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CORVIS CORP
Form 10-Q
August 13, 2002

FORM 10-Q

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 29, 2002

☐ 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 0-12751

Corvis Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

52-2041343
(I.R.S. Employer
Identification No.)

7015 Albert Einstein Drive, Columbia, Maryland 21046-9400
(Address of principal executive offices) (Zip Code)

(443) 259-4000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Number of shares of Common Stock, \$0.01 par value, outstanding at July 31, 2002:
411,482,833.

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PART I - Financial Information

Item 1. Financial Statements.

CORVIS CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

December 29,

2001

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ASSETS

Current assets:

Cash and cash equivalents	\$ 638,872
Short-term investments	21,907
Trade accounts receivable	33,676
Inventory, net	96,426
Other current assets	17,486

Total current assets	808,367
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Restricted cash, long-term	2,417
Property and equipment, net	134,393
Goodwill and other intangible assets, net	21,429
Other long-term assets, net	12,219

Total assets	\$ 978,825
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LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Notes payable, current portion	\$ 126
Capital lease obligations, current portion	6,796
Accounts payable	14,488
Accrued expenses and other liabilities	36,402
Provision for restructuring and other charges	24,050

Total current liabilities	81,862
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Noncurrent liabilities:

Notes payable, net of current portion	2,959
Capital lease obligations, net of current portion	1,743
Deferred lease liability and other	3,408

Total liabilities	89,972
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Commitments and contingencies

Stockholders' equity:

Common stock--\$0.01 par value; 1,900,000,000 shares authorized; 362,687,909 shares issued and outstanding as of December 29, 2001; 411,166,642 shares issued and outstanding as of June 29, 2002	3,621
--	-------

Additional paid-in capital	2,648,955
Shareholder notes receivable	-
Accumulated other comprehensive loss:	
Foreign currency translation adjustment	(10,796)
Accumulated deficit	(1,752,927)

Total stockholders' equity	888,853
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Total liabilities and stockholders' equity	\$ 978,825
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See accompanying notes to unaudited condensed consolidated financial statements.

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CORVIS CORPORATION AND SUBSIDIARIES UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands, except per share amounts)

	Three Months Ended		
	June 30, 2001	June 29, 2002	
Revenue	\$ 64,959	\$ 3,022	\$
Costs of Revenue:			
Product Sales	40,542	2,233	
Inventory write-downs and other charges	99,166	1,738	
Gross profit (loss)	(74,749)	(949)	
Operating expenses:			
Research and development, exclusive of equity-based	41,950	33,085	
Sales and marketing, exclusive of equity-based expense	15,101	13,988	
General and administrative, exclusive of equity-based expense	8,533	11,131	
Equity-based expense:			
Research and development	12,653	6,467	
Sales and marketing	3,632	2,954	
General and administrative	9,154	7,601	
Amortization of intangible assets	49,631	4,258	
Purchased research and development	-	34,580	
Restructuring, impairment and other charges	606,735	1,792	
Total operating expenses	747,389	115,856	
Operating loss	(822,138)	(116,805)	(
Interest income (expense) and other, net	306	(2,305)	
Net loss	\$ (821,832)	\$ (119,110)	\$ (9
Other comprehensive income (loss) -- Foreign currency translation adjustment	(24,402)	3,400	
Comprehensive loss	\$ (846,234)	\$ (115,710)	\$ (1,
Basic and diluted net loss per common share	\$ (2.36)	\$ (0.31)	\$
Weighted average number of common shares outstanding	347,909	383,412	

See accompanying notes to unaudited condensed consolidated financial statements.

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CORVIS CORPORATION AND SUBSIDIARIES UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands)

	Six Months June 30, 2001
Cash flows from operating activities:	
Net loss	\$ (922,661)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	122,768
Equity-based expense	51,072
Purchased research and development	-
Restructuring, impairment and other charges	671,959
Changes in operating assets and liabilities:	
Decrease (increase) in accounts receivable	(51,354)
Decrease (increase) in inventory, net	(23,474)
Decrease (increase) in other assets	(3,740)
Increase (decrease) in accounts payable and accrued expenses	4,437
Net cash used in operating activities	(150,993)
Cash flows from investing activities:	
Purchase of property and equipment	(86,103)
Cash acquired in business combination	-
Purchase of short-term investments	-
Increase in deposits and other non-current assets	(15,150)
Net cash used in investing activities	(101,253)
Cash flows from financing activities:	
Restricted cash	-
Payments on note payable and capital leases	(1,674)
Proceeds from the issuance of stock	3,776
Net cash provided by (used in) financing activities	2,102
Effect of exchange rate changes on cash and cash equivalents	(3,008)
Net decrease in cash and cash equivalents	(253,152)
Cash and cash equivalents--beginning	1,024,758
Cash and cash equivalents--ending	\$ 771,606
Supplemental disclosure of cash flow information:	
Interest paid	\$ 1,001
Supplemental disclosure of noncash activities:	
Obligations under capital lease	\$ 5,699
Purchase business combinations consideration paid with common stock	-

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See accompanying notes to unaudited condensed consolidated financial statements.

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CORVIS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
(Amounts in thousands, except per share data)

(1) Summary of Significant Accounting Policies and Practices

(a) Basis of Presentation

The unaudited condensed consolidated financial statements included herein for Corvis Corporation and subsidiaries (the "Company") have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the consolidated financial statements included in this report reflect all normal recurring adjustments which the Company considers necessary for the fair presentation of the results of operations for the interim periods. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year.

These financial statements should be read in conjunction with the Company's December 29, 2001 audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K filed on March 21, 2002.

(b) Revenue and Costs of Revenue

Revenue from product sales is recognized upon execution of a contract and the completion of all delivery obligations provided that there are no uncertainties regarding customer acceptance and collectibility is deemed probable. If uncertainties exist, revenue is recognized when such uncertainties are resolved.

Revenue from installation services is recognized as the services are performed unless the terms of the supply contract combine product acceptance with installation, in which case revenues for installation services are recognized when the terms of acceptance are satisfied and installation is completed. Revenues from installation service fixed price contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date compared to estimated total costs for each contract. Amounts received in excess of revenue recognized are included as deferred revenue in the accompanying condensed consolidated balance sheets. Revenue from annual maintenance agreements is recognized on a straight-line basis over the service period.

Costs of revenue include the costs of manufacturing the Company's products and other costs associated with warranty and other contractual obligations, inventory obsolescence costs and overhead related to the Company's

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manufacturing, engineering, finishing and installation. Warranty reserves are determined based upon actual warranty cost experience, estimates of component failure rates and management's industry experience.

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CORVIS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
(Amounts in thousands, except per share data)

(c) Uses of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(2) Inventory Write-downs, Restructuring and Other Charges

During 2001 and the first six months of 2002, unfavorable economic conditions resulted in reduced capital expenditures by telecommunications service providers causing a sharp decline in the demand for the Company's products. In response to these conditions, in the second, third and fourth quarters of 2001, the Company implemented restructuring plans designed to decrease the Company's operating expenses and to align resources for long-term growth opportunities. These plans included the closure of the Company's Canadian operations. Additionally, the Company evaluated the recoverability of the carrying value of its inventory and long-lived assets in light of the economic environment, the delay of customer network buildouts and projected sales. As a result, the Company recorded charges of approximately \$1.0 billion in the year ended December 29, 2001. These charges were comprised of \$216.5 million in cost of revenue charges associated with inventory write downs; \$77.7 million associated with consolidation of excess facilities and write-downs of idle equipment and workforce reductions; \$711.5 million associated with the write-down of goodwill generated in the acquisition of Algety Telecom S.A.; and \$12.3 million associated with permanent impairment charges on strategic equity investments carried at cost.

During the six months ended June 29, 2002, the Company continued to develop and implement additional restructuring plans including work force reduction programs that resulted in head count reductions of approximately 180 positions. In addition, the Company continued to evaluate the carrying value of its inventory and long-lived assets. Based on these actions, the Company recorded charges of approximately \$15.2 million in the six months ended June 29, 2002, including \$6.9 million recorded in the three months ended March 30, 2002 and \$8.3 million recorded in the three months ended June 29, 2002, net of \$8.1 million of adjustments to prior restructuring accruals. Adjustments predominantly relate to better than expected resolutions of excess inventory purchase commitments and resolution of contingencies associated with the cost of exiting certain excess facilities.

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CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

Selected information regarding these charges are as follows:

	Cost of Revenue	Restructuring and Other Charges		
	-----	-----	-----	-----
	Special Charges, Inventory Write-downs Contract Total Losses and Purchase Commitments	Workforce Reduction	Facility Consolidation	Restructuring and Other Charges
	-----	-----	-----	-----
Restructuring liability as of December 29, 2001	\$ 15,313	\$ 1,146	\$ 7,591	\$ 8,737
Quarter ended March 30, 2002:				
Restructuring and other charges	4,307	2,599	--	2,599
Non-cash charges	(4,307)	(775)	--	(775)
Cash Payments	(5,002)	(2,034)	(151)	(2,185)
Quarter ended June 29, 2002:				
Restructuring and other charges	6,895	4,232	500	4,732
Non-cash charges	(6,895)	(1,847)	--	(1,847)
Cash payments	(2,396)	(1,394)	(176)	(1,570)
Accretion of interest	--	--	127	127
Adjustments of prior estimates	(5,155)	--	(2,980)	(2,980)
	-----	-----	-----	-----
Restructuring liability as of June 29, 2002	\$ 2,760	\$ 1,927	\$ 4,911	\$ 6,838
	=====	=====	=====	=====

(3) Inventory

Inventories are comprised of the following:

	December 29, 2001	June 29, 2002
	-----	-----
Raw materials	\$ 197,549	\$ 200,922
Work-in-process	17,037	12,348

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Finished goods	52,268	64,641
Less: reserve for excess inventory and obsolescence	(170,428)	(186,776)
Inventory, net	\$ 96,426	\$ 91,135

- (4) Basic and Diluted Net Loss Per Share Basic and diluted net loss per share are computed as follows (in thousands, except per share data):

CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

	Three Months Ended	
	June 30, 2001	June 29, 2002
Net loss	\$ (821,832)	\$ (119,110)
Basic and diluted weighted average common shares	347,909	383,412
Basic and diluted net loss per common share	\$ (2.36)	\$ (0.31)
	Six Months Ended	
	June 30, 2001	June 29, 2002
Net loss	\$ (922,661)	\$ (190,146)
Basic and diluted weighted average common shares	345,172	373,302
Basic and diluted net loss per common share	\$ (2.67)	\$ (0.51)

Options and warrants outstanding as of June 29, 2002 to purchase 54,299 and 7,594 shares of common stock, respectively, and 1,772 unvested shares acquired through the exercise of options were not included in the computation of diluted loss per share for the three and six months ended June 29, 2002 as their inclusion would be anti-dilutive.

Options and warrants outstanding as of June 30, 2001 to purchase 47,975 and 7,635 shares of common stock, respectively, and 10,187 unvested shares acquired through the exercise of options were not included in the computation of diluted loss per share for the three and six months period ended June 30, 2001 as their inclusion would be anti-dilutive.

(5) Dorsal Acquisition

On May 16, 2002, the Company completed its acquisition of Dorsal Networks, Inc., a privately held provider of next-generation transoceanic and regional undersea optical network solutions for 41,809 shares of common stock

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valued at approximately \$91.8 million. The acquisition was accounted for under the "purchase" method of accounting. Under the purchase method, the purchase price of Dorsal was allocated to identifiable assets and liabilities acquired from Dorsal, with the excess being treated as goodwill.

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CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition which is based on an independent valuation.

Current assets	\$ 6,632
Property and equipment	5,506
Other assets	577
Patents	30,799
In-process research and development	34,580
Goodwill	19,089
Total assets acquired	97,183
Current liabilities	(5,365)
Total liabilities assumed	(5,365)
Net assets acquired	\$ 91,818
	=====

Acquired patents will be amortized over an estimated life of five years. Goodwill will have an indefinite life, but will be subject to periodic impairment tests. In process research and development was expensed during the year ended June 29, 2002. Dr. David R. Huber, the Company's Chairman and Chief Executive Officer, owned, directly or indirectly, approximately 31 percent of the outstanding stock of Dorsal.

The following unaudited pro forma data summarizes the results of operations for the period indicated as if the Dorsal acquisition had been completed as of the beginning of the periods presented. The unaudited pro forma data gives effect to actual operating results prior to the acquisition, adjusted to include the pro forma effect of amortization of intangibles. These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the acquisition occurred as of the beginning of the periods presented or that may be obtained in the future.

	Three Months Ended	
	June 30, 2001	June 29, 2002
Revenues	\$ 64,959	\$ 3,022
Net Loss	(834,427)	(132,256)
Basic and diluted net loss per share	\$ (2.40)	\$ (0.34)

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	Six Months Ended	
	June 30, 2001	June 29, 2002
Revenues	\$ 149,046	\$ 11,739
Net Loss	(948,956)	(277,112)
Basic and diluted net loss per share	\$ (2.75)	\$ (0.58)

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CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

(6) Legal Matters

In July 2000, Ciena Corporation ("Ciena") informed the Company of its belief that there is significant correspondence between products that the Company offers and several U.S. patents held by Ciena relating to optical networking systems and related dense wavelength division multiplexing communications systems technologies. On July 19, 2000, Ciena filed a lawsuit in the United States District Court for the District of Delaware alleging that the Company is willfully infringing three of Ciena's patents. Ciena is seeking injunctive relief, monetary damages including treble damages, as well as costs of the lawsuit, including attorneys' fees. On September 8, 2000, the Company filed an answer to the complaint, as well as counter-claims alleging, among other things, invalidity and/or unenforceability of the three patents in question. On March 5, 2001, a motion was granted, allowing Ciena to amend its complaint to include allegations that the Company is willfully infringing two additional patents. The original trial date of April 1, 2002 was postponed by the court and a new trial date has not been set. The litigation is currently in the pre-trial phase, however, and a pre-trial conference originally scheduled for July 30, 2002 has been rescheduled for September 9, 2002. Based on the status of the litigation, the Company cannot reasonably predict the likelihood of any potential outcome.

Between May 7, 2001 and June 15, 2001, nine class action lawsuits were filed in the United States District Court for the Southern District of New York relating to the Company's IPO on behalf of all persons who purchased Company stock between July 28, 2000 and the filing of the complaints. Each of the complaints names as defendants: the Company, its directors and officers who signed the registration statement in connection with the Company's IPO, and certain of the underwriters that participated in the Company's IPO. The complaints allege that the registration statement and prospectus relating to the Company's IPO contained material misrepresentations and/or omissions in that those documents did not disclose (1) that certain of the underwriters had solicited and received undisclosed fees and commissions and other economic benefits from some investors in connection with the distribution of the Company's common stock in the IPO and (2) that certain of the underwriters had entered into arrangements with some investors that were designed to distort and/or inflate the market price for the Company's common stock in the aftermarket following the IPO. The complaints ask the court to award to members

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of the class the right to rescind their purchases of Corvis common stock (or to be awarded rescissory damages if the class member has sold its Corvis stock) and prejudgment and post-judgment interest, reasonable attorneys' and experts witness' fees and other costs.

By order dated October 12, 2001, the court appointed an executive committee of six plaintiffs' law firms to coordinate their claims and function as lead counsel. Lead plaintiffs have been appointed in almost all of the IPO allocation actions including the Corvis action. On October 17, 2001, a group of underwriter defendants moved for the judge's recusal. The judge denied that application. On December 13, 2001, the moving underwriter defendants filed a petition for writ of mandamus seeking the disqualification of the judge in the United States Court of Appeals for the Second Circuit. On April 1, 2002, the Second Circuit denied the moving

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CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

underwriter defendants' application for a writ of mandamus seeking the judge's recusal from this action. On April 19, 2002, plaintiffs filed amended complaints in each of the IPO allocation actions, including the Corvis action. On May 23, 2002, a conference was held at which the court set a briefing schedule for the filing of motions to dismiss the amended complaints. On July 1, 2002, the underwriter defendants filed their motion to dismiss the amended complaints. On July 15, 2002, the issuer defendants filed their motion to dismiss the amended complaints. The briefing on the motions to dismiss is scheduled to be completed by the end of September 2002. No discovery has occurred.

It is the position of Company management that, at this time, it is not possible to estimate the amount of a probable loss, if any, that might result from this matter. Accordingly, no provision for this matter has been made in the Company's consolidated financial statements.

(7) Concentrations

The Company has relied on four customers for all of its revenue: Williams Communications, LLC, Broadwing Communications Services, Inc., Telefonica de Espana S.A.U. and France Telecom. No revenue has been recorded from our fifth customer, Qwest Communications Corporation. The Company expects that a significant portion of its future revenue will continue to be generated by a limited number of customers. The loss of any one of these customers or any substantial reduction in orders by any one of these customers could materially adversely affect the Company's financial condition or operating results.

At June 29, 2002, \$7.7 million, or 48 percent, of the Company's trade accounts receivable are due from Williams Communications, LLC, with the balance due from Broadwing Communications Services, Inc. and France Telecom. Subsequent to June 29, 2002, Williams Communications, LLC paid the Company approximately \$7.4 million of the accounts receivable as it became due. The remaining outstanding amount owed to the Company from Williams Communications, LLC is \$0.3 million. This amount is not yet due and is not subject to any setoff, counter-claim, reduction or right of recoupment of any kind known to the

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Company. At June 29, 2002, all amounts due from Williams Communications, LLC were current and, based on the Company's historical collections from Williams Communications, LLC and all publicly available financial information, the Company has determined that no allowance for uncollectable amounts is necessary at this time.

On April 22, 2002, Williams Communications Group, Inc., the parent holding company of Williams Communications, LLC, entered into an agreement with its principal creditor groups which contained the significant terms of a debt restructuring requiring a negotiated Chapter 11 bankruptcy filing. In order to effect the restructuring, the parent company filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York on April 22, 2002, which was amended on July 30,

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CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

2002. Williams Communications, LLC, the entity which is obligated to the Company, has not filed for bankruptcy and continues to operate outside of bankruptcy.

In addition to the Chapter 11 reorganization plan, Williams Communications Group, Inc. also filed a motion seeking approval of a settlement agreement between various creditors of Williams Communications Group, Inc., which contains the terms of a negotiated restructuring of the finances of Williams Communications Group, Inc. and affiliated companies, including Williams Communications, LLC. The Chapter 11 reorganization plan provides that Williams Communications, LLC will not file a bankruptcy case. As in all court proceedings, the approval and success of Williams Communications Group, Inc.'s Chapter 11 reorganization plan, and the ability of Williams Communications LLC to remain outside of bankruptcy, cannot be guaranteed.

If Williams Communications, LLC files for bankruptcy in the future, the Company cannot be certain when or if the Company will receive the outstanding accounts receivable, and if so, how much will actually be received. In addition, there may be other provisions under bankruptcy laws that would affect the Company's ability to collect any amounts owed and may affect some payments that the Company has already received. Bankruptcy laws may also allow Williams Communications, LLC, under certain circumstances, to reject the Company's purchase agreement. The Company continues to evaluate the need for allowances for accounts receivable and can give no assurances that some or all of these outstanding amounts will not be reserved for in the future.

(8) Recent Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 143 (SFAS 143), "Accounting for Asset Retirement Obligations," in August 2001. SFAS 143 requires companies to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred, and capitalize the cost by increasing the carrying amount of the related long-lived asset. The company is required to adopt SFAS 143 on January 1, 2003. The adoption of this standard did not have a material effect on the company's results of operations.

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The FASB issued SFAS 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" in April 2002. SFAS 145 clarifies guidance related to the reporting of gains and losses from extinguishment of debt and resolves inconsistencies related to the required accounting treatment of certain lease modifications. The provisions of this statement relating to the extinguishment of debt are effective for financial statements issued for fiscal years beginning after May 15, 2002. The provisions of this statement relating to lease modifications are effective for transactions occurring after May 15, 2002. The company does not believe this standard will have a material impact on its results of operations.

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CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

The FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities" in June 2002. SFAS 146 nullifies previous guidance on this issue and requires a liability for a cost associated with an exit or disposal activity to be recognized and measured at its fair value in the period in which the liability is incurred. The company is required to adopt the provisions of this statement for exit or disposal activities initiated after December 31, 2002. The Company is assessing the impact that the adoption of this standard will have on the company's results of operations.

In July 2001, the FASB issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 addresses the accounting for acquisitions of businesses and is effective for acquisitions occurring on or after July 1, 2001. SFAS No. 142 addresses the method of identifying and measuring goodwill and other intangible assets acquired in a business combination, eliminates further amortization of goodwill, provides for classification of workforce intangibles as goodwill and requires periodic evaluations of impairment of goodwill balances. SFAS No. 141 and 142 are effective January 1, 2002, except for acquisitions occurring on or after July 1, 2001, for which the provisions of SFAS No. 141 and 142 are applicable. Accordingly, through December 29, 2001, the Company continued to amortize goodwill.

Had the amortization provisions of SFAS No. 142 been applied as of January 1, 2001, for all of the Company's acquisitions, the Company's income (loss) and earnings (loss) per share would have been as follows:

	Three Mo
	June 30, 2001

Net loss, as reported	\$ 821,832
Goodwill amortization	(49,074)
Workforce in place amortization	(115)

Net loss, as adjusted	\$ 772,643

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Basic and diluted per share data:

Net loss per common share, as reported	\$ (2.36)
Goodwill and workforce in place amortization per common share	0.14

Net loss per common share, as adjusted	\$ (2.22)
	=====

Six Months
June 30, 2001

Net loss, as reported	\$ 922,661
Goodwill amortization	(95,538)
Workforce in place amortization	(223)

Net loss, as adjusted	\$ 826,900
	=====

Basic and diluted per share data:

Net loss per common share, as reported	\$ (2.67)
Goodwill and workforce in place amortization per common share	0.28

Net loss per common share, as adjusted	\$ (2.39)
	=====

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CORVIS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except per share data)

As of January 1, 2002, the Company reclassified approximately \$0.7 million of intangible assets associated with an acquired employee workforce from intangible assets to goodwill, which in accordance with SFAS No. 142, are no longer separately identifiable from goodwill. As of June 29, 2002, the Company had approximately \$69.5 million of intangible assets (\$45.8 million net of accumulated amortization) related to patents and intellectual property, which are being amortized straight-line over a period of three years. The Company has amortization expense of \$1.9 million during the six months ended June 29, 2002

and anticipates amortization expense to be the following for the next five years:

Estimated Amortization Expense:	
For the year ended 12/31/02:	\$18,492
For the year ended 12/31/03:	\$17,771
For the year ended 12/31/04:	\$10,966
For the year ended 12/31/05:	\$4,141
For the year ended 12/31/06:	\$ -

In August 2001, the Financial Accounting Standard Board issued SFAS No.

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144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations, Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of segments of a business (as previously defined in that opinion). The adoption of SFAS No. 144 did not have any effect on the Company's results of operations.

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

You should read the following discussion and analysis along with our unaudited condensed consolidated financial statements and the notes to those statements included elsewhere in this report and in conjunction with our Form 10-K for the year ended December 29, 2001 filed on March 21, 2002 with the Securities and Exchange Commission.

Overview

We design, manufacture and sell high performance all-optical and electrical/optical communications systems that we believe accelerate carrier revenue opportunities and lower the overall cost of network ownership for carriers. Our optical products have enabled a fundamental shift in network design and efficiency by allowing for the transmission, switching and management of communications traffic entirely in the optical domain. By deploying our products, carriers eliminate the need for expensive and bandwidth limiting electrical regeneration and switching equipment, significantly reducing costs, increasing network capacity and allowing them to provide new services more quickly and efficiently. Our products also open new market opportunities for carriers by enabling a flexible, in-service migration path from existing point-to-point and ring electrical/optical networks to all-optical mesh networks.

Customers

We currently have five customers, including Broadwing Communications Services, Inc., Williams Communications, LLC, Qwest Communications Corporation, Telefonica de Espana S.A.U. and France Telecom.

Broadwing has agreed to purchase at least \$200 million of our products and services as part of a multi-year purchase agreement. Since successfully completing field trials in July 2000, Broadwing has deployed a wide range of our optically optimized networking products, including the all-optical switch, to create a national all-optical network that has been in service for over a year. Sales to Broadwing continue as part of network expansions and maintenance. Cumulative sales to Broadwing through June 29, 2002 total \$190.6 million.

In 2001, Williams accepted a field trial system and agreed to purchase up to \$300 million of our products and services as part of a multi-year purchase agreement, approximately \$85 million of which must be purchased prior to December 31, 2003. Williams has deployed our switching and transport equipment

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to create a national all-optical network, which is currently in service carrying commercial traffic. Cumulative sales to Williams through June 29, 2002 total \$75.1 million.

At June 29, 2002, \$7.7 million, or 48 percent, of our trade accounts receivable are due from Williams Communications, LLC, with the balance due from Broadwing and France

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Telecom. Subsequent to June 29, 2002, Williams Communications, LLC paid us approximately \$7.4 million of the accounts receivable as it became due. The remaining outstanding amount owed to us from Williams Communications, LLC is \$0.3 million. This amount is not yet due and is not subject to any setoff, counter-claim, reduction or right of recoupment of any kind known to the Company. At June 29, 2002, all amounts due from Williams Communications, LLC were current and, based on the Company's historical collections from Williams Communications, LLC and all publicly available financial information, the Company has determined that no allowance for uncollectable amounts is necessary at this time.

On April 22, 2002, Williams Communications Group, Inc., the parent holding company of Williams Communications, LLC, entered into an agreement with its principal creditor groups which contained the significant terms of a debt restructuring requiring a negotiated Chapter 11 bankruptcy filing. In order to effect the restructuring, the parent company filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York on April 22, 2002, which was amended on July 30, 2002. Williams Communications LLC, the entity which is obligated to the Company, has not filed for bankruptcy and continues to operate outside of bankruptcy.

In addition to the Chapter 11 reorganization plan, Williams Communications Group, Inc. also filed a motion seeking approval of a settlement agreement between various creditors of Williams Communications Group, Inc., which contains the terms of a negotiated restructuring of the finances of Williams Communications Group, Inc. and affiliated companies, including Williams Communications, LLC. The Chapter 11 reorganization plan provides that Williams Communications, LLC will not file a bankruptcy case. As in all court proceedings, the approval and success of Williams Communications Group, Inc.'s Chapter 11 reorganization plan, and the ability of Williams Communications LLC to remain outside of bankruptcy, cannot be guaranteed.

If Williams Communications, LLC files for bankruptcy in the future, we cannot be certain when or how much we will receive with respect to the outstanding accounts receivable. In addition, there may be other provisions under bankruptcy laws that would affect our ability to collect any amounts owed and may affect some payments that we have already received. Bankruptcy laws may also allow Williams Communications, LLC, under certain circumstances, to reject the purchase agreement. We continue to evaluate the need for allowances for accounts receivable and can give no assurances we will not be required to write-off some or all of these outstanding amounts.

On April 22, 2002, we reached an agreement with Qwest Communications Corporation modifying the terms of our previous purchase agreement. Under the terms of the new agreement, Qwest agreed to purchase up to \$150 million of our

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products and services over a multi-year period, \$7.0 million of which must be purchased in 2002 and \$5.0 million of which must be purchased in 2003. In addition, we have agreed with Qwest to enter into two field trials

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of Corvis ON transport and switching equipment as well as our Corvis Optical Convergence Switch (OCS). The field trials are expected to begin in the second half of 2002.

During the first quarter of 2002, we completed the first sales of our XF repeaterless link product to Telefonica de Espana, which was deployed between the island of Mallorca and Telefonica's backbone network in Spain. In April 2002, we sold a XF repeaterless link to France Telecom to upgrade its link between the European mainland and the island of Corsica. The relationships with Telefonica and France Telecom are in early stages and the agreements do not include significant purchase commitment levels, however, we hope to develop these arrangements into long-term business relationships.

We have also entered into lab trials and agreements and discussions regarding laboratory and field trials with other carriers for our ON, OCS, XF products and transoceanic subsea products. Upon successful completion of these field trials, we hope to enter into agreements for commercial deployment with new customers.

Starting in 2001 and continuing in 2002, conditions within the general economy and the telecommunications sector have resulted in reduced capital expenditures by carriers and a reduced demand for telecommunications networking systems. As a response to these conditions, we implemented restructuring plans designed to decrease our business expenses and to align resources for long-term growth opportunities. Additionally, we evaluated the carrying value of our inventory and long-term assets. As a result of these steps, we recorded charges totaling approximately \$1.0 billion in the second, third and fourth quarters of 2001. These charges were comprised of \$216.5 million in cost of revenue charges associated with inventory write-downs and losses on open purchase commitment cancellations; \$24.5 million associated with workforce reductions; \$53.2 million associated with consolidation of excess facilities and write-downs of idle equipment; \$711.5 million associated with the write-down of goodwill; and \$12.3 million associated with permanent impairment charges on strategic equity investments.

During the first six months of 2002, we implemented additional restructuring plans and continued to evaluate the carrying value of our inventory and long-term assets resulting in charges of \$6.9 million and \$8.3 million in the first and second quarter, respectively, net of adjustments to prior restructuring estimates.

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These charges related to plans that we adopted to reduce head count by approximately 180 positions, and to consolidate office, research and

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manufacturing facilities. In addition, adjustments were made to previously recorded restructuring accruals. Selected financial data related to these charges are as follows:

	Cost of Revenue -----	Restructuring and Other Charges -----		
	Special Charges, Inventory Write-downs, Contract Losses and Purchase Commitments -----	Workforce Reduction -----	Facility Consolidation -----	Total Restructuring and Other Charges -----
Restructuring liability as of December 29, 2001	15,313	1,146	7,591	8,737
Quarter ended March 30, 2002:				
Restructuring and other charges	4,307	2,599	--	2,599
Non-cash charges	(4,307)	(775)	--	(775)
Cash payments	(5,002)	(2,034)	(151)	(2,185)
Quarter ended June 29, 2002:				
Restructuring and other charges	6,895	4,232	500	4,732
Non-cash charges	(6,895)	(1,847)	--	(1,847)
Cash payments	(2,396)	(1,394)	(176)	(1,570)
Accretion of interest	--	--	127	127
Adjustments of prior estimates	(5,155)	--	(2,980)	(2,980)
	-----	-----	-----	-----
Restructuring liability as of June 29, 2002	2,760 =====	1,927 =====	4,911 =====	6,838 =====

In June 2002, we announced that we were developing plans for the reorganization of its French subsidiary, Corvis Algety. Corvis Algety is a division of approximately 200 employees focusing primarily on research and development. We believe that the reorganization could involve the elimination of approximately 170 jobs at the division. French labor laws mandate specific procedures for reorganizations involving staff reductions. The procedures involve presentation of a plan and discussions with appointed worker representatives known as the "workers' committee" and with certain government entities. The workers' committee and authorities learn the reasons for the restructuring, and have an opportunity to provide their input on restructuring plans. To date, we have presented a plan to the workers' committee and are also working with government authorities to ensure compliance with all French labor laws. Upon completion of a definitive restructuring plan, we will record associated charges including charges for severance and benefits to be paid to exiting employees. In addition, the plan may result in the decommissioning of certain fixed assets and facilities. If the plans do include such actions, we

would also record charges for associated asset write-downs. At this time, we cannot estimate the amount of the charge that will be taken. We believe that the plan will be completed and associated charges will be recorded during the second half of 2002.

We continue to monitor our financial position and will make strategic decisions as necessary to position us for long-term success, which may result in additional restructuring charges. This may include such strategic initiatives as the increased use of contract manufacturers. These initiatives could lead to further reductions in our facility and fixed asset needs, resulting in associated asset impairment and write-down charges.

Critical Accounting Policies and Estimates

We have identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of our consolidated financial statements. The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to asset impairment, revenue recognition, product warranty liabilities, allowance for doubtful accounts, and contingencies and litigation. We state these accounting policies in the notes to our 2001 annual consolidated financial statements and at relevant sections in this discussion and analysis. These estimates are based on the information that is currently available to us and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could vary from those estimates under different assumptions or conditions.

We believe that the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue. Revenue from product sales is recognized upon execution of a contract and the completion of all delivery obligations provided that there are no uncertainties regarding customer acceptance and collectibility is deemed probable. If uncertainties exist, revenue is recognized when such uncertainties are resolved. Customer contracts generally include extensive lab and field trial testing and some include other acceptance criteria.

Our products can be installed by our customers, third party service providers or by us. Revenue from installation services is recognized as the services are performed unless the terms of the supply contract combine product acceptance with installation, in which case revenues for installation services are recognized when the terms of acceptance are satisfied and installation is completed. To the extent customer contracts include both product sales and installation services, revenues are recognized based on their respective fair values. Revenues from installation service fixed price contracts are recognized on the percentage-of-completion method, measured by the

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percentage of costs incurred to date compared to estimated total costs for each installation contract. Amounts received in excess of revenue recognized are included as deferred revenue in our condensed consolidated balance sheet. Revenue from annual maintenance agreements is recognized on a straight-line basis over the service period.

Costs of Revenue. Costs of revenue include the costs of manufacturing our products and other costs associated with warranty and other contractual obligations, inventory obsolescence costs and overhead related to our manufacturing, engineering, finishing and installation operations. Warranty reserves are determined based upon actual warranty cost experience, estimates of component failure rates and management's industry experience. Inventory obsolescence costs are estimated using certain assumptions, including projected sales and sales mix. Actual results may differ from those estimates. We continually monitor component failures, technical changes, and levels of on-hand inventory and adjust our estimates accordingly. If, however, actual results vary significantly from our estimates, we will adjust the assumptions utilized in our methodologies and reduce or provide for additional accruals as appropriate.

Allowance for Bad Debt. To date, we have relied on five customers for all of our revenues. We expect that a significant portion of our future revenue will continue to be generated by a limited number of customers. We monitor the financial conditions of these customers closely and have concluded that no allowance for bad debt was appropriate as of June 29, 2002.

Restructuring and Other Charges. Reflecting continued unfavorable economic conditions and continued lack of expected customer wins and product sales, our Board of Directors approved plans for the reduction of operations including the consolidation of facilities, reduction of employees and the discontinuation of certain product lines. In addition, we evaluated the recoverability of the carrying value of our inventory and long-lived assets. As a result, we recorded charges associated with estimated excess inventory and open purchase commitments based on projected sales volumes, facility consolidation costs based on assumed exit costs and time tables, disposal of property and equipment based on estimated salvage values and goodwill impairment charges based on estimated discounted future cash flows. If actual results differ significantly from our estimates and assumptions, we will adjust our reserves and allowances accordingly.

Goodwill and Other Intangible Assets. We have recorded goodwill and intangibles resulting from our acquisitions. Through December 29, 2001, goodwill and intangibles have been amortized on a straight-line basis over their respective lives of between 3 and 5 years. Upon the adoption of SFAS No. 142 on December 30, 2001, we ceased amortizing goodwill and will perform an annual impairment analysis to assess the recoverability of the goodwill, in accordance with the provisions of SFAS No. 142. If we are required to record an impairment charge in the future, it would have an adverse impact on our results of operations.

Litigation. In July 2000, Ciena Corporation ("Ciena") informed us of its belief that there is significant correspondence between products that we offer and several U.S. patents held by Ciena relating to optical networking systems and related dense wavelength division multiplexing communications

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systems technologies. On July 19, 2000, Ciena filed a lawsuit in the United States District Court for the District of Delaware alleging that we are willfully infringing three of Ciena's patents. Ciena is seeking injunctive relief, monetary damages including treble damages, as well as costs of the lawsuit, including attorneys' fees. On September 8, 2000, we filed an answer to the complaint, as well as counter-claims alleging, among other things, invalidity and/or unenforceability of the three patents in question. On March 5, 2001, a motion was granted, allowing Ciena to amend its complaint to include allegations that we are willfully infringing two additional patents. The original trial date of April 1, 2002 was postponed by the court and a new trial date has not been set. The litigation is currently in the pre-trial phase, however, a pre-trial conference originally scheduled for July 30, 2002 has been rescheduled for September 9, 2002.

Between May 7, 2001 and June 15, 2001, nine class action lawsuits were filed in the United States District Court for the Southern District of New York relating to our initial public offering on behalf of all persons who purchased our stock between July 28, 2000 and the filing of the complaints. Each of the complaints names as defendants: Corvis, our directors and officers who signed the registration statement in connection with our initial public offering, and certain of the underwriters that participated in our initial public offering. The complaints allege that the registration statement and prospectus relating to our initial public offering contained material misrepresentations and/or omissions in that those documents did not disclose (1) that certain of the underwriters had solicited and received undisclosed fees and commissions and other economic benefits from some investors in connection with the distribution of our common stock in the initial public offering and (2) that certain of the underwriters had entered into arrangements with some investors that were designed to distort and/or inflate the market price for our common stock in the aftermarket following the initial public offering. The complaints ask the court to award to members of the class the right to rescind their purchases of Corvis common stock (or to be awarded rescissory damages if the class member has sold its Corvis stock) and prejudgment and post-judgment interest, reasonable attorneys' and experts witness' fees and other costs.

By order October 12, 2001, the court appointed an executive committee of six plaintiffs' law firms to coordinate their claims and function as lead counsel. Lead plaintiffs have been appointed in almost all of the IPO allocation actions, including the Corvis action. On October 17, 2001, a group of underwriter defendants moved for the judge's recusal. The judge denied that application. On December 13, 2001, the moving underwriter defendants filed a petition for writ of mandamus seeking the disqualification of the judge in the United States Court of Appeals for the Second Circuit. On April 1, 2002, the Second Circuit denied the moving underwriter defendants' application for a writ of mandamus seeking the judge's recusal from this action. On April 19, 2002, plaintiffs filed amended complaints in each of the IPO allocation actions, including the Corvis action. On May 23, 2002, a conference was held at which the court set a

briefing schedule for the filing of motions to dismiss the amended complaints. On July 1, 2002, the underwriter defendants filed their motion to dismiss the amended complaints. On July 15, 2002, the issuer defendants filed their motion to dismiss the amended complaints. The briefing on the motions to dismiss is scheduled to be completed by the end of September 2002. No discovery has occurred.

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Based on the status of the litigation, we cannot reasonably predict the likelihood of any potential outcome. We continue to monitor the status of the litigation, however we can give no assurances that an unfavorable outcome will not result in future charges.

Results of Operations

Three months ended June 29, 2002 compared to three months ended June 30, 2001

Revenue. Revenue decreased to \$3.0 million for the three months ended June 29, 2002 from \$65.0 million for the three months ended June 30, 2001. Overall, our quarterly revenues have declined from a high of \$84.1 million in the first quarter of 2001 to \$3.0 million for the second quarter of 2002. This decrease in revenue is due to a reduction in capital spending by telecommunications carriers resulting in a sharp decline in demand for telecommunications equipment, including our products. Revenue for the three months ended June 29, 2002 was attributable to three customers. Service revenues, including maintenance, training and support totaled \$1.9 million. We expect revenue for the next quarter to be at or below current levels.

Gross Profit (loss). Costs of revenue consists of component costs, direct compensation costs, warranty and other contractual obligations, inventory obsolescence costs and overhead related to our manufacturing and engineering, finishing and installation operations. In addition, cost of revenue includes charges associated with our restructuring plans and excess inventories.

Gross profit (loss) increased to \$(0.9) million for the three months ended June 29, 2002 from \$(74.8) million for the three months ended June 30, 2001. Negative gross margins are attributable to inventory write-downs of \$1.7 million recorded in the three months ended June 29, 2002 and \$99.2 million recorded in the three months ended June 30, 2001. Excluding inventory write-downs and other charges, gross profit and gross margin were \$0.8 million and 26% for the three months ended June 29, 2002 and \$24.4 million and 38% for the three months ended June 30, 2001. Due to current competitive and economic pressures, we expect that gross margin, excluding inventory write-downs and other charges, may continue to decrease in the coming quarters.

Research and Development, Excluding Equity-Based Expense. Research and development expense, excluding equity-based expense consists primarily of salaries and related personnel costs, test and prototype expenses related to the design of our hardware and software products, laboratory costs and facilities costs. All costs related to product development, both

hardware and software, are recorded as expenses in the period in which they are incurred. Due to the timing and nature of the expenses associated with research and development, significant quarterly fluctuations may result. We believe that research and development is critical to achieving current and future strategic product objectives.

Research and development expenses, excluding equity-based expense decreased to \$33.1 million for the three months ended June 29, 2002 from \$42.0 million for the three months ended June 30, 2001. The decrease in expenses was

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primarily attributable to the effects of cost saving initiatives including staff reductions, facility consolidation and the curtailment of certain discretionary spending.

Sales and Marketing, Excluding Equity-Based Expense. Sales and marketing expense, excluding equity-based expense, consists primarily of salaries and related personnel costs, laboratory trial systems provided to customers, trade shows, other marketing programs and travel expenses.

Sales and marketing expense, excluding equity-based expense, decreased to \$14.0 million for the three months ended June 29, 2002 from \$15.1 million for the three months ended June 30, 2001. The decrease in expenses was primarily attributable to the effects of cost saving initiatives including staff reductions, facility consolidation and the curtailment of certain discretionary spending.

General and Administrative, Excluding Equity-Based Expense. General and administrative expense, excluding equity-based expense, consists primarily of salaries and related personnel costs, information systems support, recruitment expenses and facility demands associated with establishing the proper infrastructure to support our organization. This infrastructure consists of executive, financial, legal, information systems and other administrative responsibilities.

General and administrative expenses, excluding equity-based expense, increased to \$11.1 million for the three months ended June 29, 2002 from \$8.5 million for the three months ended June 30, 2001. The increase in expenses was primarily attributable to increases in professional service fees.

Equity-based Expense. Equity-based expense consists primarily of charges associated with employee options granted at below fair market value prior to our initial public offering.

Equity-based expense related to research and development, sales and marketing and general and administrative functions for the three months ended June 29, 2002 decreased to \$17.0 million from \$25.4 million for the three months ended June 30, 2001. The decrease in equity-based expense resulted from a decrease in employee headcount.

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Amortization of Intangible Assets. Amortization of intangible assets relates to the amortization of certain intangible assets with finite lives. As a result of the issuance of SFAS No. 142, we no longer record amortization of goodwill, rather goodwill will be tested at least annually for impairment. There may be more volatility in reported income (loss) than previous standards because impairment losses are likely to occur irregularly and in varying amounts.

Amortization of intangible assets expenses decreased to \$4.3 million for the three months ended June 29, 2002 from \$49.6 million for the three months ended June 30, 2001. The decrease was primarily attributable to the discontinuation of amortization of goodwill resulting from the acquisition of Algety Telecom S.A. that was being amortized over five years.

Interest Income (Expense), Net. Interest income, net of interest expense, decreased to (\$2.3) million for the three months ended June 29, 2002 from \$0.3 million of net interest income for the three months ended June 30, 2001. The decrease was primarily attributed to the write-down of certain equity

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investments in the three months ended June 30, 2001 totaling \$8.7 million.

Six months ended June 29, 2002 compared to six months ended June 30, 2001

Revenue. Revenue decreased to \$11.7 million for the six months ended June 29, 2002 from \$149.0 million for the six months ended June 30, 2001. This decrease in revenue is due to a reduction in capital spending by telecommunications carriers resulting in a sharp decline in demand for telecommunications equipment, including for our products. Revenue for the six months ended June 29, 2002 was attributable to two customers. Service revenues, including maintenance, training and support totaled \$3.4 million.

Gross Profit (loss). Costs of revenue consists of component costs, direct compensation costs, warranty and other contractual obligations, inventory obsolescence costs and overhead related to our manufacturing and engineering, finishing and installation operations. In addition, cost of revenue includes charges associated with our restructuring plans and excess inventories.

Gross profit (loss) increased to \$(3.0) million for the six months ended June 29, 2002 from \$(43.6) million for the six months ended June 30, 2001. Negative gross margins are primarily attributable to inventory write-downs of \$6.0 million in the six months ended June 29, 2002 and \$99.2 million recorded in the six months ended June 30, 2001. Excluding inventory write-downs and other charges, gross profit and gross margin were \$3.0 million or 26% in the six months ended June 29, 2002 and \$55.6 million or 37% in the six months ended June 30, 2001. Due to current competitive and economic pressures, we expect that gross margin, excluding inventory write-downs and other charges, may continue to decrease in the coming quarters.

Research and Development, Excluding Equity-Based Expense. Research and development expense, excluding equity-based expense, consists primarily of salaries and related

personnel costs, test and prototype expenses related to the design of our hardware and software products, laboratory costs and facilities costs. All costs related to product development, both hardware and software, are recorded as expenses in the period in which they are incurred. Due to the timing and nature of the expenses associated with research and development, significant quarterly fluctuations may result. We believe that research and development is critical to achieving current and future strategic product objectives.

Research and development expenses, excluding equity-based expense, decreased to \$62.1 million for the six months ended June 29, 2002 from \$82.9 million for the six months ended June 30, 2001. The decrease in expenses was primarily attributable to the effects of cost saving initiatives including staff reductions, facility consolidation and the curtailment of certain discretionary spending.

Sales and Marketing, Excluding Equity-Based Expense. Sales and marketing expense, excluding equity-based expense, consists primarily of salaries and related personnel costs, laboratory trial systems provided to customers, trade shows, other marketing programs and travel expenses.

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Sales and marketing expense, excluding equity-based expense, decreased to \$25.2 million for the six months ended June 29, 2002 from \$30.5 million for the six months ended June 30, 2001. The decrease in expenses was primarily attributable to the effects of cost saving initiatives including staff reductions, facility consolidations and the curtailment of certain discretionary spending, offset, in part, by increases in professional service fees.

General and Administrative, Excluding Equity-Based Expense. General and administrative expense, excluding equity-based expense consists primarily of salaries and related personnel costs, information systems support, recruitment expenses and facility demands associated with establishing the proper infrastructure to support our organization. This infrastructure consists of executive, financial, legal, information systems and other administrative responsibilities.

General and administrative expenses, excluding equity-based expense, decreased to \$17.1 million for the six months ended June 29, 2002 from \$19.5 million for the six months ended June 30, 2001. The decrease in expenses was primarily attributable to the effects of cost saving initiatives including staff reductions, facility consolidations and the curtailment of certain discretionary spending, offset, in part, by increases in professional service fees.

Equity-based Expense. Equity-based expense consists primarily of charges associated with employee options granted at below fair market value prior to our initial public offering.

Equity-based expense related to research and development, sales and marketing and general and administrative functions for the six months ended June 29, 2002 decreased to \$37.0 million from \$51.1 million for the six months ended June 30, 2001. The decrease in equity-based expense resulted from decreases in employee headcount.

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Amortization of Intangible Assets. Amortization of intangible assets relates to the amortization of certain intangible assets with finite lives. As a result of the issuance of SFAS No. 142, we no longer record amortization of goodwill on a straight-line basis, rather goodwill will be tested at least annually for impairment. There may be more volatility in reported income (loss) than previous standards because impairment losses are likely to occur irregularly and in varying amounts.

Amortization of intangible assets expenses decreased to \$7.2 million for the six months ended June 29, 2002 from \$101.9 million for the six months ended June 30, 2001. The decrease was primarily attributable to the discontinuation of amortization of goodwill resulting from the acquisition of Algety Telecom S.A. that was being amortized over five years.

Interest Income (Expense), Net. Interest income, net of interest expense, decreased to \$0.5 million for the six months ended June 29, 2002 from \$13.5 million of net interest income for the six months ended June 30, 2001. The decrease was primarily attributable to lower average invested cash balances and lower average returns on investments and the write-off of certain strategic investments of approximately \$4.8 million.

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Liquidity and Capital Resources

Since inception through June 29, 2002, we have financed our operations, capital expenditures and working capital primarily through public and private sales of our capital stock, borrowings under credit and lease facilities and cash generated from product sales. At June 29, 2002, our cash and cash equivalents and short-term investments totaled \$584.1 million.

Net cash used in operating activities was \$67.0 million for the six months ended June 29, 2002 and \$151.0 million for the six months ended June 30, 2001. Cash used in operating activities for the six months ended June 29, 2002 was primarily attributable to a net loss of \$190.1 million, offset in part by non-cash charges including depreciation and amortization of \$24.7 million, equity-based expense of \$37.0 million and purchased research, expense of \$34.6 million associated with our acquisition of Dorsal Networks in May 2002 and certain non-cash restructuring charges of \$10.5 million. Cash flows from operating activities were offset by decreases in accounts receivable of \$17.8 million.

Net cash used in investing activities was \$28.1 million for the six months ended June 29, 2002 and \$101.3 million for the six months ended June 30, 2001. The decrease in net cash used in investing activities for the six months ended June 29, 2002 was primarily attributable to reductions in capital expenditures offset in part by purchases of short-term investments.

Net cash used in financing activities for the six months ended June 29, 2002 was \$2.2 million, primarily attributable to the repayment of principal on notes and capital leases. Net cash provided by financing activities for the six months ended June 30, 2001 was \$2.1 million, primarily attributable to proceeds from the issuance of stock offset by payment on notes and capital leases.

As of June 29, 2002, long-term restricted cash totaled \$2.4 million associated with outstanding irrevocable letters of credit relating to lease obligations for various manufacturing and office facilities and other business arrangements. These letters of credit are collateralized by funds in our operating account. Various portions of the letters of credit expire at the end of each respective lease term or agreement term.

Due to current economic conditions, we have and may be required to sell our product to future customers at lower margins or be required to provide customers with financing which could result in reduced gross margins, extended payment terms or delayed revenue recognition, all of which could have a negative impact on our liquidity, capital resources and results of operations.

Our liquidity will also be dependent on our ability to manufacture and sell our products. Changes in the timing and extent of the sale of our products will affect our liquidity, capital resources and results of operations. We currently have a limited number of customers that could provide substantially all of our revenues for the near future and these customers are operating in a troubled economic environment. Some of these customers are nearing contractual minimum purchase commitments. The loss of any of these customers, any substantial reduction in current or anticipated orders or an inability to

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attract new customers, could materially adversely affect our liquidity and results of operations. We plan to diversify our customer base by seeking new customers both domestically and internationally.

We believe that our current cash and cash equivalents, short-term investments and cash generated from product sales will satisfy our expected working capital, capital expenditure and investment requirements through at least the next twelve months.

If cash on hand and cash generated from operations is insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities. To the extent that we raise additional capital through the sale of equity or debt securities, the issuance of such securities could result in dilution to our existing shareholders. If additional funds are raised through the issuance of debt securities, the terms of such debt could impose additional restrictions on our operations. Additional capital, if required, may not be available on acceptable terms, or at all. If we are unable to obtain additional financing, we may be required to reduce the scope of our planned product development and sales and marketing efforts, which could harm our business, financial condition and operating results. Increasingly, as a result of the financial demands of major network deployments, carriers are looking to their suppliers for financing assistance. From time to time, we have and may continue to provide or commit to extend credit or credit support to our customers as we consider appropriate in the course of our business.

Dorsal Networks

On May 16, 2002, we completed our acquisition of Dorsal Networks, Inc., a privately held provider of next-generation transoceanic and regional undersea optical network solutions for 41,809,000 shares of common stock valued at approximately \$91.8 million. The acquisition

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was accounted for under the "purchase" method of accounting. Under the purchase method, the purchase price of Dorsal was allocated to identifiable assets and liabilities acquired from Dorsal, with the excess being treated as goodwill. The acquisition resulted in an in-process research and development charge of approximately \$34.6 million as well as the recognition of certain intangible assets of \$30.2 million, which will be amortized over an estimated life of five years. In addition, the acquisition will result in goodwill of approximately \$19.1 million, which will have an indefinite life, but will be subject to periodic impairment tests. Dr. David R. Huber, our Chairman and Chief Executive Officer, owned, directly or indirectly, approximately 31 percent of the outstanding stock of Dorsal.

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 forward-looking statements. We maintain instruments subject to interest rate and foreign currency exchange rate risk. We categorize all of our market risk sensitive instruments as non-trading or other instruments.

Interest Rate Sensitivity

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We maintain a portfolio of cash equivalents and short-term investments in a variety of securities including: commercial paper, certificates of deposit, money market funds and government and non-government debt securities. Substantially all amounts are in money market funds as well as high grade, short-term commercial paper and certificates of deposit, the value of which is generally not subject to interest rate changes. We believe that a 10% increase or decline in interest rates would not be material to our investment income or cash flows. Our long-term debt obligations bear fixed interest rates. As such, we have minimal cash flow exposure due to general interest rate changes associated with our long-term debt obligations.

Foreign Rate Sensitivity

We primarily operate in the United States; however, we have expanded operations to include research and development and sales offices in various European countries. As a result, we may have sales in foreign currencies exposing us to foreign currency rate fluctuations. For the six months ended June 29, 2002, we recorded limited sales in a foreign currency. We are exposed to the impact of foreign currency changes, associated with the Euro, for financial instruments held by our European subsidiaries. These instruments are limited to cash and cash equivalents and trade receivables. It is the policy of management to fund foreign operations on a monthly basis, thus minimizing average cash and overnight investments in the Euro. At June 29, 2002, our European subsidiaries maintained cash and cash equivalents and trade accounts receivable of approximately (Euro) 6.3 million. We believe that a 10% increase or decline in the Euro exchange ratio would not be material to cash and cash equivalent balances, interest income, or cash flows from consolidated operations.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

By letter dated July 10, 2000, Ciena Corporation ("Ciena") informed us of its belief that there is significant correspondence between products that we offer and several U.S. patents held by Ciena relating to optical networking systems and related dense wavelength division multiplexing communications systems technologies. On July 19, 2000, Ciena filed a lawsuit in the United States District Court for the District of Delaware alleging that we are willfully infringing three of Ciena's patents. Ciena is seeking injunctive relief, monetary damages including treble damages, as well as costs of the lawsuit, including attorneys' fees. On September 8, 2000, we filed an answer to the complaint, as well as counter-claims alleging, among other things, invalidity and/or unenforceability of the three patents in question. On March 5, 2001, a motion was granted, allowing Ciena to amend its complaint to include allegations that we are willfully infringing two additional patents. The original trial date of April 1, 2002 was postponed by the court and a new trial date has not been set. The litigation is currently in the pre-trial phase, however, a pre-trial conference originally scheduled for July 30, 2002 has been rescheduled for September 9, 2002.

We have designed our products in an effort to respect the intellectual property rights of others. We intend to defend ourselves vigorously against these claims and we believe that we will prevail in this litigation. However, there can be no assurance that we will be successful in the defense of the litigation, and an adverse determination in the litigation could result from a finding of infringement of only one claim of a single patent. We may consider

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settlement due to the costs and uncertainties associated with litigation in general, and patent infringement litigation in particular, and due to the fact that an adverse determination in the litigation could preclude us from producing some of our products until we were able to implement a non-infringing alternative design to any portion of our products to which such a determination applied. Even if we consider settlement, there can be no assurance that we will be able to reach a settlement with Ciena. An adverse determination in, or settlement of, the Ciena litigation could involve the payment of significant amounts by us, or could include terms in addition to payments, such as a redesign of some of our products, which could have a material adverse effect on our business, financial condition and results of operations.

We believe that defense of the lawsuit may be costly and may divert the time and attention of some members of our management. Further, Ciena and other competitors may use the existence of the Ciena lawsuit to raise questions in customers' and potential customers' minds as to our ability to manufacture and deliver our products. There can be no assurance that questions raised by Ciena and others will not disrupt our existing and prospective customer relationships.

Between May 7, 2001 and June 15, 2001, nine class action lawsuits were filed in the United States District Court for the Southern District of New York relating to our initial public offering on behalf of all persons who purchased our stock between July 28, 2000 and the filing of the complaints. Each of the complaints names as defendants: Corvis, our directors and officers who signed the registration statement in connection with our initial public offering, and certain of the underwriters that participated in our initial public offering. The complaints allege that the

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registration statement and prospectus relating to our initial public offering contained material misrepresentations and/or omissions in that those documents did not disclose (1) that certain of the underwriters had solicited and received undisclosed fees and commissions and other economic benefits from some investors in connection with the distribution of our common stock in the initial public offering and (2) that certain of the underwriters had entered into arrangements with some investors that were designed to distort and/or inflate the market price for our common stock in the aftermarket following the initial public offering. The complaints ask the court to award to members of the class the right to rescind their purchases of Corvis common stock (or to be awarded rescissory damages if the class member has sold its Corvis stock) and prejudgment and post-judgment interest, reasonable attorneys' and experts witness' fees and other costs.

By order dated October 12, 2001, the court appointed an executive committee of six plaintiffs' law firms to coordinate their claims and function as lead counsel. Lead plaintiffs have been appointed in almost all of the IPO allocation actions, including the Corvis action. On October 17, 2001, a group of underwriter defendants moved for Judge Scheindlin's recusal. Judge Scheindlin denied that application. On December 13, 2001, the moving underwriter defendants filed a petition for writ of mandamus seeking the disqualification of Judge Scheindlin in the United States Court of Appeals for the Second Circuit. On April 1, 2002, the Second Circuit denied the moving underwriter defendants' application for a writ of mandamus seeking Judge Scheindlin's recusal from this action. On April 19, 2002, plaintiffs filed amended complaints in each of the actions, including the Corvis action. On May 23, 2002, a conference was held at which the court set a briefing schedule for the filing of motions to dismiss the amended complaints. On July 1, 2002, the underwriter defendants filed their motion to dismiss the amended complaints. On July 15, 2002, the issuer defendants filed their motion to dismiss the amended complaints. The briefing on

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the motions to dismiss is scheduled to be completed by the end of September 2002. No discovery has occurred. We intend to vigorously defend ourselves and our officers and directors.

Item 2. Changes in Securities and Use of Proceeds

- (a) None.
- (b) None.
- (c) None.
- (d) Not applicable.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

- (a) We held our annual meeting of stockholders on May 10, 2002.

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- (b) Joseph R. Hardiman was elected as a Class II Director, with a term expiring at the annual meeting stock holders to be held in 2005. Our Directors whose terms of office continued after the meeting are: David S. Oros, David R. Huber and Frank M. Drendel. The Board accepted Mr. Drendel's resignation as a Director on July 18, 2002.
- (c) Following is a tabulation of the number of votes cast for, the number of votes cast against, the number of votes withheld and the number of broker non-votes for each item upon which stockholders voted at our annual meeting:

Item ----	For ---	Against -----	Withhel -----
Approval of the issuance of shares of our common stock pursuant to the merger of Dorsal Networks, Inc. and a wholly-owned subsidiary of Corvis	152,410,443	34,220,784	726,
Election of Joseph R. Hardiman as a Class II Director	306,584,457	-	13,263,
Approval of the appointment of KPMG LLP as our auditors for fiscal 2002	312,429,324	4,625,466	2,793,

- (d) Not applicable.

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Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

- (a) No exhibits are required to be filed herewith.
- (b) On April 22, 2002, we filed a Current Report on Form 8-K dated April 22, 2002 announcing that we had entered into an amendment, dated April 22, 2002, with Qwest Communications Corporation ("Qwest") amending the Procurement Agreement, dated June 5, 2000, between Corvis and Qwest.

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SIGNATURES

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

CORVIS CORPORATION

Date: August 13, 2002

/s/ LYNN D. ANDERSON

Lynn D. Anderson

Senior Vice President, Chief
Financial Officer and Treasurer

Date: August 13, 2002

/s/ TIMOTHY C. DEC

Timothy C. Dec
Vice President, Chief Accounting
Officer and Corporate Controller

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