service period.

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We estimate the fair value of our restricted stock unit awards based on the fair value of our common stock on the date of grant. Our outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. We recognize the estimated fair value of service-based awards, net of estimated forfeitures, as share-based expense ratably over the vesting period on a straight-line basis. Awards with performance-based vesting conditions require the achievement of certain financial or other performance criteria or targets as a condition to the vesting, or acceleration of vesting. We recognize the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon our determination of whether it is probable that the performance targets will be achieved. At each reporting period, we reassess the probability of achieving the performance targets and the performance period required to meet those targets. Determining whether the performance targets will be achieved involves judgment, and the estimate of expense may be revised periodically based on changes in the probability of achieving the performance targets. Revisions are reflected in the period in which the estimate is changed. If any performance goals are not met, no compensation cost is ultimately recognized against that goal, and, to the extent previously recognized, compensation cost is reversed.

Because share-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures. We estimate forfeitures at the time of grant and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the measure of estimated fair value of our share-based compensation. See Note 15 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to share-based compensation and the amount of share-based compensation expense we incurred for the periods covered in this report. As of January 31, 2010, total unrecognized compensation expense was: (i) \$10.5 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 1.0 year; and (ii) \$52.8 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.4 years.

We recognize windfall tax benefits associated with the exercise of stock options or release of restricted stock units directly to stockholders' equity only when realized. A windfall tax benefit occurs when the actual tax benefit realized by us upon an employee's disposition of a share-based award exceeds the deferred tax asset, if any, associated with the award that we had recorded. When assessing whether a tax benefit relating to share-based compensation has been realized, we follow the tax law's with-and-without method. Under the with-and-without method, the windfall is considered realized and recognized for financial statement purposes only when an incremental benefit is provided after considering all other tax benefits including our net operating losses. The with-and-without method results in the windfall from share-based compensation awards always being effectively the last tax benefit to be considered. Consequently, the windfall attributable to share-based compensation will not be considered realized in instances where our net operating loss carryover (that is unrelated to windfalls) is sufficient to offset the current year's taxable income before considering the effects of current-year windfalls.

***Reserve for Inventory Obsolescence***

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. Upon recognition of the write down, a new lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. We recorded charges for excess and obsolete inventory of \$6.5 million and \$1.0 million in the first three months of fiscal 2009 and 2010, respectively. These charges were primarily related to excess inventory due to a change in forecasted product sales. In an effort to limit our exposure to delivery delays and to satisfy customer needs we purchase inventory based on forecasted sales across our product lines. In addition, part of our research and development strategy is to promote the convergence of similar features and functionalities across our product lines. Each of these practices exposes us to the risk that our customers will not order products for which we have forecasted sales, or will purchase less than we have forecasted. Historically, we have experienced write downs due to changes in strategic direction, discontinuance

of a product and declines in market conditions. If actual market conditions worsen or differ from those we have assumed, if there is a sudden and significant decrease in demand for our products, or if there is a higher incidence of inventory obsolescence due to a rapid change in technology, we may be required to take additional inventory write-downs, and our gross margin could be adversely affected. Our inventory net of allowance for excess and obsolescence was \$88.1 million and \$95.4 as of October 31, 2009 and January 31, 2010, respectively.

**Table of Contents*****Restructuring***

As part of our restructuring costs, we provide for the estimated cost of the net lease expense for facilities that are no longer being used. The provision is equal to the fair value of the minimum future lease payments under our contracted lease obligations, offset by the fair value of the estimated sublease payments that we may receive. As of January 31, 2010, our accrued restructuring liability related to net lease expense and other related charges was \$8.7 million. The total minimum remaining lease payments for these restructured facilities are \$13.5 million. These lease payments will be made over the remaining lives of our leases, which range from nine months to ten years. If actual market conditions are different than those we have projected, we will be required to recognize additional restructuring costs or benefits associated with these facilities.

***Allowance for Doubtful Accounts Receivable***

Our allowance for doubtful accounts receivable is based on management's assessment, on a specific identification basis, of the collectibility of customer accounts. We perform ongoing credit evaluations of our customers and generally have not required collateral or other forms of security from customers. In determining the appropriate balance for our allowance for doubtful accounts receivable, management considers each individual customer account receivable in order to determine collectibility. In doing so, we consider creditworthiness, payment history, account activity and communication with such customer. If a customer's financial condition changes, or if actual defaults are higher than our historical experience, we may be required to take a charge for an allowance for doubtful accounts receivable which could have an adverse impact on our results of operations. Our accounts receivable net of allowance for doubtful accounts was \$118.3 million and \$105.6 million as of October 31, 2009 and January 31, 2010, respectively. Our allowance for doubtful accounts as of October 31, 2009 and January 31, 2010 was \$0.1 million.

***Long-lived Assets***

Our long-lived assets include: equipment, furniture and fixtures; finite-lived intangible assets; and maintenance spares. As of October 31, 2009 and January 31, 2010 these assets totaled \$154.7 million and \$152.4 million, net, respectively. We test long-lived assets for impairment whenever events or changes in circumstances indicate that the assets' carrying amount is not recoverable from its undiscounted cash flows. Our long-lived assets are part of a single reporting unit which represents the lowest level for which we identify cash flows.

***Investments***

We have an investment portfolio comprised of marketable debt securities which are comprised of U.S. government obligations. The value of these securities is subject to market volatility for the period we hold these investments and until their sale or maturity. We recognize losses when we determine that declines in the fair value of our investments, below their cost basis, are other-than-temporary. In determining whether a decline in fair value is other-than-temporary, we consider various factors including market price (when available), investment ratings, the financial condition and near-term prospects of the investee, the length of time and the extent to which the fair value has been less than our cost basis, and our intent and ability to hold the investment until maturity or for a period of time sufficient to allow for any anticipated recovery in market value. We make significant judgments in considering these factors. If we judge that a decline in fair value is other-than-temporary, the investment is valued at the current fair value, and we would incur a loss equal to the decline, which could materially adversely affect our profitability and results of operations.

As of January 31, 2010, we held a minority investment of \$0.9 million in a privately held technology company that is reported in other assets. The market for technologies or products manufactured by this company is in the early stage and markets may never materialize or become significant. This investment is inherently high risk and we could lose our entire investment. We monitor this investment for impairment and make appropriate reductions in carrying value when necessary. If market conditions, the expected financial performance, or the competitive position of this company deteriorates, we may be required to record a non-cash charge in future periods due to an impairment of the value of our investment.

***Deferred Tax Valuation Allowance***

As of January 31, 2010, we have recorded a valuation allowance offsetting nearly all our net deferred tax assets of \$1.2 billion. When measuring the need for a valuation allowance, we assess both positive and negative evidence regarding the realizability of these deferred tax assets. We record a valuation allowance to reduce our deferred tax

assets to the amount that is more likely than not to be realized. In determining net deferred tax assets and valuation allowances, management is required to make judgments and estimates related to projections of profitability, the timing and extent of the utilization of net operating loss carryforwards, applicable tax rates, transfer pricing methodologies and tax planning strategies. The valuation allowance is reviewed quarterly and is maintained until sufficient positive evidence exists to support a reversal. Because evidence such as our operating results during the most recent three-year period is afforded more weight than forecasted results for future periods, our cumulative loss during this three-year period represents sufficient negative evidence regarding the need for nearly a full valuation allowance. We will release this valuation allowance when management determines that it is more likely than not that our deferred tax assets will be realized. Any future release of valuation allowance may be recorded as a tax benefit increasing net income or as an adjustment to paid-in capital, based on tax ordering requirements.

**Table of Contents*****Warranty***

Our liability for product warranties, included in other accrued liabilities, was \$40.2 million and \$38.4 million as of October 31, 2009 and January 31, 2010, respectively. Our products are generally covered by a warranty for periods ranging from one to five years. We accrue for warranty costs as part of our cost of goods sold based on associated material costs, technical support labor costs, and associated overhead. Material cost is estimated based primarily upon historical trends in the volume of product returns within the warranty period and the cost to repair or replace the equipment. Technical support labor cost is estimated based primarily upon historical trends and the cost to support the customer cases within the warranty period. The provision for product warranties was \$2.5 million and \$3.1 million for the first quarter of fiscal 2009 and 2010, respectively. The provision for warranty claims may fluctuate on a quarterly basis depending upon the mix of products and customers in that period. If actual product failure rates, material replacement costs, service or labor costs differ from our estimates, revisions to the estimated warranty provision would be required. An increase in warranty claims or the related costs associated with satisfying these warranty obligations could increase our cost of sales and negatively affect our gross margin.

***Uncertain Tax Positions***

We account for uncertainty in income tax positions using a two-step approach. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made. As of January 31, 2010, we had \$1.3 million and \$6.2 million recorded as current and long-term obligations, respectively, related to uncertain tax positions. The provision for income taxes includes the effect of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

***Loss Contingencies***

We are subject to the possibility of various losses arising in the ordinary course of business. These may relate to disputes, litigation and other legal actions. We consider the likelihood of loss or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. A loss is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether any accruals should be adjusted and whether new accruals are required.

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

The following discussion about our market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates.

**Interest Rate Sensitivity.** We maintain a short-term and long-term investment portfolio. See Notes 5 and 6 to the Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information relating to these investments and their fair value. These available-for-sale securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10 percentage points from current levels, the fair value of the portfolio would decline by approximately \$10.5 million.

**Foreign Currency Exchange Risk.** As a global concern, we face exposure to adverse movements in foreign currency exchange rates. Because our sales are primarily denominated in U.S. dollars, the impact of foreign currency fluctuations on revenue has not been material. Our primary exposures to foreign currency exchange risk are related to non-U.S. dollar denominated operating expense in Canadian Dollars ( CAD ), British Pounds ( GBP ), Euros ( EUR ) and Indian Rupees ( INR ). During the first three months of fiscal 2010, approximately 76% of our operating expense was U.S. dollar denominated.



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To reduce variability in non-U.S. dollar denominated operating expense, we have previously entered into foreign currency forward contracts and may do so in the future. We utilize these derivatives to partially offset our market exposure to fluctuations in certain foreign currencies. These derivatives are designated as cash flow hedges and typically have maturities of less than one year. Ciena's foreign currency forward contracts were fully matured as of October 31, 2009.

For the first quarter of fiscal 2010, research and development benefited by approximately \$0.8 million due to favorable foreign exchange rates related to the strengthening of the US dollar in relation to the Canadian dollar. During this same period, sales and marketing and general and administrative expenses were negatively affected by unfavorable foreign exchange rates related to the weakening of the US dollar in relation to the Euro by approximately \$0.6 million and \$0.1 million, respectively.

As of January 31, 2010, our assets and liabilities related to non-dollar denominated currencies were primarily related to intercompany payables and receivables. We do not enter into foreign exchange forward or option contracts for trading purposes.

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

As of the end of the period covered by this report, Ciena carried out an evaluation under the supervision and with the participation of Ciena's management, including Ciena's Chief Executive Officer and Chief Financial Officer, of Ciena's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon this evaluation, Ciena's Chief Executive Officer and Chief Financial Officer concluded that Ciena's disclosure controls and procedures were effective as of the end of the period covered by this report.

**Changes in Internal Control over Financial Reporting**

There was no change in Ciena's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, Ciena's internal control over financial reporting.

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

On May 29, 2008, Graywire, LLC filed a complaint in the United States District Court for the Northern District of Georgia against Ciena and four other defendants, alleging, among other things, that certain of the parties' products infringe U.S. Patent 6,542,673 (the '673 Patent'), relating to an identifier system and components for optical assemblies. The complaint, which seeks injunctive relief and damages, was served upon Ciena on January 20, 2009. Ciena filed an answer to the complaint and counterclaims against Graywire on March 26, 2009, and an amended answer and counterclaims on April 17, 2009. On April 27, 2009, Ciena and certain other defendants filed an application for inter partes reexamination of the '673 Patent with the U.S. Patent and Trademark Office (the PTO). On the same date, Ciena and the other defendants filed a motion to stay the case pending reexamination of all of the patents-in-suit. On July 17, 2009, the district court granted the defendants' motion to stay the case. On July 23, 2009, the PTO granted the defendants' application for reexamination with respect to certain claims of the '673 Patent. We believe that we have valid defenses to the lawsuit and intend to defend it vigorously in the event the stay of the case is lifted.

As a result of our June 2002 merger with ONI Systems Corp., we became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI's initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI's registration statement and by engaging in manipulative practices to artificially inflate ONI's stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters' alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and

all of these actions have been included in a single coordinated proceeding. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena's Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 22, 2009. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation, the ultimate outcome of the matter is uncertain.

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

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

#### ***Risks relating to our pending acquisition of certain Nortel Metro Ethernet Networks (MEN) Assets***

Business combinations involve a high degree of risk. In addition to the other information contained in this report, you should consider the following risk factors related to our pending acquisition of certain Nortel MEN assets before investing in our securities.

#### **We may fail to realize the anticipated benefits and operating synergies expected from the transaction, which could adversely affect our operating results and the market price of our common stock.**

The success of the transaction will depend, in significant part, on our ability to successfully integrate the acquired business and realize the anticipated benefits and operating synergies to be derived from the combination of the two businesses. We believe that the additional resources, expanded geographic reach, new and broader customer relationships, and deeper portfolio of complementary network solutions derived from the pending transaction will accelerate the execution of our corporate and product development strategy and provide opportunities to optimize our product development investment. Actual cost, operating, strategic and sales synergies, if achieved at all, may be lower than we expect and may take longer to achieve than anticipated. If we are not able to adequately address the integration challenges above, we may be unable to realize the anticipated benefits of the transaction. The anticipated benefits of the transaction may not be realized fully or at all or may take longer to realize than expected. If we are not able to achieve these objectives, the value of Ciena's common stock may be adversely affected.

#### **Our pending acquisition will result in significant integration costs and any material delays or unanticipated additional expense may harm our business and results of operations.**

We expect the magnitude of the integration effort will be significant and that it will require material capital and operating expense by Ciena. We currently expect that integration expense associated with equipment and information technology costs, transaction expense, and consulting and third party service fees associated with integration, will be approximately \$180 million over a two-year period, with a significant portion of such costs anticipated to be incurred in the first year after completion of the transaction. This amount does not give effect to any expense related to, among other things, facilities restructuring or inventory obsolescence charges. This amount also does not give effect to higher operating expense associated with transition services described below. As a result, the integration expense we incur and recognize for financial statement purposes could be significantly higher. Any material delays or unanticipated additional expense may harm our business and results of operations.

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**The integration of the acquired assets will be extremely complex and involve a number of risks. Failure to successfully integrate our respective operations, including the underlying information systems, could significantly harm our business and results of operations.**

Because of the structure of the transaction as an asset carve out from Nortel, upon completion of the transaction we will not be integrating an entire enterprise, with the back-office systems and processes that make the business run, when we complete this transaction. We must build the infrastructure and organizations, and retain third party services, to ensure business continuity and to support and scale our business. Integrating our operations will be extremely complex and there is no assurance that we will not encounter material delays or unanticipated costs that would adversely affect our business and results of operations. Successful integration involves numerous risks, including:

assimilating product offerings and sales and marketing operations;

coordinating research and development efforts;

retaining and attracting customers following a period of significant uncertainty associated with the acquired business;

diversion of management attention from business and operational matters;

identifying and retaining key personnel;

maintaining and transitioning relationships with key vendors, including component providers, manufacturers and service providers;

integrating accounting, information technology, enterprise management and administrative systems which may be difficult or costly;

making significant cash expenditures that may be required to retain personnel or eliminate unnecessary resources;

managing tax costs or liabilities;

coordinating a broader and more geographically dispersed organization;

maintaining uniform standards, procedures and policies to ensure efficient and compliant administration of the organization; and

making any necessary modifications to internal control to comply with the Sarbanes-Oxley Act of 2002 and related rules and regulations.

Delays encountered in the integration process, significant cost overruns and unanticipated expense could have a material adverse effect on our operating results and financial condition.

**Following completion of the transaction we will rely upon an affiliate of Nortel to perform certain critical transition services during a transition period and there can be no assurance that such services will be performed timely and effectively.**

Following the completion of the transaction, we will rely upon an affiliate of Nortel for certain transition services related to the operation and continuity of the business following completion of the transaction. These services include, among others, critical functions relating to accounting, information technology, customer support services and facilities. We anticipate that transition service-related expense will be significant and the administration and oversight of these services will be complex. The transition service provider will be performing services on behalf of Ciena as well as certain other purchasers of those businesses that Nortel has divested in the course of its bankruptcy

proceedings. Relying upon this transition services provider to perform critical operations and services raises a number of significant business and operational risks, including its ability to become an effective support partner for all of the Nortel purchasers, segregation of such services, and its ability to retain experienced and knowledgeable personnel. There can be no assurance such services will be performed timely and effectively. Significant disruption in these transition services or unanticipated costs related to such services could adversely affect our business and results of operations.

**As a consequence of the transaction, we will take on substantial additional indebtedness and materially reduce our cash balance.**

In accordance with the applicable asset purchase agreements, upon completion of the transaction, we will pay the sellers \$530 million in cash and issue them \$239 million in aggregate principal of senior convertible notes due in fiscal 2017. This cash expenditure will significantly reduce our cash balance. In addition, the terms of the notes to be issued provide for an adjustment of the interest rate up to a maximum of 8% per annum, depending upon the market price of our common stock upon the completion of the transaction. Prior to the closing of the transaction, we may elect to replace some or all of the convertible notes to be issued with cash equal to 102% of the face amount of the notes that are replaced. In light of this option, we continually assess market conditions to determine whether to make this election and access the capital markets for the purposes of funding the election through the issuance of debt securities that may include securities convertible into equity. Regardless of whether we make this election, our lower cash balance and increased indebtedness resulting from this transaction could adversely affect our business. In particular, it could increase our vulnerability to sustained, adverse macroeconomic weakness, limit our ability to obtain further financing and limit our ability to pursue certain operational and strategic opportunities. Our indebtedness and lower cash balance may also put us in a competitive disadvantage to other vendors with greater resources.

**Table of Contents****The transaction may expose us to significant unanticipated liabilities that could adversely affect our business and results of operations.**

Our purchase of the acquired business in connection with Nortel's bankruptcy proceedings may expose us to significant unanticipated liabilities. We may incur unforeseen liabilities relating to the operation of the Nortel business. The liabilities may include employment, retirement or severance-related obligations under applicable law or other benefits arrangements, legal claims, warranty or similar liabilities to customers, and claims by or amounts owed to vendors, including as a result of any contracts assigned to Ciena in the transaction. We may also incur liabilities or claims associated with our acquisition or licensing of Nortel's technology and intellectual property including claims of infringement. Particularly in international jurisdictions, our acquisition of Nortel's assets, or our decision to independently enter new international markets where Nortel previously conducted business, could also expose us to tax liabilities and other amounts owed by Nortel. The incurrence of such unforeseen or unanticipated liabilities, should they be significant, could have a material adverse affect on our business, results of operations and financial condition.

**The transaction may not be accretive and may cause dilution to our earnings per share, which may harm the market price of our common stock.**

We currently anticipate that the transaction will be accretive to earnings per share for fiscal 2011. This expectation is based on preliminary estimates which may materially change after the completion of the transaction. We have previously incurred operating expense, on a stand alone basis, higher than we anticipated for periods, including during fiscal 2009. The magnitude of the integration relating to our pending transaction, together with the increased scale of our operations resulting from the transaction, will make forecasting, managing and constraining our operating expense even more difficult. We could also encounter additional transaction and integration-related costs or fail to realize all of the benefits of the transaction that underlie our financial model and expectations as to profitability. All of these factors could cause dilution to our earnings per share or decrease or delay the expected accretive effect of the transaction and cause a decrease in the price of our common stock.

**The complexity of the integration and transition associated with our pending transaction, together with the increased scale of our operations, may challenge our internal control over financial reporting and our ability to effectively and timely report our financial results.**

Following the completion of the pending transaction, we will rely upon a combination of Ciena information systems and critical transition services that are necessary for us to accurately and effectively compile and report our financial results. We will also have to train new employees and third party providers, and assume operations in jurisdictions where we have not previously had operations. The scale of these operations, together with the complexity of the integration effort, including changes to or implementation of critical information technology systems and reliance upon third party transition services, may adversely affect our ability to report our financial results on a timely basis. We expect that the transaction may necessitate significant modifications to our internal control systems, processes and information systems, both on a transition basis, and over the longer-term as we fully integrate the combined company. We cannot be certain that changes to our design for internal control over financial reporting, or the controls utilized by other third parties, will be sufficient to enable management or our independent registered public accounting firm to determine that our internal controls are effective for any period, or on an ongoing basis. If we are unable to accurately and timely report our financial results, or are unable to assert that our internal controls over financial reporting are effective, our business and market perception of our financial condition may be harmed and the trading price of our stock may be adversely affected.

**Following our acquisition of the Nortel assets, the combined company must continue to retain, motivate and recruit key executives and employees, which may be difficult in light of uncertainty regarding the pending transaction and the significant integration efforts following closing.**

For the pending transaction to be successful, during the period before the transaction is completed, both Ciena and Nortel must continue to retain, motivate and recruit executives and other key employees. Moreover, following the completion of the transaction, Ciena must be successful at retaining and motivating key employees. Experienced employees, particularly with experience in optical engineering, are in high demand and competition for their talents can be intense. Employees of both companies may experience uncertainty, real or perceived, about their future role with the combined company until, or even after, Ciena's post-closing strategies are announced or executed. These

potential distractions may adversely affect the ability to retain, motivate and recruit executives and other key employees and keep them focused on corporate strategies and objectives. The failure to attract, retain and motivate executives and other key employees before and following completion of the transaction could have a negative impact on Ciena's business.

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### **The pending transaction may not be completed, may be delayed or may result in the imposition of conditions that could have a material adverse effect on Ciena's operation of the business following completion.**

Completion of the pending transaction is conditioned upon the satisfaction of customary closing conditions and is subject to information and consultation with employee representatives and/or employees in certain international jurisdictions. Ciena has previously been granted early termination of the antitrust waiting period under the Hart-Scott-Rodino Act and the Canadian Competition Act and has obtained approval under the Investment Canada Act. There can be no assurance that these clearances and approvals will be obtained and that previous clearances will be maintained. Third parties could petition to have governmental entities reconsider previously granted clearances. In addition, the governmental entities from which clearances and approvals are required may impose conditions on the completion of the transaction, require changes to the terms of the transaction or impose restrictions on the operation of the business following completion of the transaction. If the transaction is not completed, completion is delayed or Ciena becomes subject to any material conditions in order to obtain any clearances or approvals required to complete the transaction, its business and results of operations may be adversely affected and its stock price may suffer.

#### ***Risks related to our current business and operations***

Investing in our securities involves a high degree of risk. In addition to the other information contained in this report, you should consider the following risk factors before investing in our securities.

### **Our business and operating results could be adversely affected by unfavorable macroeconomic and market conditions and reductions in the level of capital expenditure by our largest customers in response to these conditions.**

Starting in the second half of fiscal 2008, our business began to experience the effects of worsening macroeconomic conditions and significant disruptions in the financial and credit markets globally. In the face of these conditions, many companies, including some of our largest communications service provider customers, significantly reduced their network infrastructure expenditures as they sought to conserve capital, reduce debt or address uncertainties or changes in their own business models brought on by broader market challenges. Our business experienced lengthening sales cycles, customer delays in network buildouts and slowing deployments, resulting in lower demand across our customer base in all geographies. Our results of operations for fiscal 2009 were materially adversely affected by the weakness, volatility and uncertainty presented by the global market conditions that we encountered during the year.

Broad macroeconomic weakness, customer financial difficulties, changes in customer business models and constrained spending on communications networks have previously resulted in sustained periods of decreased demand for our products and services that have adversely affected our operating results. Challenging economic and market conditions may also result in:

- difficulty forecasting, budgeting and planning due to limited visibility into the spending plans of current or prospective customers;

- increased competition for fewer network projects and sales opportunities;

- pricing pressure that may adversely affect revenue and gross margin;

- higher overhead costs as a percentage of revenue;

- increased risk of charges relating to excess and obsolete inventories and the write off of other intangible assets; and

- customer financial difficulty and increased risk of doubtful accounts receivable.

Our business and financial results are closely tied to the prospects, performance, and financial condition of our largest communications service provider customers and are significantly affected by market or industry-wide changes that affect their businesses and their level of infrastructure-related spending. These factors include the level of enterprise and consumer spending on communications services, adoption of new communications services or

applications and consumption of available network capacity. We are uncertain as to how long current unfavorable macroeconomic and industry conditions will persist and the magnitude of their effects on our business and results of operations.

**A small number of communications service providers account for a significant portion of our revenue. The loss of any of these customers, or a significant reduction in their spending, would have a material adverse effect on our business and results of operations.**

A significant portion of our revenue is concentrated among a relatively small number of communications service providers. Eight customers accounted for greater than 60% of our revenue in fiscal 2009. Consequently, our financial results are closely correlated with the spending of a relatively small number of communications service providers. The terms of our frame contracts generally do not obligate these customers to purchase any minimum or specific amounts of equipment or services. Because their spending may be unpredictable and sporadic, our revenue and operating results can fluctuate on a quarterly basis. Reliance upon a relatively small number of customers increases our exposure to changes in their network and purchasing strategies. Some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce or rationalize the number of vendors from which they purchase equipment. These strategies may present challenges to our business and could benefit our larger competitors. Our concentration in revenue has increased in recent years, in part, as a result of consolidations among a number of our largest customers. Consolidations may increase the likelihood of temporary or indefinite reductions in customer spending or changes in network strategy that could harm our business and operating results. The loss of one or more large service provider customers, or a significant reduction in their spending, as a result of the factors above or otherwise, would have a material adverse effect on our business, financial condition and results of operations.

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### **Our revenue and operating results can fluctuate unpredictably from quarter to quarter.**

Our revenue and results of operations can fluctuate unpredictably from quarter to quarter. Our budgeted expense levels depend in part on our expectations of long-term future revenue and gross margin, and substantial reductions in expense are difficult and can take time to implement. Uncertainty or lack of visibility into customer spending, and changes in economic or market conditions, can make it difficult to prepare reliable estimates of future revenue and corresponding expense levels. Consequently, our level of operating expense or inventory may be high relative to our revenue, which could harm our ability to achieve or maintain profitability. Given market conditions and the effect of cautious spending in recent quarters, lower levels of backlog orders and an increase in the percentage of quarterly revenue relating to orders placed in that quarter could result in more variability and less predictability in our quarterly results.

Additional factors that contribute to fluctuations in our revenue and operating results include:

broader economic and market conditions affecting us and our customers;

changes in capital spending by large communications service providers;

the timing and size of orders, including our ability to recognize revenue under customer contracts;

variations in the mix between higher and lower margin products and services; and

the level of pricing pressure we encounter.

Many factors affecting our results of operations are beyond our control, particularly in the case of large service provider orders and multi-vendor or multi-technology network infrastructure builds where the achievement of certain thresholds for acceptance is subject to the readiness and performance of the customer or other providers, and changes in customer requirements or installation plans. As a consequence, our results for a particular quarter may be difficult to predict, and our prior results are not necessarily indicative of results likely in future periods. The factors above may cause our revenue and operating results to fluctuate unpredictably from quarter to quarter. These fluctuations may cause our operating results to be below the expectations of securities analysts or investors, which may cause our stock price to decline.

### **We face intense competition that could hurt our sales and results of operations.**

The markets in which we compete for sales of networking equipment, software and services are extremely competitive, particularly the market for sales to large communications service providers. The level of competition and pricing pressure that we face increases substantially during periods of macroeconomic weakness, constrained spending or fewer network projects. As a result of current market conditions, we have experienced significant competition and increased pricing pressure, particularly for our optical transport products. We face particularly intense competition in our efforts to attract additional large carrier customers in new geographies and secure new market opportunities with existing carrier customers. In an effort to secure attractive long-term customers or new customers, we may agree to pricing or other terms that result in negative gross margins on a particular order or group of orders.

Competition in our markets, generally, is based on any one or a combination of the following factors: price, product features, functionality and performance, introduction of innovative network solutions, manufacturing capability and lead-times, incumbency and existing business relationships, scalability and the flexibility of products to meet the immediate and future network requirements of customers. A small number of very large companies have historically dominated our industry. These competitors have substantially greater financial, technical and marketing resources, greater manufacturing capacity, broader product offerings and more established relationships with service providers and other potential customers than we do. Because of their scale and resources, they may be perceived to be better positioned to offer network operating or management service for large carrier customers. Consolidation activity among large networking equipment providers has caused some of our competitors to grow even larger, which may increase their strategic advantages and adversely affect our competitive position.

We also compete with a number of smaller companies that provide significant competition for a specific product, application, customer segment or geographic market. Due to the narrower focus of their efforts, these competitors may

achieve commercial availability of their products more quickly or may be more attractive to customers.

Increased competition in our markets has resulted in aggressive business tactics, including:

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significant price competition, particularly from competitors in Asia;

customer financing assistance;

early announcements of competing products and extensive marketing efforts;

competitors offering equity ownership positions to customers;

competitors offering to repurchase our equipment from existing customers;

marketing and advertising assistance; and

intellectual property assertions and disputes.

The tactics described above can be particularly effective in an increasingly concentrated base of potential customers such as communications service providers. If competitive pressures increase or we fail to compete successfully in our markets, our sales and profitability would suffer.

### **Our reliance upon third party manufacturers exposes us to risks that could negatively affect our business and operations.**

We rely upon third party contract manufacturers to perform the majority of the manufacturing of our products and components. In recent years we have transitioned a significant portion of our product manufacturing to overseas suppliers in Asia, with much of the manufacturing taking place in China and Thailand. Some of our contract manufacturers ship products directly to our customers on behalf of Ciena. Our reliance upon these manufacturers could expose us to increased risks related to lead times, continued supply, on-time delivery, quality assurance and compliance with environmental standards and other regulations. Reliance upon third parties for manufacture of our products significantly exposes us to risks related to their business, financial position and continued viability, which may be adversely affected by broader negative macroeconomic conditions and difficulties in the credit markets. These conditions may disrupt their operations, result in discontinuation of services, or result in pricing increases that affect our manufacturing requirements. Disruptions to our business could also arise as a result of ineffective business continuity and disaster recovery plans by our manufacturers. We do not have contracts in place with some of our manufacturers and do not have guaranteed supply of components or manufacturing capacity. We could also experience difficulties as a result of geopolitical events, military actions or health pandemics in the countries where our products or components thereof are manufactured. During the first quarter of fiscal 2009, protests resulted in a blockade of Thailand's main international airport, which delayed product shipments from one of our key contract manufacturers. Significant disruptions or difficulties with our contract manufacturers could negatively affect our business and results of operations.

### **Investment of research and development resources in technologies for which there is not a matching market opportunity, or failure to sufficiently or timely invest in technologies for which there is market demand, would adversely affect our revenue and profitability.**

The market for communications networking equipment is characterized by rapidly evolving technologies and changes in market demand. We continually invest in research and development to sustain or enhance our existing products and develop or acquire new products technologies. Our current development efforts are focused upon the evolution of our CoreDirector Multiservice Optical Switch family, the expansion of our carrier Ethernet service delivery and aggregation products, and the extension of our CN 4200 converged optical service delivery portfolio, including 100G technologies and capabilities. There is often a lengthy period between commencing these development initiatives and bringing a new or revised product to market. During this time, technology preferences, customer demand and the market for our products may move in directions we had not anticipated. There is no guarantee that new products or enhancements will achieve market acceptance or that the timing of market adoption will be as predicted. There is a significant possibility, therefore, that some of our development decisions, including our acquisitions or investments in technologies, will not turn out as anticipated, and that our investment in some projects

will be unprofitable. There is also a possibility that we may miss a market opportunity because we failed to invest, or invested too late, in a technology, product or enhancement. Changes in market demand or investment priorities may also cause us to discontinue existing or planned development for new products or features, which can have a disruptive effect on our relationships with customers. If we fail to make the right investments or fail to make them at the right time, our competitive position may suffer and our revenue and profitability could be harmed.

**Product performance problems could damage our business reputation and negatively affect our results of operations.**

The development and production of highly technical and complex communications network equipment is complicated. Some of our products can be fully tested only when deployed in communications networks or when carrying traffic with other equipment. As a result, product performance problems are often more acute for initial deployments of new products and product enhancements. Our products have contained and may contain undetected hardware or software errors or defects. These defects have resulted in warranty claims and additional costs to remediate. Unanticipated problems can relate to the design, manufacturing, installation or integration of our products. Performance problems and product malfunctions can also relate to defects in components, software or manufacturing services supplied by third parties. Product performance, reliability and quality problems can negatively affect our business, including:

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increased costs to remediate software or hardware defects or replace products;

payment of liquidated damages or similar claims for performance failures or delays;

increased inventory obsolescence;

increased warranty expense or estimates resulting from higher failure rates, additional field service obligations or other rework costs related to defects;

delays in recognizing revenue or collecting accounts receivable; and

declining sales to existing customers and order cancellations.

Product performance problems could also damage our business reputation and harm our prospects with potential customers. These consequences of product defects or quality problems could negatively affect our business and results of operations.

**Network equipment sales to large communications service providers often involve lengthy sales cycles and protracted contract negotiations and may require us to assume terms or conditions that negatively affect our pricing, payment terms and the timing of revenue recognition.**

Our future success will depend in large part on our ability to maintain and expand our sales to large communications service providers. These sales typically involve lengthy sales cycles, protracted and sometimes difficult contract negotiations, and sales to service providers often involve extensive product testing and network certification, including network-specific or region-specific processes. We are sometimes required to agree to contract terms or conditions that negatively affect pricing, payment terms and the timing of revenue recognition in order to consummate a sale. As a result of current market conditions, these customers may request extended payment terms, vendor or third-party financing and other alternative purchase structures. These terms may, in turn, negatively affect our revenue and results of operations and increase our susceptibility to quarterly fluctuations in our results. Service providers may ultimately insist upon terms and conditions that we deem too onerous or not in our best interest. Moreover, our purchase agreements generally do not require that a customer guarantee any minimum purchase level and customers often have the right to modify, delay, reduce or cancel previous orders. As a result, we may incur substantial expense and devote time and resources to potential relationships that never materialize or result in lower than anticipated sales.

**Difficulties with third party component suppliers, including sole and limited source suppliers, could increase our costs and harm our business and customer relationships.**

We depend on third party suppliers for our product components and subsystems, as well as for equipment used to manufacture and test our products. Our products include key optical and electronic components for which reliable, high-volume supply is often available from sole or limited sources. We have previously encountered shortages in availability for important components that have affected our ability to deliver products in a timely manner. Our business would be negatively affected if one or more of our suppliers were to experience any significant disruption in their operations affecting the price, quality, availability or timely delivery of components. Current unfavorable economic conditions may adversely affect the business of our suppliers including their liquidity level, ability to continue to invest in their business and stock components in sufficient quantity. We have seen an increased incidence of component discontinuation as suppliers alter their businesses to adjust to market conditions. As a result of our reliance on third parties, we may be unable to secure the components or subsystems that we require in sufficient quantity and quality on reasonable terms. The loss of a source of supply, or lack of sufficient availability of key components, could require us to redesign products that use those components, which would increase our costs and negatively affect our product gross margin and results of operations. Difficulties with suppliers could also result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships. **We may not be successful in selling our products into new markets and developing and managing new sales channels.**

We continue to take steps to sell our products into new geographic markets outside of our traditional markets and to a broader customer base, including other large communications service providers, enterprises, cable operators, wireless operators and federal, state and local governments. We have less experience in these markets and, in order to succeed in these markets, we believe we must develop and manage new sales channels and distribution arrangements. We expect these relationships to be an increasingly important part of our business. This strategy may not succeed and we may be exposed to increased expense and legal, business and financial risks associated with entering new markets and pursuing new customer segments through channel partners.

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Part of our strategy is to pursue sales to federal, state and local governments. These sales require compliance with complex procurement regulations with which we have limited experience. We may be unable to increase our sales to government contractors if we determine that we cannot comply with applicable regulations. Our failure to comply with regulations for existing contracts could result in civil, criminal or administrative proceedings involving fines and suspension, or exclusion, from participation in federal government contracts. Failure to manage additional sales channels effectively would limit our ability to succeed in these new markets and could adversely affect our ability to expand our customer base and grow our business.

**We may experience delays in the development of our products that may negatively affect our competitive position and business.**

Our products are based on complex technology, and we can experience unanticipated delays in developing, manufacturing or deploying them. Each step in the development life cycle of our products presents serious risks of failure, rework or delay, any one of which could affect the cost-effective and timely development of our products. Intellectual property disputes, failure of critical design elements, and other execution risks may delay or even prevent the release of these products. Delays in product development may affect our reputation with customers and the timing and level of demand for our products. If we do not develop and successfully introduce products in a timely manner, our competitive position may suffer and our business, financial condition and results of operations would be harmed.

**We may be required to write off significant amounts of inventory as a result of our inventory purchase practices, the convergence of our product lines or unfavorable macroeconomic or industry conditions.**

To avoid delays and meet customer demand for shorter delivery terms, we place orders with our contract manufacturers and suppliers to manufacture components and complete assemblies based on forecasts of customer demand. As a result, our inventory purchases expose us to the risk that our customers either will not order the products we have forecasted or will purchase fewer products than forecasted. Unfavorable market or industry conditions can limit visibility into customer spending plans and compound the difficulty of forecasting inventory at appropriate levels. Moreover, our customer purchase agreements generally do not guarantee any minimum purchase level, and customers often have the right to modify, reduce or cancel purchase quantities. As a result, we may purchase inventory in anticipation of sales that do not occur. Historically, our inventory write-offs have resulted from the circumstances above. As features and functionalities converge across our product lines, and we introduce new products, however, we face an additional risk that customers may forego purchases of one product we have inventoried in favor of another product with similar functionality. If we are required to write off or write down a significant amount of inventory, our results of operations for the period would be materially adversely affected.

**Restructuring activities could disrupt our business and affect our results of operations.**

We have previously taken steps, including reductions in force, office closures, and internal reorganizations to reduce the size and cost of our operations and to better match our resources with market opportunities. We may take similar steps in the future. These changes could be disruptive to our business and may result in the recording of accounting charges, including inventory and technology-related write-offs, workforce reduction costs and charges relating to consolidation of excess facilities. Substantial charges resulting from any future restructuring activities could adversely affect our results of operations in the period in which we take such a charge.

**Our failure to manage effectively our relationships with third party service partners could adversely impact our financial results and relationship with customers.**

We rely on a number of third party service partners, both domestic and international, to complement our global service and support resources. We rely upon these partners for certain maintenance and support functions, as well as the installation of our equipment in some large network builds. In order to ensure the proper installation and maintenance of our products, we must identify, train and certify qualified service partners. Certification can be costly and time-consuming, and our partners often provide similar services for other companies, including our competitors. We may not be able to manage effectively our relationships with our service partners and cannot be certain that they will be able to deliver services in the manner or time required. If our service partners are unsuccessful in delivering services:

we may suffer delays in recognizing revenue;

our services revenue and gross margin may be adversely affected; and

our relationship with customers could suffer.

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Difficulties with service partners could cause us to transition a larger share of deployment and other services from third parties to internal resources, thereby increasing our services overhead costs and negatively affecting our services gross margin and results of operations.

### **We may incur significant costs as a result of our efforts to protect and enforce our intellectual property rights or respond to claims of infringement from others.**

Our business is dependent upon the successful protection of our proprietary technology and intellectual property. We are subject to the risk that unauthorized parties may attempt to access, copy or otherwise obtain and use our proprietary technology, particularly as we expand our product development into India and increase our reliance upon contract manufacturers in Asia. These and other international operations could expose us to a lower level of intellectual property protection than in the United States. Monitoring unauthorized use of our technology is difficult, and we cannot be certain that the steps that we are taking will prevent or minimize the risks of unauthorized use. If competitors are able to use our technology, our ability to compete effectively could be harmed.

From time to time we have been subject to litigation and other third party intellectual property claims, primarily alleging patent infringement. We have also been subject to third party claims arising as a result of our indemnification obligations to customers or resellers that purchase our products or as a result of alleged infringement relating to third party components that we include in our products. The frequency of these assertions is increasing as patent holders, including entities that are not in our industry and that purchase patents as an investment, use infringement assertions as a competitive tactic or as a source of additional revenue. Intellectual property infringement claims can significantly divert the time and attention of our personnel and result in costly litigation. These claims can also require us to pay substantial damages or royalties, enter into costly license agreements or develop non-infringing technology. Accordingly, the costs associated with intellectual property infringement claims could adversely affect our business, results of operations and financial condition.

### **Our international operations could expose us to additional risks and result in increased operating expense.**

We market, sell and service our products globally. We have established offices around the world, including in North America, Europe, the Middle East, Latin America and the Asia Pacific region. We have also established a major development center in India and are increasingly reliant upon overseas suppliers, particularly in Asia, for sourcing of important components and manufacturing of our products. Our increasingly global operations may result in increased risk to our business and could give rise to unanticipated expense, difficulties or other effects that could adversely affect our financial results.

International operations are subject to inherent risks, including:

effects of changes in currency exchange rates;

greater difficulty in collecting accounts receivable and longer collection periods;

difficulties and costs of staffing and managing foreign operations;

the impact of economic conditions in countries outside the United States;

less protection for intellectual property rights in some countries;

adverse tax and customs consequences, particularly as related to transfer-pricing issues;

social, political and economic instability;

higher incidence of corruption;

trade protection measures, export compliance, qualification to transact business and additional regulatory requirements; and

natural disasters, epidemics and acts of war or terrorism.

We expect that our international activities will be dynamic, and we may enter new markets and withdraw from or reduce operations in others. These changes to our international operations may require significant management attention and result in additional expense. In some countries, our success will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements for international sales of our products could impact our ability to maintain or increase international market demand for our products.

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

We have a significant development center in India and, in recent years, have increased headcount and development activity at this facility. There is no assurance that our reliance upon development resources in India will enable us to achieve meaningful cost reductions or greater resource efficiency. Further, our development efforts and other operations in India involve significant risks, including:

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

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

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

fluctuations in currency exchange rates and tax compliance in India.

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

### **We may be exposed to unanticipated risks and additional obligations in connection with our resale of complementary products or technology of other companies.**

We have entered into agreements with strategic partners that permit us to distribute their products or technology. We rely upon these relationships to add complementary products or technologies or to fulfill an element of our product portfolio. As part of our strategy to diversify our product portfolio and customer base, we may enter into additional original equipment manufacturer (OEM) or resale agreements in the future. We may incur unanticipated costs or difficulties relating to our resale of third party products. Our third party relationships could expose us to risks associated with delays in their development, manufacturing or delivery of products or technology. We may also be required by customers to assume warranty, indemnity, service and other commercial obligations greater than the commitments, if any, made to us by our technology partners. Some of our strategic partners are relatively small companies with limited financial resources. If they are unable to satisfy their obligations to us or our customers, we may have to expend our own resources to satisfy these obligations. Exposure to the risks above could harm our reputation with key customers and negatively affect our business and our results of operations.

### **Our exposure to the credit risks of our customers and resellers may make it difficult to collect receivables and could adversely affect our revenue and operating results.**

In the course of our sales to customers, we may have difficulty collecting receivables and could be exposed to risks associated with uncollectible accounts. We may be exposed to similar risks relating to third party resellers and other sales channel partners. A continued lack of liquidity in the capital markets or a sustained period of unfavorable economic conditions may increase our exposure to credit risks. While we monitor these situations carefully and attempt to take appropriate measures to protect ourselves, it is possible that we may have to write down or write off doubtful accounts. Such write-downs or write-offs could negatively affect our operating results for the period in which they occur, and, if large, could have a material adverse effect on our revenue and operating results.

### **If we are unable to attract and retain qualified personnel, we may be unable to manage our business effectively.**

Competition to attract and retain highly skilled technical and other personnel with experience in our industry is increasing in intensity, and our employees have been the subject of targeted hiring by our competitors. With respect to our engineering resources, we may find it particularly difficult to attract and retain sufficiently skilled personnel in areas including data networking, Ethernet service delivery and network management software engineering in certain geographic markets. We may experience difficulty retaining and motivating existing employees and attracting qualified personnel to fill key positions. Because we rely upon equity awards as a significant component of compensation, particularly for our executive team, a lack of positive performance in our stock price, reduced grant levels, or changes to our compensation program may adversely affect our ability to attract and retain key employees. In addition, none of our executive officers is bound by an employment agreement for any specific term. It may be difficult to replace members of our management team or other key personnel, and the loss of such individuals could be disruptive to our business. Because we generally do not have employment contracts with our employees, we must rely upon providing competitive compensation packages and a high-quality work environment in order to retain and motivate employees. If we are unable to attract and retain qualified personnel, we may be unable to manage our business effectively.

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

Because a significant portion of our sales is denominated in U.S. dollars, an increase in the value of the dollar could increase the real cost to our customers of our products in markets outside the United States. In addition, we face exposure to currency exchange rates as a result of our non-U.S. dollar denominated operating expense in Europe, Asia and Canada. In recent years, our international operations and our reliance upon international suppliers have grown considerably. A weakened dollar could increase the cost of local operating expenses and procurement of raw materials where we must purchase components in foreign currencies. As a result, we may be susceptible to negative effects of foreign exchange changes. We have previously hedged against currency exposure associated with anticipated foreign currency cash flows and may do so in the future. These hedging activities are intended to offset currency fluctuations on a portion of our non-U.S. dollar denominated operating expense. There can be no assurance that these hedging instruments will be effective in all circumstances and losses associated with these instruments may negatively affect our results of operations.

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### **Our products incorporate software and other technology under license from third parties and our business would be adversely affected if this technology was no longer available to us on commercially reasonable terms.**

We integrate third-party software and other technology into our embedded operating system, network management system tools and other products. Licenses for this technology may not be available or continue to be available to us on commercially reasonable terms. Third party licensors may insist on unreasonable financial or other terms in connection with our use of such technology. Difficulties with third party technology licensors could result in termination of such licenses, which may result in significant costs and require us to obtain or develop a substitute technology. Difficulty obtaining and maintaining third-party technology licenses may disrupt development of our products and increase our costs, which could harm our business.

### **Our business is dependent upon the proper functioning of our internal business processes and information systems and modifications may disrupt our business, operating processes and internal controls.**

The successful operation of various internal business processes and information systems is critical to the efficient operation of our business. If these systems fail or are interrupted, our operations may be adversely affected and operating results could be harmed. In recent years, we have experienced considerable growth in transaction volume, headcount and reliance upon international resources in our operations. Our business processes and information systems need to be sufficiently scalable to support the growth of our business. To improve the efficiency of our operations and achieve greater automation, we routinely upgrade business processes and information systems. Significant changes to our processes and systems expose us to a number of operational risks. These changes may be costly and disruptive, and could impose substantial demands on management time. These changes may also require the modification of a number of internal control procedures. Any material disruption, malfunction or similar problems with our business processes or information systems, or the transition to new processes and systems, could have a negative effect on the operation of our business and our results of operations.

### **Strategic acquisitions and investments may expose us to increased costs and unexpected liabilities.**

We may acquire or make strategic investments in other companies to expand the markets we address, diversify our customer base or acquire or accelerate the development of technology or products. To do so, we may use cash, issue equity that would dilute our current stockholders' ownership, incur debt or assume indebtedness. These transactions involve numerous risks, including:

- significant integration costs;

- integration and rationalization of operations, products, technologies and personnel;

- diversion of management's attention;

- difficulty completing projects of the acquired company and costs related to in-process projects;

- the loss of key employees;

- ineffective internal controls over financial reporting;

- dependence on unfamiliar suppliers or manufacturers;

- exposure to unanticipated liabilities, including intellectual property infringement claims; and

- adverse tax or accounting effects including amortization expense related to intangible assets and charges associated with impairment of goodwill.

As a result of these and other risks, our acquisitions or strategic investments may not reap the intended benefits and may ultimately have a negative impact on our business, results of operation and financial condition.

### **Changes in government regulation affecting the communications industry and the businesses of our customers could harm our prospects and operating results.**



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The Federal Communications Commission, or FCC, has jurisdiction over the U.S. communications industry and similar agencies have jurisdiction over the communication industries in other countries. Many of our largest customers are subject to the rules and regulations of these agencies. Changes in regulatory requirements in the United States or other countries could inhibit service providers from investing in their communications network infrastructures or introducing new services. These changes could adversely affect the sale of our products and services. Changes in regulatory tariff requirements or other regulations relating to pricing or terms of carriage on communications networks could slow the development or expansion of network infrastructures and adversely affect our business, operating results, and financial condition.

**Governmental regulations including in particular those relating to the import or export of our products, and regulations related to the environment and potential climate change, could adversely affect our business and operating results.**

The United States and various foreign governments have imposed controls, export license requirements and other restrictions on the import or export of some of the technologies that we sell. Governmental regulation of imports or exports, or our failure to obtain required import or export approval for our products, could harm our international and domestic sales and adversely affect our revenues and costs of sales. Failure to comply with such regulations could result in enforcement actions, fines or penalties and restrictions on export privileges.

In addition, our operations are regulated under various federal, state, local and international laws relating to the environment and potential climate change. We could incur fines, costs related to damage to property or personal injury, and costs related to investigation or remediation activities, if we were to violate or become liable under these laws or regulations. Our product design efforts, and the manufacturing of our products, are also subject to evolving requirements relating to the presence of certain materials or substances in our equipment, including regulations that make producers for such products financially responsible for the collection, treatment and recycling of certain products. For example, our operations and financial results may be negatively affected by environmental regulations, such as the Waste Electrical and Electronic Equipment (WEEE) and Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) that have been adopted by the European Union. Compliance with these and similar environmental regulations may increase our cost of designing, manufacturing, selling and removing our products. These regulations may also make it difficult to obtain supply of compliant components or require us to write off non-compliant inventory, which could have an adverse effect our business and operating results.

**We may be required to write down long-lived assets and a significant impairment charge would adversely affect our operating results.**

At January 31, 2010, we had \$152.4 million in long-lived assets, which includes \$53.4 million of intangible assets on our balance sheet. Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products. Our assumptions are used to forecast future, undiscounted cash flows. Given the current economic environment, uncertainties regarding the duration and severity of these conditions, forecasting future business is difficult and subject to modification. If actual market conditions differ or our forecasts change, we may be required to reassess long-lived assets and could record an impairment charge. Any impairment charge relating to long-lived assets would have the effect of decreasing our earnings or increasing our losses in such period. If we are required to take a substantial impairment charge, our operating results could be materially adversely affected in such period.

**Failure to maintain effective internal controls over financial reporting could have a material adverse effect on our business, operating results and stock price.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we include in our annual report a report containing management's assessment of the effectiveness of our internal controls over financial reporting as of the end of our fiscal year and a statement as to whether or not such internal controls are effective. Compliance with these requirements has resulted in, and is likely to continue to result in, significant costs and the commitment of time and operational resources. Changes in our business will necessitate ongoing modifications to our internal control systems, processes and information systems. Increases in our global operations or expansion into new regions could pose additional challenges to our internal control systems as these operations become more significant. We cannot be

certain that our current design for internal control over financial reporting will be sufficient to enable management or our independent registered public accounting firm to determine that our internal controls are effective for any period, or on an ongoing basis. If we or our independent registered public accounting firms are unable to assert that our internal controls over financial reporting are effective, our business may be harmed. Market perception of our financial condition and the trading price of our stock may be adversely affected, and customer perception of our business may suffer.

**Obligations associated with our outstanding indebtedness on our convertible notes may adversely affect our business.**

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At January 31, 2010, indebtedness on our outstanding convertible notes totaled \$798.0 million in aggregate principal. Our indebtedness and repayment obligations could have important negative consequences, including: increasing our vulnerability to adverse economic and industry conditions;

limiting our ability to obtain additional financing, particularly in light of unfavorable conditions in the credit markets;

reducing the availability of cash resources for other purposes, including capital expenditures;

limiting our flexibility in planning for, or reacting to, changes in our business and the markets in which we compete; and

placing us at a possible competitive disadvantage to competitors that have better access to capital resources.

We may also add additional indebtedness such as equipment loans, working capital lines of credit and other long-term debt. We will also likely be incurring additional indebtedness as part of the acquisition of the Nortel assets, whether by issuance to the sellers of the \$239 million aggregate principal amount of senior convertible notes provided for in the asset purchase agreements or by issuance of alternative indebtedness should we make the election to increase the cash portion of the purchase price.

### **Our stock price is volatile.**

Our common stock price has experienced substantial volatility in the past and may remain volatile in the future. Volatility in our stock price can arise as a result of a number of the factors discussed in this Risk Factors section. During fiscal 2009, our stock price ranged from a high of \$16.64 per share to a low of \$4.98 per share. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, with such volatility often unrelated to the operating performance of these companies. Divergence between our actual or anticipated financial results and published expectations of analysts can cause significant swings in our stock price. Our stock price can also be affected by announcements that we, our competitors, or our customers may make, particularly announcements related to acquisitions or other significant transactions. Our common stock is included in a number of market indices and any change in the composition of these indices to exclude our company would adversely affect our stock price. On December 18, 2009, we were removed from the S&P 500, a widely-followed index. These factors, as well as conditions affecting the general economy or financial markets, may materially adversely affect the market price of our common stock in the future.

### ***Item 2. Unregistered Sales of Equity Securities and Use of Proceeds***

Not applicable.

### ***Item 3. Defaults Upon Senior Securities***

Not applicable.

### ***Item 4. Reserved***

### ***Item 5. Other Information***

Not applicable.

### ***Item 6. Exhibits***

#### **Exhibit Description**

- 2.1 Amendment No. 2 dated December 23, 2009 to that certain Amended & Restated Asset Sale Agreement by and among Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks, Inc. and certain other entities identified therein as sellers and Ciena Corporation, dated as of November 24, 2009 ( Nortel ASA )+
- 2.2 Deed of Amendment (Amendment No. 4) dated January 13, 2010 to that certain Asset Sale Agreement (relating to the sale and purchase of certain Nortel assets in Europe, the Middle East and Africa) by and among the Nortel affiliates, Joint Administrators and Joint Israeli Administrators named therein and Ciena Corporation, dated as of October 7, 2009 ( Nortel EMEA ASA )+



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Exhibit Description

- 10.1 Letter Agreement dated February 2, 2010 between Ciena Corporation and Arthur D. Smith, Ph.D., Senior Vice President and Chief Integration Officer\*
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- \* Represents management contract or compensatory plan or arrangement
- + Pursuant to Item 601(b)(2) of Regulation S-K (i) certain schedules and exhibits referenced in this agreement or amendment have been omitted. Ciena hereby agrees to furnish supplementally a copy of any omitted exhibit or schedule to the SEC upon request. In addition, representations and warranties included in these asset sale agreements, as amended, were

made by the parties to one another in connection with a negotiated transaction. These representations and warranties were made as of specific dates, only for purposes of these agreements and for the benefit of the parties thereto. These representations and warranties were subject to important exceptions and limitations agreed upon by the parties, including being qualified by confidential disclosures, made for the purposes of allocating contractual risk between the parties rather than establishing these matters as facts. These agreements are filed with Ciena's periodic reports only to provide investors with information regarding its terms and conditions, and not to provide any other factual information regarding Ciena or any other

party thereto.  
Accordingly,  
investors should  
not rely on the  
representations  
and warranties  
contained in  
these agreements  
or any  
description  
thereof as  
characterizations  
of the actual state  
of facts or  
condition of any  
party, its  
subsidiaries or  
affiliates. The  
information in  
these agreements  
should be  
considered  
together with  
Ciena's public  
reports filed with  
the SEC.

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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.

Ciena Corporation

Date: March 5, 2010

By: /s/ Gary B. Smith  
Gary B. Smith  
President, Chief Executive Officer  
and Director  
(Duly Authorized Officer)

Date: March 5, 2010

By: /s/ James E. Moylan, Jr.  
James E. Moylan, Jr.  
Senior Vice President, Finance and  
Chief Financial Officer  
(Principal Financial Officer)

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