

CIENA CORP  
Form 10-Q  
September 08, 2011

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

(Mark one)

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

**For the quarterly period ended July 31, 2011**

**OR**

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

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

**Commission file number: 0-21969**

**Ciena Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**23-2725311**

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

**1201 Winterson Road, Linthicum, MD**

(Address of Principal Executive Offices)

**21090**

(Zip Code)

**(410) 865-8500**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(do not check if 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:

<b>Class</b>	<b>Outstanding at August 27, 2011</b>
common stock, \$.01 par value	96,884,073



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**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 July 31,		Nine Months Ended July	
	2010	2011	31,	2011
	2010	2011	2010	2011
Revenue:				
Products	\$ 312,378	\$ 350,030	\$ 667,852	\$ 1,038,483
Services	77,297	85,283	151,170	248,032
Total revenue	389,675	435,313	819,022	1,286,515
Cost of goods sold:				
Products	201,559	198,217	396,449	615,283
Services	44,107	52,199	93,462	151,996
Total cost of goods sold	245,666	250,416	489,911	767,279
Gross profit	144,009	184,897	329,111	519,236
Operating expenses:				
Research and development	100,869	93,216	222,044	288,630
Selling and marketing	52,127	61,895	131,692	180,755
General and administrative	32,649	28,172	66,915	98,966
Acquisition and integration costs	17,033	4,822	83,285	39,748
Amortization of intangible assets	38,727	13,673	61,829	56,131
Restructuring costs	2,157	504	3,985	5,190
Change in fair value of contingent consideration				(3,289)
Total operating expenses	243,562	202,282	569,750	666,131
Loss from operations	(99,553)	(17,385)	(240,639)	(146,895)
Interest and other income (loss), net	(2,668)	(3,160)	307	7,334
Interest expense	(5,990)	(9,470)	(11,931)	(28,426)
Loss before income taxes	(108,211)	(30,015)	(252,263)	(167,987)
Provision for income taxes	1,644	1,435	934	5,205
Net loss	\$ (109,855)	\$ (31,450)	\$ (253,197)	\$ (173,192)
Basic net loss per common share	\$ (1.18)	\$ (0.33)	\$ (2.73)	\$ (1.82)
Diluted net loss per potential common share	\$ (1.18)	\$ (0.33)	\$ (2.73)	\$ (1.82)

Weighted average basic common shares outstanding	92,906	96,313	92,851	95,389
Weighted average dilutive potential common shares outstanding	92,906	96,313	92,851	95,389

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

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

	October 31, 2010	July 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 688,687	\$ 486,332
Accounts receivable, net	343,582	414,826
Inventories	261,619	243,827
Prepaid expenses and other	147,680	141,401
Total current assets	1,441,568	1,286,386
Long-term investments		50,227
Equipment, furniture and fixtures, net	120,294	126,174
Other intangible assets, net	426,412	349,845
Other long-term assets	129,819	125,801
Total assets	\$ 2,118,093	\$ 1,938,433
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 200,617	\$ 140,806
Accrued liabilities	193,994	182,563
Deferred revenue	75,334	100,988
Total current liabilities	469,945	424,357
Long-term deferred revenue	29,715	26,302
Other long-term obligations	16,435	16,754
Convertible notes payable	1,442,705	1,442,449
Total liabilities	1,958,800	1,909,862
Commitments and contingencies Stockholders equity:		
Preferred stock par value \$0.01; 20,000,000 shares authorized; zero shares issued and outstanding		
Common stock par value \$0.01; 290,000,000 shares authorized; 94,060,300 and 96,883,868 shares issued and outstanding	941	969
Additional paid-in capital	5,702,137	5,743,211
Accumulated other comprehensive income	1,062	2,430
Accumulated deficit	(5,544,847)	(5,718,039)
Total stockholders equity	159,293	28,571

Total liabilities and stockholders' equity	\$ 2,118,093	\$ 1,938,433
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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)**

	Nine Months Ended July 31,	
	2010	2011
Cash flows from operating activities:		
Net loss	\$ (253,197)	\$ (173,192)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of premium (discount) on marketable securities	574	(25)
Change in fair value of embedded redemption feature	(2,570)	(3,380)
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	28,146	44,765
Share-based compensation costs	26,451	27,919
Amortization of intangible assets	82,476	76,567
Provision for inventory excess and obsolescence	10,749	11,461
Provision for warranty	16,388	10,538
Other	1,955	2,170
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	(134,844)	(72,030)
Inventories	(30,765)	6,331
Prepaid expenses and other	(29,528)	(4,462)
Accounts payable, accruals and other obligations	84,886	(81,388)
Deferred revenue	(3,957)	22,241
Net cash used in operating activities	(203,236)	(132,485)
Cash flows used in investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(34,646)	(41,138)
Restricted cash	(18,845)	(8,727)
Purchase of available for sale securities	(63,591)	(49,894)
Proceeds from maturities of available for sale securities	454,141	
Proceeds from sales of available for sale securities	179,380	
Acquisition of business	(693,247)	
Receipt of contingent consideration related to business acquisition		16,394
Net cash used in investing activities	(176,808)	(83,365)
Cash flows from financing activities:		
Proceeds from issuance of 4.0% convertible notes payable, net	364,316	
Proceeds from issuance of common stock	924	13,183
Net cash provided by financing activities	365,240	13,183
Effect of exchange rate changes on cash and cash equivalents	(664)	312
Net decrease in cash and cash equivalents	(14,804)	(202,667)
Cash and cash equivalents at beginning of period	485,705	688,687

Cash and cash equivalents at end of period	\$ 470,237	\$ 486,332
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the period for interest	\$ 4,748	\$ 18,869
Cash paid during the period for income taxes, net	\$ 2,037	\$ 1,781
<b>Non-cash investing and financing activities</b>		
Purchase of equipment in accounts payable	\$ 4,421	\$ 5,186
Fixed assets acquired under capital leases	\$	\$ 1,268

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

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

**(1) INTERIM FINANCIAL STATEMENTS**

The interim financial statements included herein for Ciena Corporation ( Ciena ) have been prepared by Ciena, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, financial statements included in this report reflect all normal recurring adjustments that Ciena considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial position of Ciena at the date of the interim balance sheets. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The October 31, 2010 Condensed Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. However, Ciena believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with Ciena's audited consolidated financial statements and notes thereto included in Ciena's annual report on Form 10-K for the fiscal year ended October 31, 2010.

On March 19, 2010, Ciena completed its acquisition of substantially all of the optical networking and Carrier Ethernet assets of Nortel's Metro Ethernet Networks ( MEN Business ). Ciena's results of operations for the nine-month period ended July 31, 2010 reflect the operations of the MEN Business beginning on the March 19, 2010 acquisition date. See Note 3 below.

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

**(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 Condensed Consolidated Financial Statements and accompanying notes. Estimates are used for purchase accounting, bad debts, valuation of inventories and investments, recoverability of intangible assets, other long-lived assets, income taxes, warranty obligations, restructuring liabilities, derivatives, 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 are 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.

Ciena has certain minority equity investments in privately held technology companies that are classified as other assets. These investments are carried at cost because Ciena does not have the ability to exercise significant influence

over these companies. These investments involve a high degree of risk as the markets for the technologies or products manufactured by these companies are usually early stage at the time of Ciena's investment and such markets may never be significant. Ciena could lose its entire investment in some or all of these companies. Ciena monitors these investments for impairment and makes appropriate reductions in carrying values when necessary.

**Table of Contents***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*

Ciena's chief operating decision maker, its chief executive officer, evaluates performance and allocates resources based on multiple factors, including segment profit (loss) information for the following product categories: (i) Packet-Optical Transport; (ii) Packet-Optical Switching; (iii) Carrier Ethernet Service Delivery; and (iv) Software and Services. Operating segments are defined as components of an enterprise: that engage in business activities which 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 considers the four product categories above to be its operating segments for reporting purposes. See Note 18.

*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*

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

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 years 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, from nine months 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. Generally, these deposits may be redeemed upon demand and, therefore, 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 Notes 7 and 18 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 their 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 they fail to deliver products or components on time, Ciena's business and results of operations may suffer.

**Table of Contents***Revenue Recognition*

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

*Accounting for multiple element arrangements entered into prior to fiscal 2011*

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

*Accounting for multiple element arrangements entered into or materially modified in fiscal 2011*

In October 2009, the Financial Accounting Standards Board ( FASB ) amended the accounting standard for revenue recognition with multiple deliverables which provided guidance on how the arrangement fee should be allocated and allows the use of management's best estimate of selling price ( BESP ) for individual elements of an arrangement when VSOE or third-party evidence ( TPE ) is unavailable. Additionally, it eliminates the residual method of revenue recognition in accounting for multiple deliverable arrangements. The FASB also amended the accounting guidance for revenue arrangements with software elements to exclude from the scope of the software revenue recognition guidance,

tangible products that contain both software and non-software components that function together to deliver the product's essential functionality.

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Ciena adopted the new accounting guidance on a prospective basis for arrangements entered into or materially modified on or after November 1, 2010. Under the new guidance, Ciena separates elements into more than one unit of accounting if the delivered element(s) have value to the customer on a stand-alone basis, and delivery of the undelivered element(s) is probable and substantially in Ciena's control. Therefore, the new guidance allows for deliverables, for which revenue was previously deferred due to an absence of fair value, to be separated and recognized as revenue as delivered. Also, because the residual method has been eliminated, discounts offered by Ciena are allocated to all deliverables, rather than to the delivered element(s). Ciena's adoption of the new guidance for revenue arrangements changed the accounting for certain Ciena products that consist of hardware and software components, in which these components together provided the product's essential functionality. For arrangements involving these products entered into prior to fiscal 2011, Ciena recognized revenue based on software revenue recognition guidance.

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 VSOE of selling price, if it exists, or TPE of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, Ciena uses its BEBP 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 BEBP 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.

Historically, for arrangements with multiple elements, Ciena was typically able to establish fair value for undelivered elements and so Ciena applied the residual method. Assuming the adoption of the accounting guidance above on a prospective basis for arrangements entered into or materially modified on or after November 1, 2009, the effect on revenue recognized for the nine months ended July 31, 2010 would not have been materially different.

*Warranty Accruals*

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

*Accounts Receivable, Net*

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

*Research and Development*

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

*Government Grants*



Ciena accounts for proceeds from government grants as a reduction of 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 19 below.

**Table of Contents***Advertising Costs*

Ciena expenses all advertising costs as incurred.

*Legal Costs*

Ciena expenses legal costs associated with litigation defense as incurred.

*Share-Based Compensation Expense*

Ciena measures and recognizes compensation expense for share-based awards based on estimated fair values on the date of grant. Ciena estimates the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This model is affected by Ciena's stock price as well as estimates regarding a number of variables including expected stock price volatility over the expected term of the award and projected employee stock option exercise behaviors. Ciena estimates the fair value of each share-based award based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense to its consolidated statement of operations for those options or shares that are expected ultimately to vest. Ciena uses two attribution methods to record expense, the straight-line method for grants with only service-based vesting and the graded-vesting method, which considers each performance period or tranche separately, for all other awards. 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. Management does not expect the outcome of this audit to have a material adverse effect on the Company's consolidated financial position, result of operations or cash flows. Ciena's major tax jurisdictions and the earliest open tax years are as follows: United States (2008), United Kingdom (2005), Canada (2005) and India (2007). However, limited adjustments can be made to Federal 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 U.S. deferred income taxes on the cumulative unremitted earnings of its non-U.S. affiliates as it plans to permanently reinvest cumulative unremitted foreign earnings outside the U.S. and it is not practicable to determine the unrecognized deferred income taxes. These cumulative unremitted foreign earnings relate to ongoing operations in foreign jurisdictions and are required to fund foreign operations, capital expenditures, and any expansion requirements.

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

*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 to determine whether any accruals should be adjusted and whether new accruals are required.

**Table of Contents***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 14 below.

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

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

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

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

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

*Restructuring*

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. Ciena implements these restructuring plans and incurs the associated liability concurrently. Generally accepted accounting principles require that a liability for the cost associated with an exit or disposal activity be recognized in the period in which the liability is incurred, except for one-time employee termination benefits related to a service period of more than 60 days, which are accrued over the service period. See Note 4 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.

*Derivatives*

Ciena's 4.0% convertible senior 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. See Note 13 below.

**Table of Contents***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.

*Software Development Costs*

Ciena develops software for sale to its customers. Generally accepted accounting principles 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 June 2011, the 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. Early adoption is permitted. Ciena does not expect this new guidance to have any impact on its financial condition, results of operations and cash flows.

In May 2011, the 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. Early application by public companies is not permitted. Ciena does not expect this new guidance to have any impact on its financial condition, results of operations and cash flows.

**(3) BUSINESS COMBINATIONS***Acquisition of MEN Business*

On March 19, 2010, Ciena completed its acquisition of the MEN Business. Ciena acquired the MEN Business in an effort to strengthen its technology leadership position in next-generation, converged optical Ethernet networking, accelerate the execution of its corporate and research and development strategies and enable Ciena to better compete with larger equipment vendors. The acquisition expanded Ciena's geographic reach, customer relationships, and portfolio of network solutions.

In accordance with the agreements for the acquisition, the \$773.8 million aggregate purchase price was subsequently adjusted downward by \$80.6 million based upon the amount of net working capital transferred to Ciena at closing. As a result, Ciena paid \$693.2 million in cash for the purchase of the MEN Business.

In connection with the acquisition, Ciena entered into an agreement with Nortel to lease the Lab 10 building on Nortel's Carling Campus in Ottawa, Canada (the Carling lease) for a term of ten years. The lease agreement contained a provision that allowed Nortel to reduce the term of the lease, and in exchange, Ciena could receive a payment of up to \$33.5 million. This amount was placed into escrow by Nortel in accordance with the acquisition agreements. The \$16.4 million fair value of this contingent refund right was recorded as a reduction to the consideration paid, resulting in a purchase price of \$676.8 million.

On October 19, 2010, Nortel issued a public announcement that it had entered into a sale agreement of its Carling campus with Public Works and Government Services Canada (PWGSC) and had been directed to exercise its early termination rights under the Carling lease, shortening the lease term from ten years to five years. As a result, and based on this change in circumstances and expected outcome probability, during the fourth quarter of fiscal 2010

Ciena recorded an unrealized gain of \$13.8 million, resulting in a fair value of \$30.2 million for the contingent consideration right. During the first quarter of fiscal 2011, Ciena received notice of early termination from Nortel and the corresponding \$33.5 million payment described above, resulting in a gain of \$3.3 million.

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During fiscal 2010, Ciena incurred \$101.4 million in transaction, consulting and third party service fees, \$8.5 million in restructuring expense, and an additional \$12.4 million in costs primarily related to purchases of capitalized information technology equipment. During the first nine months of fiscal 2011, Ciena incurred \$39.7 million in transaction, consulting and third party service fees, \$5.9 million in restructuring expense, and an additional \$10.2 million in costs primarily related to purchases of capitalized information technology equipment.

The following table summarizes the final purchase price allocation related to the MEN Business, based on the estimated fair value of the acquired assets and assumed liabilities (in thousands):

Unbilled receivables	\$ 7,136
Inventories	146,272
Prepaid expenses and other	32,517
Other long-term assets	21,924
Equipment, furniture and fixtures	41,213
Developed technology	218,774
In-process research and development	11,000
Customer relationships, outstanding purchase orders and contracts	260,592
Trade name	2,000
Deferred revenue	(28,086)
Accrued liabilities	(33,845)
Other long-term obligations	(2,644)
<b>Total purchase price allocation</b>	<b>\$ 676,853</b>

Unbilled receivables represent unbilled claims for which Ciena will invoice customers upon its completion of the acquired projects.

Under the acquisition method of accounting, Ciena recorded the acquired finished goods inventory at fair value, which was determined to be most appropriately recognized as the estimated selling price less the sum of (a) costs of disposal, and (b) a reasonable profit allowance for Ciena's selling effort.

Prepaid expenses and other include product demonstration units used to support research and development projects and indemnification assets related to uncertain tax contingencies acquired and recorded as part of other long-term obligations. Other long-term assets represent spares used to support customer maintenance commitments.

Developed technology represents purchased technology that had reached technological feasibility and for which development had been completed as of the date of the acquisition. Developed technology will be amortized on a straight line basis over its estimated useful lives of two to seven years.

In-process research and development represents development projects that had not reached technological feasibility at the time of the acquisition. This in-process research and development was completed during the fourth quarter of fiscal 2010 and is being amortized over the period of seven years. Expenditures to complete the in-process research and development were expensed as incurred.

Customer relationships, outstanding purchase orders and contracts represent agreements with existing customers of the MEN Business. These intangible assets are expected to have estimated useful lives of nine months to seven years, with the exception of \$14.6 million related to a contract asset for acquired in-process projects to be billed by Ciena and recognized as a reduction in revenue. As of July 31, 2011, Ciena has billed \$13.8 million of these contract assets. The remaining \$0.8 million will be billed during the remainder of fiscal 2011. Trade name represents acquired product trade names that are expected to have a useful life of nine months.

Deferred revenue represents obligations assumed by Ciena to provide maintenance support services for which payment for such services was already made to Nortel.

Accrued liabilities represent assumed warranty obligations, other customer contract obligations, and certain employee benefit plans. Other long-term obligations represent uncertain tax contingencies.





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The following unaudited pro forma financial information summarizes the results of operations for the period indicated as if Ciena's acquisition of the MEN Business had been completed as of the beginning of the period presented. These pro forma amounts (in thousands) 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.

	Quarter Ended July 31, 2010	Nine Months Ended July 31, 2010
Pro forma revenue	\$ 393,843	\$ 1,174,719
Pro forma net loss	\$ (77,080)	\$ (463,150)

**(4) RESTRUCTURING COSTS**

Since the acquisition of the MEN Business, Ciena has undertaken a number of restructuring activities intended to reduce operating expense and better align its workforce and operating costs with market opportunities, product development and business strategies for the combined operations.

The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the nine months ended July 31, 2011 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2010	\$ 1,576	\$ 6,392	\$ 7,968
Additional liability recorded	5,941		5,941
Adjustment to previous estimates		(751)	(751)
Cash payments	(5,800)	(1,723)	(7,523)
Balance at July 31, 2011	\$ 1,717	\$ 3,918	\$ 5,635
Current restructuring liabilities	\$ 1,717	\$ 975	\$ 2,692
Non-current restructuring liabilities	\$	\$ 2,943	\$ 2,943

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

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2009	\$ 170	\$ 9,435	\$ 9,605
Additional liability recorded	3,985		3,985
Cash payments	(2,476)	(2,098)	(4,574)
Balance at July 31, 2010	\$ 1,679	\$ 7,337	\$ 9,016
Current restructuring liabilities	\$ 1,679	\$ 1,342	\$ 3,021

Non-current restructuring liabilities \$ 5,995 \$ 5,995

**(5) MARKETABLE SECURITIES**

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

	July 31, 2011			
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
U.S. government obligations	\$ 49,920	\$ 307	\$	\$ 50,227
	\$ 49,920	\$ 307	\$	\$ 50,227

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The following table summarizes final legal maturities of debt investments at July 31, 2011 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than one year	\$	\$
Due in 1-2 years	49,920	50,227
	\$ 49,920	\$ 50,227

At October 31, 2010, Ciena did not have any investments in marketable debt securities.

**(6) FAIR VALUE MEASUREMENTS**

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

	July 31, 2011			Total
	Level 1	Level 2	Level 3	
Assets:				
U.S. government obligations	\$ 50,227	\$	\$	\$ 50,227
Foreign currency forward contracts		137		137
Embedded redemption feature			7,600	7,600
Total assets measured at fair value	\$ 50,227	\$ 137	\$ 7,600	\$ 57,964

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

	July 31, 2011			Total
	Level 1	Level 2	Level 3	
Assets:				
Prepaid expenses and other	\$	\$ 137	\$	\$ 137
Long-term investments	50,227			50,227
Other long-term assets			7,600	7,600
Total assets measured at fair value	\$ 50,227	\$ 137	\$ 7,600	\$ 57,964

Ciena's Level 3 assets included in other long-term assets reflect an embedded redemption feature contained within Ciena's 4.0% convertible senior notes. See Note 14 below. The embedded redemption feature is bifurcated from Ciena's 4.0% convertible senior 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 4.0% convertible senior 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 4.0% convertible senior 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:

Balance at October 31, 2010	Level 3 \$ 34,415
Issuances	

Settlements	(30,195)
Changes in unrealized gain (loss)	3,380
Transfers into Level 3	
Transfers out of Level 3	
Balance at July 31, 2011	\$ 7,600

**(7) ACCOUNTS RECEIVABLE**

Allowance for doubtful accounts was \$0.1 million and \$0.9 million as of October 31, 2010 and July 31, 2011, respectively. Ciena has not historically experienced a significant amount of bad debt expense.

**Table of Contents****(8) INVENTORIES**

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

	October 31, 2010	July 31, 2011
Raw materials	\$ 30,569	\$ 41,970
Work-in-process	6,993	12,271
Finished goods	177,994	154,161
Deferred cost of goods sold	76,830	66,758
	292,386	275,160
Provision for excess and obsolescence	(30,767)	(31,333)
	\$ 261,619	\$ 243,827

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 nine months of fiscal 2011, Ciena recorded a provision for excess and obsolescence of \$11.5 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory relate to disposal activities.

**(9) PREPAID EXPENSES AND OTHER**

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

	October 31, 2010	July 31, 2011
Prepaid VAT and other taxes	\$ 46,352	\$ 37,295
Deferred deployment expense	6,918	13,779
Product demonstration equipment, net	29,449	45,048
Prepaid expenses	15,087	13,537
Restricted cash	12,994	21,566
Contingent consideration	30,195	
Other non-trade receivables	6,685	10,176
	\$ 147,680	\$ 141,401

Depreciation of product demonstration equipment was \$2.3 million and \$7.1 million for the first nine months of fiscal 2010 and 2011, respectively.

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

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

	October 31, 2010	July 31, 2011
Equipment, furniture and fixtures	\$ 360,908	\$ 398,332
Leasehold improvements	49,595	54,289
	410,503	452,621
Accumulated depreciation and amortization	(290,209)	(326,447)
	\$ 120,294	\$ 126,174

Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements was \$25.8 million and \$37.7 million for the first nine months of fiscal 2010 and 2011, respectively.

**Table of Contents****(11) OTHER INTANGIBLE ASSETS**

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

	October 31, 2010			July 31, 2011		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Developed technology	\$ 417,833	\$ (186,129)	\$ 231,704	\$ 417,833	\$ (222,327)	\$ 195,506
Patents and licenses	45,388	(45,167)	221	45,388	(45,272)	116
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	323,573	(129,086)	194,487	323,573	(169,350)	154,223
Total other intangible assets	\$ 786,794	\$ (360,382)	\$ 426,412	\$ 786,794	\$ (436,949)	\$ 349,845

The amortization of finite-lived other intangible assets was \$82.5 million and \$76.6 million for the first nine months of fiscal 2010 and 2011, respectively. Expected future amortization of finite-lived other intangible assets for the fiscal years indicated is as follows (in thousands):

Period ended October 31, 2011 (remaining three months)	\$ 20,102
2012	73,564
2013	71,145
2014	56,987
2015	52,714
Thereafter	75,333
	\$ 349,845

**(12) OTHER BALANCE SHEET DETAILS**

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

	October 31, 2010	July 31, 2011
Maintenance spares inventory, net	\$ 53,654	\$ 50,117
Deferred debt issuance costs, net	28,853	24,815
Embedded redemption feature	4,220	7,600
Restricted cash	37,796	37,951
Other	5,296	5,318
	\$ 129,819	\$ 125,801

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, which is included in interest expense, was \$2.6 million and \$4.0 million during the first nine months of fiscal 2010 and fiscal 2011, respectively.



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

	October 31, 2010	July 31, 2011
Warranty	\$ 54,372	\$ 45,705
Compensation, payroll related tax and benefits	39,391	40,728
Vacation	20,412	27,614
Current restructuring liabilities	2,784	2,692
Interest payable	4,345	10,096
Other	72,690	55,728
	\$ 193,994	\$ 182,563

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

Nine months ended	Beginning	Acquired	Provisions	Settlements	Balance at end of period
July 31,	Balance				
2010	\$ 40,196	26,000	16,388	(18,074)	\$ 64,510
2011	\$ 54,372		10,538	(19,205)	\$ 45,705

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

As a result of the substantial completion of integration activities related to the MEN Business, Ciena consolidated certain support operations and processes during the first quarter of fiscal 2011, resulting in a reduction in costs to service future warranty obligations. As a result of the lower expected costs, Ciena reduced its warranty liability by \$6.9 million, which had the effect of reducing the provisions in the table above.

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

	October 31, 2010	July 31, 2011
Products	\$ 31,187	\$ 39,811
Services	73,862	87,479
	105,049	127,290
Less current portion	(75,334)	(100,988)
Long-term deferred revenue	\$ 29,715	\$ 26,302

**(13) FOREIGN CURRENCY FORWARD CONTRACTS**

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 12 months or less and are designated as cash flow hedges. Ciena considers several factors when evaluating hedges of its forecasted foreign currency exposures, such as significance of the exposure, offsetting economic exposures, potential costs of hedging, and the potential for hedge ineffectiveness. Ciena does not enter into derivative transactions for purposes other than hedging economic exposures. Beginning in the second quarter of fiscal 2011, Ciena entered into forward contracts to reduce the variability in its Canadian Dollar and Indian Rupee denominated expense, which principally relate to research and development activities. These derivative contracts have been designated as cash flow hedges and are immaterial for separate financial statement presentation.

**(14) CONVERTIBLE NOTES PAYABLE**

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

Description	July 31, 2011	
	Carrying Value	Fair Value
0.25% Convertible Senior Notes due May 1, 2013	\$ 216,210	\$ 209,048
4.0% Convertible Senior Notes due March 15, 2015 <sup>(1)</sup>	376,239	410,156

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0.875% Convertible Senior Notes due June 15, 2017	500,000	406,875
3.75% Convertible Senior Notes due October 15, 2018	350,000	370,125
	\$ 1,442,449	\$ 1,396,204

(1) Includes unamortized bond premium related to embedded redemption feature  
The fair value reported above is based on the quoted market price for the notes on the date above.

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**Table of Contents****(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.

<b>Numerator</b>	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Net loss	\$ (109,855)	\$ (31,450)	\$ (253,197)	\$ (173,192)
<b>Denominator</b>	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Basic weighted average shares outstanding	92,906	96,313	92,851	95,389
Dilutive weighted average shares outstanding	92,906	96,313	92,851	95,389
<b>EPS</b>	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Basic EPS	\$ (1.18)	\$ (0.33)	\$ (2.73)	\$ (1.82)
Diluted EPS	\$ (1.18)	\$ (0.33)	\$ (2.73)	\$ (1.82)

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 July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Shares underlying stock options, restricted stock units and warrants	7,171	6,032	8,171	6,295
0.25% Convertible Senior Notes due May 1, 2013	7,539	5,470	7,539	5,470
4.00% Convertible Senior Notes due March 15, 2015	18,396	18,396	9,333	18,396
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		17,355		17,355
Total excluded due to anti-dilutive effect	46,214	60,361	38,151	60,624

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

Ciena maintains two active equity compensation plans, the 2008 Omnibus Incentive Plan ( 2008 Plan ) and 2003 Employee Stock Purchase Plan ( ESPP ). These plans were approved by shareholders and are described in Ciena's

annual report on Form 10-K. Ciena has previously made stock option and restricted stock unit awards under the 2008 Plan and certain legacy plans. As of July 31, 2011, there were approximately 4.0 million shares authorized and remaining available for issuance under the 2008 Plan. Ciena has also previously granted restricted stock unit awards under its 2010 Inducement Equity Award Plan ( 2010 Plan ). This plan, described in Ciena's annual report on Form 10-K, expired on March 19, 2011.

*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):

	Shares Underlying Options	Weighted Average Exercise Price
Balance as of October 31, 2010	5,002	\$ 40.96
Granted		
Exercised	(405)	15.03
Canceled	(442)	87.94
Balance as of July 31, 2011	4,155	\$ 38.49

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The total intrinsic value of options exercised during the first nine months of fiscal 2010 and fiscal 2011 was \$0.8 million and \$3.3 million, respectively. The weighted average fair value of each stock option granted by Ciena during the first nine months of fiscal 2010 was \$6.95. There were no stock options granted by Ciena during the first nine months of fiscal 2011.

The following table summarizes information with respect to stock options outstanding at July 31, 2011, based on Ciena's closing stock price on the last trading day of Ciena's third fiscal quarter of 2011 (shares and intrinsic value in thousands):

Range of Exercise Price	Options Outstanding at July 31, 2011					Vested Options at July 31, 2011			
	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	
\$0.01 - \$16.52	635	5.41	\$ 11.37	\$ 2,852	511	4.82	\$ 11.68	\$ 2,188	
\$16.53 - \$17.44	351	4.12	17.20		337	3.99	17.20		
\$17.44 - \$22.97	339	3.75	21.80		326	3.61	21.85		
\$22.97 - \$31.71	1,253	3.36	29.42		1,226	3.29	29.45		
\$31.72 - \$46.91	755	4.67	39.25		712	4.57	39.40		
\$46.91 - \$73.79	399	1.37	59.14		399	1.37	59.14		
\$73.79 - \$267.52	423	0.22	116.21		423	0.22	116.21		
\$0.01 - \$267.52	4,155	3.50	\$ 38.49	\$ 2,852	3,934	3.28	\$ 39.61	\$ 2,188	

*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 nine months of fiscal 2011. During the first nine months of fiscal 2010, Ciena estimated the fair value of each option award on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions:

	Quarter Ended July 31, 2010	Nine Months Ended July 31, 2010
Expected volatility	61.9%	61.9%
Risk-free interest rate	2.4%	2.4 - 3.0%
Expected life (years)	5.3 - 5.5	5.3 - 5.5
Expected dividend yield	0.0%	0.0%

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

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

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

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The dividend yield assumption is based on Ciena's history and expectation of dividend payouts.

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

*Restricted Stock Units*

A restricted stock unit is a stock award that entitles the holder to receive shares of Ciena common stock as the unit vests. Ciena's outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. Awards subject to service-based conditions typically vest in increments over a three 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 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	Weighted Average Grant Date Fair Value	Aggregate Fair Value
	Outstanding	Per Share	
Balance as of October 31, 2010	5,191	\$ 13.81	\$ 71,681
Granted	1,855		
Vested	(1,916)		
Canceled or forfeited	(483)		
Balance as of July 31, 2011	4,647	\$ 16.12	\$ 71,849

The total fair value of restricted stock units that vested and were converted into common stock during the first nine months of fiscal 2010 and fiscal 2011 was \$19.0 million and \$38.3 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first nine months of fiscal 2010 and fiscal 2011 was \$13.43 and \$20.16, respectively.

*Assumptions for Restricted Stock Unit Awards*

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

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.



**Table of Contents***2003 Employee Stock Purchase Plan*

In March 2003, Ciena stockholders approved the ESPP, which has a ten-year term expiring on January 24, 2013. The ESPP provides for up to 3.6 million shares to be issued thereunder, subject to an 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 3.6 million. Under the ESPP, eligible employees may enroll in a six-month offer period that begins on December 21 and June 21 of each year. The purchase price under the ESPP reflects a 15% discount off of the lower of the fair market value of Ciena common stock on the day preceding the offer period or the last day of the offer period. The ESPP is considered compensatory for purposes of share-based compensation expense. During the first nine months of fiscal 2011, Ciena issued 0.5 million shares under the ESPP. At July 31, 2011, 3.2 million shares remained available for issuance under the ESPP.

Ciena estimated the fair value of each ESPP option on the first date of the offer period using the Black-Scholes option-pricing model, with the following weighted average assumptions:

	Quarter Ended July 31, 2011	Nine Months Ended July 31, 2011
Expected volatility	39.8 - 48.4%	39.8 - 49.1%
Risk-free interest rate	0.19 - .20%	0.19 - .64%
Expected life (years)	0.5	0.25 - 0.50
Expected dividend yield	0.0%	0.0%

*Share-Based Compensation Expense for Periods Reported*

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Product costs	\$ 548	\$ 578	\$ 1,475	\$ 1,658
Service costs	432	510	1,315	1,516
Share-based compensation expense included in cost of sales	980	1,088	2,790	3,174
Research and development	2,302	2,423	6,948	7,591
Sales and marketing	2,902	2,737	8,025	8,871
General and administrative	2,473	2,883	7,349	8,023
Acquisition and integration costs	883	54	1,229	288
Share-based compensation expense included in operating expense	8,560	8,097	23,551	24,773
Share-based compensation expense capitalized in inventory, net	111	(152)	110	(28)
Total share-based compensation	\$ 9,651	\$ 9,033	\$ 26,451	\$ 27,919

As of July 31, 2011, total unrecognized share-based compensation expense was \$67.8 million (i) \$1.8 million related to unvested stock options and expected to be recognized over a weighted-average period of 0.6 years and (ii) \$66.0 million related to unvested restricted stock units and expected to be recognized over a weighted-average period of 1.7 years.

**(17) COMPREHENSIVE LOSS**

The components of comprehensive loss were as follows for the periods indicated (in thousands):

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Net loss	\$ (109,855)	\$ (31,450)	\$ (253,197)	\$ (173,192)
Change in unrealized gain (loss) on available-for-sale securities, net of tax		3	(458)	378
Change in unrealized gain (loss) on foreign currency forward contracts, net of tax		(88)		87
Change in accumulated translation adjustments	(728)	(4,290)	(1,263)	903
Total comprehensive loss	\$ (110,583)	\$ (35,825)	\$ (254,918)	\$ (171,824)

**Table of Contents****(18) SEGMENT AND ENTITY WIDE DISCLOSURES***Segment Reporting*

Ciena's segments are discussed in the following product and service groupings:

*Packet-Optical Transport* includes optical transport solutions that increase network capacity and enable more rapid delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the cost effective and efficient transport of voice, video and data traffic in core networks, as well as regional, metro and access networks. Ciena's principal products in this segment include the: 6500 Packet-Optical Platform; 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 also includes sales from legacy 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.

*Packet-Optical Switching* includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Ciena's principal products in this segment include its family of CoreDirector® Multiservice Optical Switches, its 5430 Reconfigurable Switching System and its packet 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 service 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.

*Carrier Ethernet Service Delivery* principally includes Ciena's 3000 family of service delivery switches and service aggregation switches, the 5000 series of service aggregation switches, and its Carrier Ethernet 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 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 the legacy metro Ethernet routing switch (MERS) product line, from the MEN Business, and Ciena's legacy broadband products, including the CNX-5 Broadband DSL System (CNX-5), that transitions legacy 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.

*Software and Services* - includes Ciena's integrated network and service management software designed to automate and simplify network management and operation, while increasing network performance and functionality. 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 troubles. This segment also includes a broad range of consulting and support services, including installation and deployment, maintenance support, consulting, network design 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.

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Revenue:				
Packet-Optical Transport	\$ 242,057	\$ 266,551	\$ 423,216	\$ 825,667
Packet-Optical Switching	34,806	40,682	90,638	107,223
Carrier Ethernet Service Delivery	33,802	40,475	149,047	99,034
Software and Services	79,010	87,605	156,121	254,591
Consolidated revenue	\$ 389,675	\$ 435,313	\$ 819,022	\$ 1,286,515

*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; acquisition and integration costs; amortization of intangible assets; restructuring costs; change in fair value of contingent consideration; interest and other income (net); interest expense; equity investment gains or losses 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:

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Segment profit (loss):				
Packet-Optical Transport	\$ 12,874	\$ 51,827	\$ 26,402	\$ 127,359
Packet-Optical Switching	10,320	12,783	13,749	34,147
Carrier Ethernet Service Delivery	(3,212)	6,519	31,642	12,409
Software and Services	23,158	20,552	35,274	56,691
Total segment profit (loss)	43,140	91,681	107,067	230,606
Other nonperformance items:				
Selling and marketing	(52,127)	(61,895)	(131,692)	(180,755)
General and administrative	(32,649)	(28,172)	(66,915)	(98,966)
Acquisition and integration costs	(17,033)	(4,822)	(83,285)	(39,748)
Amortization of intangible assets	(38,727)	(13,673)	(61,829)	(56,131)
Restructuring costs	(2,157)	(504)	(3,985)	(5,190)
Change in fair value of contingent consideration				3,289
Interest and other financial charges, net	(8,658)	(12,630)	(11,624)	(21,092)
Provision for income taxes	(1,644)	(1,435)	(934)	(5,205)
Consolidated net loss	\$ (109,855)	\$ (31,450)	\$ (253,197)	\$ (173,192)

*Entity Wide Reporting*

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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 and Canada is reflected as Other International revenue. For the periods below, Ciena's geographic distribution of revenue was as follows (in thousands, except percentage data):

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
United States	\$ 229,739	\$ 227,524	\$ 534,174	\$ 678,674
Canada	22,840	43,815	65,125	128,770
Other International	137,096	163,974	219,723	479,071
Total	\$ 389,675	\$ 435,313	\$ 819,022	\$ 1,286,515

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

	October 31, 2010	July 31, 2011
United States	\$ 63,675	\$ 64,624
Canada	45,103	47,424
Other International	11,516	14,126
Total	\$ 120,294	\$ 126,174

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Company A	\$ 90,769	\$ 75,068	\$ 204,092	\$ 202,009
Company B	40,556	n/a	n/a	131,721
Total	\$ 131,325	\$ 75,068	\$ 204,092	\$ 333,730

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

**(19) 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 CAD\$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 CAD\$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 July 31, 2011, Ciena has recorded a CAD\$4.1 million benefit as a reduction in research and development expenses because it believes it has complied with the conditions entitling it to this disbursement and that the grant proceeds will be received.

*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, 2010 and July 31, 2011, Ciena had accrued liabilities of \$1.4 million and \$1.6 million, respectively, related to these contingencies, which are reported as a component of other current accrued liabilities. As of July 31, 2011, Ciena estimates that it could be exposed to possible losses of up to \$5.8 million, for which it has not accrued liabilities. Ciena has not accrued the additional income tax liabilities because it does not believe that such losses are 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 our 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. Patents relating to certain reconfigurable optical add-drop multiplexer (ROADM) technologies. The complaint seeks injunctive relief and damages. Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously.

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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. Ciena filed an amended answer to the complaint and counterclaims against Graywire on April 17, 2009. On April 27, 2009, Ciena and certain other defendants filed an application for inter partes reexamination of the '673 Patent with the U.S. Patent and Trademark Office (the PTO). On the same date, Ciena and the other defendants filed a motion to stay the case pending reexamination of all of the patents-in-suit. On July 17, 2009, the district court granted the defendants' motion to stay the case. On July 23, 2009, the PTO granted the defendants' application for reexamination with respect to certain claims of the '673 Patent and, on December 17, 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims. On February 28, 2011, Ciena and the other defendants filed an appeal with respect to certain aspects of the PTO's determination. Separately, on March 17, 2011, the PTO granted a third party application for ex parte reexamination with respect to certain claims of the '673 Patent and, on September 2, 2011, the PTO issued a non-final rejection of those claims. Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously in the event the stay of the case is lifted.

As a result of its June 2002 merger with ONI Systems Corp., Ciena became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI's initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI's registration statement and by engaging in manipulative practices to artificially inflate ONI's stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters' alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and all of these actions have been included in a single coordinated proceeding. On October 6, 2009, the Court entered an opinion granting final approval to a settlement among the plaintiffs, issuer defendants and underwriter defendants, and directing that the Clerk of the Court close these actions. All appeals of the opinion granting final approval have been either resolved or dismissed, except one. On August 25, 2011, on remand from the Second Circuit, the District Court determined that the last remaining appellant did not have standing to assert his appeal. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena's Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 22, 2010. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation and because the settlement remains subject to appeal, the ultimate outcome of the matter is uncertain.

In addition to the matters described above, Ciena is subject to various legal proceedings, claims and litigation arising in the ordinary course of business. Ciena does not expect that the ultimate costs to resolve these matters will have a material effect on 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, potential or continue or the negative of those words and other comparable words. You should be aware that these statements only reflect our current predictions and beliefs. These statements are subject to known and unknown risks, uncertainties and other factors, and actual events or results may differ materially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly in Item 1A Risk Factors of Part II of this report below. You should review these risk factors and the rest of this quarterly report in combination with the more detailed description of our business and management's discussion and analysis of financial condition in our annual report on*



*Form 10-K, which we filed with the Securities and Exchange Commission on December 22, 2010, for a more complete understanding of the risks associated with an investment in Ciena's securities. Ciena undertakes no obligation to revise or update any forward-looking statements.*

**Overview**

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

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We are a network specialist targeting the transition of disparate, legacy communications networks to converged, next-generation architectures that are optimized to handle increased traffic volumes and deliver more efficiently a broader mix of high-bandwidth communications services. Our communications networking products, through their embedded software and our network management software suites, enable network operators to efficiently and cost-effectively deliver critical enterprise and consumer-oriented communication services. Together with our comprehensive design, implementation and support services, our networking solutions offering seeks to enable software-defined, automated networks that address the business challenges, communications infrastructure requirements and service delivery needs of our customers. Our customers face a challenging and rapidly changing environment that requires their networks be robust enough to address increasing capacity needs from a growing set of consumer and business applications, and flexible enough to quickly adapt and execute new business strategies and support the delivery of innovative, revenue-creating services. By improving network productivity and automation, reducing network costs and providing flexibility for differentiated service offerings, our networking solutions offering creates business and operational value for our customers.

*Acquisition of Nortel Metro Ethernet Networks Business (the MEN Acquisition )*

On March 19, 2010, we completed our acquisition of substantially all of the optical networking and Carrier Ethernet assets of Nortel's Metro Ethernet Networks business (the MEN Business ) for a purchase price of \$676.8 million. See Note 3 to the Condensed Consolidated Financial Statements in Item 1 of this report for more information.

*Effect of MEN Acquisition upon Results of Operations and Financial Condition*

Due to the relative scale of its operations, the MEN Acquisition has materially affected our operations, financial results and liquidity and may make period to period comparisons difficult. Our revenue and operating expense increased materially compared to periods prior to the MEN Acquisition. We also experienced increases in our concentration of Packet-Optical Transport revenue and revenue from outside of the United States, each of which has contributed to somewhat lower gross margins since the MEN Acquisition. From the closing of the MEN Acquisition through the third quarter of fiscal 2011, we incurred significant integration costs and transition services expense. Integration activities resulted in \$141.1 million in transaction, consulting and third party service fees, \$14.5 million in severance expense, and an additional \$22.6 million, primarily related to purchases of capitalized information technology equipment through the third quarter of fiscal 2011. We anticipate that we will incur approximately \$8.0 million to \$12.0 million in additional integration costs during the remainder of fiscal 2011. From the date of the MEN Acquisition through the second quarter of fiscal 2011, Ciena incurred significant transition service expense, principally reflected in operating expense, for services performed by a Nortel affiliate relating to finance and accounting functions, supply chain and logistics management, maintenance and product support, order management and fulfillment, trade compliance, and information technology. In addition, as a result of the MEN Acquisition, we recorded \$492.4 million in other intangible assets that will be amortized over their useful lives and increase our operating expense.

Gross margin was also adversely affected by the valuation, required under accounting rules, of the acquired finished goods inventory of the MEN Business to fair value upon closing. This valuation increased marketable inventory carrying value by \$62.3 million, of which \$48.0 million and \$14.3 million were recognized in cost of goods sold during fiscal 2010 and the first nine months of fiscal 2011, respectively. See Critical Accounting Policies and Estimates- Long-lived Assets and Note 3 of the Condensed Consolidated Financial Statements found under Item 1 of this report.

*Restructuring Activities*

Since the MEN Acquisition, we have undertaken a number of restructuring activities intended to reduce operating expense and better align our workforce and operating costs with market opportunities, product development initiatives and business strategies for the combined operations. During the first nine months of fiscal 2011, we incurred approximately \$5.9 million in restructuring costs and expect these actions to result in an additional restructuring charge in the range of \$1.0 million to \$2.0 million during the remainder of fiscal 2011. As we look to manage operating expense and optimize the resources of the combined operations, we will continue to assess the allocation of headcount, facilities and other resources toward key growth opportunities for our business and evaluate additional cost

reduction measures.

*Global Market Conditions and Competitive Landscape*

The recent period of macroeconomic weakness and volatility in global markets has resulted in heightened uncertainty and cautious customer behavior in our industry and markets. We have experienced increased customer scrutiny with respect to network investment, which has resulted in protracted sales cycles, lengthier network deployments, revenue recognition delays and extended collection cycles, particularly for international network projects. Broad macroeconomic weakness has previously resulted in periods of decreased demand for our products and services that have adversely affected our results of operations. We remain uncertain as to how long current macroeconomic and industry conditions will persist, the pace of any recovery, and the magnitude of the effect of these conditions on the growth of our markets and business, as well as our results of operations.

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We continue to encounter a highly competitive marketplace for sales of our networking solutions offering, particularly within our Packet-Optical Transport segment. Competition has intensified as we and our competitors have introduced new, high-capacity, high-speed network solutions and more aggressively sought to capture market share and displace incumbent vendors at large carrier customers. We have also encountered increased competition as we have expanded our business in emerging geographies and new markets or applications for our communications networking products. For example, we have made early progress in the sale of our products for application in submarine networks and with sales to customers in the Middle East. In this competitive environment, securing new opportunities, particularly in international markets, often requires that we agree to less favorable commercial terms or pricing, financial commitments requiring collateralized performance bonds or similar instruments that place cash resources at risk, and other contractual commitments that place a disproportionate allocation of risk upon the vendor. These terms can adversely affect our result of operations. We expect the level of competition, particularly in North America, to continue and potentially increase, as Chinese equipment vendors seek to gain entry into the U.S. market, and other multinational competitors seek to retain incumbent positions with large customers in the region.

*Strategy*

We believe that a number of important underlying drivers represent significant long-term opportunities and growing demand for converged optical Ethernet networking solutions in our target markets. We believe that market trends including the proliferation of mobile web applications, prevalence of video applications and shift of enterprise applications to the cloud or virtualized environments are emblematic of increased use and dependence by consumers and enterprises upon a growing variety of broadband applications and services. These services will continue to add network traffic and consume available bandwidth, requiring our customers to invest in high-capacity, next-generation network infrastructures that are more efficient and robust, and better able to handle multiservice traffic and increased transmission rates.

To capitalize on the market dynamics above, we have been investing heavily in our business and are in the process of introducing, or transitioning to new solutions offerings in each of our product segments. These developments include the enhancement of our 100G coherent optical transport solution to further improve network flexibility, performance, spectral efficiency and reach. We are also bringing to market a re-architected, integrated network management software platform that unifies visibility, control and service enablement across our product portfolio. Within Packet-Optical Switching, we are transitioning from our CoreDirector platform to our data-optimized, 5430 Reconfigurable Switching System, to enable an end-to-end Optical Transport Network (OTN) architecture that offers improved cost per bit, flexibility and reliability. We are also expanding our Carrier Ethernet Service Delivery portfolio to include the Carrier-Ethernet configuration of our 5410 Reconfigurable Switching Solution, a high-capacity (terabit scale) Ethernet metro aggregation switch to support wireless backhaul, Ethernet business services and residential broadband applications. Simultaneously, we have also been investing in market entry into multiple, new geographies and vertical segments, as well as the expansion of footprint and market share within our traditional customer base across our segments. Managing these platform introductions, market share capture initiatives and market expansions has required increased investment that has impacted and continues to impact a number of financial and operational metrics, including margin, operating expense and cash flows. These investments are a critical element of our effort to address evolving industry trends and end user network requirements, and we believe they will position us to seize market opportunities for long-term growth. Additional components of our overall corporate strategy include:

*Optimize operations, infrastructure and resources to achieve desired operating leverage.* With critical integration activities relating to the MEN Acquisition substantially complete, we are focused on optimizing and gaining leverage from our business processes, systems, infrastructure and resources. These initiatives include the enhancement and further automation of business processes and systems, and the consolidation of our supply chain, third party manufacturers, logistics providers and facilities. We seek to leverage these and other longer-term opportunities, to improve operating efficiencies and promote the growth of the business.

*Diversify our customer segments and customer application of our products.* Historically, service providers have represented the largest portion of our revenue, with their application of our products largely supporting terrestrial, wireline networks. Part of our strategy is to seek opportunities to address new customer segments, and increase our sales to wireless providers, cable and multiservice operators, enterprises, government agencies and research and

educational institutions. We are also seeking to sell our product and service solutions to support additional network applications of our products, including in submarine networks, content delivery networks, business Ethernet services and mobile backhaul.

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*Expand our geographic reach.* We seek to enhance our brand internationally and build upon the broader global presence of our business following the MEN Acquisition. In particular, we seek to expand our geographic reach and market share in growing markets including Brazil, the Middle East, Russia and India. Some of these jurisdictions maintain restrictions on importation, trade protection measures and other domestic preference requirements that could limit our access or success in these markets. For example, India has recently implemented certain security requirements affecting network equipment vendors and has imposed significant tariffs upon certain telecommunications equipment manufactured in China, where we assemble certain products and source many components and parts. These requirements may make sales in these markets costly or necessitate changes in our supply chain and operations.

*Increase sales of Packet-Optical Switching and Carrier Ethernet Service Delivery solutions.* Through cross-selling and other sales initiatives, we seek to increase the number of customers of and revenue contribution from our Packet-Optical Switching and Carrier Ethernet Service Delivery products, particularly in international markets. By extending our technology leadership in next-generation, coherent transport technology, we seek to drive additional business opportunities for our Packet-Optical Switching and Carrier Ethernet Service Delivery products. Each of these product segments is in the early stages of significant platform transitions and we expect our revenue, gross margin and results of operations may fluctuate in the future in large part depending upon our success in selling new platforms within these segments.

*Leverage our consultative, network specialist approach to drive service and software sales.* Our close, consultative relationship with customers enables us to bring strategic value to customer relationships beyond the sale of next-generation communications networking solutions. By understanding and addressing their business needs and the challenging markets in which they compete, we can offer solutions that create additional business and operational value for our customers. We intend to leverage this approach to drive customized opportunities for our Ciena specialist services and sales of integrated, network management software solutions that enable service level management across network layers, rapid service provisioning and increased automation.

***Financial Results***

Revenue for the third quarter of fiscal 2011 was \$435.3 million, representing a sequential increase of 4.2% from \$417.9 million in the second quarter of fiscal 2011. Revenue-related details reflecting sequential changes from the second quarter of fiscal 2011 include:

Product revenue for the third quarter of fiscal 2011 increased by \$14.0 million, reflecting increases of \$9.5 million in sales of Carrier Ethernet Service Delivery products, \$9.4 million in Packet-Optical Switching revenue and \$1.1 million in sales of integrated network and service management software. These increases were partially offset by a \$6.1 million decrease in Packet-Optical Transport revenue.

Service revenue for the third quarter of fiscal 2011 increased by \$3.4 million.

Revenue from the United States for the third quarter of fiscal 2011 was \$227.5 million, a decrease from \$230.8 million in the second quarter of fiscal 2011.

International revenue for the third quarter of fiscal 2011 was \$207.8 million, an increase from \$187.1 million in the second quarter of fiscal 2011.

As a percentage of revenue, international revenue was 47.7% during the third quarter of fiscal 2011, an increase from 44.8% during the second quarter of fiscal 2011.

For the third quarter of fiscal 2011, one customer accounted for greater than 10% of revenue, representing 17.2% of total revenue. This compares to two customers that accounted for 25.9% of total revenue in the second quarter of fiscal 2011.

Gross margin for the third quarter of fiscal 2011 was 42.5%, an increase from 39.7% in the second quarter of fiscal 2011. Gross margin for the third quarter of fiscal 2011 benefitted from improved product mix, including increased sales of Packet-Optical Switching and Carrier Ethernet Service Delivery products as a percentage of revenue. Gross margin has been, and may continue to be, affected by increased competitive pressures across our segments and our strategy to gain new customers, enter new markets and capture additional market share, particularly for 40G and 100G coherent optical transport solutions within our 6500 Packet-Optical Platform.



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Operating expense was \$202.3 million for the third quarter of fiscal 2011, a decrease from \$221.5 million in the second quarter of fiscal 2011. Third quarter operating expense reflects reductions of \$5.9 million in acquisition and integration costs, \$2.7 million in restructuring costs and the termination, in all material respects, of transition services previously performed by an affiliate of Nortel. Operating expense for the third quarter also reflects a \$4.3 million benefit recorded in relation to a conditional grant that we received from the Province of Ontario in June 2011. Under this strategic jobs investment fund grant, we can receive up to an aggregate of CAD\$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. We anticipate receiving future disbursements, approximating CAD\$5.0 million per fiscal year over the period above, with benefits to operating expense more evenly realized throughout each fiscal year, as compared to the third quarter of fiscal 2011. Amounts received under the grant are subject to recoupment in the event that we fail to achieve certain minimum investment, employment and project milestones.

As a result of the progress in gross margin and operating expense reductions described above, our loss from operations for the third quarter of fiscal 2011 was \$17.4 million, an improvement from a \$55.6 million loss from operations during the second quarter of fiscal 2011. Our net loss for the third quarter of fiscal 2011 was \$31.5 million, or \$0.33 per share. This compares to a net loss of \$62.7 million, or \$0.66 per share, for the second quarter of fiscal 2011.

We used \$17.0 million in cash from operations during the third quarter of fiscal 2011, consisting of a use of cash of \$44.3 million in changes in working capital partially offset by cash provided from net losses (adjusted for non-cash charges) of \$27.3 million. Use of cash for the third quarter of fiscal 2011 reflects cash payments of \$8.5 million in acquisition and integration-related expense and restructuring costs, of which \$6.1 million was reflected in net losses (adjusted for non-cash charges) and \$2.4 million was reflected in changes in working capital. This compares with the use of \$51.8 million in cash from operations during the second quarter of fiscal 2011, consisting of \$41.4 million in cash used for changes in working capital and \$10.4 million from net losses (adjusted for non-cash charges). Use of cash for the second quarter of fiscal 2011 reflects cash payments of \$26.4 million in acquisition and integration-related expense and restructuring costs, of which \$13.9 million was reflected in net losses (adjusted for non-cash charges) and \$12.5 million was reflected in changes in working capital.

As of July 31, 2011, we had \$486.3 million in cash and cash equivalents and \$50.2 million of long-term investments in U.S. treasury securities. This compares to \$506.8 million and \$688.7 million in cash and cash equivalents at April 30, 2011 and October 31, 2010, respectively, and \$50.1 million of long-term investments in U.S. treasury securities at April 30, 2011.

As of July 31, 2011, headcount was 4,339, an increase from 4,301 at April 30, 2011, and 4,201 at October 31, 2010.

**Consolidated Results of Operations**

Our results of operations for the nine-month period ended July 31, 2010 reflect the operations of the MEN Business beginning on the March 19, 2010 acquisition date, and therefore only reflect a partial period of combined operations. Our internal organizational structure and the management of our business and results of operations are presented based upon the following operating segments:

*Packet-Optical Transport* includes optical transport solutions that increase network capacity and enable more rapid delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the cost effective and efficient transport of voice, video and data traffic in core networks, as well as regional, metro and access networks. Our principal products in this segment include the: 6500 Packet-Optical Platform; 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 also includes sales from legacy 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.



*Packet-Optical Switching* includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Our principal products in this segment include our family of CoreDirector® Multiservice Optical Switches, our 5430 Reconfigurable Switching System and our packet 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 service 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.

*Carrier Ethernet Service Delivery* principally includes our 3000 family of service delivery switches and service

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aggregation switches, the 5000 series of service aggregation switches, and our Carrier Ethernet 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 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 the legacy metro Ethernet routing switch (MERS) product line from the MEN Business, and our legacy broadband products, including our CNX-5 Broadband DSL System (CNX-5), that transitions legacy 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.

*Software and Services* includes our integrated network and service management software designed to automate and simplify network management and operation, while increasing network performance and functionality. 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 troubles. This segment also includes a broad range of consulting and support services, including installation and deployment, maintenance support, consulting, network design 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.

**Quarter ended July 31, 2010 compared to the quarter ended July 31, 2011****Revenue**

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

	2010	Quarter Ended July 31, %*	2011	%*	Increase (decrease)	%**
Revenue:						
Packet-Optical Transport	\$ 242,057	62.1	\$ 266,551	61.3	\$ 24,494	10.1
Packet-Optical Switching	34,806	8.9	40,682	9.3	5,876	16.9
Carrier Ethernet Service						
Delivery	33,802	8.7	40,475	9.3	6,673	19.7
Software and Services	79,010	20.3	87,605	20.1	8,595	10.9
Consolidated revenue	\$ 389,675	100.0	\$ 435,313	100.0	\$ 45,638	11.7

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**Packet-Optical Transport revenue** increased reflecting a \$45.3 million increase in sales of our 6500 Packet-Optical Platform, largely driven by service provider demand for high-capacity, optical transport, including coherent 40G and 100G network infrastructures. Packet-Optical Transport revenue also benefited from an \$11.7 million increase in sales of our 4200 Advanced Services Platform and a \$6.6 million increase in sales of our 6100 Multiservice Optical Platform. These increases were partially offset by decreases of \$19.5 million in sales of our 5100/5200 Advanced Services Platform, \$9.2 million in sales of our Corestream® Agility Optical Transport System and \$10.2 million in legacy transport products.

**Packet-Optical Switching revenue** increased reflecting a \$3.2 million increase in sales of our CoreDirector® Multiservice Optical Switches and a \$2.6 million increase in sales of our 5430 Reconfigurable Switching System. Packet-Optical Switching revenue has historically reflected sales of our CoreDirector platform, which

has a concentrated customer base. Our Packet-Optical Switching segment is in the initial stages of a platform transition to our next-generation 5430 Reconfigurable Switching System. As a result of these factors, revenue for this segment can fluctuate considerably depending upon individual customer purchasing decisions and the level of initial deployments with customers.

**Carrier Ethernet Service Delivery revenue** increased reflecting an \$11.8 million increase in sales of our 3000 and 5000 families of service delivery switches and service aggregation switches, partially offset by a \$5.1 million decrease in sales of our legacy metro Ethernet and broadband products. Quarterly revenue for this segment remains subject to fluctuation due to customer concentration and the timing of customer purchasing and deployment cycles. We expect segment results to be dependent upon further adoption of these products to support business Ethernet service applications and the level of customer adoption of our high-capacity, Carrier Ethernet configuration for our 5410 Service Aggregation Switch to support wireless backhaul, Ethernet business services and residential broadband applications.

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**Software and Services revenue** increased primarily due to increases of \$4.9 million in installation, deployment and consulting services and \$3.1 million in maintenance support 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:

	2010	Quarter Ended July 31, %*	2011	%*	Increase (decrease)	%**
United States	\$ 229,739	59.0	\$ 227,524	52.3	\$ (2,215)	(1.0)
International	159,936	41.0	207,789	47.7	47,853	29.9
Total	\$ 389,675	100.0	\$ 435,313	100.0	\$ 45,638	11.7

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**United States revenue** decreased primarily due to decreases of \$5.4 million in Packet-Optical Switching, \$2.9 million in Software and Services, and \$2.6 million in Packet-Optical Transport. These decreases were partially offset by an \$8.8 million increase in Carrier Ethernet Service Delivery sales.

**International revenue** increased primarily due to a \$27.1 million increase in Packet-Optical Transport revenue, an \$11.6 million increase in Software and Services revenue, and an \$11.2 million increase in sales of Packet-Optical Switching products. These increases were partially offset by a \$2.1 million decrease in Carrier Ethernet Service Delivery sales.

A sizable portion of our revenue continues to come from sales to a small number of service providers, particularly within our Packet-Optical Switching and Carrier-Ethernet Service Delivery businesses. As a result, our financial results are significantly affected by spending levels and the business challenges encountered by these customers. Moreover, our contracts do not have terms that obligate these customers to purchase any minimum or specific amounts of equipment or services. In recent years our concentration of revenue has been adversely affected by consolidation activity among our customers. In addition, 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 could further affect our concentration of revenue where we participate in these efforts. For the third quarter of fiscal 2011, one customer accounted for greater than 10% of revenue, representing 17.2% of total revenue. This compares to two customers that accounted for 33.7% of total revenue in the third quarter of fiscal 2010.

*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.

Gross profit as a percentage of revenue, or gross margin, continues to be susceptible to quarterly fluctuation due to a number of factors. Gross margin can vary significantly depending upon the mix and concentration of revenue by segment or product line, the concentration of lower margin common equipment sales within a segment or product line, geographic mix and the mix of customers and services in a given fiscal quarter. Gross margin can also be affected by our introduction of new products, charges for excess and obsolete inventory, changes in warranty costs and sales volume. We expect that gross margins will be subject to fluctuation based on our level of success in driving cost

reductions, rationalizing our supply chain and consolidating third party contract manufacturers and distribution sites as part of our effort to optimize our combined operations with the MEN Business. Gross margin can also be adversely affected by the competitive environment and level of pricing pressure we encounter.

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The combination of the recent period of uncertain market conditions, constraints on customer capital expenditures and increased competition has resulted in a heightened customer focus on pricing and return on network investment, as customers address network traffic growth and strive to increase revenue and profit. While competition is intense across our segments, our exposure to pricing pressure has been most severe in metro and core applications for our Packet-Optical Transport platforms, particularly in international markets. As a result, in an effort to retain or secure customers, enter new markets or capture market share, in the past we have and in the future 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. Because Packet-Optical Transport and international revenue comprise a greater percentage of our overall revenue than in prior periods, these market dynamics 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:

	2010	Quarter Ended July 31, %*	2011	%*	Increase (decrease)	%**
Total revenue	\$ 389,675	100.0	\$ 435,313	100.0	\$ 45,638	11.7
Total cost of goods sold	245,666	63.0	250,416	57.5	4,750	1.9
Gross profit	\$ 144,009	37.0	\$ 184,897	42.5	\$ 40,888	28.4

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

	2010	Quarter Ended July 31, %*	2011	%*	Increase (decrease)	%**
Product revenue	\$ 312,378	100.0	\$ 350,030	100.0	\$ 37,652	12.1
Product cost of goods sold	201,559	64.5	198,217	56.6	(3,342)	(1.7)
Product gross profit	\$ 110,819	35.5	\$ 151,813	43.4	\$ 40,994	37.0

\* Denotes % of product revenue

\*\* Denotes % change from 2010 to 2011

	2010	Quarter Ended July 31, %*	2011	%*	Increase (decrease)	%**
Service revenue	\$ 77,297	100.0	\$ 85,283	100.0	\$ 7,986	10.3
Service cost of goods sold	44,107	57.1	52,199	61.2	8,092	18.3
Service gross profit	\$ 33,190	42.9	\$ 33,084	38.8	\$ (106)	(0.3)

\* Denotes % of service revenue

\*\* Denotes % change from 2010 to 2011

**Gross profit as a percentage of revenue** increased due to higher product gross margins described below, partially offset by decreased service gross margin.

**Gross profit on products as a percentage of product revenue** would have been largely unchanged but for the adverse effect in fiscal 2010 of acquisition accounting rules, which required the revaluation of the acquired finished goods inventory of the MEN Business to fair value upon closing. This revaluation increased marketable inventory carrying value by approximately \$62.3 million, of which \$28.6 million and \$1.9 million was recognized in cost of goods sold during the third quarter of fiscal 2010 and 2011, respectively.

**Gross profit on services as a percentage of services revenue** decreased due to a higher concentration of installation service and less favorable geographic mix.

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

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

	2010	Quarter Ended July 31,			Increase	
		%*	2011	%*	(decrease)	%**
Research and development	\$ 100,869	25.8	\$ 93,216	21.4	\$ (7,653)	(7.6)
Selling and marketing	52,127	13.4	61,895	14.2	9,768	18.7
General and administrative	32,649	8.4	28,172	6.5	(4,477)	(13.7)
Acquisition and integration costs	17,033	4.4	4,822	1.1	(12,211)	(71.7)
Amortization of intangible assets	38,727	9.9	13,673	3.1	(25,054)	(64.7)
Restructuring costs	2,157	0.6	504	0.1	(1,653)	(76.6)
Total operating expenses	\$ 243,562	62.5	\$ 202,282	46.4	\$ (41,280)	(16.9)

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**Research and development expense** was adversely affected by \$4.1 million in foreign exchange rates, primarily due to the weakening of the U.S. dollar in relation to the Canadian dollar. The \$7.7 million decrease primarily reflects decreases of \$5.6 million in prototype expense, \$2.3 million in professional services and fees and \$1.0 million in depreciation expense. Decreases also reflect the \$4.3 million benefit related to the conditional grant from the province of Ontario described above. These decreases were partially offset by increases of \$4.8 million in employee compensation and related costs and \$1.3 million in facilities and information systems.

**Selling and marketing expense** was adversely affected by \$1.2 million in foreign exchange rates primarily due to the weakening of the U.S. dollar in relation to the Euro and the Canadian dollar. The \$9.8 million increase primarily reflects increases of \$6.6 million in employee compensation and related costs, \$1.5 million in facilities and information systems and \$1.1 million in professional services and fees.

**General and administrative expense** decreased by \$3.9 million in professional services and fees and \$4.5 million in facilities and information systems, partially offset by an increase of \$4.7 million in employee compensation and related costs. The decreases in professional services and information systems reflect the termination, in all material respects, of transition services previously performed by an affiliate of Nortel in the second quarter of fiscal 2011.

**Acquisition and integration costs** principally consist of transaction, consulting and third party service fees related to the integration of the MEN Business into the combined operations.



**Amortization of intangible assets** decreased due to certain intangible assets from the MEN Acquisition reaching the end of their economic lives. See Note 3 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report.

**Restructuring costs** primarily reflect the headcount reductions and restructuring activities described in Note 4 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report.

**Table of Contents***Other items*

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

	2010	Quarter Ended July 31, %*	2011	%*	Increase (decrease)	%**
Interest and other income (loss), net	\$ (2,668)	(0.7)	\$ (3,160)	(0.7)	\$ (492)	(18.4)
Interest expense	\$ 5,990	1.5	\$ 9,470	2.2	\$ 3,480	58.1
Provision for income taxes	\$ 1,644	0.4	\$ 1,435	0.3	\$ (209)	(12.7)

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**Interest and other income (loss), net** reflects changes in non-cash gains or losses related to the change in fair value of the embedded redemption feature associated with our 4.0% convertible senior notes due March 15, 2015 and the effect of foreign exchange rates on assets and liabilities denominated in a currency other than the relevant functional currency. See Notes 6 and 14 to the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report for more information regarding the issuance of these convertible notes and the fair value of the redemption feature contained therein.

**Interest expense** increased due to our private placement during fiscal 2010 of \$350.0 million in aggregate principal amount of 3.75% convertible senior notes on October 18, 2010. See Note 14 to the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report.

**Provision for income taxes** remained relatively flat and is primarily related to foreign income tax.

***Nine months ended July 31, 2010 compared to the nine months ended July 31, 2011****Revenue*

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

	2010	Nine Months Ended July 31, %*	2011	%*	Increase (decrease)	%**
Revenue:						
Packet-Optical Transport	\$ 423,216	51.6	\$ 825,667	64.2	\$ 402,451	95.1
Packet-Optical Switching	90,638	11.1	107,223	8.3	16,585	18.3
Carrier Ethernet Service						
Delivery	149,047	18.2	99,034	7.7	(50,013)	(33.6)
Software and Services	156,121	19.1	254,291	19.8	98,170	62.9
Consolidated revenue	\$ 819,022	100.0	\$ 1,286,215	100.0	\$ 467,193	57.0

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**Packet-Optical Transport revenue** increased reflecting a \$324.7 million increase in sales of our 6500 Packet-Optical Platform, largely driven by service provider demand for high-capacity, optical transport, including coherent 40G and 100G network infrastructures. Packet-Optical Transport revenue also benefited from sales increases of \$29.5 million in CPL, \$27.4 million in 5100/5200 Advanced Services Platform, \$23.6 million in 6100 Multiservice Optical Platform, \$7.8 million in 4200 Advanced Services Platform and \$4.5 million in legacy transport products. These increases were partially offset by decreases of \$17.4 million in

Corestream® Agility Optical Transport System.

**Packet-Optical Switching revenue** reflects a \$12.3 million increase in CoreDirector® Multiservice Optical Switches revenue and the addition of \$4.2 million related to 5430 Reconfigurable Switching System.

**Carrier Ethernet Service Delivery revenue** reflects decreases of \$54.2 million in sales of our 3000 and 5000 families of service delivery switches and service aggregation switches. Carrier Ethernet Service Delivery revenue benefited from \$6.3 million in initial revenue from the introduction of the 5410 Service Aggregation Switch to support wireless backhaul, Ethernet business services and residential broadband applications.

**Software and Services revenue** increased reflecting a \$66.9 million increase in maintenance support revenue and \$30.0 million in installation, deployment and consulting services.

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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:

	2010	Nine Months Ended July 31, %*	2011	%*	Increase (decrease)	%**
United States	\$ 534,174	65.2	\$ 678,674	52.8	\$ 144,500	27.1
International	284,848	34.8	607,841	47.2	322,993	113.4
Total	\$ 819,022	100.0	\$ 1,286,515	100.0	\$ 467,493	57.1

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**United States revenue** increased primarily due to a \$162.3 million increase in sales of Packet-Optical Transport products and a \$36.0 million increase in services revenue. These increases were partially offset by a \$50.5 million decrease in Carrier Ethernet Service Delivery sales.

**International revenue** increased primarily due to a \$240.1 million increase in Packet-Optical Transport revenue, a \$60.8 million increase in services revenue, and a \$19.3 million increase in sales of Packet-Optical Switching products. Increased Packet-Optical Transport and services revenue principally reflect the addition of the MEN Business.

*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:

	2010	Nine Months Ended July 31, %*	2011	%*	Increase (decrease)	%**
Total revenue	\$ 819,022	100.0	\$ 1,286,515	100.0	\$ 467,493	57.1
Total cost of goods sold	489,911	59.8	767,279	59.6	277,368	56.6
Gross profit	\$ 329,111	40.2	\$ 519,236	40.4	\$ 190,125	57.8

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

	2010	Nine Months Ended July 31, %*	2011	%*	Increase (decrease)	%**
Product revenue	\$ 667,852	100.0	\$ 1,038,483	100.0	\$ 370,631	55.5
Product cost of goods sold	396,449	59.4	615,283	59.2	218,834	55.2
Product gross profit	\$ 271,403	40.6	\$ 423,200	40.8	\$ 151,797	55.9

\* Denotes % of product revenue

\*\* Denotes % change from 2010 to 2011



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	Nine Months Ended July 31,					
	2010	%*	2011	%*	Increase (decrease)	%**
Service revenue	\$ 151,170	100.0	\$ 248,032	100.0	\$ 96,862	64.1
Service cost of goods sold	93,462	61.8	151,996	61.3	58,534	62.6
Service gross profit	\$ 57,708	38.2	\$ 96,036	38.7	\$ 38,328	66.4

\* Denotes % of service revenue

\*\* Denotes % change from 2010 to 2011

**Gross profit as a percentage of revenue** increased slightly, in spite of less favorable product mix, as a result of the factors described below.

**Gross profit on products as a percentage of product revenue** would have declined due to less favorable product mix but for the adverse effect in fiscal 2010 of a number of items relating to the MEN Acquisition that increased costs of goods sold in that period. These items include \$39.7 million related to the revaluation of inventory and \$6.6 million in excess purchase commitment losses on Ciena's pre-acquisition inventory relating to product rationalization decisions. Fiscal 2011 cost of goods sold included \$14.3 million related to the revaluation of inventory and an \$8.7 million increase in amortization of intangible assets.

**Gross profit on services as a percentage of services revenue** remained relatively flat.

*Operating Expense*

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

	Nine Months Ended July 31,					
	2010	%*	2011	%*	Increase (decrease)	%**
Research and development	\$ 222,044	27.1	\$ 288,630	22.4	\$ 66,586	30.0
Selling and marketing	131,692	16.1	180,755	14.0	49,063	37.3
General and administrative	66,915	8.2	98,966	7.7	32,051	47.9
Acquisition and integration costs	83,285	10.2	39,748	3.1	(43,537)	(52.3)
Amortization of intangible assets	61,829	7.5	56,131	4.4	(5,698)	(9.2)
Restructuring costs	3,985	0.5	5,190	0.4	1,205	30.2
Change in fair value of contingent consideration		0.0	(3,289)	(0.3)	(3,289)	100.0
Total operating expenses	\$ 569,750	69.6	\$ 666,131	51.7	\$ 96,381	16.9

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**Research and development expense** was adversely affected by \$10.6 million in foreign exchange rates, primarily due to the weakening of the U.S. dollar in relation to the Canadian dollar. The \$66.6 million increase primarily reflects increases of \$49.0 million in employee compensation and related costs, \$13.2 million in facilities and information systems, \$10.0 million in professional services and fees, \$5.8 million in depreciation expense, partially offset by a decrease of \$7.1 million in prototype expense and \$4.3 million benefit related to the conditional grant from the province of Ontario described above.

**Selling and marketing expense** was adversely affected by \$1.5 million in foreign exchange rates, primarily due to the weakening of the U.S. dollar in relation to the Canadian dollar. The \$49.1 million increase primarily reflects increases of \$31.8 million in employee compensation and related costs, \$6.0 million in facilities and information systems, \$4.5 million in travel-related expenditures, \$3.4 million in channel marketing programs expense and trade show costs, \$2.6 million in professional services and fees, and \$1.4 million in depreciation expense.

**General and administrative expense** was adversely affected by \$0.7 million in foreign exchange rates, primarily due to the weakening of the U.S. dollar in relation to the Canadian dollar. The \$32.1 million increase primarily reflects increases of \$19.9 million in employee compensation and related costs, \$7.3 million in professional services and fees, and \$4.7 million in facilities and information systems expense.

**Acquisition and integration costs** principally consist of transaction, consulting and third party service fees related to the integration of the MEN Business into the combined operations.

**Amortization of intangible assets** decreased due certain intangible assets from the MEN Acquisition reaching the end

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of their economic lives. See Note 3 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report.

**Restructuring costs** primarily reflect the headcount reductions and restructuring activities described in Note 4 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report.

**Change in fair value of contingent consideration** is related to the contingent refund right we received relating to the Carling lease entered into as part of the MEN Acquisition. See Note 3 to our Condensed Consolidated Financial Statements in Item 1 of Part I for additional information relating to Nortel's exercise of its early termination of the Carling lease.

*Other items*

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

	Nine Months Ended July 31,					
	2010	%*	2011	%*	Increase (decrease)	%**
Interest and other income (loss), net	\$ 307		\$ 7,334	0.6	\$ 7,027	(2,288.9)
Interest expense	\$ 11,931	1.5	\$ 28,426	2.2	\$ 16,495	138.3
Provision for income taxes	\$ 934	0.1	\$ 5,205	0.4	\$ 4,271	457.3

\* Denotes % of total revenue

\*\* Denotes % change from 2010 to 2011

**Interest and other income (loss), net** reflects increases of \$5.3 million due to the positive effect of foreign exchange rates on assets and liabilities denominated in a currency other than the relevant functional currency. Fiscal 2010 reflects a \$2.0 million charge relating to the termination of an indemnification asset upon the expiration of the statute of limitations applicable to one of the uncertain tax contingencies acquired as part of the MEN Acquisitions.

**Interest expense** increased due to our private placements during fiscal 2010 of \$375.0 million in aggregate principal amount of 4.0% convertible senior notes on March 15, 2010 and \$350.0 million in aggregate principal amount of 3.75% convertible senior notes on October 18, 2010. See Note 14 to the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report.

**Provision for income taxes** increased primarily due to increased foreign taxes.

*Segment Profit (Loss)*

The table below (in thousands, except percentage data) sets forth the changes in our segment profit (loss), including the presentation of prior periods to reflect the change in reportable segments, for the respective periods:

	Quarter Ended July 31,			
	2010	2011	Increase (decrease)	%*
Segment profit (loss):				
Packet-Optical Transport	\$ 12,874	\$ 51,827	\$ 38,953	302.6
Packet-Optical Switching	\$ 10,320	\$ 12,783	\$ 2,463	23.9
Carrier Ethernet Service Delivery	\$ (3,212)	\$ 6,519	\$ 9,731	303.0
Software and Services	\$ 23,158	\$ 20,552	\$ (2,606)	(11.3)



\* Denotes % change from 2010 to 2011

**Packet-Optical Transport segment profit** during fiscal 2010 was significantly reduced by the revaluation of the acquired finished goods inventory of the MEN Business to fair value upon closing described above. In addition, increased segment profit benefitted from higher sales volume and lower research and development costs.

**Packet-Optical Switching segment profit** increased due to higher sales volume and lower research and development costs, partially offset by lower gross margin.

**Carrier Ethernet Service Delivery segment profit** increased due to higher sales volume, increased gross margin and lower research and development costs.

**Software and Services segment profit** decreased due to lower gross margin, increased research and development costs, partially offset by increased sales volume.

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	Nine Months Ended July 31,		Increase (decrease)	%*
	2010	2011		
Segment profit (loss):				
Packet-Optical Transport	\$ 26,402	\$ 127,359	\$ 100,957	382.4
Packet-Optical Switching	\$ 13,749	\$ 34,147	\$ 20,398	148.4
Carrier Ethernet Service Delivery	\$ 31,642	\$ 12,409	\$ (19,233)	(60.8)
Software and Services	\$ 35,274	\$ 56,691	\$ 21,417	60.7

\* Denotes % change from 2010 to 2011

**Packet-Optical Transport segment profit** increased primarily due to higher sales volume. Also, segment profit during fiscal 2010 was significantly reduced by the revaluation of the acquired finished goods inventory of the MEN Business to fair value upon closing and the excess purchase commitment losses on Ciena's pre-acquisition inventory relating to product rationalization decisions described above.

**Packet-Optical Switching segment profit** increased due to higher sales volume and decreased research and development costs, partially offset by lower product gross margin.

**Carrier Ethernet Service Delivery segment profit** decreased due to lower sales volume, partially offset by higher gross margin and decreased research and development costs.

**Software and Services segment profit** was significantly affected by the MEN Acquisition. Segment profit increased due to increased sales volume, partially offset by increased research and development costs.

**Liquidity and Capital Resources**

At July 31, 2011, our principal sources of liquidity were cash and cash equivalents and long-term investments in marketable debt securities, representing U.S. treasuries. The following table summarizes our cash and cash equivalents and long-term investments (in thousands):

	October 31, 2010	July 31, 2011	Increase (decrease)
Cash and cash equivalents	\$ 688,687	\$ 486,332	\$ (202,355)
Long-term investments in marketable debt securities		50,227	50,227
Total cash and cash equivalents and investments in marketable debt securities	\$ 688,687	\$ 536,559	\$ (152,128)

During the first nine months of fiscal 2011, we received \$33.5 million related to the early termination of the Carling lease, of which \$17.1 million reduced cash used by operations and \$16.4 million reduced cash used by investing activities. See Note 3 to our Condensed Consolidated Financial Statements in Item 1 of Part I for additional information relating to the valuation of this contingent refund right at closing of the MEN Acquisition and the early termination of the Carling lease.

The decrease in total cash and cash equivalents and investments in marketable debt securities during the first nine months of fiscal 2011, including the effect of the receipt of the early termination payment above, was primarily related to the following:

\$132.5 million cash used from operations, consisting of \$129.3 million for changes in working capital and \$3.2 million in net losses (adjusted for non-cash charges). Use of cash reflects cash payments of \$59.5 million of acquisition and integration-related expense and restructuring costs, of which \$45.7 million was reflected in net losses (adjusted for non-cash charges) and \$13.8 million was reflected in changes in working capital,

\$41.1 million for purchases of equipment, furniture, fixtures and intellectual property; and

\$8.7 million transferred to restricted cash related to collateral for our standby letters of credit.

These decreases were partially offset by receipts of \$13.2 million from stock issuances upon sales under our employee stock purchase plan and the exercise of stock options.

As expected, the investment in working capital for the first nine months of fiscal 2011 reflects the increased scale of our business as the result of the MEN Acquisition. We regularly evaluate our liquidity position, debt obligations, and anticipated

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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 existing operations through at least the next 12 months.

The following sections set forth the components of our \$132.5 million of cash used by operating activities during the first nine months of fiscal 2011:

*Net loss (adjusted for non-cash charges)*

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

	Nine months ended July 31, 2011
Net loss	\$ (173,192)
Adjustments for non-cash charges:	
Amortization of premium on marketable securities	(25)
Change in fair value of embedded redemption feature	(3,380)
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	44,765
Share-based compensation costs	27,919
Amortization of intangible assets	76,567
Provision for inventory excess and obsolescence	11,461
Provision for warranty	10,538
Other	2,170
Net losses (adjusted for non-cash charges)	\$ (3,177)

*Working Capital**Accounts Receivable, Net*

Cash used by accounts receivable, net of \$0.9 million in allowance for doubtful accounts, during the first nine months of fiscal 2011 was \$72.0 million primarily due to higher sales volume. Our days sales outstanding (DSOs) increased slightly from 86 days for the first nine months of fiscal 2010 to 87 days for the first nine months of fiscal 2011. Our DSOs increased due to an increase in international sales, which generally involve longer payment cycles. The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2010 through the end of the third quarter of fiscal 2011:

	October 31, 2010	July 31, 2011	Increase (decrease)
Accounts receivable, net	\$ 343,582	\$ 414,826	\$ 71,244

*Inventory*

Cash generated by inventory during the first nine months of fiscal 2011 was \$6.3 million. Our inventory turns increased from 2.4 turns during the first nine months of fiscal 2010 to 4.2 turns during the first nine months of fiscal 2011. During the first nine months of fiscal 2011, changes in inventory reflect an \$11.5 million reduction related to a non-cash provision for excess and obsolescence. The following table sets forth (in thousands) changes to the components of our inventory from the end of fiscal 2010 through the end of the third quarter of fiscal 2011:

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	October 31, 2010	July 31, 2011	Increase (decrease)
Raw materials	\$ 30,569	\$ 41,970	\$ 11,401
Work-in-process	6,993	12,271	5,278
Finished goods	177,994	154,161	(23,833)
Deferred cost of goods sold	76,830	66,758	(10,072)
Gross inventory	292,386	275,160	(17,226)
Provision for inventory excess and obsolescence	(30,767)	(31,333)	(566)
Inventory	\$ 261,619	\$ 243,827	\$ (17,792)

*Prepaid expense and other*

Cash used by prepaid expense and other during the first nine months of fiscal 2011 was \$4.5 million. This usage was primarily related to increases in product demonstration units and non-trade receivables, partially offset by the receipt of the contingent refund receivable related to the Carling Lease termination.

*Accounts payable, accruals and other obligations*

Cash used in operations related to accounts payable, accruals and other obligations during the first nine months of fiscal 2011 was \$81.4 million. Between the end of fiscal 2010 and the third quarter of fiscal 2011, the change in unpaid equipment purchases was \$0.1 million. Changes in accrued liabilities reflect non-cash provisions of \$10.5 million related to warranties. The following table sets forth (in thousands) changes in our accounts payable, accruals and other obligations from the end of fiscal 2010 through the end of the third quarter of fiscal 2011:

	October 31, 2010	July 31, 2011	Increase (decrease)
Accounts payable	\$ 200,617	\$ 140,806	\$ (59,811)
Accrued liabilities	193,994	182,563	(11,431)
Other long-term obligations	16,435	16,754	319
Accounts payable, accruals and other obligations	\$ 411,046	\$ 340,123	\$ (70,923)

*Interest Payable on Convertible Notes*

Interest on our outstanding 0.25% convertible senior notes, due May 1, 2013, is payable on May 1 and November 1 of each year. We paid \$0.5 million in interest on these convertible notes during the first nine months of fiscal 2011.

Interest on our outstanding 4.0% convertible senior notes, due March 15, 2015, is payable on March 15 and September 15 of each year. We paid \$7.5 million in interest on these convertible notes during the first nine months of fiscal 2011.

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 \$4.4 million in interest on these convertible notes during the first nine months of fiscal 2011.

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 \$6.5 million in interest on these convertible notes during the first nine months of fiscal 2011.

For additional information about our convertible notes, see Note 14 to the Condensed Consolidated Financial Statements under Item 1 of Part I of this report

*Deferred revenue*

Deferred revenue increased by \$22.2 million during the first nine months of fiscal 2011. 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 2010 through the end of the third quarter of fiscal 2011:

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	October 31, 2010	July 31, 2011	Increase (decrease)
Products	\$ 31,187	\$ 39,811	\$ 8,624
Services	73,862	87,479	13,617
Total deferred revenue	\$ 105,049	\$ 127,290	\$ 22,241

**Contractual Obligations**

During the first quarter of fiscal 2011, we received notice from Nortel of the exercise of its early termination rights under the Carling lease, shortening our lease term from ten years to five years and materially reducing the operating lease commitments in the table below. The following is a summary of our future minimum payments under contractual obligations as of July 31, 2011 (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Interest due on convertible notes	\$ 185,769	\$ 33,041	\$ 65,541	\$ 50,000	\$ 37,187
Principal due at maturity on convertible notes	1,441,210		216,210	375,000	850,000
Operating leases (1)	106,645	30,956	49,785	19,296	6,608
Purchase obligations (2)	207,510	207,510			
Total (3)	\$ 1,941,134	\$ 271,507	\$ 331,536	\$ 444,296	\$ 893,795

- (1) The amount for operating leases above does not include insurance, taxes, maintenance and other costs required by the applicable operating lease. These costs are variable and are not expected to have a material impact.
- (2) Purchase obligations relate to purchase order commitments to our contract manufacturers and component suppliers for inventory. In certain instances, we are permitted to cancel, reschedule or adjust these orders. Consequently, only a portion of the amount reported above relates to firm, non-cancelable and unconditional obligations.
- (3) As of July 31, 2011, we also had approximately \$7.7 million of other long-term obligations in our Condensed Consolidated Balance Sheet for unrecognized tax positions that are not included in this table because the 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 by 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 July 31, 2011, 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
Standby letters of credit	\$ 61,073	\$ 56,791	\$ 3,876	\$ 406

**Off-Balance Sheet Arrangements**

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

**Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expense, and related disclosure of contingent assets and liabilities. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. On an ongoing basis, we reevaluate our estimates, including those related to bad debts, inventories, intangible 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.



**Table of Contents***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 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, 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.

*Accounting for multiple element arrangements entered into prior to fiscal 2011*

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

*Accounting for multiple element arrangements entered into or materially modified in fiscal 2011*

In October 2009, the Financial Accounting Standards Board, ( FASB ) amended the accounting standard for revenue recognition with multiple deliverables which provided guidance on how the arrangement fee should be allocated. The amended guidance allows the use of management's best estimate of selling price ( BESP ) for individual elements of an arrangement when VSOE or third-party evidence ( TPE ) is unavailable. Additionally, it eliminates the residual method of revenue recognition in accounting for multiple deliverable arrangements. The FASB also amended the accounting guidance for revenue arrangements with software elements to exclude from the scope of the software revenue

recognition guidance, tangible products that contain both software and non-software components that function together to deliver the product's essential functionality.

We adopted the new accounting guidance on a prospective basis for arrangements entered into or materially modified on or after November 1, 2010. Under the new guidance, we separate elements into more than one unit of accounting if the delivered element(s) have value to the customer on a stand-alone basis, and delivery of the undelivered element(s) is probable and substantially in our control. Therefore, the new guidance allows for deliverables, for which revenue was previously deferred due to an absence of fair value, to be separated and recognized as revenue as delivered. Also, because the residual method has been eliminated, discounts offered are allocated to all deliverables, rather than to the delivered element(s).

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Our adoption of the new guidance for revenue arrangements changed the accounting for certain products that consist of hardware and software components, in which these components together provided the product's essential functionality. For transactions involving these products entered into prior to fiscal 2011, we recognized revenue based on software revenue recognition guidance.

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each element, with revenue recognized when the revenue recognition criteria are met for each delivered element. We determine the selling price for each deliverable based upon the selling price hierarchy for multiple-deliverable arrangements. Under this hierarchy, we use VSOE of selling price, if it exists, or TPE of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, we use our BEBP for that deliverable.

VSOE is established based on our standard pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, which exists across certain of our service offerings, we require that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range. We have generally been unable to establish TPE of selling price because our go-to-market strategy differs from that of others in our markets, and the extent of customization and differentiated features and functions varies among comparable products or services from our peers. We determine BEBP 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.

Historically, for arrangements with multiple elements, we were typically able to establish fair value for undelivered elements and so we applied the residual method. As a result, assuming the adoption of the accounting guidance above on a prospective basis for arrangements entered into or materially modified on or after November 1, 2009, the effect on revenue recognized for the nine months ended July 31, 2010 would not have been materially different.

The new accounting guidance for revenue recognition is not expected to have a significant effect on revenue after the initial period of adoption when applied to multiple-element arrangements based on our current go-to-market strategies. However, we expect that this new accounting guidance will facilitate our efforts to optimize our offerings due to the better alignment between the economics of an arrangement and the accounting. This may lead to engaging in new go-to-market practices in the future. In particular, we expect that the new accounting standards will enable us to better integrate products and services without VSOE into existing offerings and solutions. As these go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in selling prices, including both VSOE and BEBP. As a result, our future revenue recognition for multiple-element arrangements could differ materially from the results in the current period. We are currently unable to determine the impact that the newly adopted accounting guidance could have on our revenue as these go-to-market strategies evolve.

Our total deferred revenue for products was \$31.2 million and \$39.8 million as of October 31, 2010 and July 31, 2011, 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 \$73.9 million and \$87.5 million as of October 31, 2010 and July 31, 2011, respectively.

***Business Combinations***

We record acquisitions using the purchase method of accounting. All of the assets acquired, liabilities assumed, contractual contingencies and contingent consideration are recognized at their fair value as of the acquisition date. The excess of the purchase price over the estimated fair values of the net tangible and net intangible assets acquired is recorded as goodwill. The application of the purchase method of accounting for business combinations requires management to make significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration between assets that are depreciated and amortized from goodwill. These assumptions and estimates include a market participant's use of the asset and the appropriate discount rates for a market participant. Our estimates are based on historical experience, information obtained from the management of the acquired companies and, when appropriate, includes assistance from independent third-party appraisal firms. Our significant assumptions and estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and

unpredictable. In addition, unanticipated events and circumstances may occur which may affect the accuracy or validity of such estimates. During fiscal 2010, we completed the MEN Acquisition for a purchase price of \$676.8 million. As a result of the purchase price allocation to the assets acquired and liabilities assumed, as well as contingent consideration, there was no value assigned to goodwill. See Note 3 to the Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

**Table of Contents*****Share-Based Compensation***

We measure and recognize compensation expense for share-based awards based on estimated fair values on the date of grant. We estimate the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This option pricing model requires that we make several estimates, including the option's expected life and the price volatility of the underlying stock. The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding. We calculate the expected term using detailed historical information about specific exercise behavior of our grantees. We considered the implied volatility and historical volatility of our stock price in determining our expected volatility, and, finding both to be equally reliable, determined that a combination of both measures would result in the best estimate of expected volatility. We recognize the estimated fair value of option-based awards, net of estimated forfeitures, as share-based compensation expense on a straight-line basis over the requisite service period.

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 July 31, 2011, total unrecognized compensation expense was \$67.8 million: (i) \$1.8 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 0.6 year; and (ii) \$66.0 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.7 years.

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

***Reserve for Inventory Obsolescence***

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount

equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. Upon recognition of the write down, a new lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. We recorded charges for excess and obsolete inventory of \$10.7 million and \$11.5 million in the first nine months of fiscal 2010 and 2011, respectively. These charges were primarily related to excess inventory due to a change in forecasted sales across our product line. 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.

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Each of these practices exposes us to the risk that our customers will not order products for which we have forecasted sales, or will purchase less than we have forecasted. Historically, we have experienced write downs due to changes in strategic direction, discontinuance of a product and declines in market conditions. If actual market conditions worsen or differ from those we have assumed, if there is a sudden and significant decrease in demand for our products, or if there is a higher incidence of inventory obsolescence due to a rapid change in technology, we may be required to take additional inventory write-downs, and our gross margin could be adversely affected. Our inventory net of allowance for excess and obsolescence was \$261.6 million and \$243.8 million as of October 31, 2010 and July 31, 2011, 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 \$343.6 million and \$414.8 million as of October 31, 2010 and July 31, 2011, respectively. Our allowance for doubtful accounts was \$0.1 million and \$0.9 million as of October 31, 2010 and July 31, 2011, respectively.

***Long-lived Assets***

Our long-lived assets include: equipment, furniture and fixtures; finite-lived intangible assets; and maintenance spares. As of October 31, 2010 and July 31, 2011 these assets totaled \$600.4 million and \$526.1 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.

***Derivatives***

Our 4.0% convertible senior notes include a redemption feature that is accounted for as a separate embedded derivative. The embedded redemption feature is bifurcated from these 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 these 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 our stock, the recovery rates of bonds, and the implied default intensity of the 4.0% convertible senior notes. The embedded redemption feature is recorded at fair value on a recurring basis and these changes are included in interest and other income (expense), net on the Condensed Consolidated Statement of Operations. We recorded a \$3.4 million non-cash gain related to the change in fair value of this embedded redemption feature in the first nine months of fiscal 2011.

***Deferred Tax Valuation Allowance***

As of July 31, 2011, we have recorded a valuation allowance offsetting nearly all our net deferred tax assets of \$1.4 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.

***Uncertain Tax Positions***

We account for uncertainty in income tax positions using a two-step approach. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any.



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The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made. As of July 31, 2011, we had \$0.9 million and \$7.7 million recorded as current and long-term obligations, respectively, related to uncertain tax positions. The provision for income taxes includes the effect of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest. The total amount of unrecognized tax benefits as of July 31, 2011 was \$8.6 million, which includes \$1.6 million of interest and some minor penalties.

**Warranty**

Our liability for product warranties, included in other accrued liabilities, was \$54.4 million and \$45.7 million as of October 31, 2010 and July 31, 2011, respectively. Our products are generally covered by a warranty for periods ranging from one to five years. We accrue for warranty costs as part of our cost of goods sold based on associated material costs, technical support labor costs, and associated overhead. Material cost is estimated based primarily upon historical trends in the volume of product returns within the warranty period and the cost to repair or replace the equipment. Technical support labor cost is estimated based primarily upon historical trends and the cost to support the customer cases within the warranty period. The provision for product warranties was \$16.4 million and \$10.5 million for the first nine months of fiscal 2010 and 2011, respectively. As a result of the substantial completion of integration activities related to the MEN Acquisition, Ciena consolidated certain support operations and processes during the first quarter of fiscal 2011, resulting in a reduction in costs to service future warranty obligations. Due to this consolidation and resulting efficiencies, Ciena expects to realize lower failure rate costs and accordingly reversed a \$6.9 million non-cash loss contingency included in its warranty liability. The provision for warranty claims may fluctuate on a quarterly basis depending upon the mix of products and customers in that period. If actual product failure rates, material replacement costs, service or labor costs differ from our estimates, revisions to the estimated warranty provision would be required. An increase in warranty claims or the related costs associated with satisfying these warranty obligations could increase our cost of sales and negatively affect our gross margin.

**Loss Contingencies**

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

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

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

**Interest Rate Sensitivity.** We currently hold an investment in a U.S. Government obligation that matures in January 2013. See Notes 5 and 6 to our Condensed Consolidated Financial Statements for information relating to investments and fair value. This investment is sensitive to interest rate movements and its fair value will decline as interest rates rise and increase as interest rates decline. The estimated impact on this investment 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 \$0.8 million decline in value.

**Foreign Currency Exchange Risk.** As a global concern, our business and results of operations are exposed to adverse movements in foreign currency exchange rates. Historically, our sales have primarily been denominated in U.S. dollars and the impact of foreign currency fluctuations on revenue has not been material. As a result of our

increased global presence, in large part resulting from the MEN Acquisition, a larger percentage of our revenue is non-U.S. dollar denominated with Canadian Dollars and Euros being our most significant foreign currency revenue streams. As a result, if the U.S. dollar strengthens against these currencies, our revenues could be adversely affected. 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.

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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 nine months of fiscal 2011, approximately 45.3% of our operating expense was non-U.S. dollar denominated. If these currencies strengthen, costs reported in U.S. dollars will increase, which would adversely affect our operating results. For the first nine months of fiscal 2011, research and development was negatively affected by approximately \$10.6 million, net of hedging, due to unfavorable foreign exchange rates related to the weakening of the U.S. dollar in relation to the Canadian Dollar.

From time to time, Ciena uses foreign currency forward contracts to reduce part of the variability in certain forecasted non-U.S. dollar denominated cash flows. Generally, these derivatives are for maturities of 12 months or less and are designated as cash flow hedges. Ciena considers several factors when evaluating hedges of its forecasted foreign currency exposures, such as significance of the exposure, offsetting economic exposures, potential costs of hedging, and the potential for hedge ineffectiveness. Ciena does not enter into derivative transactions for purposes other than hedging economic exposures. During the second and third quarters of fiscal 2011, Ciena entered into forward contracts to reduce the variability in its Canadian Dollar and Indian Rupee denominated operating expenses which principally relate to the Company's research and development activities.

*Convertible Debt 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 14 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 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 were no changes 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.

As described elsewhere in this report, we acquired the MEN Business on March 19, 2010. During the second quarter of fiscal 2011, we integrated the MEN Business operations into Ciena's enterprise resource planning system and other critical business systems. This system integration enabled us to substantially end our reliance upon transition services performed by an affiliate of Nortel following the MEN Acquisition and represented the completion of our critical integration milestones. The combined operations will be part of our evaluation of the effectiveness of internal control over financial reporting in our Annual Report on Form 10-K for our fiscal year ending October 31, 2011, in which report we will be initially required to include the MEN Business in our annual assessment.

**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. Patents relating to certain reconfigurable optical add-drop multiplexer (ROADM) technologies. The complaint seeks injunctive relief and damages. We believe that we have valid defenses to the lawsuit and intend to defend it vigorously.



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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. Ciena filed an amended answer to the complaint and counterclaims against Graywire on April 17, 2009. On April 27, 2009, Ciena and certain other defendants filed an application for inter partes reexamination of the '673 Patent with the U.S. Patent and Trademark Office (the PTO). On the same date, Ciena and the other defendants filed a motion to stay the case pending reexamination of all of the patents-in-suit. On July 17, 2009, the district court granted the defendants' motion to stay the case. On July 23, 2009, the PTO granted the defendants' application for reexamination with respect to certain claims of the '673 Patent and, on December 17, 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims. On February 28, 2011, Ciena and the other defendants filed an appeal with respect to certain aspects of the PTO's determination. Separately, on March 17, 2011, the PTO granted a third party application for ex parte reexamination with respect to certain claims of the '673 Patent and, on September 2, 2011, the PTO issued a non-final rejection of those claims. We believe that we have valid defenses to the lawsuit and intend to defend it vigorously in the event the stay of the case is lifted.

As a result of its June 2002 merger with ONI Systems Corp., we became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI's initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI's registration statement and by engaging in manipulative practices to artificially inflate ONI's stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters' alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and all of these actions have been included in a single coordinated proceeding. On October 6, 2009, the Court entered an opinion granting final approval to a settlement among the plaintiffs, issuer defendants and underwriter defendants, and directing that the Clerk of the Court close these actions. All appeals of the opinion granting final approval have been either resolved or dismissed, except one. On August 25, 2011, on remand from the Second Circuit, the District Court determined that the last remaining appellant did not have standing to assert his appeal. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena's Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 22, 2010. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation and because the settlement remains subject to appeal, the ultimate outcome of the matter is uncertain.

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

**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 21.6% of fiscal 2010 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 introduction and adoption of new communications products and services, and the capacity, speed and service delivery capability of networks required to meet end user demands. 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 customers increases our exposure to changes in their network and purchasing strategies. Some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce the number of vendors from which they purchase equipment, which may benefit our larger competitors. Our concentration in revenue has increased in recent years, in part, 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 large service provider customers, or a significant reduction in their spending, would have a material adverse effect on our business, financial condition and results of operations.

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

Our revenue and results of operations can fluctuate unpredictably from quarter to quarter. Our budgeted expense levels depend in part on our expectations of long-term, future revenue and gross margin, and substantial reductions in expense are difficult and can take time to implement.

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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 corresponding expense levels. Consequently, our level of operating expense or inventory may be high relative to revenue, which could harm our profitability and cash flow. Increases in the percentage of quarterly revenue relating to orders placed in that quarter, along with significant order volume late in the quarter, could further result in variability and less predictability in our quarterly results.

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

broader macroeconomic conditions, including weakness and volatility in global markets, affecting our customers and their consumer and enterprise end users;

changes in capital spending by large communications service providers;

the timing and size of orders and our ability to recognize revenue relating to these sales;

the mix of revenue by product segment, geography and customer in any particular quarter;

the level of pricing pressure we encounter, particularly for our Packet-Optical Transport products which comprise a significant concentration of our revenue;

the transition of product sales to new, next-generation technology platforms across our segments; and

changes in material and labor costs, including our ability to optimize our resources, improve manufacturing efficiencies and achieve cost reductions in our supply chain.

Many factors affecting our results of operations are beyond our control, particularly in the case of large service provider orders and multi-vendor or multi-technology network infrastructure builds where the achievement of certain thresholds for acceptance is subject to the readiness and performance of the customer or other providers, and changes in customer requirements or installation plans. The factors above may cause our revenue and operating results to fluctuate unpredictably from quarter to quarter. These fluctuations may cause our operating results to be below the expectations of securities analysts or investors, which may cause our stock price to decline.

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

We face an extremely competitive market for sales of communications networking equipment, software and services. Competition is particularly intense as we and our competitors more aggressively seek to displace incumbent equipment vendors at large carrier customers and secure new customers and additional market share for new, next-generation products. In an effort to secure customer opportunities and capture market share, we have in the past, and may in the future, agree to onerous 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 and potentially increase, particularly in the U.S., as larger Chinese equipment vendors seek to gain market entry and other global competitors seek to retain incumbent positions with customers in the region.

Competition in our markets, generally, is based on any one or a combination of the following factors: price, product features, functionality and performance, service offering, manufacturing capability and lead-times, incumbency and existing business relationships, scalability and the flexibility of products to meet the immediate and future network and service requirements of customers. A small number of very large companies have dominated our industry. These competitors have substantially greater financial and marketing resources, greater manufacturing capacity, broader product offerings and more established relationships with service providers and other potential customers than we do. Because of their scale and resources, they may be perceived to be 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.

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

- significant price competition, particularly for our Packet-Optical Transport platforms;
- early announcement of product development initiatives and new platform offerings;
- customer financing assistance provided by other vendors or their sponsors;
- assumption of onerous or atypical commercial terms that involve a greater degree of risk;
- offers to repurchase our equipment from existing customers; and
- intellectual property assertions and disputes.



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

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

We rely upon third party contract manufacturers to perform the substantially all of the manufacturing of our products and a significant portion of our component sourcing. We do not have contracts in place with some of our manufacturers, do not have guaranteed supply of components or access to manufacturing capacity, and in some cases are utilizing temporary or transitional commercial arrangements intended to facilitate the integration of the MEN Business. Our reliance upon third party manufacturers could expose us to increased risks related to lead times, continuity of supply, on-time delivery, quality assurance, and compliance with environmental standards and other regulations. Reliance upon third party manufacturers exposes us to risks related to their operations, financial position, business continuity and continued viability. Our operations may also be affected by geopolitical events, natural disasters, military actions or health pandemics in the countries where our products or critical components are manufactured. Our product manufacturing principally takes place in Mexico, Canada, Thailand and China. Significant disruptions in these countries affecting supply and manufacturing capacity, or other difficulties with our contract manufacturers would negatively affect our business and results of operations.

In an effort to drive cost reductions and further optimize Ciena's operations following the MEN Acquisition, we are working to rationalize our supply chain and consolidate third party contract manufacturers and distribution facilities. We also intend to pursue additional opportunities for direct fulfillment of products from our manufacturers to our customers. There can be no assurance that these efforts, including any reallocation of the third party manufacturing and sourcing or changes in fulfillment involving our manufacturers, will not ultimately result in additional costs, changes in quality or disruptions in our operations and business.

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

We depend on third party suppliers for our product components and subsystems, as well as for equipment used to manufacture and test our products. Our products include key optical and electronic components for which reliable, high-volume supply is often available only from sole or limited sources. Increases in market demand or periods of economic weakness have previously resulted in shortages in availability of important components. Unfavorable economic conditions or other challenges in their businesses can affect our suppliers' liquidity levels, ability to continue to invest in their business, stocking of components in sufficient quantity, and increased lead times, and can result in a higher incidence of component discontinuation. These difficulties could result in lost revenue, additional product costs 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 relating to the MEN Business, are relying upon temporary or transitional commercial arrangements intended to facilitate the integration. 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 of difficulties with key suppliers affecting the price, quality, availability or timely delivery of required components.

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

The market for communications networking equipment is characterized by rapidly evolving technologies and changes in market demand. We continually invest in research and development to sustain or enhance our existing products and develop or acquire new product technologies. Our current development efforts are focused upon the platform evolution of our CoreDirector Multiservice Optical Switch family to our 5430 Reconfigurable Switching System, expansion of our service delivery and aggregation switches, and extension of our 40G and 100G coherent technologies and capabilities for our Packet-Optical Transport platforms. There is often a lengthy period between

commencing these development initiatives and bringing a new or improved product to market. During 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.

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There is also a possibility that we may miss a market opportunity because we failed to invest, or invested too late, in a technology, product or enhancement. Changes in market demand or investment priorities may also cause us to discontinue existing or planned development for new products or features, which can have a disruptive effect on our relationships with customers. These product development risks can be compounded in the context of rationalizing offerings and the significant development work required to integrate products and network management software following a significant acquisition. 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.

**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.**

Global markets have experienced a recent period of significant volatility that has resulted in heightened uncertainty and cautious customer behavior. 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. Continuation of or an increase in these challenging market conditions and macroeconomic weakness could result in:

reductions in customer capital spending and delay or deferral of network initiatives;

difficulty forecasting, budgeting and planning;

increased competition for fewer network projects and sales opportunities;

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

higher overhead costs as a percentage of revenue;

tightening of credit markets to fund capital expenditures by our customers and us;

customer financial difficulty, including longer collection cycles and other difficulties collecting accounts receivable; and

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

Our business and operating results could be materially affected by reduced customer spending in response to unfavorable or uncertain macroeconomic and market conditions, globally or specific to a particular region where we operate.

**The international scale of our operations could expose us to additional risks and expense and adversely affect our results of operations.**

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

effects of changes in currency exchange rates;

more unfavorable commercial terms;

greater difficulty in collecting accounts receivable and longer collection periods;

difficulties and costs of staffing and managing foreign operations;

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

less protection for intellectual property rights in some countries;

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

social, political and economic instability;

higher incidence of corruption 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.

Moreover, while we have seen early progress and sales opportunities with new customers in the Middle East, there can be no assurance that recent instability and unrest in the region will not adversely affect our business, operations and financial results relating to these and other opportunities. We expect that we may enter new markets and withdraw from or reduce operations in others. In some countries, our success will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements could adversely affect our business and operations. Our global operations may result in increased risk and expense to our business and could give rise to unanticipated liabilities or difficulties that could adversely affect our operations and financial results.

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**Product performance problems and undetected errors 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, including any unforeseen security vulnerabilities, can relate to the design, manufacturing and installation of our products, as well as defects in components, software or manufacturing, installation or maintenance services supplied by third parties. These product performance, reliability and quality problems can negatively affect our business, including:

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

payment of liquidated damages, contractual or similar penalties, or other claims for performance failures or delays;

increased inventory obsolescence;

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

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

delays in recognizing revenue or collecting accounts receivable; and

declining sales and order cancellations.

Product performance problems could also damage our business reputation and harm our prospects with potential customers. These consequences of product defects or quality problems, including any significant costs to remediate, 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.**

Our future success will depend in large part on our ability to maintain and expand our sales to large communications service providers. These sales typically involve lengthy sales cycles, 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 contract terms or conditions that adversely affect pricing, expose us to penalties for delays or non-performance, allocate to us a disproportionate amount of risk, and extend the timing of payment and revenue recognition. We may also be requested to provide deferred payment terms, vendor or third-party financing, or offer other alternative purchase structures. These terms may negatively affect our revenue and results of operations and increase our risk and susceptibility to quarterly fluctuations in our results. Service providers may ultimately insist upon terms and conditions that we deem too onerous or not in our best interest. Moreover, our purchase agreements generally do not include minimum purchase commitments and customers often have the right to modify, delay, reduce or cancel previous orders. As a result, we may incur substantial expense and devote time and resources to potential sales opportunities that never materialize or result in lower than anticipated sales.

**We may not be successful in selling our products into new markets and developing and managing new sales channels.**

We have expanded our geographic presence significantly in recent years, including as a result of our acquisition of the MEN Business. We continue to take steps to sell our products into new markets and to a broader customer base,

including other large communications service providers, enterprises, wireless operators, cable operators, submarine network operators, content providers, research and education institutions, and federal, state and local governments. In many cases, we have less experience in these markets and customers have less familiarity with our company. To succeed in some of these markets we believe we must develop and manage new sales channels and distribution arrangements. We expect these relationships to be an important part of our business internationally as well as for sales to federal, state and local governments. Failure to manage additional sales channels effectively, and exposure to liabilities relating to their actions or omissions, would limit our ability to succeed in these new markets and could adversely affect our result of operations and the growth of our business.

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

Our products are based on complex technology, and we can experience unanticipated delays in developing, manufacturing or deploying them. Each step in the development life cycle of our products presents serious risks of failure, rework or delay, any one of which could adversely affect the cost-effective and timely development of our products. The development of our products, including the integration of the products acquired from the MEN Business into our portfolio and the development of an integrated software tool to manage the combined portfolio, present significant complexity. In addition, intellectual property disputes, failure of critical design elements, and other execution risks may delay or even prevent the release of these products. Delays in product development may affect our reputation with customers and the timing and level of demand for our products. If we do not develop and successfully introduce products in a timely manner, our competitive position may suffer and our business, financial condition and results of operations would be harmed.

**We may be required to write off significant amounts of inventory as a result of our inventory purchase practices, the convergence of 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 suppliers to manufacture components and complete assemblies based in part on forecasts of customer demand. As a result, our inventory purchases expose us to the risk that our customers either will not order the products we have forecasted, or will purchase fewer products than forecasted. Market uncertainty can 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. As a result, we may purchase inventory in anticipation of sales that ultimately do not occur. Historically, our inventory write-offs have resulted from the circumstances above. As features and functionalities converge across our product lines, and we introduce new products with overlapping feature sets, however, we face an additional risk that customers may forego purchases of one product we have inventoried in favor of another product with similar functionality. If we are required to write off or write down a significant amount of inventory, our results of operations for the period would be materially adversely affected.

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

We have previously taken steps, including reductions in force, office closures, and internal reorganizations to reduce the size and cost of our operations and to better match our resources with market opportunities. We may take similar steps in the future, particularly as we seek to realize operating synergies, optimize our operations and achieve cost reductions following the integration of the MEN Business. These changes could be disruptive to our business 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 in the period in which we take such a charge.

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

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

we may suffer delays in recognizing revenue;

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

our relationship with customers could suffer.

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



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We are subject to the risk that third parties may attempt to 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. These assertions have increased over time due to our growth, the increased number of products and competitors in the communications network equipment industry and the corresponding overlaps, and the general increase in the rate of patent claims assertions both by operating entities and third party non-practicing entities (sometimes referred to as patent trolls), particularly in the United States and Canada. Asserted claims, litigation or other proceedings can include claims against us or our manufacturers, suppliers or customers, alleging infringement of third party proprietary rights with respect our existing or future 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 pursuant to contractual obligations and pay 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.

**We may fail to realize the anticipated benefits of our acquisition of the MEN Business, which could adversely affect our operating results and the market price of our common stock.**

The success of our acquisition of the MEN Business will depend, in significant part, on our ability to grow the combined business and realize the anticipated strategic benefits and operating synergies from the combination. Achieving these benefits requires revenue growth and the realization of targeted sales, cost reductions in our supply chain, and other operating and research and development synergies. As a result, we may not realize the benefits of this transaction or these benefits may be less significant than we expect, or may take longer to achieve than anticipated. If we are not able to realize the anticipated benefits of the MEN Acquisition within a reasonable time, our results of operations and the value of Ciena's common stock may be adversely affected.

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

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

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

exposure to misappropriation of intellectual property and proprietary information;

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

fluctuations in currency exchange rates and tax compliance in India.

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

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

We have entered into agreements with strategic partners that permit us to distribute their products or technology. We 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 and viability 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 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, we may have difficulty collecting receivables and could be exposed to risks associated with uncollectible accounts. We may be exposed to similar risks relating to third party resellers and other sales channel partners. Lack of liquidity in the capital markets, macroeconomic weakness and market volatility may increase our exposure to 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 doubtful accounts. Such write-downs or write-offs could negatively affect our operating results for the period in which they occur, and, if large, could have a material adverse effect on our revenue and operating results.

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

Competition to attract and retain highly skilled technical, 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. It may be difficult to replace members of our management team or other key personnel, and the loss of such individuals could be disruptive to our business. 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 was no longer available to us on commercially reasonable terms.**

We integrate third-party software and other technology into our embedded operating system, network management system tools and other products. Licenses for this technology may not be available or continue to be available to us on commercially reasonable terms. Third party licensors may insist on unreasonable financial or other terms in connection with our use of such technology. Difficulties with third party technology licensors could result in

termination of such licenses, which may result in significant costs and require us to obtain or develop a substitute technology. Difficulty obtaining and maintaining third-party technology licenses may disrupt development of our products and increase our costs, which could harm our business.

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

The successful operation of various internal business processes and information systems is critical to the efficient operation of our business. If these systems fail or are interrupted, our operations may be adversely affected and operating results could be harmed. Our business processes and information systems need to be sufficiently scalable to support the future growth of our business and may require modifications or upgrades that expose us to a number of operational risks. These changes may be costly and disruptive, and could impose substantial demands on management time. These changes may also require changes in system design, the modification of internal control procedures and significant training of employees. Any material disruption, malfunction or similar problems with our business processes or information systems, or the transition to new processes and systems, could have a negative effect on the operation of our business and our results of operations.

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

We may acquire or make 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 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 inhibit service providers from investing in their communications network infrastructures or introducing new services. These changes could adversely affect the sale of our products and services. Changes in regulatory tariff requirements or other regulations relating to pricing or terms of carriage on communications networks could slow the development or expansion of network infrastructures and adversely affect our business, operating results, and financial condition.

**Governmental regulations affecting the use, import or export of products could negatively affect our revenue.**

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. Governmental 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 recently implemented and is considering additional 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.

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

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

As of July 31, 2011, our balance sheet includes \$526.1 million in long-lived assets, which includes \$349.8 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. Given the significant uncertainty and instability of macroeconomic conditions in recent periods, forecasting future business is difficult and subject to modification. If actual market conditions differ or our forecasts change, we may be required to reassess long-lived assets and could record an impairment charge. Any impairment charge relating to long-lived assets would have the effect of decreasing our earnings or increasing our losses in such period. If we are required to take a substantial impairment charge, our operating results could be materially adversely affected in such period.

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

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we include in our annual report a report containing management's assessment of the effectiveness of our internal controls over financial reporting as of the end of our fiscal year and a statement as to whether or not such internal controls are effective. Compliance with these requirements has resulted in, and is likely to continue to result in, significant costs and the commitment of time and operational resources. Changes in our business, including the integration of the MEN Business will necessitate modifications to our internal control systems, processes and information systems as we optimize the operations of the combined company. 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 during fiscal 2011, 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, our business may be harmed. Market perception of our financial condition and the trading price of our stock may be adversely affected, and customer perception of our business may suffer.

**Outstanding indebtedness under our convertible notes may adversely affect our business.**

At July 31, 2011, indebtedness on our outstanding convertible notes totaled approximately \$1.4 billion in aggregate principal. 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 light of unfavorable conditions in the credit markets;

debt service and repayment obligations that reduce the availability of cash resources for other purposes, including capital expenditures;

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

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

We may also add additional indebtedness such as equipment loans, working capital lines of credit and other long-term debt.



**Table of Contents****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 the first nine months of fiscal 2011, our closing stock price ranged from a high of \$28.81 per share to a low of \$13.55 per share. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, with such volatility often unrelated to the operating performance of these companies. Divergence between our actual or anticipated financial results and published expectations of analysts can cause significant swings in our stock price. Our stock price can also be affected by announcements that we, our competitors, or our customers may make, particularly announcements related to acquisitions or other significant transactions. Our common stock is included in a number of market indices and any change in the composition of these indices to exclude our company would adversely affect our stock price. These factors, as well as conditions affecting the general economy or financial markets, may materially adversely affect the market price of our common stock in the future.

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

Not applicable.

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

Not applicable.

***Item 4. Removed and Reserved******Item 5. Other Information***

Not applicable.

***Item 6. Exhibits***

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|----------|--|
| 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   |

\* 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.

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**SIGNATURES**

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

Ciena Corporation

Date: September 8, 2011

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

Date: September 8, 2011

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