

CIENA CORP  
Form 10-Q  
June 12, 2013  
Table of Contents

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 April 30, 2013

OR

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

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

Commission file number: 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.)

7035 Ridge Road, Hanover, MD

21076

(Address of Principal Executive Offices)

(Zip Code)

(410) 694-5700

(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 June 7, 2013

common stock, \$0.01 par value

102,052,816



Table of Contents

CIENA CORPORATION  
 INDEX  
 FORM 10-Q

	PAGE NUMBER
<u>PART I — FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Quarters and Six Months Ended April 30, 2012 and April 30, 2013</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the Quarters and Six Months Ended April 30, 2012 and April 30, 2013</u>	<u>4</u>
<u>Condensed Consolidated Balance Sheets at October 31, 2012 and April 30, 2013</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended April 30, 2012 and April 30, 2013</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>27</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>49</u>
<u>Item 4. Controls and Procedures</u>	<u>49</u>
<u>PART II — OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>50</u>
<u>Item 1A. Risk Factors</u>	<u>50</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>60</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>60</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>60</u>
<u>Item 5. Other Information</u>	<u>61</u>
<u>Item 6. Exhibits</u>	<u>62</u>
<u>Signatures</u>	<u>63</u>

Table of Contents

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

CIENA CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Revenue:				
Products	\$384,726	\$413,217	\$718,399	\$766,274
Services	92,891	94,495	175,903	194,531
Total revenue	477,617	507,712	894,302	960,805
Cost of goods sold:				
Products	234,372	239,441	432,124	435,962
Services	60,304	58,758	111,481	119,535
Total cost of goods sold	294,676	298,199	543,605	555,497
Gross profit	182,941	209,513	350,697	405,308
Operating expenses:				
Research and development	90,399	100,787	180,063	189,912
Selling and marketing	62,517	74,475	126,928	141,063
General and administrative	26,670	30,883	56,334	59,091
Amortization of intangible assets	12,967	12,439	26,438	24,892
Restructuring costs	1,851	1,509	3,573	6,539
Total operating expenses	194,404	220,093	393,336	421,497
Loss from operations	(11,463 )	(10,580 )	(42,639 )	(16,189 )
Interest and other income (loss), net	(4,387 )	(2,716 )	(9,274 )	(2,853 )
Interest expense	(9,646 )	(11,392 )	(19,216 )	(22,124 )
Loss on extinguishment of debt	—	—	—	(28,630 )
Loss before income taxes	(25,496 )	(24,688 )	(71,129 )	(69,796 )
Provision for income taxes	2,284	2,391	4,304	4,607
Net loss	\$(27,780 )	\$(27,079 )	\$(75,433 )	\$(74,403 )
Basic net loss per common share	\$(0.28 )	\$(0.27 )	\$(0.77 )	\$(0.73 )
Diluted net loss per potential common share	\$(0.28 )	\$(0.27 )	\$(0.77 )	\$(0.73 )
Weighted average basic common shares outstanding	98,981	101,913	98,525	101,560
Weighted average dilutive potential common shares outstanding	98,981	101,913	98,525	101,560

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

CIENA CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (in thousands)  
 (unaudited)

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Net loss	\$(27,780 )	\$(27,079 )	\$(75,433 )	\$(74,403 )
Change in unrealized gain (loss) on available-for-sale securities, net of tax	(55 )	13	(79 )	(31 )
Change in unrealized gain (loss) on foreign currency forward contracts, net of tax	(128 )	(194 )	236	(117 )
Change in accumulated translation adjustments	10	(2,004 )	(2,212 )	(1,044 )
Total comprehensive loss	\$(27,953 )	\$(29,264 )	\$(77,488 )	\$(75,595 )

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

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

	October 31, 2012	April 30, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 642,444	\$ 356,498
Short-term investments	50,057	99,973
Accounts receivable, net	345,496	421,014
Inventories	260,098	248,096
Prepaid expenses and other	117,595	138,577
Total current assets	1,415,690	1,264,158
Equipment, furniture and fixtures, net	123,580	117,553
Other intangible assets, net	257,137	221,476
Other long-term assets	84,736	90,157
Total assets	\$ 1,881,143	\$ 1,693,344
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
Current liabilities:		
Accounts payable	\$ 179,704	\$ 198,820
Accrued liabilities	209,540	222,783
Deferred revenue	79,516	98,603
Convertible notes payable	216,210	—
Total current liabilities	684,970	520,206
Long-term deferred revenue	27,560	28,272
Other long-term obligations	31,779	32,989
Long-term convertible notes payable	1,225,806	1,209,814
Total liabilities	1,970,115	1,791,281
Commitments and contingencies		
Stockholders' equity (deficit):		
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; 100,601,792 and 102,035,119 shares issued and outstanding	1,006	1,020
Additional paid-in capital	5,797,765	5,864,381
Accumulated other comprehensive loss	(3,354 )	(4,546 )
Accumulated deficit	(5,884,389 )	(5,958,792 )
Total stockholders' equity (deficit)	(88,972 )	(97,937 )
Total liabilities and stockholders' equity (deficit)	\$ 1,881,143	\$ 1,693,344

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

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

	Six Months Ended April	
	30,	
	2012	2013
Cash flows from operating activities:		
Net loss	\$(75,433	) \$(74,403
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Loss on extinguishment of debt	—	28,630
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	29,079	28,857
Share-based compensation costs	16,830	18,147
Amortization of intangible assets	37,865	35,661
Provision for inventory excess and obsolescence	13,982	9,027
Provision for warranty	16,615	11,060
Other	7,993	5,068
Changes in assets and liabilities:		
Accounts receivable	19,107	(76,526
Inventories	(26,630	) 2,975
Prepaid expenses and other	19,597	(33,969
Accounts payable, accruals and other obligations	8,315	24,805
Deferred revenue	6,036	19,799
Net cash provided by (used in) operating activities	73,356	(869
Cash flows used in investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(16,150	) (21,496
Restricted cash	(17,202	) 1,679
Purchase of available for sale securities	—	(99,914
Proceeds from maturities of available for sale securities	—	50,000
Proceeds from sale of cost method investment	524	—
Net cash used in investing activities	(32,828	) (69,731
Cash flows from financing activities:		
Payment of long term debt	—	(216,210
Payment for debt and equity issuance costs	—	(3,661
Payment of capital lease obligations	(699	) (1,427
Proceeds from issuance of common stock	5,715	5,955
Net cash provided by (used in) financing activities	5,016	(215,343
Effect of exchange rate changes on cash and cash equivalents	(1,893	) (3
Net increase (decrease) in cash and cash equivalents	45,544	(285,943
Cash and cash equivalents at beginning of period	541,896	642,444
Cash and cash equivalents at end of period	\$585,547	\$356,498
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	\$16,520	\$15,720
Cash paid during the period for income taxes, net	\$5,811	\$5,136
Non-cash investing and financing activities		
Purchase of equipment in accounts payable	\$4,004	\$3,006
Fixed assets acquired under capital leases	\$4,427	\$1,286

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

6

---



Table of Contents

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 ("SEC"). 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 ("GAAP") have been condensed or omitted pursuant to such rules and regulations. The October 31, 2012 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 herein. 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 the notes thereto included in Ciena's annual report on Form 10-K for the fiscal year ended October 31, 2012.

Ciena has a 52 or 53-week fiscal year, which ends on the Saturday nearest to the last day of October of each year. Fiscal 2013 is a 52-week fiscal year. Fiscal 2012 was a 53-week fiscal year with the additional week occurring in the fourth quarter. 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.

(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 convertible notes payable valuations, purchase accounting, bad debts, valuation of inventories and investments, recoverability of intangible assets, other long-lived assets, income taxes, warranty obligations, restructuring liabilities, derivatives, incentive compensation, 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 credit is included in other current assets and other long-term assets depending upon the duration of the restriction.

Investments

Ciena's 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.

#### 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.

#### Segment Reporting

7

---

## Table of Contents

Ciena's chief operating decision maker, its chief executive officer, evaluates the company's performance and allocates resources based on multiple factors, including measures of segment profit (loss). Operating segments are defined as components of an enterprise that engage in business activities that may earn revenue and incur expense, for which discrete financial information is available, and for which such information is evaluated regularly by the chief operating decision maker for purposes of allocating resources and assessing performance. See Note 17 below.

### Long-lived Assets

Long-lived assets include: equipment, furniture and fixtures; intangible assets; and maintenance spares. Ciena tests long-lived assets for impairment whenever triggering events or changes in circumstances indicate that the assets' carrying amount is not recoverable from its undiscounted cash flows. An impairment loss is measured as the amount by which the carrying amount of the asset or asset group exceeds its fair value. Ciena's long-lived assets are assigned to asset groups which represent the lowest level for which cash flows can be identified.

### Equipment, Furniture and Fixtures and Internal Use Software

Equipment, furniture and fixtures are recorded at cost. Depreciation and amortization are computed using the straight-line method over useful lives of two to five years for equipment, furniture and fixtures and the shorter of useful life or lease term for leasehold improvements.

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 lives of two to five years.

### Intangible Assets

Ciena has recorded finite-lived intangible assets as a result of several acquisitions. Finite-lived intangible assets are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the expected economic lives of the respective assets, up to seven years, which approximates the use of intangible assets.

### Maintenance Spares

Maintenance spares are recorded at cost. Spares usage cost is expensed ratably over four years.

### Concentrations

Substantially all of Ciena's cash and cash equivalents are maintained at a small number of 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. Because these deposits generally may be redeemed upon demand, management believes that they bear minimal risk.

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

Additionally, Ciena's access to certain materials or components is dependent upon sole or limited source suppliers. The inability of any of these suppliers to fulfill Ciena's supply requirements, or significant changes in supply cost, could affect future results. Ciena relies on a small number of contract manufacturers to perform the majority of the

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

#### 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 or services rendered. Ciena assesses whether the price is fixed or determinable based on the payment terms associated with the

## Table of Contents

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. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are performed.

Ciena applies the percentage-of-completion method to long-term arrangements where it is required to undertake significant production, customizations or modification engineering, and reasonable and reliable estimates of revenue and cost are available. Utilizing the percentage-of-completion method, Ciena recognizes revenue based on the ratio of actual costs incurred to date to total estimated costs expected to be incurred. In instances that do not meet the percentage-of-completion method criteria, recognition of revenue is deferred until there are no uncertainties regarding customer acceptance.

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 criteria of the software is specified by the customer, revenue is deferred until there are no uncertainties regarding customer acceptance.

Ciena limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or refund privileges.

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each delivered element, with revenue recognized for each delivered element when the revenue recognition criteria are met. Ciena determines the selling price for each deliverable based upon the selling price hierarchy for multiple-deliverable arrangements. Under this hierarchy, Ciena uses vendor-specific objective evidence ("VSOE") of selling price, if it exists, or third party evidence ("TPE") of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, Ciena uses its best estimate of selling price ("BESP") for that deliverable.

VSOE is established based on Ciena's standard pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, which exists across certain of Ciena's service offerings, Ciena requires that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range. Ciena has been unable to establish TPE of selling price because its go-to-market strategy differs from that of others in its markets, and the extent of customization and differentiated features and functions varies among comparable products or services from its peers. Ciena determines BESP based upon management-approved pricing guidelines, which consider multiple factors including the type of product or service, gross margin objectives, competitive and market conditions, and the go-to-market strategy, all of which can affect pricing practices.

## Warranty Accruals

Ciena provides for the estimated costs to fulfill customer warranty obligations upon recognition of the related revenue. Estimated warranty costs include estimates for material costs, technical support labor costs and associated overhead. Warranty is included in cost of goods sold and is 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 the 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 the 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.

#### 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, cost of prototype equipment, consulting and third party services, depreciation, facility costs and information technology.

#### Government Grants

9

---

## Table of Contents

Ciena accounts for proceeds from government grants as a reduction of operating expense when there is reasonable assurance that Ciena has complied with the conditions attached to the grant and that the grant proceeds will be received. Grant benefits are recorded to the line item in the Condensed Consolidated Statement of Operations to which the grant activity relates. See Note 18 below.

### 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 restricted stock unit based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense to its Condensed Consolidated Statement of Operations for those options or shares that are expected ultimately to vest. 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 its 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. Ciena uses the straight-line method to record expense for grants with only service-based vesting. See Note 16 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 carryforwards. 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.

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 is currently under audit in India for 2007, 2008 and 2009, Canada for 2010 and 2011, and in the United Kingdom for 2009. Management does not expect the outcome of these audits to have a material adverse effect on Ciena's consolidated financial position, results of operations or cash flows. Ciena's major tax jurisdictions and the earliest open tax years are as follows: United States (2009), United Kingdom (2007), Canada (2005) and India (2007). However, limited adjustments can be made to Federal U.S. tax returns in earlier years in order to reduce net operating loss carryforwards. Ciena classifies 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.

Ciena has not provided for 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



## Table of Contents

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.

### 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 in order 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. For information related to the fair value of Ciena's convertible notes, see Note 13 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; and

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

From time to time, Ciena takes actions to better align its workforce, facilities and operating costs with perceived market opportunities, business strategies and changes in market and business conditions. GAAP requires 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. See Note 3 below.

## 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. 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 monetary assets and liabilities are transacted in a currency other than the entity's functional currency, 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

Ciena's 4.0% convertible senior notes due March 15, 2015 (the "2015 Notes") include a redemption feature that is accounted for as a separate embedded derivative. The embedded redemption feature is recorded at fair value on a recurring basis, and these changes are included in interest and other income, net on the Condensed Consolidated Statement of Operations.

From time to time, Ciena uses foreign currency forward contracts to reduce variability in certain forecasted non-U.S.-dollar denominated cash flows. Generally, these derivatives have maturities of twelve months or less and are designated as cash flow hedges. At the inception of the cash flow hedge, and on an ongoing basis, Ciena assesses whether the forward contract has been effective in offsetting changes in cash flows attributable to the hedged risk during the hedging period. The effective portion of the derivative's net gain or loss is initially reported as a component of accumulated other comprehensive income (loss), and, upon the occurrence of the forecasted transaction, is subsequently reclassified to the line item in the Condensed Consolidated Statement of Operations 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. From time to time Ciena may also use foreign currency forwards to hedge certain balance sheet exposures. These forwards are not designated as hedges for accounting purposes and any net gain or loss associated with these derivatives is reported in interest and other income, net. See Note 12 below.

### Computation of Net Income (Loss) per 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 other potential dilutive shares that would be outstanding 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 15 below.

### Software Development Costs

Ciena develops software for sale to its customers. GAAP require the capitalization of certain software development costs that are 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.

### Newly Issued Accounting Standards

In May 2011, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that amends current fair value measurement and disclosure guidance to converge with International Financial Reporting Standards ("IFRS"). This update provides improved comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. This guidance is effective for fiscal years and interim periods beginning after December 15, 2011. Ciena adopted this guidance in the first quarter of fiscal 2013.

In June 2011, FASB issued an accounting standards update that requires an entity to present total comprehensive income, the components of net income, and the components of other comprehensive income either in a single

continuous statement of comprehensive income or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This guidance is effective for fiscal years and interim periods beginning after December 15, 2011. Ciena adopted this guidance in the first quarter of fiscal 2013.

In February 2013, FASB issued an accounting standards update to require reclassification adjustments from other comprehensive income to be presented either in the financial statements or in the notes to the financial statements. This accounting standard update will be effective for Ciena beginning in the first quarter of fiscal 2014, at which time Ciena will include the required disclosures.

### (3) RESTRUCTURING COSTS

Ciena has undertaken a number of restructuring activities intended to reduce expense and better align its workforce and costs with market opportunities, product development and business strategies. The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the six months ended April 30, 2013 (in thousands):

12

---

Table of Contents

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2012	\$1,449	\$3,600	\$5,049
Additional liability recorded	4,916	1,623	6,539
Non-cash disposal	—	(735	) (735
Cash payments	(5,733	) (2,153	) (7,886
Balance at April 30, 2013	\$632	\$2,335	\$2,967
Current restructuring liabilities	\$632	\$1,606	\$2,238
Non-current restructuring liabilities	\$—	\$729	\$729

The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the six months ended April 30, 2012 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2011	\$160	\$3,293	\$3,453
Additional liability recorded	3,573	—	3,573
Cash payments	(2,883	) (818	) (3,701
Balance at April 30, 2012	\$850	\$2,475	\$3,325
Current restructuring liabilities	\$850	\$380	\$1,230
Non-current restructuring liabilities	\$—	\$2,095	\$2,095

**(4) MARKETABLE SECURITIES**

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

	April 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations	\$99,952	\$21	\$—	\$99,973
Included in short-term investments	\$99,952	\$21	\$—	\$99,973
	October 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations	\$49,987	\$70	\$—	\$50,057
Included in short-term investments	\$49,987	\$70	\$—	\$50,057

The following table summarizes final legal maturities of debt investments at April 30, 2013 (in thousands):

Amortized Cost	Estimated Fair Value
-------------------	-------------------------

Less than one year	\$99,952	\$99,973
Due in 1-2 years	—	—
	\$99,952	\$99,973

Table of Contents

## (5) FAIR VALUE MEASUREMENTS

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

	April 30, 2013			Total
	Level 1	Level 2	Level 3	
Assets:				
U.S. government obligations	\$99,973	\$—	\$—	\$99,973
Foreign currency forward contracts	—	52	—	52
Embedded redemption feature	—	—	220	220
Total assets measured at fair value	\$99,973	\$52	\$220	\$100,245
Liabilities:				
Foreign currency forward contracts	\$—	\$67	\$—	\$67
Total liabilities measured at fair value	\$—	\$67	\$—	\$67

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

	April 30, 2013			Total
	Level 1	Level 2	Level 3	
Assets:				
Short-term investments	\$99,973	\$—	\$—	\$99,973
Prepaid expenses and other	—	52	—	52
Other long-term assets	—	—	220	220
Total assets measured at fair value	\$99,973	\$52	\$220	\$100,245
Liabilities:				
Accrued liabilities	\$—	\$67	\$—	\$67
Total liabilities measured at fair value	\$—	\$67	\$—	\$67

Ciena's Level 3 assets included in other long-term assets reflect an embedded redemption feature contained within the 2015 Notes. The embedded redemption feature is bifurcated from the 2015 Notes using the "with-and-without" approach. As such, the total value of the embedded redemption feature is calculated as the difference between the value of the 2015 Notes (the "Hybrid Instrument") and the value of an identical instrument without the embedded redemption feature (the "Host Instrument"). Both the Host Instrument and the Hybrid Instrument are valued using a modified binomial model. The modified binomial model utilizes a risk free interest rate, an implied volatility of Ciena's stock, the recovery rates of bonds and the implied default intensity of the 2015 Notes.

As of the dates indicated, the following table sets forth, in thousands, the reconciliation of changes in fair value measurements of Level 3 assets:

Table of Contents

	Level 3
Balance at October 31, 2012	\$420
Issuances	—
Settlements	(630 )
Changes in unrealized gain (loss)	430
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at April 30, 2013	\$220

## (6) ACCOUNTS RECEIVABLE

As of October 31, 2012, no single customer accounted for greater than 10% of net accounts receivable. As of April 30, 2013, two customers each accounted for greater than 10% of net accounts receivable, and in aggregate accounted for 28% of net accounts receivable. Allowance for doubtful accounts was \$1.5 million and \$1.6 million as of October 31, 2012 and April 30, 2013, respectively. Ciena has not historically experienced a significant amount of bad debt expense.

## (7) INVENTORIES

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

	October 31, 2012	April 30, 2013
Raw materials	\$39,678	\$49,933
Work-in-process	10,736	9,749
Finished goods	178,210	145,051
Deferred cost of goods sold	71,484	84,159
	300,108	288,892
Provision for excess and obsolescence	(40,010 )	(40,796 )
	\$260,098	\$248,096

Ciena writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated net realizable value based on assumptions about future demand and market conditions. During the first six months of fiscal 2013, Ciena recorded a provision for excess and obsolescence of \$9.0 million, primarily related to engineering design changes and the discontinuance of certain parts and components used in the manufacture of our Optical Transport and Converged Packet Optical products. Deductions from the provision for excess and obsolete inventory relate to disposal activities.

## (8) PREPAID EXPENSES AND OTHER

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

	October 31, 2012	April 30, 2013
Prepaid VAT and other taxes	\$37,806	\$57,445
Deferred deployment expense	19,449	21,978
Product demonstration equipment, net	33,144	36,262
Prepaid expenses	16,477	16,689
Restricted cash	2,030	333
Other non-trade receivables	8,689	5,870
	\$117,595	\$138,577



Depreciation of product demonstration equipment was \$4.2 million and \$3.5 million for the first six months of fiscal 2012 and 2013, respectively.

Table of Contents

## (9)EQUIPMENT, FURNITURE AND FIXTURES

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

	October 31, 2012	April 30, 2013
Equipment, furniture and fixtures	\$422,118	\$380,240
Leasehold improvements	61,493	63,133
	483,611	443,373
Accumulated depreciation and amortization	(360,031 )	(325,820 )
	\$123,580	\$117,553

Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements was \$24.9 million and \$25.4 million for the first six months of fiscal 2012 and 2013, respectively. During the first six months of fiscal 2013, in connection with the restructuring activities described above, Ciena disposed of equipment, furniture and fixtures with an original cost of \$38.6 million and related accumulated depreciation of \$37.9 million.

## (10) OTHER INTANGIBLE ASSETS

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

	October 31, 2012			April 30, 2013		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Developed technology	\$417,833	\$(279,195 )	\$138,638	\$417,833	\$(300,420 )	\$117,413
Patents and licenses	46,538	(45,566 )	972	46,538	(45,662 )	876
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	323,573	(206,046 )	117,527	323,573	(220,386 )	103,187
Total other intangible assets	\$787,944	\$(530,807 )	\$257,137	\$787,944	\$(566,468 )	\$221,476

The amortization of finite-lived other intangible assets was \$37.9 million and \$35.7 million for the first six months of fiscal 2012 and 2013, respectively. Expected future amortization of finite-lived other intangible assets for the fiscal years indicated is as follows (in thousands):

Period ended October 31, 2013 (remaining six months)	\$35,647
2014	57,151
2015	52,879
2016	52,879
2017	22,783
Thereafter	137
	\$221,476

## (11)OTHER BALANCE SHEET DETAILS

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

Table of Contents

	October 31, 2012	April 30, 2013
Maintenance spares inventory, net	\$57,548	\$64,619
Deferred debt issuance costs, net	20,575	18,011
Embedded redemption feature	420	220
Restricted cash	2,413	2,431
Other	3,780	4,876
	\$84,736	\$90,157

Deferred debt issuance costs are amortized using the straight-line method, which approximates the effect of the effective interest rate method, through the maturity of the related debt. Amortization of debt issuance costs related to our convertible notes payable and the Credit Facility, which is included in interest expense, was \$2.7 million and \$3.0 million during the first six months of fiscal 2012 and fiscal 2013, respectively.

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

	October 31, 2012	April 30, 2013
Warranty	\$55,132	\$54,729
Compensation, payroll related tax and benefits	48,885	58,031
Vacation	29,581	31,986
Current restructuring liabilities	3,516	2,238
Interest payable	4,404	6,013
Other	68,022	69,786
	\$209,540	\$222,783

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

Six months ended	Beginning			Balance at
April 30,	Balance	Provisions	Settlements	end of
2012	\$47,282	16,615	(12,793	period
2013	\$55,132	11,060	(11,463	) \$54,729
			)	\$51,104

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

	October 31, 2012	April 30, 2013
Products	\$29,279	\$38,659
Services	77,797	88,216
	107,076	126,875
Less current portion	(79,516	) (98,603
Long-term deferred revenue	\$27,560	\$28,272

**(12) FOREIGN CURRENCY FORWARD CONTRACTS**

As of April 30, 2013, Ciena had forward contracts to reduce the variability in its Canadian Dollar denominated expense, which expense principally relates to research and development activities. These derivative contracts have been designated as cash flow hedges. During the first six months of fiscal 2013, in order to hedge certain balance sheet exposures, Ciena entered into a three-month forward contract to sell Brazilian Real and buy equivalent U.S. Dollars. This derivative contract has not been designated as a hedge. Ciena's foreign currency forward contracts are

immaterial for separate financial statement presentation.

17

---

Table of Contents

(13) CONVERTIBLE NOTES PAYABLE

Payment of 2013 Convertible Notes at Maturity

On May 1, 2013, Ciena paid at maturity the remaining \$216.2 million in aggregate principal amount outstanding on its 0.25% convertible senior notes.

Private Exchange Offer Transactions

On December 27, 2012, Ciena issued \$187.5 million in aggregate principal amount of 4.0% Convertible Senior Notes due 2020 (the "2020 Notes") in separate private offerings in exchange for \$187.5 million in aggregate principal amount of 2015 Notes (the "Exchange Transactions"). The Exchange Transactions resulted in the retirement of outstanding 2015 Notes with a carrying value of \$187.9 million, the write-off of unamortized debt issuance costs of \$2.3 million, and settlement of \$0.6 million relating to the redemption feature on the 2015 Notes accounted for as a separate embedded derivative. The 2020 Notes offered in the Exchange Transactions had a fair value of \$213.6 million, which resulted in a loss on extinguishment of debt of \$28.6 million in the first quarter of fiscal 2013. Ciena does not expect the Exchange Transactions to affect its taxes from continuing operations, as the company continues to provide a valuation allowance against its deferred tax assets.

The 2020 Notes are senior unsecured obligations and rank equally with all of Ciena's other existing and future senior unsecured debt. The 2020 Notes pay interest from the date of issuance at a rate of 4.0% per year. The interest is payable semi-annually on June 15 and December 15, commencing on June 15, 2013. The principal amount of the 2020 Notes will also accrete at a rate of 1.85% per year commencing December 27, 2012, compounding on a semi-annual basis. The accreted portion of the principal payable at maturity does not bear interest and is not convertible into shares of Ciena's common stock. The 2020 Notes will mature on December 15, 2020. Consequently, in the event the 2020 Notes are converted, the accreted liability will extinguish without payment.

The 2020 Notes may be converted prior to maturity, at the option of the holder, into shares of Ciena's common stock at an initial conversion rate of 49.0557 shares of common stock per \$1,000 in original principal amount, which is equal to an initial conversion price of \$20.385 per share. In addition, Ciena may elect to convert the 2020 Notes in whole or in part at any time on or prior to December 15, 2020, if the daily volume weighted average price of the common stock equals or exceeds 130% of the conversion price then in effect for at least 20 trading days in any 30 consecutive trading day period. If Ciena elects to convert the 2020 Notes on or before maturity, the conversion rate will be adjusted to include an amount of additional shares, determined by reference to a make-whole table, payable in Ciena common stock, or its cash equivalent, at Ciena's election. An aggregate of 9,197,944 shares of Ciena common stock issuable upon conversion of the 2020 Notes has been reserved for issuance.

Upon certain fundamental changes, holders of the 2020 Notes have the option to require Ciena to purchase the 2020 Notes at a price equal to the accreted principal amount of the notes delivered for repurchase plus any accrued and unpaid interest on the original principal amount. Upon a holder's election to convert the 2020 Notes in connection with certain fundamental changes, the conversion rate will be adjusted to include an amount of additional shares, determined by reference to a make-whole table, payable in Ciena common stock, or its cash equivalent, at Ciena's election.

Accounting guidance issued by the FASB requires the issuer of convertible debt instruments with cash settlement features, including partial cash settlement, to account separately for the liability and equity components of the instrument. Under this guidance, the debt is recognized at the present value of its cash flows discounted using the

issuer's nonconvertible debt borrowing rate at the time of issuance and the equity component is recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability. The reduced carrying value on the convertible debt results in a debt discount that is accreted back to the convertible debt's principal amount through the recognition of non-cash interest expense over the expected life of the debt, which results in recognizing the interest expense on these borrowings at effective rates approximating what Ciena would have incurred had nonconvertible debt with otherwise similar terms been issued.

Because the additional make-whole shares can be settled in cash or common stock at Ciena's option, the debt and equity components were accounted for separately. Ciena measured the fair value of the debt component of the 2020 Notes using an effective interest rate of 7.0%. As a result, Ciena attributed \$170.4 million of the fair value of the 2020 Notes to the debt component, which is netted against the face value of the 2020 Notes as a debt discount. The debt discount will be accreted over the period from the date of issuance to the contractual maturity date, resulting in the recognition of non-cash interest expense. In addition, Ciena recorded \$43.1 million within additional paid-in capital representing the equity component of the 2020 Notes.

Table of Contents

The 2020 Notes were issued pursuant to an Indenture entered into as of December 27, 2012 (the “Indenture”) with The Bank of New York Mellon Trust Company, N.A., as trustee. The Indenture provides for customary events of default which include (subject in certain cases to customary grace and cure periods), among others, the following: nonpayment of principal (including accreted portion) or interest; breach of covenants or other agreements in the Indenture; defaults in failure to pay certain other indebtedness; and certain events of bankruptcy or insolvency. Generally, if an event of default occurs and is continuing under the Indenture, the trustee or the holders of at least 25% in aggregate original principal amount of the 2020 Notes then outstanding may declare the principal (including accreted portion) of, premium, if any, and accrued interest on all the 2020 Notes immediately due and payable.

The principal balance, unamortized discount and net carrying amount of the liability and equity components of our 2020 Notes were as follows as of April 30, 2013

	Liability Component			Equity Component
	Principal Balance	Unamortized Discount	Net Carrying Amount	Net Carrying Amount
4.0% Convertible Senior Notes due December 15, 2020	\$ 188,718	\$ 16,722	\$ 171,996	\$ 43,131

The following table sets forth, in thousands, the carrying value and the estimated fair value of Ciena’s outstanding convertible notes:

Description	April 30, 2013	
	Carrying Value	Fair Value <sup>(2)</sup>
4.0% Convertible Senior Notes, due March 15, 2015 <sup>(1)</sup>	187,818	204,609
0.875% Convertible Senior Notes due June 15, 2017	500,000	463,750
3.75% Convertible Senior Notes due October 15, 2018	350,000	387,625
4.0% Convertible Senior Notes due December 15, 2020 <sup>(3)</sup>	171,996	216,338
	\$ 1,209,814	\$ 1,272,322

(1)Includes unamortized bond premium related to embedded redemption feature.

(2)The fair value reported above is based on the quoted prices for the notes on the date above.

(3)Includes unamortized discount and accretion of principal.

**(14) CREDIT FACILITY**

During fiscal 2012, Ciena entered into a \$150.0 million senior secured asset-based revolving credit facility (the “Credit Facility”). The Credit Facility matures on August 13, 2015, provided that it will mature early on December 15, 2014, if any of Ciena’s 4.0% senior convertible notes due March 15, 2015 are then outstanding. Ciena principally expects to use the Credit Facility to support the issuance of letters of credit that arise in the ordinary course of its business and thereby to reduce its use of cash required to collateralize these instruments. As of April 30, 2013, letters of credit totaling \$48.1 million were collateralized by the Credit Facility. There were no borrowings outstanding under the Credit Facility as of April 30, 2013.

**(15) 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 under Ciena’s employee stock purchase plan and upon exercise of outstanding stock options, using the treasury stock method, and (iv) shares underlying Ciena’s outstanding convertible notes.

Edgar Filing: CIENA CORP - Form 10-Q

Numerator	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Net loss	\$(27,780 )	\$(27,079 )	\$(75,433 )	\$(74,403 )



Table of Contents

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Denominator				
Basic weighted average shares outstanding	98,981	101,913	98,525	101,560
Dilutive weighted average shares outstanding	98,981	101,913	98,525	101,560
	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
EPS				
Basic EPS	\$(0.28 )	\$(0.27 )	\$(0.77 )	\$(0.73 )
Diluted EPS	\$(0.28 )	\$(0.27 )	\$(0.77 )	\$(0.73 )

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

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Shares underlying stock options, restricted stock units and warrants	6,074	4,267	6,054	4,366
0.25% Convertible Senior Notes due May 1, 2013	5,470	5,288	5,470	5,379
4.0% Convertible Senior Notes due March 15, 2015	18,396	9,198	18,396	11,891
0.875% Convertible Senior Notes due June 15, 2017	13,108	13,108	13,108	13,108
3.75% Convertible Senior Notes due October 15, 2018	17,356	17,356	17,356	17,356
4.0% Convertible Senior Notes due December 15, 2020	—	9,198	—	6,505
Total excluded due to anti-dilutive effect	60,404	58,415	60,384	58,605

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

Ciena maintains two active equity compensation plans, the 2008 Omnibus Incentive Plan (“2008 Plan”) and the Amended and Restated Employee Stock Purchase Plan (“ESPP”). These plans were approved by stockholders and are described in Ciena’s annual report on Form 10-K.

**2008 Omnibus Incentive Plan**

The 2008 Omnibus Incentive Plan (the “2008 Plan”) authorizes the issuance of awards including stock options, restricted stock units (RSUs), restricted stock, unrestricted stock, stock appreciation rights (SARs) and other equity and/or cash performance incentive awards to employees, directors, and consultants of Ciena. Subject to certain restrictions, the Compensation Committee of the Board of Directors has broad discretion to establish the terms and conditions for awards under the 2008 Plan, including the number of shares, vesting conditions, and the required service or performance criteria. Options and SARs have a maximum term of ten years, and their exercise price may not be less than 100% of fair market value on the date of grant. Repricing of stock options and SARs is prohibited without stockholder approval. Certain change in control transactions may cause awards granted under the 2008 Plan to vest, unless the awards are continued or substituted for in connection with the transaction. The total number of shares authorized for issuance under the 2008 Plan is 18.5 million shares. As of April 30, 2013, approximately 5.1 million shares remained available for issuance under the 2008 Plan.

**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 period indicated (shares in thousands):



Table of Contents

	Shares Underlying Options Outstanding	Weighted Average Exercise Price
Balance at October 31, 2012	3,207	\$27.58
Granted	—	—
Exercised	(37	) 7.64
Canceled	(738	) 30.89
Balance at April 30, 2013	2,432	\$26.88

The total intrinsic value of options exercised during the first six months of fiscal 2012 and fiscal 2013 was \$0.3 million and \$0.3 million, respectively. There were no stock options granted by Ciena during the first six months of fiscal 2012 or fiscal 2013.

The following table summarizes information with respect to stock options outstanding at April 30, 2013, based on Ciena's closing stock price on the last trading day of Ciena's second fiscal quarter of 2013 (shares and intrinsic value in thousands):

Range of Exercise Price	Options Outstanding at April 30, 2013				Vested Options at April 30, 2013			
	Number of Underlying Shares	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Underlying Shares	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
\$0.94 — \$16.31	274	4.51	\$8.48	\$1,710	264	4.43	\$8.34	\$1,686
\$16.52 — \$17.29	359	2.16	16.67	—	359	2.16	16.67	—
\$17.43 — \$24.50	480	1.99	20.48	—	480	1.99	20.48	—
\$24.69 — \$28.28	359	3.51	26.97	—	359	3.51	26.97	—
\$28.61 — \$31.43	162	3.21	29.53	—	162	3.21	29.53	—
\$31.71 — \$32.55	21	4.63	31.92	—	21	4.63	31.92	—
\$33.00 — \$37.10	297	3.94	35.21	—	297	3.94	35.21	—
\$37.31 — \$47.32	456	1.46	44.92	—	456	1.46	44.92	—
\$47.53 — \$55.79	24	0.47	48.97	—	24	0.47	48.97	—
\$0.94 — \$55.79	2,432	2.75	\$26.88	\$1,710	2,422	2.74	\$26.94	\$1,686

#### 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 did not grant any option-based awards during the first six months of fiscal 2012 or fiscal 2013.

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 and/or performance-based vesting

conditions. Awards subject to service-based conditions typically vest in increments over a three or 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 the acceleration of vesting, of such awards. Ciena recognizes the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based compensation 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

Table of Contents

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 following table is a summary of Ciena's restricted stock unit activity for the period indicated, with the aggregate fair 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 fair value in thousands):

	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value Per Share	Aggregate Fair Value
Balance at October 31, 2012	4,403	\$14.16	\$56,267
Granted	2,225		
Vested	(970)	)	
Canceled or forfeited	(531)	)	
Balance at April 30, 2013	5,127	\$14.91	\$75,405

The total fair value of restricted stock units that vested and were converted into common stock during the first six months of fiscal 2012 and fiscal 2013 was \$15.1 million and \$15.9 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first six months of fiscal 2012 and fiscal 2013 was \$10.90 and \$15.75 respectively.

#### Assumptions for Restricted Stock Unit Awards

The fair value of each restricted stock unit award 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.

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.

#### Amended and Restated Employee Stock Purchase Plan

Under the ESPP, eligible employees may enroll in a twelve-month offer period that begins in December and June of each year. Each offer period includes two six-month purchase periods. Employees may purchase a limited number of shares of Ciena common stock at 85% of the fair market value on either the day immediately preceding the offer date or the purchase date, whichever is lower. The ESPP is considered compensatory for purposes of share-based compensation expense. Pursuant to the ESPP's "evergreen" provision, on December 31 of each year, the number of shares available under the ESPP increases by up to 0.6 million shares, provided that the total number of shares available at that time shall not exceed 8.2 million. Unless earlier terminated, the ESPP will terminate on January 24, 2023.

During the first six months of fiscal 2013, Ciena issued 0.4 million shares under the ESPP. At April 30, 2013, 7.7 million shares remained available for issuance under the ESPP.

#### Share-Based Compensation Expense for Periods Reported

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

22

---

Table of Contents

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Product costs	\$460	\$686	\$944	\$1,247
Service costs	367	435	805	862
Share-based compensation expense included in cost of sales	827	1,121	1,749	2,109
Research and development	2,092	2,204	4,226	4,237
Sales and marketing	2,820	3,382	5,921	6,125
General and administrative	2,141	3,144	4,938	5,700
Acquisition and integration costs	—	—	6	—
Share-based compensation expense included in operating expense	7,053	8,730	15,091	16,062
Share-based compensation expense capitalized in inventory, net	62	(24)	(10)	(24)
Total share-based compensation	\$7,942	\$9,827	\$16,830	\$18,147

As of April 30, 2013, total unrecognized share-based compensation expense was \$67.3 million: (i) \$0.1 million related to unvested stock options and expected to be recognized over a weighted-average period of 0.3 years, and (ii) \$67.2 million related to unvested restricted stock units and expected to be recognized over a weighted-average period of 1.5 years.

## (17) SEGMENTS AND ENTITY WIDE DISCLOSURES

## Segment Reporting

During the first quarter of fiscal 2013, Ciena reorganized its internal organizational structure and the management of its business into the following new operating segments: (i) Converged Packet Optical; (ii) Packet Networking; (iii) Optical Transport; and (iv) Software and Services. Ciena's chief operating decision maker, its chief executive officer, evaluates the company's performance and allocates resources based on multiple factors, including measures of segment profit (loss). Operating segments are defined as components of an enterprise that engage in business activities that may earn revenue and incur expense; for which discrete financial information is available, and for which such information is evaluated regularly by the chief operating decision maker for purposes of allocating resources and assessing performance. Ciena's segment revenue and segment profit (loss) for fiscal 2012 have been restated to reflect the new operating segments adopted in fiscal 2013. The following describes each of the newly reorganized operating segments:

**Converged Packet Optical** — includes networking solutions optimized for the convergence of coherent optical transport, OTN switching and packet switching. These platforms enable automated packet-optical infrastructures that create and efficiently allocate high-capacity bandwidth for the delivery of a wide variety of enterprise and consumer-oriented network services. Products in this segment include the 6500 Packet-Optical Platform featuring Ciena's WaveLogic coherent optical processors. Products also include Ciena's family of CoreDirector® Multiservice Optical Switches, its 5430 Reconfigurable Switching System and its OTN configuration for the 5410 Reconfigurable Switching System. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

**Packet Networking** — principally includes Ciena's 3000 family of service delivery switches and service aggregation switches, the 5000 series of service aggregation switches, and its Ethernet packet configuration for the 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have

principally been deployed to support wireless backhaul infrastructures and business data services. Employing sophisticated, carrier-grade Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment includes stand-alone broadband products that transition voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.



Table of Contents

Optical Transport — includes optical transport solutions that add capacity to core, regional and metro networks and enable cost-effective and efficient transport of voice, video and data traffic at high transmission speeds. Ciena's principal products in this segment include the 4200 Advanced Services Platform, Corestream® Agility Optical Transport System, 5100/5200 Advanced Services Platform, Common Photonic Layer (CPL), and 6100 Multiservice Optical Platform. This segment includes sales from SONET/SDH, transport and data networking products, as well as certain enterprise-oriented transport solutions that support storage and LAN extension, interconnection of data centers, and virtual private networks. This segment also includes operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Software and Services — includes Ciena's network software suite, including the OneControl Unified Management System, an integrated network and service management software designed to automate and simplify network management, operation and service delivery. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network performance. This segment includes the ON-Center® Network & Service Management Suite, Ethernet Services Manger, Optical Suite Release and network level applications. This segment includes a broad range of consulting, network design and support services from Ciena's Network Transformation Solutions offering. This segment also includes installation and deployment, maintenance support and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Condensed Consolidated Statement of Operations.

Reportable segment asset information is not disclosed because it is not reviewed by the chief operating decision maker for purposes of evaluating performance and allocating resources.

## Segment Revenue

The table below (in thousands) sets forth Ciena's segment revenue for the respective periods:

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Revenue:				
Converged Packet Optical	\$264,646	\$294,325	\$466,690	\$534,285
Packet Networking	29,922	54,190	51,423	100,027
Optical Transport	84,384	57,371	192,040	114,968
Software and Services	98,665	101,826	184,149	211,525
Consolidated revenue	\$477,617	\$507,712	\$894,302	\$960,805

## Segment Profit (Loss)

Segment profit (loss) is determined based on internal performance measures used by the chief executive officer to assess the performance of each operating segment in a given period. In connection with that assessment, the chief executive officer excludes the following items: selling and marketing costs; general and administrative costs; amortization of intangible assets; restructuring costs; interest and other income (net); interest expense; loss on extinguishment of debt and provisions (benefit) for income taxes.

The table below (in thousands) sets forth Ciena's segment profit (loss) and the reconciliation to consolidated net income (loss) during the respective periods:

Table of Contents

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Segment profit (loss):				
Converged Packet Optical	\$45,200	\$57,528	\$75,488	\$104,646
Packet Networking	(3,114 )	2,556	(7,402 )	7,639
Optical Transport	29,150	21,413	63,181	42,000
Software and Services	21,306	27,229	39,367	61,111
Total segment profit	92,542	108,726	170,634	215,396
Less: non-performance operating expenses				
Selling and marketing	62,517	74,475	126,928	141,063
General and administrative	26,670	30,883	56,334	59,091
Amortization of intangible assets	12,967	12,439	26,438	24,892
Restructuring costs	1,851	1,509	3,573	6,539
Add: other non-performance financial items				
Interest expense and other income (loss), net	(14,033 )	(14,108 )	(28,490 )	(24,977 )
Loss on extinguishment of debt	—	—	—	(28,630 )
Less: Provision for income taxes	2,284	2,391	4,304	4,607
Consolidated net loss	\$(27,780 )	\$(27,079 )	\$(75,433 )	\$(74,403 )

## Entity Wide Reporting

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

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
United States	\$252,668	\$287,572	\$485,746	\$551,807
International	224,949	220,140	408,556	408,998
Total	\$477,617	\$507,712	\$894,302	\$960,805

The following table reflects Ciena's geographic distribution of equipment, furniture and fixtures, net, with any country accounting for a significant percentage of total equipment, furniture and fixtures, net, specifically identified.

Equipment, furniture and fixtures, net, attributable to geographic regions outside of the United States and Canada are reflected as "Other International." For the periods below, Ciena's geographic distribution of equipment, furniture and fixtures was as follows (in thousands):

	October 31,	April 30,
	2012	2013
United States	\$64,653	\$62,720
Canada	48,376	43,964
Other International	10,551	10,869
Total	\$123,580	\$117,553

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



Table of Contents

	Quarter Ended April 30,		Six Months Ended April 30,	
	2012	2013	2012	2013
Company A	\$71,839	\$101,531	\$152,425	\$173,210
Company B	56,671	57,293	90,827	105,356
Total	\$128,510	\$158,824	\$243,252	\$278,566

The customers identified above purchased products and services from each of Ciena's operating segments.

**(18) COMMITMENTS AND CONTINGENCIES****Ontario Grant**

Ciena was awarded a conditional grant from the Province of Ontario in June 2011. Under this strategic jobs investment fund grant, Ciena can receive up to an aggregate of C\$25.0 million in funding for eligible costs relating to certain next-generation, coherent optical transport development initiatives over the period from November 1, 2010 to October 31, 2015. Ciena anticipates receiving disbursements, approximating C\$5.0 million per fiscal year, over the period above. Amounts received under the grant are subject to recoupment in the event that Ciena fails to achieve certain minimum investment, employment and project milestones. As of April 30, 2013, Ciena has recorded a C\$13.7 million benefit to date as a reduction in research and development expenses, of which C\$2.8 million was recorded in the first six months of fiscal 2013. As of April 30, 2013, amounts receivable from this grant were C\$2.8 million.

**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, 2012 and April 30, 2013, Ciena had accrued liabilities of \$1.7 million and \$2.0 million, respectively, related to these contingencies, which are reported as a component of other current accrued liabilities. As of April 30, 2013, Ciena estimates that it could be exposed to possible losses of up to \$6.1 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 probable. 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).

In addition to the matters described above, Ciena is subject to various tax liabilities arising in the ordinary course of business. Ciena does not expect that the ultimate settlement of these liabilities will have a material effect on its results of operations, financial position or cash flows.

**Litigation**

On July 29, 2011, Cheetah Omni LLC filed a complaint in the United States District Court for the Eastern District of Texas against Ciena and several other defendants, alleging, among other things, that certain of the parties' products infringe upon multiple U.S. relating to certain reconfigurable optical add-drop multiplexer (ROADM) technologies. The complaint seeks injunctive relief and damages. On November 8, 2011, Ciena filed an answer and counterclaims to Cheetah Omni's amended complaint. A Markman hearing was held in February 2013 and, on April 11, 2013, the district court issued an opinion and order construing or electing not to construe the disputed claim terms of the patents-in-suit. On the same date, the district court denied defendants' motion for summary judgment of indefiniteness with respect to the claims of two patents. In March 2013, the plaintiff filed a motion for leave to amend its

infringement contentions against Ciena to add additional infringing products, to which we filed an opposition. In May 2013, following the claim construction order, the plaintiff withdrew several claims on some of the patents but retained certain other claims on each of the remaining patents. The parties continue to engage in discovery. Trial is currently scheduled for March 2014. Ciena believes that it has valid defenses to the lawsuit and intends to continue to defend it vigorously.

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 seeks injunctive relief and damages. In July 2009, upon request of Ciena and certain other defendants, the U.S. Patent and Trademark

Table of Contents

Office (“PTO”) granted the defendants' inter partes application for reexamination with respect to certain claims of the '673 Patent, and the district court granted the defendants' motion to stay the case pending reexamination of all of the patents-in-suit. In December 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims of the '673 Patent, to which Ciena and other defendants filed an appeal. On March 16, 2012, the PTO on appeal rejected multiple claims of the '673 Patent, including the two claims on which Ciena is alleged to infringe.

Subsequently, the plaintiff requested a reopening of the prosecution of the '673 Patent, which request was denied by the PTO on April 29, 2013. Thereafter, on May 28, 2013, the plaintiff filed an amendment with the PTO in which it canceled the claims of the '673 Patent on which Ciena is alleged to infringe. The case currently remains stayed, and there can be no assurance as to whether or when the stay will be lifted.

In addition to the matters described above, Ciena is subject to various legal proceedings and claims arising in the ordinary course of business, including claims against third parties that may involve contractual indemnification obligations on the part of Ciena. Ciena does not expect that the ultimate costs to resolve these matters will have a material effect on its results of operations, financial position or cash flows.

**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,” “potentially,” “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. For a more complete understanding of the risks associated with an investment in Ciena’s securities, 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 21, 2012. Ciena undertakes no obligation to revise or update any forward-looking statements.

## Table of Contents

### Overview

We are a network specialist focused on networking solutions that enable converged, next-generation architectures, optimized to handle the broad array of high-bandwidth communications services relied upon by business and consumer end users. We provide equipment, software and services that support the transport, switching, aggregation, service delivery and management of voice, video and data traffic on communications networks.

Our Converged Packet Optical, Packet Networking, Optical Transport and Software products are used, individually or as part of an integrated solution, in communications networks operated by service providers, cable operators, governments, enterprises, research and education institutions and other network operators across the globe. Our products allow network operators to scale capacity, increase transmission speeds, allocate network traffic efficiently, and deliver services to end users. Our network solutions also include our integrated Ciena One software suite, which provides network management capabilities that unify our product portfolio and provide automation, programmability and management features that enable efficient service delivery. To complement our product portfolio, we offer a broad range of Network Transformation Solutions and support services that help our customers design, optimize, deploy, manage and maintain their networks. We believe that the close, collaborative partnership with customers enabled by our engagement model and solutions offering is an important component of our network specialist approach and a significant differentiator for us with customers.

Rapid proliferation and reliance upon communications services and devices, increased mobility and growth in cloud-based services have fundamentally affected the demands placed upon communications networks and how they are architected. Network operators face a challenging and rapidly changing environment that requires their networks to be robust enough to address increasing capacity needs and flexible enough to adapt quickly to emerging applications and evolving consumer and business use of communications services. At the same time, network operators are competing to distinguish their service offerings and add revenue-generating services, while managing the cost to implement and maintain their networks. To address these business, infrastructure and service delivery challenges, we offer a comprehensive, solutions-oriented portfolio that builds upon the principles of our OP<sup>n</sup> Architecture for next-generation networks. Our OP<sup>n</sup> Architecture, which underpins our solutions offering and guides our research and development strategy, is described more fully in "Market Opportunity and Strategy" below. Through this network approach, we seek to enable high-capacity, configurable infrastructures that can be managed and adapted by network-level applications, and to provide flexible interfaces for the integration of computing, storage and network resources. By increasing network flexibility for service delivery, reducing required network elements and enabling increased scale at reduced cost, our solutions enable converged, next-generation architectures and 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 information about Ciena important to investors on the "Investors" page of our website at [www.ciena.com](http://www.ciena.com). Investors are encouraged to review the "Investors" page of our website because, as with the other disclosure channels that we use, from time to time we may post material information on that site that is not otherwise disseminated by us.

### Market Opportunity and Strategy

We believe that the shift that is underway in network architectures to next-generation, converged infrastructures represents significant, long-term opportunities for our business. We believe that market trends underlying this shift, including the proliferation of devices running mobile web applications, the prevalence of video applications, and the shift of enterprise and consumer applications to cloud-based or virtualized network environments, are indicative of

increasing use and dependence by consumers and enterprises upon a growing variety of broadband applications and services. We expect that these services will continue to require network operators to invest in converged next-generation network infrastructures that are more automated, open and software programmable.

Our corporate strategy to capitalize on these market dynamics, promote operational efficiency and drive profitable growth of our business includes the following initiatives:

Promote our OP<sup>n</sup> Architecture for Next-Generation Networks. The services and applications running on communications networks require that more of the traffic on these networks be packet-oriented. The traditional approach to this problem has been to add IP routing capability at various points in the network. As capacity needs grow, this approach becomes unnecessarily complex and costly. We reduce the cost and complexity of growing networks with a programmable infrastructure that brings together the reliability and capacity of optical networking with the flexibility and economics of packet networking technologies. Combining these attributes with network level applications creates an approach we call our OP<sup>n</sup> Architecture. Our



## Table of Contents

OP<sup>n</sup> Architecture leverages the convergence of optical and packet networking to enable network scale, applies advanced control plane software for network programmability, and enables cloud-level applications to integrate and optimize network resources — along with computing and storage resources — in a virtualized environment. We intend to promote the scalability, programmability, flexibility and cost effectiveness advantages of our OP<sup>n</sup> Architecture, and we see opportunities in offering a portfolio of carrier-class solutions that facilitates the transition to converged, next-generation networks.

Alignment of Research and Development Investment with Growth Opportunities. We seek to ensure that our product development initiatives and investments are closely aligned with market growth opportunities and reflect the changing dynamics faced by network operators. We are investing in our OP<sup>n</sup> Architecture with current development efforts focused on expanding packet capabilities on our Packet Networking and Converged Packet Optical products for metro and service aggregation applications, optimizing our core network solutions for application in metro networks, and investing in new vectors for growth. Our research and development efforts seek to extend our WaveLogic coherent optical processor for 40G and 100G optical transport across our portfolio and to introduce 400G transmission products. We are also focused on enhancing our software applications, extending our OneConnect control plane across the 5400 and 6500 platform families, and developing network level applications that automate network functions and support new service introduction.

Evolve Go-to-Market Model. We seek to evolve our go-to-market sales model, both from a coverage and an engagement perspective.

Coverage. Our coverage model is focused on penetrating high-growth geographic markets, selling into key customer segments and addressing additional network applications with our solutions. We seek to enhance our brand internationally, expand our geographic reach and capture market share in international markets, including Brazil, the Middle East, Russia, Japan and India. We intend to pursue opportunities to diversify our customer base beyond our traditional customer base. We are expanding our sales efforts to: capture opportunities arising from enterprise migration to, and increased reliance upon, cloud-based services; build upon our reputation as a trusted network equipment supplier with government agencies and research and educational institutions; and target Internet content providers and other network operators emerging as a result of network modernization drivers and the adoption of new communication services. We seek to expand the application of our solutions, including in metro aggregation, submarine networks, and in support of cloud-based services, business Ethernet services and mobile backhaul. We intend to pursue selling initiatives and strategic channel opportunities, including relationships with key resellers. We also intend to pursue carrier-managed sales to end users through our service provider customers, in order to complement our direct sales force and penetrate more deeply our targeted geographic markets and customer segments.

Engagement. Our strategy is to leverage our close relationship with customers in the design, development, implementation and support of their networks and to promote a close alignment of our solutions with customer network priorities. This engagement model is a key differentiator for our business and provides us with unique insight into the business and network needs of our customers. We seek to expand our Network Transformation Solutions offering to address the network modernization and service delivery demands of our customers, as well as their desire to drive additional value from their network infrastructure. We believe this services-oriented solutions offering shifts our value proposition beyond the sale of our next-generation communications networking products and allows us to play a key role in the design and evolution of our customers' networks to support their strategic business objectives. By understanding and addressing their network infrastructure needs and the evolving markets in which our customers compete, we believe this engagement approach creates additional business and operational value for our customers, enabling them to better compete in a challenging environment.

Business optimization to yield operating leverage. We seek to improve the operational efficiencies in our business and gain additional operating leverage. We are focused on the transformation and redesign of certain business processes,

systems, and resources. These initiatives include additional investments, re-engineering and automation of certain key business processes, including the engagement of strategic partners or resources to assist with select business functions. In addition, we are focused on optimizing our supply chain structure in order to increase efficiency, reduce overhead and reduce costs to produce our product solutions. These initiatives include the rationalization and consolidation of third party manufacturers, distribution facilities and logistics providers, direct order fulfillment of additional products, and the consideration of select vertical integration within our supply chain. We seek to leverage these opportunities to promote the profitable growth of our business.

#### Global Market Conditions and Competitive Landscape

Over the past few years, the sustained period of macroeconomic uncertainty and volatility in the global economy and in capital markets has caused a high degree of uncertainty and cautious customer behavior in our industry and markets. These conditions, most notably in Europe, have resulted in lower levels of capital expenditure on communications network

## Table of Contents

infrastructure. Broad macroeconomic weakness has previously resulted in periods of decreased demand for our products and services and has adversely affected our results of operations. In fiscal 2012, for example, our market experienced a challenging environment that included declining growth rates in spending in the markets addressed by our packet-optical networking solutions. Notwithstanding these recent macroeconomic conditions, we believe that the market opportunity described above, together with the significant increase in multiservice traffic growth, is driving a shift in network priorities and spending toward high-capacity, next-generation network architectures. This shift gave rise to a steadily improving environment during the first half of fiscal 2013, particularly as reflected in the spending patterns and decisions of our largest North American service provider customers. Because the market opportunity and related dynamics described above are in their early stages, however, we remain uncertain as to their longer-term effect on the growth of our markets and business, as well as our results of operations.

We continue to encounter a highly competitive marketplace, particularly for our converged packet optical products, as we and our competitors have introduced new, high-capacity, high-speed network solutions and have aggressively sought to capture market share. In this competitive environment, securing new opportunities, particularly in international markets, often requires that we agree to less favorable initial pricing, commercial terms that can elongate the revenue recognition cycle, startup costs to operationalize our solutions in customer networks, financial commitments or performance bonds that place cash resources at risk, and other onerous contractual commitments that place a disproportionate allocation of risk upon the vendor. These terms can adversely affect our results of operations and contribute to fluctuations in our results.

Although we are beginning to see network operators adopt converged network architectures that align well with our OPn Architecture and solutions offering, particularly in North America, competition in our sector remains significant. We expect the competitive landscape to remain challenging and dynamic as we and other multinational equipment vendors introduce new, competing, next-generation platforms, seek adoption of network architectural approaches and compete to obtain new business or retain incumbent positions with large customers around the world. As networking technologies, features or layers converge, our competitive landscape may broaden beyond traditional competitors to include additional competitors focused on IP routing, information technology and software.

### Operational Reorganization

To address the market and technological dynamics described above, including the growing need to transport, aggregate and manage multiple types of services, network operators are increasingly demanding and adopting solutions that enable the convergence of both network functions and network layers, particularly the integration of transport, OTN switching and packet switching capabilities. Our OP<sup>n</sup> Architecture, which underpins our solutions offering and guides our research and development strategy, and our continued development and addition of features to our solutions portfolio, are intended to address these market and networking design dynamics. Specifically, we continue to converge OTN switching functionality into our coherent optical transport solutions. At the same time, we are integrating more transport functionality and packet switching into our switching platforms. To address these changes in our markets and the convergence of certain solutions portfolios, during the first quarter of fiscal 2013, we reorganized our organizational structure and the management of our business into the following new operating segments: (i) Converged Packet Optical; (ii) Packet Networking; (iii) Optical Transport; and (iv) Software and Services. Notably, our Converged Packet Optical segment consists of our former Packet-Optical Switching segment with the addition of our 6500 Packet-Optical Platform. We have restated segment revenue and segment profit (loss) for fiscal 2012 presented in this Form 10-Q to reflect the new operating segments. See "Results of Operations — Operating Segments" below for additional details regarding our new operating segments effective for fiscal 2013 and the product families and platforms that make up these segments.

### Convertible Debt Exchange Offer Transactions

On December 27, 2012, we issued \$187.5 million in aggregate principal amount of new 4.0% Convertible Senior Notes due 2020 (the “2020 Notes”) in separate, private transactions with holders in exchange for \$187.5 million in aggregate principal amount of our outstanding 4.0% Convertible Senior Notes due 2015 (the “2015 Notes”). Certain terms of the new 2020 Notes are the same as the 2015 Notes that they replaced, including the 4.0% annual cash interest rate and the conversion rate of 49.0557 shares of Ciena common stock per \$1,000 in original principal amount, which is equal to an initial conversion price of \$20.385 per share. Unlike the 2015 Notes, however, the principal amount of the 2020 Notes will accrete at a rate of 1.85% per year commencing December 27, 2012, compounding on a semi-annual basis. The accreted portion of the principal is payable in cash upon maturity but does not bear cash interest and is not convertible into additional Ciena common stock. Consequently, in the event the 2020 Notes are converted, the accreted liability will extinguish without payment. Accretion of principal is reflected as a non-cash component of interest expense during the term of the 2020 Notes. The 2020 Notes also provide us with the option, at our election, to convert the 2020 Notes in whole or in part, prior to maturity, into the underlying

Table of Contents

common stock, provided the trading price of our common stock exceeds \$26.50 (or 130% of the then applicable conversion price) for the required measurement period. If we elect to convert the 2020 Notes on or before maturity, holders would receive a make-whole premium payable in Ciena common stock, or its cash equivalent, at our election. The 2020 Notes will mature on December 15, 2020. Following these private exchange offer transactions, \$187.5 million in aggregate principal amount of the 2015 Notes remained outstanding with terms unchanged. We believe that the extension of maturity enabled by these exchange transactions has strengthened our balance sheet and provided enhanced financial flexibility. See Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report for a summary of the 2020 Notes, and an explanation of the \$28.6 million loss on the extinguishment of a portion of the 2015 Notes and the separate accounting for the debt and equity components of the 2020 Notes.

## Financial Results

Revenue for the second quarter of fiscal 2013 was \$507.7 million, representing a sequential increase of 12.1% from \$453.1 million in the first quarter of fiscal 2013. Revenue-related details reflecting sequential changes from the first quarter of fiscal 2013 include:

- Product revenue for the second quarter of fiscal 2013 increased by \$60.2 million, primarily due to increases of \$54.3 million in Converged Packet Optical and \$8.4 million in Packet Networking.

- Service revenue for the second quarter of fiscal 2013 decreased by \$5.5 million.

- Revenue from the United States for the second quarter of fiscal 2013 was \$287.6 million, an increase from \$264.2 million in the first quarter of fiscal 2013.

- International revenue for the second quarter of fiscal 2013 was \$220.1 million, an increase from \$188.9 million in the first quarter of fiscal 2013.

- As a percentage of revenue, international revenue was 43.4% during the second quarter of fiscal 2013, an increase from 41.7% during the first quarter of fiscal 2013.

For the second quarter of fiscal 2013, two customers each accounted for greater than 10% of revenue and represented 31.3% of total revenue. This compares to two customers that accounted for greater than 10% of revenue and represented 26.4% of total revenue in the first quarter of fiscal 2013.

Gross margin for the second quarter of fiscal 2013 was 41.3%, a decrease from 43.2% in the first quarter of fiscal 2013. Gross margin for the second quarter reflects a sequential shift in mix in our Converged Packet Optical segment, including decreased revenue from higher margin products, and high start up costs for early stage platform deployments in international markets. This compares to gross margin for the first quarter of fiscal 2013; which benefited from a particularly favorable mix of higher-margin packet platforms and software content.

Operating expense was \$220.1 million for the second quarter of fiscal 2013, an increase from \$201.4 million in the first quarter of fiscal 2013. Increased second quarter fiscal 2013 operating expense reflects increases of \$11.7 million in research and development expense, \$7.9 million in selling and marketing expense, and \$2.7 million in general and administrative expense. These increases were primarily due to increased employee compensation expense, including variable incentive compensation resulting from our strong performance in the first half of fiscal 2013. As expected, increased research and development expense also reflects increased prototype costs relating to certain planned research and development activities, the timing of which moved from the first to the second fiscal quarter of 2013. These increases were partially offset by a \$3.5 million reduction in restructuring costs. We expect operating expense for the second half of fiscal 2013 to increase from the level during the first half of fiscal 2013, in part due to increased variable compensation expense.

Reflecting the margin decrease and operating expense increase above, our loss from operations for the second quarter of fiscal 2013 was \$10.6 million, compared to a \$5.6 million loss from operations during the first quarter of fiscal

2013. Our net loss for the second quarter of fiscal 2013 was \$27.1 million, or \$0.27 per share. This compares to a net loss of \$47.3 million or \$0.47 per share, for the first quarter of fiscal 2013, which reflects a \$28.6 million loss on the early extinguishment of debt.

In the second fiscal quarter of 2013, we generated cash from operations of \$44.9 million, consisting of \$29.6 million in cash provided by net losses adjusted for non-cash charges and \$15.3 million provided by working capital. This compares with \$45.7 million of cash used by operations during the first quarter of fiscal 2013, consisting of \$32.5 million in cash provided by net losses adjusted for non-cash charges and \$78.2 million used in working capital.

During the second quarter of fiscal 2013, we paid at maturity the remaining \$216.2 million in aggregate principal amount outstanding on our 0.25% convertible senior notes. As a result, as of April 30, 2013, we had \$356.5 million in cash and cash

## Table of Contents

equivalents and \$100.0 million of short-term investments in U.S. treasury securities. This compares to \$585.5 million in cash and cash equivalents and \$50.2 million of short-term investments in U.S. treasury securities at April 30, 2012 and \$642.4 million in cash and cash equivalents and \$50.1 million of short-term investments in U.S. treasury securities at October 31, 2012.

As of April 30, 2013, we had 4,546 employees, an increase from 4,481 at October 31, 2012 and an increase from 4,387 at April 30, 2012.

## Consolidated Results of Operations

### Operating Segments

For the reasons described in "Overview" above, during the first quarter of fiscal 2013, Ciena reorganized its internal organizational structure and the management of its business into the following new operating segments:

**Converged Packet Optical** — includes networking solutions optimized for the convergence of coherent optical transport, OTN switching and packet switching. These platforms enable automated packet-optical infrastructures that create and efficiently allocate high-capacity bandwidth for the delivery of a wide variety of enterprise and consumer-oriented network services. Products in this segment include the 6500 Packet-Optical Platform featuring Ciena's WaveLogic coherent optical processors. Products also include Ciena's family of CoreDirector® Multiservice Optical Switches, its 5430 Reconfigurable Switching System and its OTN configuration for the 5410 Reconfigurable Switching System. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

**Packet Networking** — principally includes Ciena's 3000 family of service delivery switches and service aggregation switches, the 5000 series of service aggregation switches, and its Ethernet packet configuration for the 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have principally been deployed to support wireless backhaul infrastructures and business data services. Employing sophisticated, carrier-grade Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment also includes stand-alone broadband products that transition voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

**Optical Transport** — includes optical transport solutions that add capacity to core, regional and metro networks and enable cost-effective and efficient transport of voice, video and data traffic at high transmission speeds. Ciena's principal products in this segment include the 4200 Advanced Services Platform, Corestream® Agility Optical Transport System, 5100/5200 Advanced Services Platform, Common Photonic Layer (CPL), and 6100 Multiservice Optical Platform. This segment includes sales from SONET/SDH, transport and data networking products, as well as certain enterprise-oriented transport solutions that support storage and LAN extension, interconnection of data centers, and virtual private networks. This segment also includes operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

•

Software and Services — includes Ciena's network software suite, including the OneControl Unified Management System, an integrated network and service management software designed to automate and simplify network management, operation and service delivery. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network performance. This segment includes the ON-Center® Network & Service Management Suite, Ethernet Services Manger, Optical Suite Release and network level applications. This segment includes a broad range of consulting, network design and support services from Ciena's Network Transformation Solutions offering. This segment also includes installation and deployment, maintenance support and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Condensed Consolidated Statement of Operations.



Table of Contents

Quarter ended April 30, 2012 compared to the quarter ended April 30, 2013

## Revenue

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

	Quarter Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Revenue:						
Converged Packet Optical	\$264,646	55.4	\$294,325	57.9	\$29,679	11.2
Packet Networking	29,922	6.3	54,190	10.7	24,268	81.1
Optical Transport	84,384	17.7	57,371	11.3	(27,013)	(32.0)
Software and Services	98,665	20.6	101,826	20.1	3,161	3.2
Consolidated revenue	\$477,617	100.0	\$507,712	100.0	\$30,095	6.3

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

Converged Packet Optical revenue increased reflecting a \$28.4 million increase in sales of our 5430 reconfigurable switching system and a \$10.4 million increase in sales of our 6500 Packet-Optical Platform, largely driven by service provider demand for high-capacity, optical transport for coherent 40G and 100G network infrastructures. In addition, sales for the OTN configuration for the 5410 Reconfigurable Switching System increased by \$2.7 million. These increases were partially offset by a \$11.8 million decrease in sales of our CoreDirector® Multiservice Optical Switches. The strong performance of this segment, particularly as compared to the expected annual revenue declines in Optical Transport segment revenue, reflects the preference of network operators to adopt next-generation architectures that enable the convergence of high-capacity, coherent optical transport with integrated OTN switching, packet switching and control plane functionality.

Packet Networking revenue increased reflecting a \$24.0 million increase in sales of our 3000 and 5000 families of service delivery and aggregation switches to support wireless backhaul, Ethernet business services and residential broadband applications. Segment revenue benefited from the expansion of Ethernet business services by our North American service provider customers and sales of service delivery and aggregation products in support of their related network initiatives.

Optical Transport revenue decreased reflecting sales decreases of \$13.0 million in our 4200 Advanced Services Platform, \$8.0 million in stand-alone transport products, \$3.4 million of 5100/5200 Advanced Services Platform, \$1.5 million in our 6100 Multiservice Optical Platform and \$1.1 million of CPL. Revenue for our Optical Transport segment, which currently consists principally of stand-alone WDM and SONET/SDH-based transport platforms, has experienced meaningful declines in annual revenue in recent years, reflecting network operators' transition toward next-generation network architectures as described above.

Software and Services revenue increased reflecting sales increases of \$1.6 million in software, \$1.0 million in maintenance and support services, and \$0.6 million in installation and deployment services.

Revenue from sales to customers 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:

	Quarter Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
United States	\$252,668	52.9	\$287,572	56.6	\$34,904	13.8
International	224,949	47.1	220,140	43.4	(4,809)	(2.1)
Total	\$477,617	100.0	\$507,712	100.0	\$30,095	6.3



Table of Contents

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

United States revenue reflects increases of \$28.3 million in Packet Networking sales, \$11.0 million in Converged Packet Optical sales and \$1.3 million in Software and Services revenue. These increases were partially offset by a \$5.7 million decrease in Optical Transport sales.

International revenue reflects decreases of \$21.3 million in Optical Transport sales and \$4.0 million in Packet Networking sales. These decreases were offset by increases of \$18.7 million in Converged Packet Optical sales and \$1.8 million in Software and Services revenue.

A sizable portion of our revenue continues to come from sales to a small number of service providers. As a result, our financial results are significantly affected by and can fluctuate depending upon spending levels and the business opportunities and challenges encountered by our service provider customers. Some of our customers have indicated a procurement strategy to reduce the number of vendors from which they purchase equipment, which could further affect our concentration of revenue where we participate in these efforts. For the second quarter of fiscal 2013, two customers accounted for greater than 10% of revenue and represented 31.3% of total revenue. This compares to two customers that accounted for 26.9% of total revenue in the second quarter of fiscal 2012.

#### Cost of Goods Sold and Gross Profit

Product cost of goods sold consists primarily of amounts paid to third-party contract manufacturers, component costs, employee-related 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 employee-related costs, associated with our provision of services including installation, deployment, maintenance support, consulting and training activities and when applicable, estimated losses on committed customer contracts.

Our gross profit as a percentage of revenue, or "gross margin," is susceptible to fluctuations due to a number of factors. In any given period, gross margin can vary significantly depending upon the mix and concentration of revenue by segment, product line within a particular segment, geography, and customers. Gross margin can also be affected by our concentration of lower margin "commons" equipment sales and higher margin channel cards, the mix of lower margin installation services within our service revenue, our introduction of new products, and changes in expense for excess and obsolete inventory and warranty obligations. We expect that gross margins will be subject to fluctuation based on our level of success in driving product cost reductions, rationalizing our supply chain and consolidating third party contract manufacturers and distribution sites as part of our effort to optimize our operations. Gross margin can also be adversely affected by the level of pricing pressure and competition that we encounter in the market. In an effort to retain or secure customers, enter new markets or capture market share, we may agree to pricing or other unfavorable commercial terms that result in lower or negative gross margins on a particular order or group of orders. These market dynamics and factors may adversely affect our gross margins and results of operations in certain periods.

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.

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

Quarter Ended April 30,

Increase

Edgar Filing: CIENA CORP - Form 10-Q

	2012	%*	2013	%*	(decrease)	%**
Total revenue	\$477,617	100.0	\$507,712	100.0	\$30,095	6.3
Total cost of goods sold	294,676	61.7	298,199	58.7	3,523	1.2
Gross profit	\$182,941	38.3	\$209,513	41.3	\$26,572	14.5

---

\* Denotes % of total revenue

34

---

Table of Contents

\*\* Denotes % change from 2012 to 2013

	Quarter Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Product revenue	\$384,726	100.0	\$413,217	100.0	\$28,491	7.4
Product cost of goods sold	234,372	60.9	239,441	57.9	5,069	2.2
Product gross profit	\$150,354	39.1	\$173,776	42.1	\$23,422	15.6

\* Denotes % of product revenue

\*\* Denotes % change from 2012 to 2013

	Quarter Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Service revenue	\$92,891	100.0	\$94,495	100.0	\$1,604	1.7
Service cost of goods sold	60,304	64.9	58,758	62.2	(1,546)	(2.6)
Service gross profit	\$32,587	35.1	\$35,737	37.8	\$3,150	9.7

\* Denotes % of services revenue

\*\* Denotes % change from 2012 to 2013

Gross profit as a percentage of revenue increased as a result of the factors described below.

Gross profit on products as a percentage of product revenue increased primarily due to improved mix of higher-margin packet platforms with software content, including within our Packet Networking and Converged Packet Optical segments, higher sales of integrated network service management software, lower warranty costs, and greater leverage from efforts to streamline and optimize our supply chain activities.

Gross profit on services as a percentage of services revenue increased primarily due to improved margins on installation and deployment services revenue due to improved operational efficiencies.

#### Operating Expense

Operating expense consists of the component elements described below.

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

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.

Restructuring costs primarily reflect actions Ciena has taken to better align its workforce, facilities and operating costs with perceived market opportunities, business strategies and changes in market and business conditions.

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

35

---

Table of Contents

	Quarter Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Research and development	\$90,399	18.9	\$100,787	19.9	\$10,388	11.5
Selling and marketing	62,517	13.1	74,475	14.6	11,958	19.1
General and administrative	26,670	5.6	30,883	6.1	4,213	15.8
Amortization of intangible assets	12,967	2.7	12,439	2.4	(528)	(4.1)
Restructuring costs	1,851	0.4	1,509	0.3	(342)	(18.5)
Total operating expenses	\$194,404	40.7	\$220,093	43.3	\$25,689	13.2

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

Research and development expense benefited from \$1.6 million as a result of foreign exchange rates, primarily due to strengthening of the U.S. dollar in relation to the Canadian dollar. The \$10.4 million increase consisted of a \$5.6 million increase in prototypes, a \$4.9 million increase in employee compensation and related costs, and a \$1.9 million increase in facilities and information systems expense. These increases were partially offset by a \$2.2 million decrease in professional services. Our prioritization of expense reflects the research and development strategy described above and our focused transition from traditional optical transport platforms toward converged packet networking platforms that promote our OP<sup>n</sup> Architecture vision.

Selling and marketing expense increased by \$12.0 million, primarily reflecting increases of \$7.7 million in employee compensation and related costs, \$2.2 million in facilities and information systems expense, \$1.1 million in travel and related expense and \$1.1 million in trade show and demonstration equipment expense.

General and administrative expense increased by \$4.2 million reflecting an increase in employee compensation and related costs.

Amortization of intangible assets decreased slightly due to certain intangible assets having reached the end of their economic lives.

Restructuring costs primarily reflect certain severance and related expense associated with headcount reductions and initiatives to improve efficiency. In an effort to manage operating expense and execute on our strategy to drive additional operating leverage from our business, we have undertaken a number of restructuring activities intended to better align our workforce and operating costs with market opportunities and product development strategies. During the second quarter of fiscal 2013, we reorganized certain supply chain and administrative activities primarily in the APAC region. Restructuring costs for the second quarter of fiscal 2013 also reflect costs associated with the initiative previously announced in the first quarter of fiscal 2013 to consolidate and reallocate certain engineering resources. As we look to manage operating expense and drive further efficiency and leverage from our operations, we will continue to assess allocation of headcount, facilities and other resources to ensure that they are optimized toward key growth opportunities.

#### Other items

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

	Quarter Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Interest and other income (loss), net	\$(4,387)	(0.9)	\$(2,716)	(0.5)	\$1,671	(38.1)
Interest expense	\$9,646	2.0	\$11,392	2.2	\$1,746	18.1
Provision for income taxes	\$2,284	0.5	\$2,391	0.5	\$107	4.7

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

Interest and other income (loss), net increased, reflecting a \$3.9 million non-cash gain related to the change in fair value of the embedded redemption feature associated with our 2015 Notes. This was partially offset by a \$2.2 million





Table of Contents

loss in foreign exchange rates on assets and liabilities denominated in a currency other than the relevant functional currency.

Interest expense increased reflecting increases of \$1.0 million relating to our convertible note exchange transactions during the first quarter of fiscal 2013 as described in Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report, and \$0.7 million in expense relating to our asset-backed loan facility entered into during the fourth quarter of fiscal 2012.

Provision for income taxes remained relatively unchanged.

Six months ended April 30, 2012 compared to the six months ended April 30, 2013

## Revenue

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

	Six Months Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Revenue:						
Converged Packet Optical	\$466,690	52.2	\$534,285	55.6	\$67,595	14.5
Packet Networking	51,423	5.8	100,027	10.4	48,604	94.5
Optical Transport	192,040	21.5	114,968	12.0	(77,072)	(40.1)
Software and Services	184,149	20.5	211,525	22.0	27,376	14.9
Consolidated revenue	\$894,302	100.0	\$960,805	100.0	\$66,503	7.4

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

Converged Packet Optical revenue increased reflecting a \$57.7 million increase in sales of our 6500 Packet-Optical Platform, largely driven by service provider demand for high-capacity, optical transport for coherent 40G and 100G network infrastructures. In addition, sales of our 5430 reconfigurable switching system and the OTN configuration for the 5410 Reconfigurable Switching System increased by \$33.9 million and \$7.9 million respectively. These increases were partially offset by a \$31.9 million decrease in sales of our CoreDirector® Multiservice Optical Switches. The strong performance of this segment, particularly as compared to the expected annual revenue declines in Optical Transport segment revenue, reflects the preference of network operators to adopt next-generation architectures that enable the convergence of high-capacity, coherent optical transport with integrated OTN switching and control plane functionality.

Packet Networking revenue increased reflecting increases of \$42.0 million in sales of our 3000 and 5000 families of service delivery and aggregation switches and a \$7.0 million increase in sales of our 5410 Service Aggregation Switch to support wireless backhaul, Ethernet business services and residential broadband applications. Segment revenue benefited from the expansion of Ethernet business services by our North American service provider customers and sales of service delivery and aggregation products in support of their related network initiatives.

Optical Transport revenue decreased reflecting sales decreases of \$30.7 million in our 4200 Advanced Services Platform, \$20.0 million in stand-alone transport products, \$15.9 million of 5100/5200 Advanced Services Platform, \$6.0 million of CPL and \$4.5 million in our 6100 Multiservice Optical Platform. Revenue for our Optical Transport segment, which currently consists principally of stand-alone WDM and SONET/SDH-based transport platforms, has experienced meaningful declines in annual revenue in recent years, reflecting network operators' transition toward next-generation network architectures as described above.

Software and Services revenue increased reflecting increases of \$11.0 million in installation and deployment, \$8.8 million in software sales, \$4.5 million in network transformation consulting and \$3.1 million in maintenance and support services revenue.

Revenue from sales to customers 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:

37

---

Table of Contents

	Six Months Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
United States	\$485,746	54.3	\$551,807	57.4	\$66,061	13.6
International	408,556	45.7	408,998	42.6	442	0.1
Total	\$894,302	100.0	\$960,805	100.0	\$66,503	7.4

---

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

United States revenue reflects increases of \$50.9 million in Packet Networking sales, \$20.8 million in Converged Packet Optical sales and \$12.9 million in Software and Services revenue. These increases were partially offset by an \$18.5 million decrease in Optical Transport sales.

International revenue reflects increases of \$46.8 million in Converged Packet Optical sales and \$14.5 million in Software and Services revenue. These increases were offset by a \$58.6 million decrease in Optical Transport sales and a \$2.3 million decrease in Packet Networking sales.

#### Cost of Goods Sold and Gross Profit

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

	Six Months Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Total revenue	\$894,302	100.0	\$960,805	100.0	\$66,503	7.4
Total cost of goods sold	543,605	60.8	555,497	57.8	11,892	2.2
Gross profit	\$350,697	39.2	\$405,308	42.2	\$54,611	15.6

---

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

	Six Months Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Product revenue	\$718,399	100.0	\$766,274	100.0	\$47,875	6.7
Product cost of goods sold	432,124	60.2	435,962	56.9	3,838	0.9
Product gross profit	\$286,275	39.8	\$330,312	43.1	\$44,037	15.4

---

\* Denotes % of product revenue

\*\* Denotes % change from 2012 to 2013

	Six Months Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Service revenue	\$175,903	100.0	\$194,531	100.0	\$18,628	10.6
Service cost of goods sold	111,481	63.4	119,535	61.4	8,054	7.2
Service gross profit	\$64,422	36.6	\$74,996	38.6	\$10,574	16.4

---

\* Denotes % of services revenue

\*\* Denotes % change from 2012 to 2013

Gross profit as a percentage of revenue increased as a result of the factors described below.



Table of Contents

Gross profit on products as a percentage of product revenue increased primarily due to improved mix of higher-margin packet platforms with software content, including within our Packet Networking and Converged Packet Optical segments, higher sales of integrated network service management software, lower warranty costs, lower excess and obsolete inventory charges and greater leverage from efforts to streamline and optimize our supply chain activities.

Gross profit on services as a percentage of services revenue increased primarily due to improved margins on installation and deployment services due to improved operational efficiencies, and increased consulting service revenue, from our Network Transformation Solutions offering.

## Operating Expense

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

	Six Months Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Research and development	\$180,063	20.1	\$189,912	19.8	\$9,849	5.5
Selling and marketing	126,928	14.2	141,063	14.7	14,135	11.1
General and administrative	56,334	6.3	59,091	6.2	2,757	4.9
Amortization of intangible assets	26,438	3.0	24,892	2.6	(1,546)	(5.8)
Restructuring costs	3,573	0.4	6,539	0.7	2,966	83.0
Total operating expenses	\$393,336	44.0	\$421,497	44.0	\$28,161	7.2

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

Research and development expense increased \$9.8 million primarily reflecting increases of \$6.7 million in prototype expense, \$5.2 million in employee compensation and related costs and \$3.0 million in facilities and information systems expense. These increases were partially offset by a \$5.3 million decrease in professional services.

Selling and marketing expense increased \$14.1 million primarily reflecting increases of \$5.7 million in employee compensation and related costs, \$3.9 million in facilities and information systems expense, \$2.6 million of travel and related costs and \$1.1 million in trade show and demonstration equipment expense.

General and administrative expense increased by \$2.8 million in employee compensation and related costs.

Amortization of intangible assets decreased slightly due to certain intangible assets having reached the end of their economic lives.

Restructuring costs primarily reflect certain severance and related expense associated with headcount reductions and initiatives to improve efficiency. During the first quarter of fiscal 2013, we announced an initiative to achieve greater research and engineering efficiencies by consolidating and reallocating certain engineering resources to ensure alignment with development priorities. These activities resulted in a headcount reduction affecting approximately 85 employees, principally in our global products group in North America. We believe these actions will facilitate synergies across our engineering teams and further clarify the mandate of each our remaining research and development centers. In addition, we implemented a headcount reduction of a small number of sales and services resources in EMEA in order to free up investment capacity and reallocate global resources to better support our evolving go-to-market sales coverage model described above. In the second quarter of fiscal 2013, we reorganized certain supply chain and administrative activities primarily in the APAC region. During fiscal 2013, we have incurred approximately \$6.5 million in restructuring costs, including expense related to the actions above. As we look to manage operating expense and drive further efficiency and leverage from our operations, we will continue to assess allocation of headcount, facilities and other resources to ensure that they are optimized toward key growth opportunities.

Other items

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

39

---

Table of Contents

	Six Months Ended April 30,				Increase	
	2012	%*	2013	%*	(decrease)	%**
Interest and other income (loss), net	\$(9,274 )	(1.0 )	\$(2,853 )	(0.3 )	\$6,421	(69.2 )
Interest expense	\$19,216	2.1	\$22,124	2.3	\$2,908	15.1
Loss on extinguishment of debt	\$—	0.0	\$28,630	3.0	\$28,630	—
Provision for income taxes	\$4,304	0.5	\$4,607	0.5	\$303	7.0

\* Denotes % of total revenue

\*\* Denotes % change from 2012 to 2013

Interest and other income (loss), net increased reflecting a \$5.2 million non-cash gain related to the change in fair value of the embedded redemption feature associated with our 2015 Notes. Interest and other income (loss), net also benefited from a \$1.0 million improvement in foreign exchange rates on assets and liabilities denominated in a currency other than the relevant functional currency.

Interest expense increased reflecting increases of \$1.6 million relating to our convertible note exchange transactions during the first quarter of fiscal 2013 as described in Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report, and \$1.3 million in expense relating to our asset backed loan facility entered into during the fourth quarter of fiscal 2012.

Loss on extinguishment of debt reflects a non-cash loss of \$28.6 million relating to the exchange transactions described in "Overview" above during the first quarter of fiscal 2013. Upon issuance, the 2020 Notes were recorded at a fair value of \$213.6 million. The exchange transactions resulted in the retirement of outstanding 2015 Notes with a carrying value of \$187.9 million and the write-off of unamortized debt issuance costs of \$2.3 million and \$0.6 million relating to the redemption feature on the 2015 Notes accounted for as a separate embedded derivative.

Provision for income taxes remained relatively unchanged.

### Segment Profit (Loss)

The table below (in thousands, except percentage data) sets forth the changes in our segment profit (loss) for the respective periods:

	Quarter Ended April 30,			
	2012	2013	Increase (decrease)	%*
Segment profit (loss):				
Converged Packet Optical	\$45,200	\$57,528	\$12,328	27.3
Packet Networking	\$(3,114 )	\$2,556	\$5,670	n/a
Optical Transport	\$29,150	\$21,413	\$(7,737 )	(26.5 )
Software and Services	\$21,306	\$27,229	\$5,923	27.8

\* Denotes % change from 2012 to 2013

Converged Packet Optical segment profit increased primarily due to increased sales volume and improved gross margin partially offset by increased research and development costs.

Packet Networking segment profit improvement was primarily due to increased sales volume and improved gross margin, partially offset by increased research and development costs.

Optical Transport segment profit decreased primarily due to reduced sales volume, partially offset by improved gross margin and lower research and development costs.

Software and Services segment profit increased primarily due to increased sales volume and improved gross margin.





Table of Contents

	Six Months Ended April			
	2012	2013	Increase (decrease)	%*
Segment profit (loss):				
Converged Packet Optical	\$75,488	\$104,646	\$29,158	38.6
Packet Networking	\$(7,402)	\$7,639	\$15,041	n/a
Optical Transport	\$63,181	\$42,000	\$(21,181)	(33.5)
Software and Services	\$39,367	\$61,111	\$21,744	55.2

\* Denotes % change from 2012 to 2013

Converged Packet Optical segment profit increased primarily due to increased sales volume and improved gross margin, partially offset by increased research and development costs.

Packet Networking segment profit improvement was due to increased sales volume and improved gross margin, partially offset by increased research and development costs.

Optical Transport segment profit decreased primarily due to reduced sales volume, partially offset by improved gross margin and lower research and development costs.

Software and Services segment profit increased primarily due to increased sales volume and improved gross margin.

#### Liquidity and Capital Resources

At April 30, 2013, our principal sources of liquidity were cash and cash equivalents and short-term investments in marketable debt securities, representing U.S. treasuries. The following table summarizes our cash and cash equivalents and short-term and long-term investments (in thousands):

	October 31, 2012	April 30, 2013	Increase (decrease)
Cash and cash equivalents	\$642,444	\$356,498	\$(285,946)
Short-term investments in marketable debt securities	50,057	99,973	49,916
Total cash and cash equivalents and investments in marketable debt securities	\$692,501	\$456,471	\$(236,030)

The change in total cash and cash equivalents and investments in marketable debt securities during the first six months of fiscal 2013 was primarily related to the following:

\$0.9 million cash used from operations, consisting of \$62.0 million provided by net losses (adjusted for non-cash charges) and \$62.9 million used in working capital;

\$21.5 million used for purchases of equipment, furniture, fixtures and intellectual property, partially offset by \$1.7 million transferred from restricted cash due to a decrease in the amount of collateral required to support our standby letters of credit;

\$216.2 million used to pay our 0.25% convertible senior notes at maturity;

\$3.7 million used for transaction costs for the private exchange offers relating to our 2015 Notes completed during the first quarter of fiscal 2013 as described in "Overview" above;

\$1.4 million used relating to payment of capital lease obligations; and

\$6.0 million from stock issuances under our employee stock purchase plan.

As described above, on December 27, 2012, we issued \$187.5 million in aggregate principal amount of new 2020 Notes in separate, private transactions with holders in exchange for the retirement of \$187.5 million in aggregate

principal amount of our outstanding 2015 Notes. For a summary of the exchange transactions and the material terms of the 2020 Notes see "Overview" above and Note 13 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report. Following these private exchange offer transactions, \$187.5 million in aggregate principal amount of the 2015 Notes remained

Table of Contents

outstanding with terms unchanged. We believe that the extension of maturity enabled by these exchange transactions has strengthened our balance sheet and provided enhanced financial flexibility.

We regularly evaluate our liquidity position, debt obligations, and anticipated cash needs to fund our operating plans and may consider capital raising and other market opportunities that may be available to us. Based on past performance and current expectations, we believe that our cash, cash equivalents and investments will satisfy our working capital needs, capital expenditures and other liquidity requirements associated with our operations through at least the next 12 months.

The following sections set forth the components of our \$0.9 million of cash used by operating activities during the first six months of fiscal 2013:

Net loss (adjusted for non-cash charges)

The following table sets forth (in thousands) our net loss (adjusted for non-cash charges) during the period:

	Six months ended April 30, 2013
Net loss	\$(74,403 )
Adjustments for non-cash charges:	
Loss on extinguishment of debt	28,630
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	28,857
Share-based compensation costs	18,147
Amortization of intangible assets	35,661
Provision for inventory excess and obsolescence	9,027
Provision for warranty	11,060
Other	5,068
Net losses (adjusted for non-cash charges)	\$62,047

### Working Capital

#### Accounts Receivable, Net

The accounts receivable increase during the first six months of fiscal 2013, net of \$1.0 million in provision for doubtful accounts, was \$76.5 million. This increase was primarily due to increased revenues. Our days sales outstanding (DSOs) remained relatively unchanged from 80 days for the first six months of fiscal 2012 to 79 days for the first six months of fiscal 2013.

The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2012 through the end of the second quarter of fiscal 2013:

	October 31, 2012	April 30, 2013	Increase (decrease)
Accounts receivable, net	\$345,496	\$421,014	\$75,518

#### Inventory

Cash generated by inventory during the first six months of fiscal 2013 was \$3.0 million. Our inventory turns remained relatively unchanged from 3.6 turns during the first six months of fiscal 2012 to 3.5 turns during the first six months of fiscal 2013. During the first six months of fiscal 2013 the net change in inventory was \$12.0 million which reflects a \$9.0 million non-cash provision taken for excess and obsolescence. The following table sets forth (in thousands) changes to the components of our inventory from the end of fiscal 2012 through the end of the second quarter of fiscal 2013:



Table of Contents

	October 31, 2012	April 30, 2013	Increase (decrease)
Raw materials	\$39,678	\$49,933	\$10,255
Work-in-process	10,736	9,749	(987 )
Finished goods	178,210	145,051	(33,159 )
Deferred cost of goods sold	71,484	84,159	12,675
Gross inventory	300,108	288,892	(11,216 )
Provision for inventory excess and obsolescence	(40,010 )	(40,796 )	(786 )
Inventory	\$260,098	\$248,096	\$(12,002 )

## Prepaid expense and other

The increase in prepaid expense and other during the first six months of fiscal 2013 was \$34.0 million and primarily related to increases in prepaid value added tax, maintenance spares, product demonstration units and deferred deployment expense.

## Accounts payable, accruals and other obligations

Cash generated by accounts payable, accruals and other obligations during the first six months of fiscal 2013 was \$24.8 million. Changes in accrued liabilities reflect a \$11.1 million non-cash provision related to warranties. Changes in accounts payable reflect a decrease of \$2.2 million for investing activities related to equipment purchases.

The following table sets forth (in thousands) changes in our accounts payable, accruals and other obligations from the end of fiscal 2012 through the end of the second quarter of fiscal 2013:

	October 31, 2012	April 30, 2013	Increase (decrease)
Accounts payable	\$179,704	\$198,820	\$19,116
Accrued liabilities	209,540	222,783	13,243
Other long-term obligations	31,779	32,989	1,210
Accounts payable, accruals and other obligations	\$421,023	\$454,592	\$33,569

## Interest Paid on Convertible Notes and Credit Facility

The final interest payment due on our 0.25% convertible senior notes was paid on May 1, 2013. We paid \$0.3 million of interest on these convertible notes during the first six months of fiscal 2013. The remaining principal amount outstanding on these notes was paid at maturity during the second quarter of fiscal 2013 and these notes are no longer outstanding.

Interest on our outstanding 4.0% convertible senior notes, due March 15, 2015, is payable on March 15 and September 15 of each year. Upon completion of the debt exchange described above, we paid \$2.1 million in accrued interest on these notes with respect to the portion exchanged. We paid \$3.8 million of interest on these convertible notes during the first six months of fiscal 2013.

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 these convertible notes during the first six months of fiscal 2013.

Interest on our outstanding 3.75% convertible senior notes, due October 15, 2018, is payable on April 15 and October 15 of each year. We paid \$6.6 million in interest on these convertible notes during the first six months of fiscal 2013.

Interest on our outstanding 4.0% convertible senior notes, due December 15, 2020, is payable on June 15 and December 15 of each year.

During the fourth quarter of fiscal 2012, Ciena utilized the Credit Facility to collateralize certain standby letters of credit. We paid \$0.8 million in commitment fees, interest expense and other administrative charges relating to the Credit Facility during the first six months of fiscal 2013.

Table of Contents

## Deferred revenue

Deferred revenue increased by \$19.8 million during the first six months of fiscal 2013. 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 2012 through the first six months of fiscal 2013:

	October 31, 2012	April 30, 2013	Increase (decrease)
Products	\$29,279	\$38,659	\$9,380
Services	77,797	88,216	10,419
Total deferred revenue	\$107,076	\$126,875	\$19,799

Table of Contents

## Asset-Backed Credit Facility

During fiscal 2012, Ciena entered into a \$150.0 million senior secured asset-based revolving credit facility (the “Credit Facility”). The Credit Facility matures on August 13, 2015, provided that it will mature early on December 15, 2014, if any of Ciena's 4.0% senior convertible notes due March 15, 2015 are then outstanding. Ciena principally expects to use the Credit Facility to support the issuance of letters of credit that arise in the ordinary course of its business and thereby to reduce its use of cash required to collateralize these instruments. As of April 30, 2013, letters of credit totaling \$48.1 million were collateralized by the Credit Facility. There were no borrowings outstanding under the Credit Facility as of April 30, 2013.

## Contractual Obligations

During the first quarter of fiscal 2013, we completed the debt exchange transactions described above and issued new 4.0% convertible senior notes, due December 15, 2020. The following is a summary of our future minimum payments under contractual obligations as of April 30, 2013 (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Principal due at maturity on convertible notes (1)	\$1,254,627	\$—	\$187,500	\$500,000	\$567,127
Interest due on convertible notes	166,619	32,243	57,500	47,813	29,063
Operating leases (2)	130,119	31,041	43,487	12,806	42,785
Purchase obligations (3)	107,066	107,066	—	—	—
Capital leases	6,495	3,529	2,966	—	—
Other obligations	1,882	955	927	—	—
Total (4)	\$1,666,808	\$174,834	\$292,380	\$560,619	\$638,975

(1) Includes the accretion of the principal amount on the 2020 Notes payable at maturity at a rate of 1.85% per year compounded semi-annually, commencing December 27, 2012.

(2) Does not include variable insurance, taxes, maintenance and other costs required by the applicable operating lease. These costs are not expected to have a material future impact.

Purchase obligations relate to purchase order commitments to our contract manufacturers and component suppliers (3) 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.

As of April 30, 2013, we also had approximately \$12.3 million of other long-term obligations in our Condensed (4) Consolidated Balance Sheet for unrecognized tax positions that are not included in this table because the timing or amount of any cash settlement with the respective tax authority cannot be reasonably estimated.

Some of our commercial commitments, including some of the future minimum payments in operating leases set forth above and certain commitments to customers, are secured by standby letters of credit collateralized under our Credit Facility or restricted cash. Restricted cash balances are included in other current assets or other long-term assets depending upon the duration of the underlying letter of credit obligation. The following is a summary, as of April 30, 2013, of our commitments secured by standby letters of credit by expiration date (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Standby letters of credit	\$50,805	\$42,161	\$6,375	\$1,950	\$319



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

45

---

## Table of Contents

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 share-based compensation, bad debts, inventories, intangible and other long-lived assets, 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.

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 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 or services rendered. 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. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are to be performed.

We apply the percentage of completion method to long-term arrangements where we are required to undertake significant production, customizations or modification engineering, and reasonable and reliable estimates of revenue and cost are available. Utilizing the percentage of completion method, we recognize revenue based on the ratio of actual costs incurred to date to total estimated costs expected to be incurred. In instances that do not meet the percentage of completion method criteria, recognition of revenue is deferred until there are no uncertainties regarding customer acceptance.

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 criteria of the software is specified by the customer, revenue is deferred until there are no uncertainties regarding customer acceptance.

We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or refund privileges.

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each delivered element, with revenue recognized when the revenue recognition criteria are met for each delivered element. Ciena determines the selling price for each deliverable based upon the selling price hierarchy for multiple-deliverable arrangements. Under this hierarchy, Ciena uses vendor-specific objective evidence ("VSOE") of selling price, if it exists, or third party evidence ("TPE") of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, Ciena uses its best estimate of selling price ("BESP") for that deliverable.

VSOE is established based on Ciena's standard pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, which exists across certain of Ciena's service offerings, Ciena requires that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range. Ciena has been unable to establish TPE of selling price because its go-to-market strategy differs from that of others in its markets, and the extent of customization and differentiated features and functions varies among comparable products or services from its peers. Ciena determines BSP based upon management-approved pricing guidelines, which consider multiple factors including the type of product or service, gross margin objectives, competitive and market conditions, and the go-to-market strategy; all of which can affect pricing practices.

Our total deferred revenue for products was \$29.3 million and \$38.7 million as of October 31, 2012 and April 30, 2013, 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 \$77.8 million and \$88.2 million as of October 31, 2012 and April 30, 2013, respectively.

Table of Contents

## Share-Based Compensation

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 16 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 April 30, 2013, total unrecognized compensation expense was \$67.3 million: (i) \$0.1 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 0.3 years; and (ii) \$67.2 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.5 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 "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.

## Incentive Compensation Expense

We provide incentive-based compensation opportunities to employees through cash incentive awards and, as described in "Share-Based Compensation" above, performance-based equity awards. The expense associated with these awards is reflected as a component of employee-related expense within our operating expense and costs of goods sold, as applicable.

For fiscal 2013, the Compensation Committee has approved an annual cash incentive arrangement generally applicable to full-time employees excluding commissioned salespersons, with the aggregate amount of any awards payable dependent upon the achievement of certain financial and operational goals for fiscal 2013. Given that the

awards are generally contingent upon achieving annual objectives, the payment of cash incentive awards is not expected to be made until after fiscal year-end results are finalized. As a result, the expense that we accrue for incentive compensation in any interim period in fiscal 2013 is based upon estimates of expected financial results for the year and expected performance against relevant operating objectives. Because assessing actual performance against many of these objectives cannot generally occur until at or near fiscal year-end, determining the amount of expense that we incur in our interim financial statements for incentive compensation involves management judgment. Amounts accrued are subject to change in future interim periods if actual future financial results or operational performance are higher or lower than expected. We incurred an aggregate of \$20.4 million of expense in the first six months of fiscal 2013 associated with our cash incentive bonus plan for fiscal 2013.

Reserve for Inventory Obsolescence

## Table of Contents

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. 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 our strategic direction, discontinuance of a product and declines in market conditions. We recorded charges for excess and obsolete inventory of \$14.0 million and \$9.0 million in the first six months of fiscal 2012 and 2013, respectively. The charges in fiscal 2013 primarily related to engineering design changes and the discontinuance of certain parts and components used in the manufacture of our Optical Transport and Converged Packet Optical products. Our inventory net of allowance for excess and obsolescence was \$260.1 million and \$248.1 million as of October 31, 2012 and April 30, 2013, respectively.

### 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 \$345.5 million and \$421.0 million as of October 31, 2012 and April 30, 2013, respectively. Our allowance for doubtful accounts was \$1.5 million and \$1.6 million as of October 31, 2012 and April 30, 2013, respectively.

### Long-lived Assets

Our long-lived assets include: equipment, furniture and fixtures, finite-lived intangible assets and maintenance spares. As of October 31, 2012 and April 30, 2013 these assets totaled \$438.3 million and \$403.6 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 assigned to asset groups which represents the lowest level for which we identify cash flows.

### Deferred Tax Valuation Allowance

As of April 30, 2013, we have recorded a valuation allowance offsetting nearly all our net deferred tax assets of \$1.5 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.

#### Warranty

Our liability for product warranties, included in other accrued liabilities, was \$55.1 million and \$54.7 million as of October 31, 2012 and April 30, 2013, 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

## Table of Contents

estimated based primarily upon historical trends and the cost to support the customer cases within the warranty period. The provision for product warranties was \$16.6 million and \$11.1 million for the first six months of fiscal 2012 and 2013, respectively.

### 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 currently hold investments in U.S. Government obligations that mature within the next twelve months. See Notes 4 and 5 to our Condensed Consolidated Financial Statements for information relating to investments and fair value. These investments are sensitive to interest rate movements and their fair value will decline as interest rates rise and increase as interest rates decline. The estimated impact on these investments of a 100 basis point (1.0%) increase in interest rates across the yield curve from rates in effect as of the balance sheet date would be a \$0.4 million decline in value.

**Foreign Currency Exchange Risk.** As a global concern, our business and results of operations are exposed to movements in foreign currency exchange rates. Due to our global presence, some of our revenue is non-U.S. dollar denominated with Canadian Dollars and Euros being our most significant foreign currency revenue streams. If the U.S. dollar strengthens against these currencies, our revenues reported in U.S. dollars would decline. For our U.S. dollar denominated sales, an increase in the value of the U.S. dollar would increase the real cost to our customers of our products in markets outside the United States, which could impact our competitive position.

With regard to operating expense, our primary exposure to foreign currency exchange risk relates to operating expense incurred in Canadian Dollars, British Pounds, Euros and Indian Rupees. During the first six months of fiscal 2013, approximately 48.4% of our operating expense was non-U.S. dollar denominated. If these currencies strengthen, costs reported in U.S. dollars will increase. During the first six months of fiscal 2013, research and development expense benefited from approximately \$0.5 million, net of hedging, due to the strengthening of the U.S. dollar in relation to the Canadian Dollar in comparison to the first six months of fiscal 2012. Selling and marketing expense benefited from \$0.6 million due to foreign exchange rates, primarily due to the strengthening of the U.S. dollar in relation to the Euro and the Indian Rupee, in comparison to the first six months of fiscal 2012.

From time to time, Ciena uses foreign currency forward contracts to reduce variability in certain forecasted non U.S.-dollar denominated cash flows. Generally, these derivatives have maturities of twelve months or less and are designated as cash flow hedges. At the inception of the cash flow hedge, and on an ongoing basis, Ciena assesses whether the forward contract has been effective in offsetting changes in cash flows attributable to the hedged risk during the hedging period. The effective portion of the derivative's net gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and, upon the occurrence of the forecasted transaction, is subsequently reclassified to the line item in the Condensed Consolidated Statement of Operations 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. From time to time Ciena may also use foreign currency forwards to hedge certain balance sheet exposures. These forwards are not designated as hedges for accounting purposes and any net gain or loss associated with these derivatives is reported in interest and other income, net. See Note 12 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

**Convertible Notes Outstanding.** The fair market value of each of our outstanding issues of convertible notes is subject to interest rate and market price risk due to the convertible feature of the notes and other factors. Generally the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. The fair market value of the notes may also increase as the market price of our stock rises and decrease as the market price of the stock falls. Interest rate and market value changes affect the fair market value of the notes, and may affect the



prices at which we would be able to repurchase such notes were we to do so. These changes do not impact our financial position, cash flows or results of operations. For additional information on the fair value of our outstanding notes, see Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

#### Item 4. Controls and Procedures

##### Disclosure Controls and Procedures

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

## Table of Contents

this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

### Changes in Internal Control over Financial Reporting

There was no change in our 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, our internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. Legal Proceedings

On July 29, 2011, Cheetah Omni LLC filed a complaint in the United States District Court for the Eastern District of Texas against Ciena and several other defendants, alleging, among other things, that certain of the parties' products infringe upon multiple U.S. relating to certain reconfigurable optical add-drop multiplexer (ROADM) technologies. The complaint seeks injunctive relief and damages. On November 8, 2011, Ciena filed an answer and counterclaims to Cheetah Omni's amended complaint. A Markman hearing was held in February 2013 and, on April 11, 2013, the district court issued an opinion and order construing or electing not to construe the disputed claim terms of the patents-in-suit. On the same date, the district court denied defendants' motion for summary judgment of indefiniteness with respect to the claims of two patents. In March 2013, the plaintiff filed a motion for leave to amend its infringement contentions against Ciena to add additional infringing products, to which we filed an opposition. In May 2013, following the claim construction order, the plaintiff withdrew several claims on some of the patents but retained certain other claims on each of the remaining patents. The parties continue to engage in discovery. Trial is currently scheduled for March 2014. Ciena believes that it has valid defenses to the lawsuit and intends to continue to defend it vigorously.

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 seeks injunctive relief and damages. In July 2009, upon request of Ciena and certain other defendants, the U.S. Patent and Trademark Office ("PTO") granted the defendants' inter partes application for reexamination with respect to certain claims of the '673 Patent, and the district court granted the defendants' motion to stay the case pending reexamination of all of the patents-in-suit. In December 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims of the '673 Patent, to which Ciena and other defendants filed an appeal. On March 16, 2012, the PTO on appeal rejected multiple claims of the '673 Patent, including the two claims on which Ciena is alleged to infringe. Subsequently, the plaintiff requested a reopening of the prosecution of the '673 Patent, which request was denied by the PTO on April 29, 2013. Thereafter, on May 28, 2013, the plaintiff filed an amendment with the PTO in which it canceled the claims of the '673 Patent on which Ciena is alleged to infringe. The case currently remains stayed, and there can be no assurance as to whether or when the stay will be lifted.

In addition to the matters described above, we are subject to various legal proceedings and claims arising in the ordinary course of business, including claims against third parties that may involve contractual indemnification obligations on the part of Ciena. 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

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 revenue and operating results can fluctuate significantly and unpredictably from quarter to quarter.

Our revenue and results of operations can fluctuate significantly and 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 can take time to implement. Uncertainty or lack of visibility into customer spending, and changes in economic or market conditions that affect customer spending can make it difficult to forecast future revenue and margins. In addition, increases in the percentage of a given quarter's revenue generated from orders placed during that quarter, along with significant order volume late that quarter, could further result in variability and less predictability in our quarterly revenue and cash flow. Consequently, our level of operating expense or inventory may be high relative to revenue, which could harm our profitability and cash flow. Additional factors that contribute to fluctuations in our revenue and operating results include:

## Table of Contents

broader macroeconomic conditions, including weakness and volatility in global markets, affecting our customers;  
changes in capital spending by large communications service providers;  
order flow and backlog levels;  
the timing of our ability to recognize revenue on sales;  
the mix of revenue by product segment, geography and customer in any particular quarter;  
the level of competition and pricing pressure we encounter;  
seasonal effects in our business;  
the level of start-up costs we incur to support initial deployments, gain new customers or enter new markets; and  
our level of success in improving manufacturing efficiencies and achieving cost reductions in our supply chain.

Quarterly fluctuations from these and other factors may cause our results of operations to fall short of or significantly exceed the expectations of securities analysts or investors, which may cause volatility in our stock price.

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

We face a competitive market for sales of communications networking equipment, software and services and this level of competition could result in pricing pressure, reduced demand, lower gross margins and loss of market share that could harm our business and results of operations. Competition is particularly intense as we and our competitors aggressively seek to displace incumbent equipment vendors at large service providers and secure new customers. In an effort to secure customer opportunities and capture market share, we have in the past, and may in the future, agree to commercial terms or pricing that result in low or negative gross margins on a particular order or group of orders. We expect this level of competition to continue, as multinational equipment vendors seek to obtain new business or retain incumbent positions with large customers around the world. We expect our competitive landscape to broaden, and competition to potentially increase, as network technologies, features and layers converge and our business thereby begins to overlap more directly with additional networking supplier competitors, including IP router vendors and information technology and software vendors.

Competition in our markets, generally, is based on any one or a combination of the following factors: product features; functionality and performance; price; services offerings; manufacturing capability and lead-times; incumbency and existing business relationships; scalability and flexibility of products to meet the immediate and future network and service requirements of network operators. A small number of very large companies have historically dominated our industry, many of which have substantially greater financial and marketing resources, broader product offerings and more established relationships with service providers and other customer segments than we do. In addition, a number of these vendors are putting forth competing visions for how next-generation network architectures should be designed. Because of their scale and resources, they may be perceived to be a better fit for the procurement, or network operating and management, strategies of large service providers. 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. If competitive pressures increase or we fail to compete successfully in our markets, our business and results of operations could suffer.

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

Our business and operating results could be materially adversely affected by reduced customer spending in response to unfavorable or uncertain macroeconomic and market conditions, globally or with respect to a particular region where we operate. Broad macroeconomic weakness and market volatility have previously resulted in sustained periods of decreased demand for our products and services that have adversely affected our operating results. Macroeconomic and market conditions could be adversely affected by a variety of political, economic or other factors in the U.S. and elsewhere that could adversely affect spending levels, including the effect of the U.S. governmental budget discussions and the impact of any sequestration or cessation of government operations, as well as volatility or

deteriorating conditions in the markets in which we operate, including continuing challenges in Europe. Continuation of or an increase in macroeconomic uncertainty or weakness could result in:

- reductions in customer spending and delay, deferral or cancellation of network infrastructure initiatives;
- increased competition for fewer network projects and sales opportunities;
- increased pricing pressure that may adversely affect revenue, gross margin and profitability;
- difficulty forecasting, budgeting and planning;
- higher overhead costs as a percentage of revenue;
- tightening of credit markets to fund capital expenditures by our customers and us;

Table of Contents

customer financial difficulty, including longer collection cycles and difficulties collecting accounts receivable or write-offs of receivables; and  
increased risk of charges relating to excess and obsolete inventories and the write-off of other intangible assets. Reductions in customer spending in response to unfavorable or uncertain macroeconomic and market conditions, globally or with respect to a particular region where we operate, would adversely affect our business and results of operations.

A small number of large communications service providers account for a significant portion of our revenue and 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 few, large global communications service providers. By way of example, AT&T accounted for approximately 13.5% of fiscal 2012 revenue and our largest ten customers contributed 54.2% of fiscal 2012 revenue. Consequently, our financial results are closely correlated with the spending of a relatively small number of service provider customers and can be significantly affected by market or industry changes that affect their businesses. These factors can include consumer and enterprise spending on communication services, macroeconomic volatility, the adoption of new communications products and services, the emergence of competing network operators and changing demands of end user customers. Because the terms of our frame contracts generally do not include any minimum purchase commitment and spending by these service providers can be unpredictable and sporadic, our revenue and operating results can fluctuate on a quarterly basis. Reliance upon a relatively small number of service providers 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 the number of vendors from which they purchase equipment, which may benefit our larger competitors. Our concentration in revenue has increased in the past as a result of consolidation among a number of our largest customers. Consolidation 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 of our large service provider customers, a significant reduction in their spending, or market or industry factors adversely affecting service providers generally, would have a material adverse effect on our business, financial condition and results of operations.

Our reliance upon third party component suppliers, including sole and limited source suppliers, exposes our business to additional risk and could limit our sales, increase our costs and harm our customer relationships.

We maintain a global sourcing strategy and depend on third party suppliers for our product components and subsystems. Our products include key optical and electronic components for which reliable, high-volume supply is often available only from sole or limited sources. Increases in market demand or scarcity of resources or manufacturing capability have previously resulted in shortages in availability of important components for our solutions, allocation challenges and increased lead times. We are exposed to risks relating to unfavorable economic conditions or other similar challenges affecting the businesses of our component providers that can affect their liquidity levels, ability to continue to invest in their business, and manufacturing capability. This could expose our business to increased costs, lack of supply or discontinuation of components that can result in lost revenue, additional product costs, increased lead times and deployment delays that could harm our business and customer relationships. We do not have any guarantee of supply from these third parties, and in certain cases are relying upon temporary or transitional commercial arrangements. As a result, there is no assurance that we will be able 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 that we locate an alternate source or redesign our products, each of which could increase our costs and negatively affect our product gross margin and results of operations. Our business and results of operations would be negatively affected if we were to experience any significant disruption or difficulties with key suppliers affecting the price, quality, availability or timely delivery of

required components.

Investment of research and development resources in communications networking 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 product technologies. Our current development efforts are focused upon enhancing our software applications, extending our OneConnect control plane across the 5400 and 6500 platform families, expanding packet applications on service delivery switches, aggregation switches, and coherent optical transport platforms, extending our WaveLogic chipset, enabling 40G and 100G coherent optical transport across our portfolio, and introducing 400G transmission products. There is often a lengthy period between commencing these development initiatives and bringing a new or improved products to market. During

52

---

Table of Contents

this time, technology preferences, customer demand and the market for our products, or those introduced by our competitors, may move in directions we had not anticipated. There is no guarantee that our 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 significant expenditures on acquisitions, research and development costs, 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 sought by our customers, or addressing growth markets or emerging customer segments or applications beyond our traditional customer base. 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.

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 and manufacturing these solutions. Our current development efforts are focused upon enhancing our software applications, extending our OneConnect control plane across the 5400 and 6500 platform families, expanding packet applications on service delivery switches, aggregation switches, and coherent optical transport platforms, extending our WaveLogic chipset for 40G and 100G coherent optical transport across our portfolio, and introducing 400G transmission products. Delays in these and other product development efforts may affect our reputation with customers, affect our ability to seize market opportunities and impact the timing and level of demand for our products. Each step in the development life cycle of our products presents serious risks of failure, rework or delay, any one of which could adversely affect the cost-effective and timely development of our products. We may encounter delays relating to engineering development activities and software, design, sourcing and manufacture of critical components, and the development of prototypes. In addition, intellectual property disputes, failure of critical design elements, and other execution risks may delay or even prevent the release of these products. If we do not successfully develop products in a timely manner, our competitive position may suffer and our business, financial condition and results of operations could be harmed.

Product performance problems and undetected errors affecting the performance, reliability or security of our products could damage our business reputation and negatively affect our results of operations.

The development and production of sophisticated hardware and software for 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, undetected defects or errors, and product quality, interoperability, reliability and performance problems are often more acute for initial deployments of new products and product enhancements. We are in the process of launching a number of new platforms across our product segments.

Unanticipated product performance problems can relate to the design, manufacturing and installation of our products. Undetected errors can also arise as a result of defects in components, software or manufacturing, installation or maintenance services supplied by third parties, and technology acquired from or licensed by third parties.

Unanticipated security vulnerabilities relating to our products or the activities of our supply chain, including any actual or perceived exposure of our solutions to malicious software or cyber-attacks, would adversely affect our business and reputation. Product performance, reliability, security and quality problems can negatively affect our business, including:

- damage to our reputation, declining sales and order cancellations;
- increased costs to remediate defects or replace products;
- payment of liquidated damages, contractual or similar penalties, or other claims for performance failures or delays;
-



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

• increased inventory obsolescence;

• costs and claims that may not be covered by liability insurance coverage or recoverable from third parties; and

• delays in recognizing revenue or collecting accounts receivable.

These and other consequences relating to undetected errors affecting the quality, reliability and security of our products 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 commercial terms or conditions that negatively affect pricing, risk allocation, payment and the timing of revenue recognition.

Table of Contents

A significant portion of our revenue comes from sales to large communications service providers. These sales typically involve lengthy sales cycles, extensive product testing, and demonstration laboratory or network certification, including network-specific or region-specific product certification or homologation processes. These sales also often involve protracted and sometimes difficult contract negotiations in which we may deem it necessary to agree to unfavorable contractual or commercial terms that adversely affect pricing, expose us to penalties for delays or non-performance, and require us to assume a disproportionate amount of risk. We may also be requested to provide deferred payment terms, vendor or third-party financing, or offer other alternative purchase structures that extend the timing of payment and revenue recognition. Moreover, our purchase agreements generally do not include minimum purchase commitments, and customers often have the right to modify, delay, reduce or cancel previous orders. These terms may negatively affect our revenue and results of operations and increase our susceptibility to quarterly fluctuations in our financial results. Moreover, service providers may insist upon terms and conditions that we deem too onerous or not in our best interest, and we may be unable to reach a commercial agreement. As a result, we may incur substantial expense and devote time and resources to potential sales opportunities that never materialize or result in lower than anticipated sales.

Efforts by us or our strategic third party channel partners to sell our solutions into targeted geographic markets and customer segments may be unsuccessful.

We continue to take steps, including sales initiatives and strategic channel relationships, to sell our products into new markets, growth geographies and diverse customer segments beyond our traditional service provider customer base. Specifically, we are targeting opportunities in Brazil, the Middle East, Russia, Japan and India. We are also targeting sales opportunities with enterprises, wireless operators, cable operators, submarine network operators, Internet content providers, cloud infrastructure providers, research and education institutions, and federal, state and local governments. We believe sales to these customer segments, as well as emerging network operators supporting new communications services and applications, will be an important component of our growth strategy. In many cases, we have less experience in these markets and customer segments, and they may have less familiarity with our company. To succeed in some of these geographic markets and customer segments we have engaged or intend to leverage strategic sales channels and distribution arrangements and expect these relationships to be an important part of our business. Our efforts may be unsuccessful, and difficulties selling into these target markets, including through third party channels, could limit our growth and harm our results of operations.

The international scale of our operations exposes us to additional risk and expense that could adversely affect our results of operations.

We market, sell and service our products globally and rely upon a global supply chain for sourcing important components and manufacturing of our products. Our international operations are subject to inherent risks, including:

- the impact of economic conditions in countries outside the United States;
- effects of changes in currency exchange rates;
- greater difficulty in collecting accounts receivable and longer collection periods;
- difficulty and cost of staffing and managing foreign operations;
- 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 or unethical business practices that could expose us to liability or damage our reputation;
- trade protection measures, export compliance, domestic preference procurement requirements, qualification to transact business and additional regulatory requirements; and
- natural disasters, epidemics and acts of war or terrorism.

We expect that we may enter new international markets and withdraw from or reduce operations in others. Our global operations expose us to additional risk and expense that could give rise to unanticipated liabilities, costs or other

difficulties that could adversely affect our operations and financial results.

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

To avoid delays and meet customer demand for shorter delivery terms, we place orders with our contract manufacturers and component suppliers based in part on forecasts of customer demand. As a result, our business is exposed to the risk that our customers ultimately may not order the products we have forecast, or will purchase fewer products than forecast. As features and functionalities converge across our product lines, and we introduce new products with overlapping feature sets, it is

Table of Contents

increasingly possible that customers may forgo purchases of one product we have inventoried in favor of another product with similar functionality. Market uncertainty can also limit our visibility into customer spending plans and compound the difficulty of forecasting inventory at appropriate levels. Moreover, our customer purchase agreements generally do not include any minimum purchase commitment, and customers often have the right to modify, reduce or cancel purchase quantities. We may also be exposed to the risk of inventory write offs as a result of certain supply chain initiatives, including consolidation and transfer of key manufacturing activities. As a result, we may purchase inventory in anticipation of sales that ultimately do not occur. 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. Our intellectual property rights may be difficult and costly to enforce.

We generally rely on a combination of patents, copyrights, trademarks and trade secret laws to establish and maintain proprietary rights in our products and technology. Although we have been issued numerous patents and other patent applications are currently pending, there can be no assurance that any of these patents or other proprietary rights will not be challenged, invalidated or circumvented or that our rights will provide us with any competitive advantage. In addition, there can be no assurance that patents will be issued from pending applications or that claims allowed on any patents will be sufficiently broad to protect our technology. Further, the laws of some foreign countries may not protect our proprietary rights to the same extent as do the laws of the United States.

We are subject to the risk that third parties may attempt to access, divert or use our intellectual property without authorization. Protecting against the unauthorized use of our products, technology and other proprietary rights is difficult, time-consuming and expensive, and we cannot be certain that the steps that we are taking will prevent or minimize the risks of such unauthorized use. Litigation may be necessary to enforce or defend our intellectual property rights or to determine the validity or scope of the proprietary rights of others. Such litigation could result in substantial cost and diversion of management time and resources, and there can be no assurance that we will obtain a successful result. Any inability to protect and enforce our intellectual property rights, despite our efforts, could harm our ability to compete effectively.

We may incur significant costs in response to claims by others that we infringe their intellectual property rights. From time to time third parties may assert claims or initiate litigation or other proceedings related to patent, copyright, trademark and other intellectual property rights to technologies and related standards that are relevant to our business. The rate of infringement assertions by patent assertion entities is increasing, particularly in the United States. Generally, these patent owners neither manufacture nor use the patented invention directly, and simply seek to derive value from their ownership through royalties from patent licensing programs.

We can be adversely affected by litigation, other proceedings or claims against us, as well as claims against our manufacturers, suppliers or customers, alleging infringement of third party proprietary rights by our products and technology, or components of those products. Regardless of the merit of these claims, they can be time-consuming, divert the time and attention of our technical and management personnel, and result in costly litigation. These claims, if successful, can require us to:

- pay substantial damages or royalties;
- comply with an injunction or other court order that could prevent us from offering certain of our products;
- seek a license for the use of certain intellectual property, which may not be available on commercially reasonable terms or at all;
- develop non-infringing technology, which could require significant effort and expense and ultimately may not be successful; and
- indemnify our customers or other third parties pursuant to contractual obligations to hold them harmless or pay expenses or damages on their behalf.

Any of these events could adversely affect our business, results of operations and financial condition. Our exposure to risks associated with the use of intellectual property may be increased as a result of acquisitions, as we have a lower level of visibility into the development process with respect to such technology or the steps taken to safeguard against the risks of infringing the rights of third parties.

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 installation, maintenance and support functions. In addition, as network operators seek to increasingly rely on vendors to perform additional services relating to the design, construction and

## Table of Contents

operation of their networks, the scope of work performed by our support partners is likely to increase and may include areas where we have less experience providing or managing such services. We must successfully identify, assess, train and certify qualified service partners in order to ensure the proper installation, deployment and maintenance of our products, and the skillful performance of other services associated with expanded solutions offerings, including site assessment and construction related services. Vetting and certification of these partners can be costly and time-consuming, and certain partners may not have the same operational history, financial resource and scale as Ciena. Moreover, certain partners may 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 or that we will be able to maintain the continuity of their services. We may also be exposed to a number of risks or challenges relating to the performance of our service partners, including:

- we may suffer delays in recognizing revenue;
- we may be exposed to liability for injuries to persons, damage to property or other claims relating to the actions or omissions of our support partners;
- our services revenue and gross margin may be adversely affected; and
- our relationships with customers could suffer.

If we do not manage effectively our relationships with third party service partners, or if they fail to perform these services in the manner or time required, our financial results and relationships with customers could be adversely affected.

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 supply partners that permit us to distribute their products or technology. We may rely upon these relationships to add complementary products or technologies, diversify our product portfolio, or address a particular customer or geographic market. We may enter into additional original equipment manufacturer (OEM), resale or similar strategic arrangements in the future, including in support of our selection as a domain supply partner with AT&T. 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 the business, financial condition, intellectual property rights and supply chain continuity of such partners, as well as 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, including potential liability to customers, greater than the commitments, if any, made to us by our technology partners. Some of our strategic supply 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 these risks 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 and resale channel partners, we may have difficulty collecting receivables and our business and results of operations could be exposed to risks associated with uncollectible accounts. Lack of liquidity in the capital markets, macroeconomic weakness and market volatility may increase our exposure to these credit risks. Our attempts to monitor these situations carefully and take appropriate measures to protect ourselves may not be sufficient, and it is possible that we may have to write down or write off accounts receivable. 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.

Our business is dependent upon the proper functioning of our internal business processes and information systems and modification or interruption of such systems may disrupt our business, processes and internal controls.

We rely upon a number of internal business processes and information systems to support key business functions and the efficient operation of these processes and systems is critical to our business. Our business processes and information systems need to be sufficiently scalable to support the growth of our business and may require modifications or upgrades that expose us to a number of operational risks. We are currently pursuing initiatives to transform and optimize our business operations through the reengineering of certain processes, investment in automation and engagement of strategic partners or resources to assist with certain business functions. These changes may be costly and disruptive to our operations, and could impose substantial demands on management time.

## Table of Contents

These changes may also require changes in our information systems, modification of internal control procedures and significant training of employees or third party resources. There can be no assurance that our business and operations will not experience any disruption in connection with this transition. Our information technology systems, and those of third party information technology providers or business partners, may also be vulnerable to damage or disruption caused by circumstances beyond our control including catastrophic events, power anomalies or outages, natural disasters, viruses or malware, and computer system or network failures. We may also be exposed to cyber-security related incidents including unauthorized access of information systems and disclosure or diversion of intellectual property or confidential data. There can be no assurance that our business systems or those of our third party business partners would not be subject to similar incidents, exposing us to significant cost, reputational harm and disruption or damage to our business.

Data breaches and cyber-attacks could compromise our intellectual property or other sensitive information and cause significant damage to our business and reputation.

In the ordinary course of our business, we maintain sensitive data on our networks, including our intellectual property and proprietary or confidential business information relating to our business and that of our customers and business partners. The secure maintenance of this information is critical to our business and reputation. We believe that companies in the technology industry have been increasingly subject to a wide variety of security incidents, cyber-attacks and other attempts to gain unauthorized access. Our network and storage applications may be subject to unauthorized access by hackers or breached due to operator error, malfeasance or other system disruptions. In some cases, it is difficult to anticipate or immediately detect such incidents and the damage caused thereby. These data breaches and any unauthorized access or disclosure of our information, could compromise our intellectual property and expose sensitive business information. Cyber-attacks could also cause us to incur significant remediation costs, disrupt key business operations and divert attention of management and key information technology resources. These incidents could also subject us to liability, expose us to significant expense, and cause significant harm to our reputation and business.

Outstanding indebtedness under our convertible notes may adversely affect our liquidity and results of operations and could limit our business.

At April 30, 2013, indebtedness on our outstanding convertible notes totaled approximately \$1.2 billion in aggregate principal, including the accretion of principal at maturity on our 2020 Notes. Our indebtedness could have important negative consequences, including:

- increasing our vulnerability to adverse economic and industry conditions;
- limiting our ability to obtain additional financing, particularly in unfavorable capital and credit market conditions;
- incurrence of debt service and repayment obligations that reduce the availability of cash resources for other business purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business and the markets; and
- placing us at a possible competitive disadvantage to competitors that have better access to capital resources.

During fiscal 2012, we entered into a \$150 million senior secured asset-based revolving Credit Facility. In addition to customary remedies that would apply should we default under the credit agreement governing this facility, we may be subject to lender control over certain cash assets and required to comply with a fixed charge coverage ratio in the event that we do not maintain the requisite level of availability under the facility. The credit agreement also contains customary covenants that limit our ability to, among other things, pay cash dividends, incur debt, create liens and encumbrances, redeem or repurchase stock, enter into certain acquisition transactions, repay indebtedness, make investments or dispose of assets. The Credit Facility matures on August 13, 2015, provided that it will mature early on December 15, 2014, if any of Ciena's 4.0% convertible senior notes due March 15, 2015 are then outstanding. We



may also enter into additional transactions or lending facilities, including equipment loans, working capital lines of credit and other long-term debt, that may increase our indebtedness and result in additional restrictions upon our business.

Significant volatility and uncertainty in the capital markets may limit our access to funding.

We have accessed the capital markets in the past and successfully raised funds, through the issuance of equity or convertible debt, to increase our cash position, support our operations and undertake strategic growth initiatives, including the acquisition of the MEN Business. We regularly evaluate our liquidity position, debt obligations, and anticipated cash needs to fund our long-term operating plans and may consider it necessary or advisable to raise additional capital in the future. Global capital markets have undergone a sustained period of significant volatility and uncertainty, and there can be no assurance that such financing alternatives would be available to us, should we determine it necessary or advisable to seek additional cash resources.

Table of Contents

Facilities transitions could be disruptive to our operations and may result in unanticipated expense and adversely affect our cash position and cash flows.

We have recently undertaken and expect to undertake a number of significant facilities transitions affecting a number of our largest employee populations, including our headquarters facility. In addition, the lease of our “Lab 10” building on the Carling Campus in Ottawa, Canada will expire in fiscal 2016 and the lease for our research and development facility in Gurgaon, India will expire in fiscal 2014. Both locations include sophisticated research and development lab equipment and key engineering personnel. We are currently considering facilities and development alternatives in advance of the expiration of these leases. However, locating appropriate alternative space for our engineering operations may be costly and there can be no assurance that the transition of key engineering functions to a successor facility will not be disruptive or adversely affect productivity. Significant facilities transitions could be disruptive to our operations and may result in unanticipated expense and adversely affect our cash position and cash flows.

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, improve efficiencies, or realign our organization and staffing to better match our market opportunities and our technology development initiatives. We may take similar steps in the future as we seek to realize operating synergies, optimize our operations to achieve our target operating model and profitability objectives, or better reflect changes in the strategic direction of our business. These changes could be disruptive to our business, including development efforts, and may result in significant expense including accounting charges for inventory and technology-related write-offs, workforce reduction costs and charges relating to consolidation of excess facilities. Substantial expense or charges resulting from restructuring activities could adversely affect our results of operations and use of cash in those period in which we undertake such actions.

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, engineering and other personnel with experience in our industry is intense, and our employees have been the subject of targeted hiring by our competitors. 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. The loss of members of our management team or other key personnel could be disruptive to our business, and, were it necessary, it could be difficult to replace members of our management team or other key personnel. In addition, none of our executive officers is bound by an employment agreement for any specific term. If we are unable to attract and retain qualified personnel, we may be unable to manage our business effectively, and our operations and results of operations could suffer.

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

As a global concern, we face exposure to adverse movements in foreign currency exchange rates. Historically, our sales were primarily denominated in U.S. dollars. As a result of our increased global presence, a larger percentage of our revenue and operating expense are now non-U.S. dollar denominated and therefore subject to foreign currency fluctuation. We face exposure to currency exchange rates as a result of the growth in our non-U.S. dollar denominated operating expense in Canada, Europe, Asia and Latin America. From time to time, we may hedge against currency exposure associated with anticipated foreign currency cash flows. There can be no assurance that any hedging instruments will be effective, and losses associated with these instruments and the adverse effect of foreign currency

exchange rate fluctuation may negatively affect our results of operations.

Our products incorporate software and other technology under license from third parties and our business would be adversely affected if this technology were 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.

Table of Contents

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

We may acquire or make investments in other technology companies, or enter into other strategic relationships, 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, or incur debt or assume indebtedness. These transactions involve numerous risks, including:

- significant integration costs;
- disruption due to the 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, investments or strategic transactions 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.

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, including service providers and multiservice network operators, are subject to the rules and regulations of these agencies. Changes in regulatory requirements applicable to wireline or wireless communications and the Internet in the United States or other countries could serve as a disincentive to providers to invest in their communications network infrastructures or introduce 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.

Government regulations affecting the use, import or export of products could adversely affect our operations, and negatively affect our revenue and increase our costs.

The United States and various foreign governments have imposed controls, license requirements and other restrictions on the usage, import or export of some of the technologies that we sell. Government regulation of usage, import or export of our products, technology within our products, or our failure to obtain required approvals for our products, could harm our international and domestic sales and adversely affect our revenue 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, costly tariffs on our equipment, restrictions on importation, trade protection measures and domestic preference requirements of certain countries could limit our access to these markets and harm our sales. For example, India's government has implemented security regulations applicable to network equipment vendors, and has imposed significant tariffs that may inhibit sales of certain communications equipment, including equipment manufactured in China, where certain of our products are assembled. These and other regulations could adversely affect the sale or use of our products, substantially increase our cost of sales and could adversely affect our business and revenue.

Government regulations related to the environment and potential climate change could adversely affect our business and operating results.

Our operations are regulated under various federal, state, local and international laws relating to the environment and potential climate change. If we were to violate or become liable under these laws or regulations, we could incur fines, costs related to damage to property or personal injury, and costs related to investigation or remediation activities. 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

## Table of Contents

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 may 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 these impairment charges would adversely affect our operating results.

As of April 30, 2013, our balance sheet includes \$403.6 million in long-lived assets, which includes \$221.5 million of intangible assets. Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products. These assumptions are used to forecast future, undiscounted cash flows upon which our estimates are based. Periods of significant uncertainty or instability of macroeconomic conditions can make forecasting future business difficult. 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 would 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, including certain initiatives to transform business processes, to invest in information systems or to transition certain functions to third party resources or providers, will necessitate modifications to our internal control systems, processes and information systems as we optimize our business and operations. Our increased global operations and expansion into new regions could pose additional challenges to our internal control systems. We cannot be certain that our current design for internal control over financial reporting, or any additional changes to be made, will be sufficient to enable management to determine that our internal controls are effective for any period, or on an ongoing basis. If we are unable to assert that our internal controls over financial reporting are effective, 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.

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 2012, our closing stock price ranged from a high of \$17.98 per share to a low of \$10.38 per share. The stock market has experienced significant price and volume fluctuation that has 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. These and other factors affecting macroeconomic conditions 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. Mine Safety Disclosures

Not applicable.

60

---

Table of Contents

Item 5. Other Information

Not applicable.

61

---



Table of Contents

Item 6. Exhibits

- 10.1 Omnibus Second Amendment to Credit Agreement and First Amendment to U.S. Security Agreement, Canadian Security Agreement, U.S. Pledge Agreement, U.S. Guaranty and Canadian Guaranty, entered into as of March 5, 2013, by and among Ciena Corporation, Ciena Communications, Inc., Ciena Canada, Inc., and Deutsche Bank AG New York Branch (a)
- 10.2 Joinder Agreement under Credit Agreement and Related Agreements as of March 15, 2013 by and between Ciena Government Solutions, Inc. and Deutsche Bank AG New York Branch, as Administrative Agent and as Collateral Agent, for the benefit of the Secured Creditors (a)
- 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
- 101.INS\* XBRL Instance Document
- 101.SCH\* XBRL Taxonomy Extension Schema Document
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

Representations and warranties included in these 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 this report 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.

\* In accordance with Regulation S-T, XBRL (Extensible Business Reporting Language) related information in Exhibit No. (101) to this Quarterly Report on Form 10-Q shall be deemed “furnished” and not “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section, and shall not be incorporated by reference into any registration statement pursuant to the Securities Act of 1933, as amended.

Table of Contents

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: June 12, 2013

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

Date: June 12, 2013

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