

CIENA CORP  
Form 10-Q  
September 09, 2014  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q  
(Mark one)

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

For the quarterly period ended July 31, 2014

OR

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

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

Commission file number: 0-21969

Ciena Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

23-2725311

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

7035 Ridge Road, Hanover, MD

21076

(Address of Principal Executive Offices)

(Zip Code)

(410) 694-5700

(Registrant's telephone number, including area code)

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

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

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

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

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

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

Class  
common stock, \$0.01 par value

Outstanding at September 2, 2014  
106,566,064



Table of Contents

CIENA CORPORATION  
INDEX  
FORM 10-Q

	PAGE NUMBER
<u>PART I — FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Quarters and Nine Months Ended July 31, 2013 and July 31, 2014</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Quarters and Nine Months Ended July 31, 2013 and July 31, 2014</u>	<u>4</u>
<u>Condensed Consolidated Balance Sheets at October 31, 2013 and July 31, 2014</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended July 31, 2013 and July 31, 2014</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>28</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>49</u>
<u>Item 4. Controls and Procedures</u>	<u>50</u>
<u>PART II — OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>51</u>
<u>Item 1A. Risk Factors</u>	<u>51</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>61</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>61</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>61</u>
<u>Item 5. Other Information</u>	<u>61</u>
<u>Item 6. Exhibits</u>	<u>62</u>
<u>Signatures</u>	<u>63</u>

Table of Contents

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

CIENA CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
Revenue:				
Products	\$437,442	\$495,889	\$1,203,716	\$1,389,651
Services	100,914	107,673	295,445	307,675
Total revenue	538,356	603,562	1,499,161	1,697,326
Cost of goods sold:				
Products	247,768	275,003	683,730	777,851
Services	62,367	64,586	181,902	191,960
Total cost of goods sold	310,135	339,589	865,632	969,811
Gross profit	228,221	263,973	633,529	727,515
Operating expenses:				
Research and development	93,069	97,685	282,981	302,674
Selling and marketing	75,613	81,919	216,676	243,929
General and administrative	32,066	36,285	91,157	98,264
Amortization of intangible assets	12,440	11,019	37,332	34,951
Restructuring costs	202	63	6,741	178
Total operating expenses	213,390	226,971	634,887	679,996
Income (loss) from operations	14,831	37,002	(1,358)	) 47,519
Interest and other income (loss), net	(3,167)	) (6,328)	) (6,020)	) (14,231)
Interest expense	(10,972)	) (11,508)	) (33,096)	) (33,556)
Loss on extinguishment of debt	—	—	(28,630)	) —
Income (loss) before income taxes	692	19,166	(69,104)	) (268)
Provision for income taxes	1,923	3,006	6,530	9,666
Net income (loss)	\$(1,231)	) \$16,160	\$(75,634)	) \$(9,934)
Basic net income (loss) per common share	\$(0.01)	) \$0.15	\$(0.74)	) \$(0.09)
Diluted net income (loss) per potential common share	\$(0.01)	) \$0.15	\$(0.74)	) \$(0.09)
Weighted average basic common shares outstanding	102,713	106,236	101,951	105,404
Weighted average dilutive potential common shares outstanding	102,713	120,809	101,951	105,404

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

Table of Contents

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

	Quarter Ended July		Nine Months Ended	
	31,		July 31,	
	2013	2014	2013	2014
Net income (loss)	\$(1,231 )	\$16,160	\$(75,634 )	\$(9,934 )
Change in unrealized gain (loss) on available-for-sale securities, net of tax	14	(43 )	(17 )	(12 )
Change in unrealized gain (loss) on foreign currency forward contracts, net of tax	(508 )	383	(625 )	34
Change in cumulative translation adjustment	(1,498 )	(122 )	(2,542 )	(4,287 )
Other comprehensive income (loss)	(1,992 )	218	(3,184 )	(4,265 )
Total comprehensive income (loss)	\$(3,223 )	\$16,378	\$(78,818 )	\$(14,199 )

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

Table of ContentsCIENA CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	October 31, 2013	July 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 346,487	\$ 532,884
Short-term investments	124,979	120,250
Accounts receivable, net	488,578	541,573
Inventories	249,103	293,092
Prepaid expenses and other	186,655	210,632
Total current assets	1,395,802	1,698,431
Long-term investments	15,031	65,019
Equipment, furniture and fixtures, net	119,729	116,949
Other intangible assets, net	185,828	141,897
Other long-term assets	86,380	78,121
Total assets	\$ 1,802,770	\$ 2,100,417
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
Current liabilities:		
Accounts payable	\$ 254,849	\$ 236,630
Accrued liabilities	271,656	267,846
Deferred revenue	88,550	114,590
Term loan payable	—	2,500
Convertible notes payable	—	187,605
Total current liabilities	615,055	809,171
Long-term deferred revenue	23,620	25,078
Other long-term obligations	34,753	37,206
Long-term term loan payable	—	246,263
Long-term convertible notes payable	1,212,019	1,027,853
Total liabilities	1,885,447	2,145,571
Commitments and contingencies (Note 18)		
Stockholders' equity (deficit):		
Preferred stock – par value \$0.01; 20,000,000 shares authorized; zero shares issued and outstanding	—	—
Common stock – par value \$0.01; 290,000,000 shares authorized; 103,705,709 and 106,562,629 shares issued and outstanding	1,037	1,066
Additional paid-in capital	5,893,880	5,945,573
Accumulated other comprehensive loss	(7,774 )	(12,039 )
Accumulated deficit	(5,969,820 )	(5,979,754 )
Total stockholders' equity (deficit)	(82,677 )	(45,154 )
Total liabilities and stockholders' equity (deficit)	\$ 1,802,770	\$ 2,100,417

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,	
	2013	2014
Cash flows used in operating activities:		
Net loss	\$(75,634	) \$(9,934
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss on extinguishment of debt	28,630	—
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	42,613	41,463
Share-based compensation costs	28,032	34,204
Amortization of intangible assets	53,485	43,931
Provision for inventory excess and obsolescence	15,301	22,026
Provision for warranty	15,148	18,720
Other	8,384	21,254
Changes in assets and liabilities:		
Accounts receivable	(86,808	) (55,688
Inventories	9,267	(66,015
Prepaid expenses and other	(56,958	) (26,698
Accounts payable, accruals and other obligations	49,253	(34,794
Deferred revenue	10,414	27,498
Net cash provided by operating activities	41,127	15,967
Cash flows used in investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(31,884	) (35,974
Restricted cash	1,921	2,059
Purchase of available for sale securities	(144,893	) (195,259
Proceeds from maturities of available for sale securities	80,000	150,000
Settlement of foreign currency forward contracts, net	62	(10,796
Net cash used in investing activities	(94,794	) (89,970
Cash flows from financing activities:		
Proceeds from issuance of term loan, net	—	248,750
Payment of long term debt	(216,210	) —
Payment for debt and equity issuance costs	(3,670	) (3,263
Payment of capital lease obligations	(2,370	) (2,275
Proceeds from issuance of common stock	14,060	17,518
Net cash provided by (used in) financing activities	(208,190	) 260,730
Effect of exchange rate changes on cash and cash equivalents	(2,408	) (330
Net increase (decrease) in cash and cash equivalents	(261,857	) 186,727
Cash and cash equivalents at beginning of period	642,444	346,487
Cash and cash equivalents at end of period	\$378,179	\$532,884
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	\$21,674	\$23,425
Cash paid during the period for income taxes, net	\$7,117	\$9,051
Non-cash investing and financing activities		
Purchase of equipment in accounts payable	\$1,222	\$4,334

Debt issuance costs in accrued liabilities	\$22	\$655
Fixed assets acquired under capital leases	\$2,538	\$—

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



Table of Contents

CIENA CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)

(1) INTERIM FINANCIAL STATEMENTS

The interim financial statements included herein for Ciena Corporation (“Ciena”) have been prepared by Ciena, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In the opinion of management, the 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 Condensed Consolidated Balance Sheet as of October 31, 2013 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. However, Ciena believes that the disclosures are adequate to understand the information presented herein. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with Ciena’s audited consolidated financial statements and the notes thereto included in Ciena’s annual report on Form 10-K for the fiscal year ended October 31, 2013.

Ciena has a 52 or 53-week fiscal year, which ends on the Saturday nearest to the last day of October of each year. Fiscal 2014 and 2013 are 52-week fiscal years. For purposes of financial statement presentation, each fiscal year is described as having ended on October 31, and the fiscal quarters are described as having ended on January 31, April 30 and July 31 of each fiscal year.

(2) SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

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

Cash and Cash Equivalents

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

Investments

Ciena's investments are classified as available-for-sale and are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (loss). 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, with all others considered to be long-term investments.

#### Inventories

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

#### Segment Reporting

7

---

## Table of Contents

Ciena's chief operating decision maker, its chief executive officer, evaluates the company's performance and allocates resources based on multiple factors, including measures of segment profit (loss). Operating segments are defined as components of an enterprise that engage in business activities that may earn revenue and incur expense, for which discrete financial information is available, and for which such information is evaluated regularly by the chief operating decision maker for purposes of allocating resources and assessing performance. Ciena considers the following to be its operating segments for reporting purposes: (i) Converged Packet Optical, (ii) Packet Networking, (iii) Optical Transport, and (iv) Software and Services. See Note 17 below.

### Long-lived Assets

Long-lived assets include: equipment, furniture and fixtures; intangible assets; and maintenance spares. Ciena tests long-lived assets for impairment whenever triggering events or changes in circumstances indicate that the asset's 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 that represent the lowest level for which cash flows can be identified.

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

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

Qualifying internal use software and website development costs incurred during the application development stage, which consist primarily of outside services and purchased software license costs, are capitalized and amortized straight-line over the estimated useful lives of two to five years.

### Intangible Assets

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

### Maintenance Spares

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

### Concentrations

Substantially all of Ciena's cash and cash equivalents are maintained at a small number of major U.S. financial institutions. The majority of Ciena's cash equivalents consist of money market funds. Deposits held with banks may exceed the amount of insurance provided on such deposits. Because these deposits generally may be redeemed upon demand, management believes that they bear minimal risk.

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

Additionally, Ciena's access to certain materials or components is dependent upon sole or limited source suppliers. The inability of any of these suppliers to fulfill Ciena's supply requirements, or significant changes in supply cost, could affect future results. Ciena relies on a small number of contract manufacturers to perform the majority of the manufacturing for its products. If Ciena cannot effectively manage these manufacturers and forecast future demand, or if these manufacturers fail to deliver products or components on time, Ciena's business and results of operations may suffer.

#### Revenue Recognition

Ciena recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine the existence of an

## Table of Contents

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 performed. Shipping and handling fees billed to customers are included in revenue, with the associated expenses included in product cost of goods sold.

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. Unbilled percentage- of-completion revenues recognized are accumulated in the contracts in progress account included in accounts receivable, net. Billings in excess of revenues recognized to date on these contracts are recorded within deferred revenue.

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

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

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

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

## Warranty Accruals

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

return of the product by the customer after the product has been accepted.

Accounts Receivable, Net

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

## Table of Contents

### Research and Development

Ciena charges all research and development costs to expense as incurred. Types of expense incurred in research and development include employee compensation, cost of prototype equipment, consulting and third party services, depreciation, facility costs and information technology.

### Government Grants

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

### Advertising Costs

Ciena expenses all advertising costs as incurred.

### Legal Costs

Ciena expenses legal costs associated with litigation defense as incurred.

### Share-Based Compensation Expense

Ciena measures and recognizes compensation expense for share-based awards based on estimated fair values on the date of grant. Ciena estimates the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This model is affected by Ciena's stock price as well as estimates regarding a number of variables, including expected stock price volatility over the expected term of the award and projected employee stock option exercise behaviors. Ciena estimates the fair value of each restricted stock unit award based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense in its Condensed Consolidated Statement of Operations for those stock options or restricted stock units that are ultimately expected to vest. Ciena recognizes the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon its determination of whether it is probable that the performance targets will be achieved. At each reporting period, Ciena reassesses the probability of achieving the performance targets and the performance period required to meet those targets. Ciena uses the straight-line method to record expense for share-based awards with only service-based vesting. See Note 16 below.

### Income Taxes

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

In the ordinary course of business, transactions occur for which the ultimate outcome may be uncertain. In addition, tax authorities periodically audit Ciena's income tax returns. These audits examine significant tax filing positions, including the timing and amounts of deductions and the allocation of income tax expenses among tax jurisdictions.

Ciena is currently under audit in India for 2008 through 2012 and in Canada for 2010 through 2012. Management does not expect the outcome of these audits to have a material adverse effect on Ciena's consolidated financial position, results of operations or cash flows. Ciena's major tax jurisdictions and the earliest open tax years are as follows: United States (2011), United Kingdom (2012), Canada (2009) and India (2008). However, limited adjustments can be made to Federal U.S. tax returns in earlier years in order to reduce net operating loss carryforwards. Ciena classifies interest and penalties related to uncertain tax positions as a component of income tax expense. All of the uncertain tax positions, if recognized, would decrease the effective income tax rate.

Ciena has not provided for U.S. deferred income taxes on the cumulative unremitted earnings of its non-U.S. affiliates, as it plans to indefinitely 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 will be used to fund foreign operations, capital expenditures and any expansion requirements.



## Table of Contents

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 available to it in order to determine whether any accruals should be adjusted and whether new accruals are required.

## Fair Value of Financial Instruments

The carrying value of Ciena's cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximates fair market value due to the relatively short period of time to maturity. For information related to the fair value of Ciena's convertible notes and term loan, see Note 13 below.

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

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

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

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

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

## Restructuring

From time to time, Ciena takes actions to better align its workforce, facilities and operating costs with perceived market opportunities, business strategies and changes in market and business conditions. GAAP requires that a liability for the cost associated with an exit or disposal activity be recognized in the period in which the liability is incurred, except for one-time employee termination benefits related to a service period of more than 60 days, which are accrued over the service period. See Note 3 below.

Foreign Currency

11

---

## Table of Contents

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 interest and other income (loss), net on the Condensed Consolidated Statement of Operations. Interest and other income (loss), net reflects a net loss on foreign currency re-measurement and exchange rate changes of \$9.2 million for the nine months ended July 31, 2013 and a net gain of \$1.0 million for the nine months ended July 31, 2014.

## Derivatives

Ciena's 4.0% convertible senior notes due March 15, 2015 (the "2015 Notes") include a redemption feature that is accounted for as a separate embedded derivative. The embedded redemption feature is recorded at fair value on a recurring basis, and these changes are included in interest and other income (loss), net on the Condensed Consolidated Statements of Operations. Interest and other income (loss), net reflects an increase in fair value of \$2.7 million for the nine months ended July 31, 2013 and a reduction in fair value of \$2.7 million for the nine months ended July 31, 2014.

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. 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 Statements 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 (loss), net.

From time to time, Ciena uses foreign currency forwards to hedge certain balance sheet exposures. These forwards are not designated as hedges for accounting purposes, and any net gain or loss associated with these derivatives is reported in interest and other income (loss), net on the Condensed Consolidated Statements of Operations. Interest and other income (loss), net reflects a gain of \$0.9 million for the nine months ended July 31, 2013 and a loss of \$11.7 million related to foreign currency forward contracts for the nine months ended July 31, 2014. See Note 12 below.

Ciena records derivative instruments in the Condensed Consolidated Statements of Cash Flows within operating, investing, or financing activities consistent with the cash flows of the hedged items.

## 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 contracts to issue common stock were exercised or converted into common stock. Ciena uses a dual presentation of basic and diluted EPS on the face of its income statement. A reconciliation of the numerator and denominator used for the basic and diluted EPS computations is set forth in Note 15 below.

## Software Development Costs

Ciena develops software for sale to its customers. GAAP requires 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 February 2013, the Financial Accounting Standards Board ("FASB") issued an accounting standard update to require reclassification adjustments from other comprehensive income to be presented either in the financial statements or in the notes to the financial statements. This accounting standard update was effective for Ciena beginning in the first quarter of fiscal 2014.

Table of Contents

Ciena has determined that reclassifications from other comprehensive income to net income are immaterial for separate financial statement presentation.

In May 2014, FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. The standard will be effective for Ciena beginning in the first quarter of fiscal 2018. Ciena is currently evaluating the impact of the adoption of this accounting standard update on its condensed consolidated financial statements.

**(3) RESTRUCTURING COSTS**

Ciena has undertaken a number of restructuring activities intended to reduce expense and better align its workforce and costs with market opportunities, product development and business strategies. The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the nine months ended July 31, 2014 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2013	\$80	\$1,936	\$2,016
Additional liability recorded	169	9	178
Cash payments	(208)	(269)	(477)
Balance at July 31, 2014	\$41	\$1,676	\$1,717
Current restructuring liabilities	\$41	\$612	\$653
Non-current restructuring liabilities	\$—	\$1,064	\$1,064

The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the nine months ended July 31, 2013 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2012	\$1,449	\$3,600	\$5,049
Additional liability recorded	5,003	1,738	6,741
Non-cash disposal	—	(747)	(747)
Cash payments	(6,107)	(2,999)	(9,106)
Balance at July 31, 2013	\$345	\$1,592	\$1,937
Current restructuring liabilities	\$345	\$453	\$798
Non-current restructuring liabilities	\$—	\$1,139	\$1,139

**(4) SHORT-TERM AND LONG-TERM INVESTMENTS**

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



Table of Contents

	July 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations:				
Included in short-term investments	\$90,210	\$42	—	\$90,252
Included in long-term investments	65,043	—	(24	) 65,019
	\$155,253	\$42	\$(24	) \$155,271
Commercial paper:				
Included in short-term investments	29,998	—	—	29,998
	\$29,998	\$—	\$—	\$29,998
	October 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations:				
Included in short-term investments	\$99,974	\$11	\$—	\$99,985
Included in long-term investments	14,996	35	—	15,031
	\$114,970	\$46	\$—	\$115,016
Commercial paper:				
Included in short-term investments	24,994	—	—	24,994
	\$24,994	\$—	\$—	\$24,994

The following table summarizes final legal maturities of debt investments at July 31, 2014 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than one year	\$120,208	\$120,250
Due in 1-2 years	65,043	65,019
	\$185,251	\$185,269

## (5) FAIR VALUE MEASUREMENTS

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

Table of Contents

	July 31, 2014			Total
	Level 1	Level 2	Level 3	
Assets:				
Money market funds	\$390,006	\$—	\$—	\$390,006
U.S. government obligations	—	155,271	—	155,271
Commercial paper	—	79,993	—	79,993
Foreign currency forward contracts	—	849	—	849
Total assets measured at fair value	\$390,006	\$236,113	\$—	\$626,119
Liabilities:				
Foreign currency forward contracts	\$—	\$390	\$—	\$390
Total liabilities measured at fair value	\$—	\$390	\$—	\$390

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

	July 31, 2014			Total
	Level 1	Level 2	Level 3	
Assets:				
Cash equivalents	\$390,006	\$49,995	\$—	\$440,001
Short-term investments	—	120,250	—	120,250
Prepaid expenses and other	—	849	—	849
Long-term investments	—	65,019	—	65,019
Total assets measured at fair value	\$390,006	\$236,113	\$—	\$626,119
Liabilities:				
Accrued liabilities	\$—	\$390	\$—	\$390
Total liabilities measured at fair value	\$—	\$390	\$—	\$390

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

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

Balance at October 31, 2013	Level 3	\$2,740
Issuances		—
Settlements		—
Changes in unrealized gain (loss)		(2,740)
Transfers into Level 3		—
Transfers out of Level 3		—
Balance at July 31, 2014		\$—

## (6) ACCOUNTS RECEIVABLE





Table of Contents

As of October 31, 2013, two customers each accounted for greater than 10% of net accounts receivable, and in the aggregate accounted for 22.5% of net accounts receivable. As of July 31, 2014, two customers each accounted for greater than 10% of net accounts receivable, and in the aggregate accounted for 24.3% of net accounts receivable. Allowance for doubtful accounts was \$2.0 million and \$2.7 million as of October 31, 2013 and July 31, 2014, respectively. Ciena has not historically experienced a significant amount of bad debt expense.

**(7) INVENTORIES**

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

	October 31, 2013	July 31, 2014
Raw materials	\$53,274	\$61,429
Work-in-process	7,773	8,268
Finished goods	153,855	172,321
Deferred cost of goods sold	75,764	103,701
	290,666	345,719
Provision for excess and obsolescence	(41,563 )	(52,627 )
	\$249,103	\$293,092

Ciena writes down its inventory for estimated obsolescence or unmarketable inventory by an amount 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 2014, Ciena recorded a provision for excess and obsolescence of \$22.0 million, primarily related to engineering design changes and the discontinuance of certain parts and components used in the manufacture of our Optical Transport products, including our Corestream® Agility Optical Transport platform, and Converged Packet Optical products. Deductions from the provision for excess and obsolete inventory relate to disposal activities.

**(8) PREPAID EXPENSES AND OTHER**

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

	October 31, 2013	July 31, 2014
Prepaid VAT and other taxes	\$101,072	\$111,004
Product demonstration equipment, net	33,382	42,754
Deferred deployment expense	23,190	27,992
Prepaid expenses	16,963	20,742
Other non-trade receivables	12,048	8,140
	\$186,655	\$210,632

Depreciation of product demonstration equipment was \$5.5 million and \$6.7 million for the first nine months of fiscal 2013 and 2014, respectively.

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

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

	October 31, 2013	July 31, 2014
Equipment, furniture and fixtures	\$364,574	\$368,986
Leasehold improvements	46,247	45,423

Accumulated depreciation and amortization	410,821	414,409
	(291,092 )	(297,460 )
	\$ 119,729	\$ 116,949

Table of Contents

The total of depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements, was \$37.1 million and \$34.8 million for the first nine months of fiscal 2013 and 2014, respectively.

**(10) OTHER INTANGIBLE ASSETS**

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

	October 31, 2013			July 31, 2014		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Developed technology	\$417,833	\$ (321,645 )	\$96,188	\$417,833	\$ (345,178 )	\$72,655
Patents and licenses	46,538	(45,744 )	794	46,538	(45,867 )	671
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	323,573	(234,727 )	88,846	323,573	(255,002 )	68,571
Total other intangible assets	\$787,944	\$ (602,116 )	\$185,828	\$787,944	\$ (646,047 )	\$141,897

The amortization of finite-lived other intangible assets was \$53.5 million and \$43.9 million for the first nine months of fiscal 2013 and 2014, respectively. Expected future amortization of finite-lived other intangible assets for the fiscal years indicated is as follows (in thousands):

Period ended October 31,	
2014 (remaining three months)	\$13,220
2015	52,879
2016	52,879
2017	22,783
2018	136
	\$141,897

**(11) OTHER BALANCE SHEET DETAILS**

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

	October 31, 2013	July 31, 2014
Maintenance spares inventory, net	\$61,305	\$56,202
Deferred debt issuance costs, net	15,677	16,360
Embedded redemption feature	2,740	—
Restricted cash	2,053	46
Other	4,605	5,513
	\$86,380	\$78,121

Deferred debt issuance costs are amortized using the straight-line method, which approximates the effect of the effective interest rate method, through the maturity of the related debt. Amortization of debt issuance costs related to our convertible notes payable, term loan (described in Note 13 below) and the Credit Facility (described in Note 14 below), which is included in interest expense, was \$4.2 million and \$3.6 million during the first nine months of fiscal 2013 and fiscal 2014, respectively.

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

Table of Contents

	October 31, 2013	July 31, 2014
Warranty	\$56,303	\$57,442
Compensation, payroll related tax and benefits	98,770	77,272
Vacation	32,118	33,837
Current restructuring liabilities	674	653
Interest payable	6,186	8,679
Other	77,605	89,963
	\$271,656	\$267,846

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

Nine months ended July 31,	Beginning Balance	Provisions	Settlements	Balance at end of period
2013	\$55,132	15,148	(16,904	) \$53,376
2014	\$56,303	18,720	(17,581	) \$57,442

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

	October 31, 2013	July 31, 2014
Products	\$36,671	\$57,590
Services	75,499	82,078
	112,170	139,668
Less current portion	(88,550	) (114,590
Long-term deferred revenue	\$23,620	\$25,078

**(12) FOREIGN CURRENCY FORWARD CONTRACTS**

As of July 31, 2014, Ciena had forward contracts to reduce the variability in its Canadian Dollar and Indian Rupee denominated expense, which expense principally relates to research and development activities. These derivative contracts have been designated as cash flow hedges. During the first nine months of fiscal 2014, in order to hedge certain balance sheet exposures, Ciena entered into forward contracts to sell Brazilian Real and buy an equivalent U.S. Dollar amount and forward contracts to sell U.S. Dollars and buy an equivalent amount of Canadian Dollars. These derivative contracts have not been designated as hedges. Ciena's foreign currency forward contracts are immaterial for separate financial statement presentation.

**(13) SHORT-TERM AND LONG-TERM DEBT****Term Loan**

On July 15, 2014, Ciena entered into a Credit Agreement (the "Term Loan Credit Agreement") which provides for senior secured term loans in an aggregate principal amount of \$250 million (the "Term Loan"). Ciena received proceeds from the Term Loan, net of original issue discount and debt issuance costs, of approximately \$246 million.

The Term Loan bears interest at a rate equal to LIBOR (subject to a floor of 0.75%) plus an applicable margin of 3.00% and matures on July 15, 2019. The Term Loan Credit Agreement requires Ciena to make quarterly installment

payments in aggregate amounts equal to 0.25% of the original principal amount of the Term Loan, with the balance of the Term Loan payable at maturity. The Term Loan Credit Agreement requires mandatory prepayments on the occurrence of certain customary events and, when the total secured net leverage ratio (as defined in the Term Loan Credit Agreement) is in excess of 2.50 to

Table of Contents

1.00, the Term Loan Credit Agreement requires a mandatory prepayment of 50% of excess annual cash flow (as defined in the Term Loan Credit Agreement).

The Term Loan Credit Agreement contains customary covenants that limit, absent lender approval, the ability of Ciena to, among other things, incur additional debt, create liens and encumbrances, pay cash dividends, enter into certain acquisition transactions or transactions with affiliates, merge, dissolve, repay certain indebtedness, change the nature of Ciena's business, make investments or dispose of assets.

The Term Loan Credit Agreement contains customary events of default including, among other things, failure to pay obligations when due, initiation of bankruptcy or insolvency proceedings, defaults on certain other indebtedness, change of control, incurrence of certain material judgments, violation of affirmative and negative covenants, and breaches of representations and warranties set forth in the Term Loan Credit Agreement. Upon an event of default, the administrative agent may, subject to various customary cure rights, require the immediate payment of all amounts outstanding and foreclose on collateral.

In connection with Ciena entering into the Term Loan Credit Agreement, Ciena and certain of its subsidiaries entered into a guaranty, a security agreement and a pledge agreement, each on customary terms. The Term Loan is secured by (i) second-priority security interests in the ABL Priority Collateral (as defined in Note 14 below), and (ii) first-priority security interests in substantially all other tangible and intangible assets including equipment, intercompany notes, intellectual property and material owned real property (the "Term Loan Priority Collateral").

The principal balance, unamortized discount and net carrying amount of the Term Loan was as follows as of July 31, 2014:

	Principal Balance	Unamortized Discount	Net Carrying Amount
Term Loan Payable due July 15, 2019	\$250,000	\$1,237	\$248,763
	\$250,000	\$1,237	\$248,763

The following table sets forth, in thousands, the carrying value and the estimated fair value of the Term Loan:

	July 31, 2014	
	Carrying Value	Fair Value <sup>(2)</sup>
Term Loan Payable due July 15, 2019 <sup>(1)</sup>	\$248,763	\$249,375
	\$248,763	\$249,375

(1) Includes unamortized bond discount.

The term loan was categorized as Level 2 in the fair value hierarchy. Ciena estimated the fair value of its term loan (2) using a market approach based upon observable inputs, such as current market transactions involving comparable securities.

### Convertible Notes

The principal balance, unamortized discount and net carrying amount of the liability and equity components of our 4.0% convertible senior notes due December 15, 2020 ("2020 Notes") were as follows as of July 31, 2014:

Liability Component			Equity Component
Principal Balance	Unamortized Discount	Net Carrying Amount	Net Carrying Amount

Edgar Filing: CIENA CORP - Form 10-Q

4.0% Convertible Senior Notes due December 15, 2020	\$193,101	\$15,248	\$177,853	\$43,131
---	-----------	----------	-----------	----------

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

19

---



Table of Contents

	July 31, 2014	
	Carrying Value	Fair Value <sup>(2)</sup>
4.0% Convertible Senior Notes, due March 15, 2015 <sup>(1)</sup>	\$187,605	\$206,719
0.875% Convertible Senior Notes due June 15, 2017	500,000	494,375
3.75% Convertible Senior Notes due October 15, 2018	350,000	445,813
4.0% Convertible Senior Notes due December 15, 2020 <sup>(3)</sup>	177,853	242,822
	\$1,215,458	\$1,389,729

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

The convertible notes were categorized as Level 2 in the fair value hierarchy. Ciena estimated the fair value of its

(2) outstanding convertible notes using a market approach based upon observable inputs, such as current market transactions involving comparable securities.

(3) Includes unamortized discount and accretion of principal.

#### (14) ABL CREDIT FACILITY

During fiscal 2012, Ciena and certain of its subsidiaries entered into a senior secured asset-based revolving credit facility (the "ABL Credit Facility"). On July 15, 2014, Ciena amended the ABL Credit Facility to, among other things:

- increase the total commitment from \$150 million to \$200 million;

- extend the maturity date from August 13, 2015 to December 31, 2016, and eliminate the maturity date acceleration to December 15, 2014 in the event that any of Ciena's 4.00% senior convertible notes due March 15, 2015 are then outstanding;

- reduce the minimum aggregate amount of unrestricted cash and cash equivalents that Ciena is required to maintain at all times from \$200 million to \$150 million;

- reduce the interest rate on borrowings from LIBOR plus an applicable margin ranging from 200 basis points to 250 basis points, to an applicable margin ranging from 150 basis points to 200 basis points, with the actual margin based upon Ciena's utilization of the ABL Credit Facility; and

- amend the borrowing base to include, among other items, up to \$50 million in eligible cash.

Ciena also amended the terms of the existing security and pledge agreements to provide the lenders with second-priority security interests in the Term Loan Priority Collateral, in addition to its existing first-priority security interests in current assets, consisting principally of accounts receivable, inventory, cash, and deposit and securities accounts (the "ABL Priority Collateral"). Except as amended, the remaining terms of the ABL Credit Facility, and related security and pledge agreements, remain in full force and effect.

Ciena principally uses the ABL Credit Facility to support the issuance of letters of credit that arise in the ordinary course of its business and thereby to reduce its use of cash required to collateralize these instruments. As of July 31, 2014, letters of credit totaling \$56.0 million were collateralized by the ABL Credit Facility. There were no borrowings outstanding under the ABL Credit Facility as of July 31, 2014.

#### (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 the following, in each case, to the extent the effect is not anti-dilutive: (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.



Table of Contents

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
Numerator				
Net income (loss)	\$(1,231 )	\$16,160	\$(75,634 )	\$(9,934 )
Add: Interest expense associated with 0.875% convertible senior notes due 2017	—	1,384	\$—	—
Net income (loss) used to calculate Diluted EPS	\$(1,231 )	\$17,544	\$(75,634 )	\$(9,934 )
	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
Denominator				
Weighted average basic common shares outstanding	102,713	106,236	101,951	105,404
Add: Shares underlying outstanding stock options, employees stock purchase plan and restricted stock units	—	1,465	—	—
Add: Shares underlying 0.875% convertible senior notes due 2017	—	13,108	—	—
Weighted average dilutive potential common shares outstanding	102,713	120,809	101,951	105,404
	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
EPS				
Basic EPS	\$(0.01 )	\$0.15	\$(0.74 )	\$(0.09 )
Diluted EPS	\$(0.01 )	\$0.15	\$(0.74 )	\$(0.09 )

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 periods indicated (in thousands):

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
Shares underlying stock options and restricted stock units	3,599	1,123	3,727	3,205
0.25% Convertible Senior Notes due May 1, 2013	—	—	3,580	—
4.0% Convertible Senior Notes due March 15, 2015	9,198	9,198	10,990	9,198
0.875% Convertible Senior Notes due June 15, 2017	13,108	—	13,108	13,108
3.75% Convertible Senior Notes due October 15, 2018	17,356	17,356	17,356	17,356
4.0% Convertible Senior Notes due December 15, 2020	9,198	9,198	7,406	9,198
Total shares excluded due to anti-dilutive effect	52,459	36,875	56,167	52,065

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

Ciena grants equity awards under its 2008 Omnibus Incentive Plan (the "2008 Plan") and the Amended and Restated Employee Stock Purchase Plan (the "ESPP"). These plans were approved by stockholders and are described in Ciena's Annual Report on Form 10-K for the fiscal year ended October 31, 2013.

**2008 Omnibus Incentive Plan**

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

substituted for in connection with the transaction. Pursuant to Board and stockholder approval, effective April 10, 2014, Ciena amended its 2008 Plan to increase the number of shares available for issuance by 6.6 million shares. The total number of shares authorized for issuance under the 2008 Plan is 25.1 million shares. As of July 31, 2014, approximately 9.4 million shares remained available for issuance under the 2008 Plan.

Table of Contents

## Stock Options

Outstanding stock option awards to employees are generally subject to service-based vesting restrictions and vest incrementally over a four-year period. As of July 31, 2014, all outstanding options have completed their service-based vesting conditions and are fully vested. The following table is a summary of Ciena's stock option activity for the period indicated (shares in thousands):

	Shares Underlying Options Outstanding	Weighted Average Exercise Price
Balance at October 31, 2013	2,102	\$27.46
Exercised	(153	) 17.28
Canceled	(571	) 36.11
Balance at July 31, 2014	1,378	\$25.00

The total intrinsic value of options exercised during the first nine months of fiscal 2013 and fiscal 2014 was \$1.0 million and \$1.0 million, respectively. Ciena did not grant any stock options during the first nine months of fiscal 2013 or fiscal 2014.

The following table summarizes information with respect to stock options outstanding at July 31, 2014, based on Ciena's closing stock price on the last trading day of Ciena's third fiscal quarter of 2014 (shares and intrinsic value in thousands):

		Options Outstanding and Vested at July 31, 2014			
Range of Exercise Price		Number of Underlying Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
\$0.94	— \$16.31	163	3.44	\$8.08	\$1,791
\$16.52	— \$17.29	247	0.95	16.64	609
\$17.43	— \$24.50	196	1.44	18.70	195
\$24.69	— \$28.28	286	2.65	27.31	—
\$28.61	— \$31.43	102	3.03	29.79	—
\$31.71	— \$32.55	19	1.43	31.92	—
\$33.00	— \$37.10	249	3.29	35.23	—
\$37.31	— \$47.32	116	2.99	44.30	—
\$0.94	— \$47.32	1,378	2.42	\$25.00	\$2,595

## 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.

## Restricted Stock Units

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

recognizes the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based compensation expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon Ciena's determination of whether it is 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.

Table of Contents

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

	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value Per Share	Aggregate Fair Value
Balance at October 31, 2013	4,419	\$15.33	\$102,745
Granted	1,819		
Vested	(1,757)	)	
Canceled or forfeited	(127)	)	
Balance at July 31, 2014	4,354	\$17.90	\$83,173

The total fair value of restricted stock units that vested and were converted into common stock during the first nine months of fiscal 2013 and fiscal 2014 was \$25.3 million and \$40.4 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first nine months of fiscal 2013 and fiscal 2014 was \$15.89 and \$21.96 respectively.

#### Assumptions for Restricted Stock Unit Awards

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

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

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.

#### Amended and Restated Employee Stock Purchase Plan (ESPP)

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

During the first nine months of fiscal 2014, Ciena issued 0.9 million shares under the ESPP. At July 31, 2014, 6.8 million shares remained available for issuance under the ESPP.

Share-Based Compensation Expense for Periods Reported

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

23

---



Table of Contents

	Quarter Ended July		Nine Months Ended	
	31,		July 31,	
	2013	2014	2013	2014
Product costs	\$658	\$737	\$1,905	\$1,984
Service costs	461	572	1,323	1,720
Share-based compensation expense included in cost of sales	1,119	1,309	3,228	3,704
Research and development	2,054	2,368	6,291	7,722
Sales and marketing	3,562	3,890	9,687	12,199
General and administrative	3,198	3,376	8,898	10,543
Share-based compensation expense included in operating expense	8,814	9,634	24,876	30,464
Share-based compensation expense capitalized in inventory, net	(48	) (182	) (72	) 36
Total share-based compensation	\$9,885	\$10,761	\$28,032	\$34,204

As of July 31, 2014, total unrecognized share-based compensation expense related to unvested restricted stock units was \$64.5 million, and this expense is expected to be recognized over a weighted-average period of 1.5 years.

Table of Contents

## (17) SEGMENTS AND ENTITY WIDE DISCLOSURES

## Segment Reporting

Ciena's internal organizational structure and the management of its business are grouped into the following operating segments:

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

**Packet Networking** — principally includes Ciena's 3000 family of service delivery switches and service aggregation switches, the 5000 series of service aggregation switches. This segment also includes Ciena's new 8700 Packetwave Platform, a multi-terabit packet switching platform for high-density metro networks. The 8700 combines Ethernet switching and optical transport to help network operators deliver on-demand, cloud-based services with improved economics. In addition, this segment includes Ciena's Ethernet packet configuration for the 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have principally been deployed to support wireless backhaul infrastructures and business data services. Employing sophisticated, carrier-grade Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment includes stand-alone broadband products that transition voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

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

**Software and Services** — includes Ciena's network software suite, including the Agility software portfolio which includes a multilayer software-defined networking (SDN) controller and new software applications for enabling on-demand, high-bandwidth wide area network (WAN) services delivered in an open network ecosystem. With Agility, Ciena's customers can better monetize cloud-based services and virtual network functions created in a traditional or an SDN environment. This segment also includes the OneControl Unified Management System. These software solutions can track individual services across multiple product suites, facilitating planned network

maintenance, outage detection and identification of customers or services affected by network performance. In addition, this segment includes the ON-Center® Network & Service Management Suite, Ethernet Services Manager, Optical Suite Release and network level applications. This segment includes a broad range of consulting, network design and support services from Ciena's Network Transformation Solutions offering. This segment also includes installation and deployment, maintenance support and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Condensed Consolidated Statement of Operations.

Table of Contents

Asset information for reportable segments is not disclosed because it is not reviewed by the chief operating decision maker for purposes of evaluating performance and allocating resources.

## Segment Revenue

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
Revenue:				
Converged Packet Optical	\$302,018	\$382,031	\$836,303	\$1,072,272
Packet Networking	61,631	69,464	161,658	187,699
Optical Transport	66,218	31,016	181,186	100,729
Software and Services	108,489	121,051	320,014	336,626
Consolidated revenue	\$538,356	\$603,562	\$1,499,161	\$1,697,326

## Segment Profit

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

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
Segment profit:				
Converged Packet Optical	\$66,952	\$104,020	\$171,598	\$279,299
Packet Networking	7,620	14,566	15,259	23,147
Optical Transport	29,459	8,900	71,459	29,259
Software and Services	31,121	38,802	92,232	93,136
Total segment profit	135,152	166,288	350,548	424,841
Less: non-performance operating expenses				
Selling and marketing	75,613	81,919	216,676	243,929
General and administrative	32,066	36,285	91,157	98,264
Amortization of intangible assets	12,440	11,019	37,332	34,951
Restructuring costs	202	63	6,741	178
Add: other non-performance financial items				
Interest expense and other income (loss), net	(14,139)	(17,836)	(39,116)	(47,787)
Loss on extinguishment of debt	—	—	(28,630)	—
Less: Provision for income taxes	1,923	3,006	6,530	9,666
Consolidated net loss	\$(1,231)	\$16,160	\$(75,634)	\$(9,934)

## Entity Wide Reporting

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

below, Ciena's geographic distribution of revenue was as follows (in thousands):

26

---

Table of Contents

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
United States	\$339,426	\$368,056	\$891,233	\$1,009,433
International	198,930	235,506	607,928	687,893
Total	\$538,356	\$603,562	\$1,499,161	\$1,697,326

The following table reflects Ciena's geographic distribution of equipment, furniture and fixtures, net, with any country accounting for a significant percentage of total equipment, furniture and fixtures, net, specifically identified. Equipment, furniture and fixtures, net, attributable to geographic regions outside of the United States and Canada are reflected as "Other International." For the periods below, Ciena's geographic distribution of equipment, furniture and fixtures was as follows (in thousands):

	October 31, July 31,	
	2013	2014
United States	\$64,132	\$62,733
Canada	43,772	42,755
Other International	11,825	11,461
Total	\$119,729	\$116,949

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2013	2014	2013	2014
Company A	\$104,070	\$130,278	\$277,280	\$351,323
Company B	67,051	n/a	172,407	n/a
Total	\$171,121	\$130,278	\$449,687	\$351,323

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

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

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

Ciena was awarded a conditional grant from the Province of Ontario in June 2011. Under this strategic jobs investment fund grant, Ciena can receive up to an aggregate of C\$25.0 million in funding for eligible costs relating to certain next-generation, coherent optical transport development initiatives over the period from November 1, 2010 to October 31, 2015. Ciena anticipates receiving disbursements, approximating C\$5.0 million per fiscal year, over the period above. Amounts received under the grant are subject to recoupment in the event that Ciena fails to achieve certain minimum investment, employment and project milestones. As of July 31, 2014, Ciena has recorded a C\$21.5 million benefit to date as a reduction in research and development expenses, of which C\$5.1 million was recorded in the first nine months of fiscal 2014. As of July 31, 2014, amounts receivable from this grant were C\$1.5 million.

**Foreign Tax Contingencies**

As of October 31, 2013 and July 31, 2014, Ciena had accrued liabilities of \$0.4 million related to a preliminary assessment notice from the India tax authorities asserting deficiencies in payments for the tax year 2009 related to income taxes. This contingency has been reported as a component of other long-term liabilities. During February

2014, Ciena received a final audit assessment notice from the India tax authorities with respect to this matter. Ciena has filed an appeal citing deficiencies in this assessment. Although Ciena estimates that it could be exposed to possible losses of up to \$2.8 million, it has not accrued a liability of such amount as of July 31, 2014. Ciena has not accrued the additional income tax liability because it does not believe that such a loss is more likely than not. Ciena continues to evaluate the likelihood of a probable and reasonably possible

27

---

## Table of Contents

loss, if any, related to this assessment. 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 to occur.

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

## Litigation

On May 29, 2008, Graywire, LLC filed a complaint in the United States District Court for the Northern District of Georgia against Ciena and four other defendants, alleging, among other things, that certain of the parties' products infringe U.S. Patent 6,542,673 (the "673 Patent"), relating to an identifier system and components for optical assemblies. The complaint seeks injunctive relief and damages. In July 2009, upon request of Ciena and certain other defendants, the U.S. Patent and Trademark Office ("PTO") granted the defendants' inter partes application for reexamination with respect to certain claims of the '673 Patent, and the district court granted the defendants' motion to stay the case pending reexamination of all of the patents-in-suit. In December 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims of the '673 Patent, to which Ciena and other defendants filed an appeal. On March 16, 2012, the PTO on appeal rejected multiple claims of the '673 Patent, including the two claims on which Ciena is alleged to infringe. Subsequently, the plaintiff requested a reopening of the prosecution of the '673 Patent, which request was denied by the PTO on April 29, 2013. Thereafter, on May 28, 2013, the plaintiff filed an amendment with the PTO in which it canceled the claims of the '673 Patent on which Ciena is alleged to infringe. The case currently remains stayed, and there can be no assurance as to whether or when the stay will be lifted.

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

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

Some of the statements contained 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 and other comparable words. You should be aware that these statements only reflect our current predictions and beliefs. These statements are subject to known and unknown risks, uncertainties and other factors, and actual events or results may differ materially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly in Item 1A "Risk Factors" of Part II of this report below. For a more complete understanding of the risks associated with an investment in Ciena's securities, you should review these risk factors and the rest of this quarterly report in combination with the more detailed description of our business and management's discussion and analysis of financial condition in our annual report on Form 10-K, which we filed with the Securities and Exchange Commission ("SEC") on December 20, 2013. Ciena undertakes no obligation to revise or update any forward-looking statements.

## Overview

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



service delivery and management of voice, video and data traffic on communications networks.

Our Converged Packet Optical, Packet Networking, Optical Transport and Software products are used, individually or as part of an integrated, programmable solution, in networks operated by communications service providers, cable operators, governments, enterprises, research and education institutions, content service providers and other network operators across the globe. Our products allow network operators to scale capacity, increase transmission speeds, allocate network traffic and deliver services to end users. Our network solutions also include an integrated software suite that provides network and service management capabilities that unify our product portfolio, facilitating automation and software-defined programmability to enable efficient service delivery. To complement our product portfolio, we offer a broad range of Network Transformation Solutions and related support services that help our customers design, optimize, deploy, manage and maintain their networks.

## Table of Contents

We believe that the close, collaborative partnership with customers enabled by our engagement model and services offering is an important component of our network specialist approach and a significant differentiator for Ciena with our customers.

Rapid proliferation of, and reliance by end users upon, communications services and devices, together with increased mobility and growth in cloud-based services, have fundamentally affected the demands placed upon communications networks and how they are designed. Network operators face a challenging and rapidly changing environment that requires that their network infrastructures be robust enough to address increasing capacity needs and be flexible enough to adapt to new application and service offerings. Network operators are competing to distinguish their service offerings to end users and generate revenue, while managing the costs required to implement and maintain their networks. To address these business, infrastructure and service delivery challenges, we believe network operators need a flexible infrastructure that can be adapted to support a variety of applications and controlled through the use of software.

Our OP<sup>n</sup> Architecture is designed to meet these challenges by providing increased scalability and programmability, as well as network-level software applications to control and configure the network dynamically. Through this network approach, we seek to enable high-capacity, configurable infrastructures that can adapt to the changing needs of end-users and the applications that they require, while providing flexible interfaces for the integration of computing, storage and network resources. By increasing network flexibility for service delivery, reducing required network elements and enabling increased scale at reduced cost, our solutions optimize networks. At the same time, our approach facilitates introduction of new service offerings, creating business and operational value for our customers. Our OP<sup>n</sup> Architecture, which underpins our solutions offering and guides our research and development strategy, is described more fully in “Strategy” below.

Our quarterly reports on Form 10-Q, annual reports on Form 10-K, and current reports on Form 8-K filed with the SEC are available through the SEC's website at [www.sec.gov](http://www.sec.gov) or free of charge on our website as soon as reasonably practicable after we file these documents. We routinely post the reports above, recent news and announcements, financial results and other information about Ciena that is important to investors in the "Investors" section of our website at [www.ciena.com](http://www.ciena.com). Investors are encouraged to review the “Investors” section of our website because, as with the other disclosure channels that we use, from time to time we may post material information on that site that is not otherwise disseminated by us.

### AT&T Domain 2.0

In September 2014, we announced that AT&T had selected Ciena to participate in its Domain 2.0 supplier program. The Domain 2.0 initiative is the next generation of AT&T's Supplier Domain Program, intended to enable AT&T to quickly transition to next-generation, cloud-based network architectures that embrace Network Function Virtualization (NFV) and Software Defined Networks (SDN), and accelerate AT&T's time-to-market with new products and services. Our commercial arrangement relating to this opportunity includes certain commercial concessions that we expect to have a significant, short-term adverse impact on our revenue and gross margin. We expect these concessions primarily to affect our fourth quarter of fiscal 2014, with a proportionately lesser impact on our first quarter of fiscal 2015, and thereafter having a less significant impact on our quarterly results. We believe that this selection represents a significant achievement for Ciena, that AT&T's network objectives in this program align well with our OP<sup>n</sup> Architecture, and that this program potentially expands our addressable market with this key customer.

### Recent Product Announcements

In June 2014, we announced the launch of our 8700 Packetwave platform, a multi-terabit packet switching platform for high-density metro networks. The 8700 combines Ethernet switching and optical transport to help network operators deliver on-demand, cloud-based services with improved economics. In July 2014, we also introduced our Agility software portfolio, which includes a multilayer software-defined networking (SDN) controller and new software applications for enabling on-demand, high-bandwidth wide area network (WAN) services delivered in an open network ecosystem. With Agility, our customers can better monetize cloud-based services and virtual network functions created in a traditional or an SDN environment. Our 8700 product will be included within our Packet Networking segment and our Agility software portfolio will be included within our Software and Services segment.

#### Market Opportunity

We believe that the shift that is underway in network architectures to next-generation, converged infrastructures represents a significant, long-term opportunity for Ciena. We believe that certain market dynamics, including the proliferation of devices running mobile web applications, the prevalence of video applications, the increase in machine-to-machine connections, and the shift of enterprise and consumer applications to cloud-based or virtualized network environments, are representative of the magnitude of changing demands being placed upon network architectures. At the same time, bandwidth requirements and the

## Table of Contents

use and dependence by consumers and enterprises upon a variety of communications applications, services and devices continues to grow. We expect that these drivers will require existing and emerging network operators to invest in converged next-generation network infrastructures that are more automated, open and software programmable. This year we have seen certain service provider customers increase efforts to constrain capital expenditure budgets, resulting in a reduction in aggregate spending levels and adversely impacting certain segments of our market, including in the U.S. Notwithstanding these market dynamics, our specialist strategy to focus on certain higher growth and higher value segments of the network infrastructure market, combined with efforts to expand our addressable market and diversify our business, have enabled us to continue to grow revenue and take market share in fiscal 2014 to date.

### Competitive Landscape

We continue to encounter a highly competitive marketplace. Our sales of Converged Packet Optical solutions reflect an intense and fragmented competitive environment, as we and our competitors introduce and enhance new, high-capacity, high-speed network solutions. Our sales of Packet Networking solutions, including our new 8700 Packetwave Platform, also face a competitive marketplace as we seek to promote the benefits of our OP<sup>n</sup> Architecture, as compared to alternative network approaches, and to secure network operator adoption of our solutions. We expect the current competitive landscape to remain challenging and dynamic. As networking technologies become more software-driven, and network features and layers continue to converge, our competitive landscape continues to broaden beyond traditional competitors. As a result, we are competing with, and expect to compete increasingly with, additional vendors focused on IP routing, information technology and software.

Within these competitive dynamics, maintaining incumbency with key customers domestically and abroad, and securing new opportunities with network operators often requires that we agree to aggressive pricing, significant commercial concessions or other unfavorable commercial terms. These terms can adversely affect our quarterly results of operations and contribute to fluctuations in our results. These terms can also elongate our revenue recognition or cash collection cycles, add startup costs to initial sales or deployment of our solutions, require financial commitments or performance bonds that place cash resources at risk, and include onerous contractual commitments that place a disproportionate allocation of risk upon us.

### Strategy

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

Promotion of our OP<sup>n</sup> Architecture for Next-Generation Networks. The services and applications running on communications networks require that more of the traffic on these networks be packet-oriented. The traditional approach to this problem has been to add IP routing capability at many points of intersection in the network. As capacity needs grow, this approach becomes unnecessarily complex and costly. We reduce the cost and complexity of growing networks with a programmable infrastructure that brings together the reliability and capacity of optical networking with the flexibility and economics of packet networking technologies. Combining these attributes with network level applications creates an approach we call our OP<sup>n</sup> Architecture. Our OP<sup>n</sup> Architecture leverages the convergence of optical and packet networking to enable network scale, applies advanced control plane software for network programmability, and enables cloud-level applications to integrate and optimize network resources — along with computing and storage resources — in a virtualized environment. The software-driven aspects of this architecture become increasingly important as network operators increasingly seek to leverage an open ecosystem of virtualized resources to enable the real-time analytics and network agility required for on-demand, next-generation network architectures. Our OP<sup>n</sup> Architecture offers network operators scalability, programmability, flexibility and cost-effectiveness, and we see opportunities in offering a portfolio of solutions that facilitate the transition to next-generation networks that are optimized to create new services rapidly and to meet end user demands.

Alignment of Research and Development Investment with Growth Opportunities. We seek to ensure that our product development initiatives are closely aligned with changing dynamics in our markets, network operator and end user demands, and growth opportunities for Ciena. We are investing in our OP<sup>n</sup> Architecture with current development efforts focused on expanding packet capabilities in our Packet Networking and Converged Packet Optical products for metro and service aggregation applications. We are also focused on optimizing our existing core networking solutions for application in metro networks. Our research and development efforts seek to extend and converge our existing technologies, including our WaveLogic coherent optical processor for 40G and 100G optical transport, and to introduce 400G and greater transmission speeds. In the packet area, we are increasing the scale and capability of our packet offerings and integrating standards-based open control interfaces. In the software area, we are enhancing our network management and planning applications. We are also focusing on initiatives to increase software-defined programmability and control of networks, including through our joint

## Table of Contents

development initiative with Ericsson, and working to develop network-level software applications that configure networks and support new service introduction.

Evolution of our Go-to-Market Model. We seek to evolve our go-to-market sales model, from both coverage and engagement perspectives.

Coverage. Our coverage model is focused on selling into key customer segments, penetrating high-growth geographic markets and addressing additional network applications with our solutions. To complement our existing service provider customers, we continue to pursue opportunities to diversify our customer base into key market segments. We are expanding our sales efforts to capture opportunities arising from enterprise migration to cloud-based services, and promoting our reputation with government agencies and research and educational institutions as a trusted network equipment supplier. We are also focused on further penetrating significant Web 2.0 players, including Internet content providers and other emerging network operators, who are changing the ways in which information is accessed and shared. To expand the geographic reach of our direct sales resources, and to broaden the role our solutions play in communications networks, we have pursued strategic channel opportunities enabling sales through third parties, including service providers, systems integrators and value-added resellers. Through our packet-optical distribution relationship with Ericsson, we are seeking to expand our geographic reach as well as the applications for our products. Our direct and indirect selling efforts are focused on the sale of our solutions into additional applications, including metro aggregation and submarine networks, and in support of cloud-based services, business Ethernet services and mobile backhaul.

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

Business optimization to yield operating leverage. We are actively pursuing the transformation and redesign of certain business processes, systems, and resources. These initiatives include additional investments, re-engineering of enterprise systems and automation of certain key business processes. In addition, we are focused on optimizing our supply chain, including efforts to reduce our material and overhead costs in an effort to increase efficiency and reduce the cost to produce our product solutions. These initiatives include portfolio and process optimization, reducing our fulfillment, shipping and logistics expense, and identifying ways to drive improved efficiencies in the design and development of our solutions. We seek to leverage these opportunities to promote the profitable growth of our business and drive additional operating leverage.

## Term Loan and Asset-Based Credit Facilities

On July 15, 2014, we entered into a credit agreement that provides for senior secured term loans in an aggregate principal amount of \$250 million (the "Term Loan"). We expect to use the approximately \$246 million in net proceeds to repay, in whole or part, the outstanding principal amount owing under our 4.00% senior convertible notes due March 15, 2015 in the event the holders thereof do not elect to convert such notes into common stock prior to

maturity. In the event the holders of such notes elect to convert their notes into common stock upon or prior to maturity, we may elect to repay the Term Loan, in whole or in part, or may utilize the net proceeds for other general corporate purposes, including the repayment or refinancing of other existing indebtedness. See Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report for a summary of the material terms and conditions of the Term Loan and the related security documents.

On July 15, 2014, we also amended the terms of our existing senior secured asset-based revolving credit facility to, among other things, increase the total commitment under the ABL Credit Facility from \$150 million to \$200 million and extend the maturity date from August 13, 2015 to December 31, 2016. See Note 14 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report for a summary of the material terms and conditions of the amendment to this credit agreement and the related security documents.

Financial Results

## Table of Contents

Revenue for the third quarter of fiscal 2014 was \$603.6 million, representing a sequential increase of 7.8% from \$560.1 million in the second quarter of fiscal 2014. Revenue-related details reflecting sequential changes from the second quarter of fiscal 2014 include:

Product revenue for the third quarter of fiscal 2014 increased by \$35.1 million, reflecting increased sales of \$25.2 million in Converged Packet Optical, \$5.6 million in software, \$2.9 million in Packet Networking and \$1.4 million in Optical Transport.

Service revenue for the third quarter of fiscal 2014 increased by \$8.4 million.

Revenue from the United States for the third quarter of fiscal 2014 was \$368.1 million, an increase from \$324.0 million in the second quarter of fiscal 2014.

- International revenue for the third quarter of fiscal 2014 was \$235.5 million, a decrease from \$236.1 million in the second quarter of fiscal 2014.

As a percentage of revenue, international revenue was 39.0% during the third quarter of fiscal 2014, a decrease from 42.2% during the second quarter of fiscal 2014.

For the third quarter of fiscal 2014, one customer accounted for 21.6% of total revenue. This compares to one customer that accounted for 21.5% of total revenue in the second quarter of fiscal 2014.

Gross margin for the third quarter of fiscal 2014 was 43.7%, an increase from 42.4% in the second quarter of fiscal 2014.

Operating expense was \$227.0 million for the third quarter of fiscal 2014, a decrease from \$230.5 million in the second quarter of fiscal 2014. Third quarter fiscal 2014 operating expense primarily reflects decreases of \$5.8 million in research and development expense and \$1.7 million in sales and marketing expense. These decreases were partially offset by an increase of \$4.4 million in general and administrative expense.

Reflecting the improvements in revenue and gross margin above, income from operations for the third quarter of fiscal 2014 was \$37.0 million, compared to income from operations of \$7.2 million during the second quarter of fiscal 2014. Our net income for the third quarter of fiscal 2014 was \$16.2 million, or \$0.15 per diluted common share. This compares to a net loss of \$10.2 million or \$0.10 per diluted common share, for the second quarter of fiscal 2014.

We generated cash from operations of \$51.1 million during the third quarter of fiscal 2014, consisting of \$80.9 million in cash provided by net income adjusted for non-cash charges, offset by a \$29.8 million use of cash related to changes in working capital. This compares with \$2.0 million of cash generated from operations during the second quarter of fiscal 2014, consisting of \$49.5 million in cash provided by net losses adjusted for non-cash charges offset by a \$47.5 million use of cash related to changes in working capital.

As of July 31, 2014, we had \$532.9 million in cash and cash equivalents, \$120.3 million of short-term investments in U.S. treasury securities and commercial paper, and \$65.0 million of long-term investments in U.S. treasury securities. This compares to \$378.2 million in cash and cash equivalents, \$100.0 million of short-term investments in U.S. treasury securities and \$15.0 million of long-term investments in U.S. treasury securities, at July 31, 2013, and \$346.5 million in cash and cash equivalents, \$125.0 million of short-term investments in U.S. treasury securities and commercial paper, and \$15.0 million of long-term investments in U.S. treasury securities at October 31, 2013.

As of July 31, 2014, we had 5,136 employees, an increase from 4,754 at October 31, 2013 and an increase from 4,680 at July 31, 2013.

## Consolidated Results of Operations

### Operating Segments



Ciena's internal organizational structure and the management of its business are grouped into the following operating segments:

Converged Packet Optical — includes networking solutions optimized for the convergence of coherent optical transport, OTN switching and packet switching. These platforms enable automated packet-optical infrastructures that create and efficiently allocate high-capacity bandwidth for the delivery of a wide variety of enterprise and consumer-oriented network services. Products in this segment include the 6500 Packet-Optical Platform and the 5430 Reconfigurable Switching System, which feature Ciena's WaveLogic coherent optical processors. Products also

Table of Contents

include Ciena's family of CoreDirector® Multiservice Optical Switches and the OTN configuration for the 5410 Reconfigurable Switching System. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Packet Networking — principally includes Ciena's 3000 family of service delivery switches and service aggregation switches, the 5000 series of service aggregation switches. This segment also includes Ciena's new 8700 Packetwave Platform, a multi-terabit packet switching platform for high-density metro networks. The 8700 combines Ethernet switching and optical transport to help network operators deliver on-demand, cloud-based services with improved economics. In addition, this segment includes Ciena's Ethernet packet configuration for the 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have principally been deployed to support wireless backhaul infrastructures and business data services. Employing sophisticated, carrier-grade Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment includes stand-alone broadband products that transition voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

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

Software and Services — includes Ciena's network software suite, including the Agility software portfolio which includes a multilayer software-defined networking (SDN) controller and new software applications for enabling on-demand, high-bandwidth wide area network (WAN) services delivered in an open network ecosystem. With Agility, our customers can better monetize cloud-based services and virtual network functions created in a traditional or an SDN environment. This segment also includes the OneControl Unified Management System. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network performance. In addition, this segment includes the ON-Center® Network & Service Management Suite, Ethernet Services Manager, Optical Suite Release and network level applications. This segment includes a broad range of consulting, network design and support services from Ciena's Network Transformation Solutions offering. This segment also includes installation and deployment, maintenance support and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Condensed Consolidated Statement of Operations.

Quarter ended July 31, 2013 compared to the quarter ended July 31, 2014  
Revenue

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

33

---

Table of Contents

	Quarter Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Revenue:						
Converged Packet Optical	\$ 302,018	56.1	\$ 382,031	63.3	\$ 80,013	26.5
Packet Networking	61,631	11.4	69,464	11.5	7,833	12.7
Optical Transport	66,218	12.3	31,016	5.1	(35,202 )	(53.2 )
Software and Services	108,489	20.2	121,051	20.1	12,562	11.6
Consolidated revenue	\$ 538,356	100.0	\$ 603,562	100.0	\$ 65,206	12.1

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

Converged Packet Optical revenue increased, reflecting a \$70.6 million increase in sales of our 6500 Packet-Optical Platform, largely driven by service provider demand for high-capacity, optical transport for coherent 40G and 100G network infrastructures. In addition, sales of our 5430 Reconfigurable Switching System increased by \$19.5 million and sales of the OTN configuration for the 5410 Reconfigurable Switching System increased by \$2.7 million. These increases were slightly offset by a decrease of \$12.8 million in sales of our CoreDirector® Multiservice Optical Switches. The strong performance of this segment, particularly as compared to the expected declines in Optical Transport segment revenue, reflects the preference of network operators to adopt next-generation architectures that enable the convergence of high-capacity, coherent optical transport with integrated OTN switching and control plane functionality.

Packet Networking revenue increased, reflecting a \$10.6 million increase in sales of our 3000 and 5000 families of service delivery and aggregation switches. This increase was partially offset by a \$2.2 million decrease in our older stand-alone broadband products. Segment revenue benefited from the expansion of Ethernet business services by our North American service provider customers and sales of service delivery and aggregation products in support of their packet-related network initiatives.

Optical Transport revenue decreased, reflecting a \$16.0 million decrease of our 5100/5200 Advanced Services Platform, a \$12.6 million decrease in sales of other stand-alone transport products and a \$6.6 million decrease in sales of our 4200 Advanced Services Platform. Revenue for our Optical Transport segment, which currently consists principally of stand-alone WDM and SONET/SDH-based transport platforms, has experienced meaningful declines in revenue in recent years. We expect this trend to continue, reflecting network operators' transition toward next-generation converged network architectures as described above.

Software and Services revenue increased, reflecting increases of \$5.8 million in software revenue, \$5.3 million in maintenance and support services revenue, and \$2.2 million in network transformation consulting 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:

	Quarter Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
United States	\$ 339,426	63.0	\$ 368,056	61.0	\$ 28,630	8.4
International	198,930	37.0	235,506	39.0	36,576	18.4
Total	\$ 538,356	100.0	\$ 603,562	100.0	\$ 65,206	12.1

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

United States revenue reflects increases of \$33.8 million in Converged Packet Optical sales, \$8.7 million in Packet Networking sales and \$8.2 million in Software and Services revenue. These increases were partially offset by a \$22.0 million decrease in Optical Transport sales. Increased revenues reflect adoption by network operators in the United

States of converged network architectures that align well with our OP<sup>n</sup> Architecture and solutions offering.

34

---

## Table of Contents

International revenue reflects increases of \$46.3 million in Converged Packet Optical sales and \$4.4 million in Software and Services revenue, partially offset by decreases of \$13.2 million in Optical Transport sales and \$1.0 million in Packet Networking sales.

While we have taken steps to expand our addressable market and diversify our business and customer base, a sizable portion of our revenue continues to come from sales to a small number of service providers. As a result, our financial results are significantly affected by, and can fluctuate depending upon, spending levels of our key service provider customers, changes in their network and purchasing strategies, and the business opportunities and challenges encountered by our largest service provider customers. During the third quarter of fiscal 2014, one customer accounted for greater than 10% of total revenue and represented 21.6% of total revenue. This compares to the third quarter of fiscal 2013, when two such customers together accounted for 31.8% of total revenue.

### 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.

While we have experienced recent periods in which our gross profit as a percentage of revenue, or “gross margin,” has been more consistent, it remains susceptible to fluctuation in any quarter due to a number of factors impacting our business. Gross margin can be adversely affected by the level of pricing pressure and competition that we encounter in the market, particularly in our efforts to compete to obtain business with new customers or to maintain business with existing customers. In an effort to penetrate additional markets, secure new business or capture market share, we may agree to pricing or other unfavorable commercial terms that result in lower or negative gross margins on a particular order or group of orders, particularly associated with initial sales or deployment projects. Similarly, to maintain incumbency with key customers for existing and future business opportunities, we may be required to offer discounted pricing, provide commitments with respect to future technology development, or offer less favorable commercial terms as compared to our historical business arrangements with these customers. Some of our large existing customers are pursuing purchasing strategies or adopting procurement approaches intended to drive further pricing reductions, seek additional commercial concessions and consolidate their number of direct suppliers of networking technology. The impact of significant new wins or commercial concessions to significant customers can adversely affect our gross margin during the relevant periods and result in fluctuation in our results of operations.

Our product gross margin can also vary significantly depending upon the mix and concentration of revenue by segment, product line within a particular segment, geography and customers. Within our Converged Packet Optical segment, gross margin can be affected by our mix of lower margin “commons” equipment sales and higher margin channel cards and software content. We also expect that gross margins will be subject to fluctuation based on our introduction of new products, changes in expense for excess and obsolete inventory and warranty obligations, as well as our degree of success in driving product cost reductions and other effort to optimize our operations. Service gross margin can be affected by customer and geographic mix, and the mix between lower margin deployment services as compared to maintenance and other service offerings. These market dynamics and factors may adversely affect our gross margins and results of operations in certain periods.

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:

Edgar Filing: CIENA CORP - Form 10-Q

	Quarter Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Total revenue	\$538,356	100.0	\$603,562	100.0	\$65,206	12.1
Total cost of goods sold	310,135	57.6	339,589	56.3	29,454	9.5
Gross profit	\$228,221	42.4	\$263,973	43.7	\$35,752	15.7

---

\* Denotes % of total revenue

35

---

Table of Contents

\*\* Denotes % change from 2013 to 2014

	Quarter Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Product revenue	\$437,442	100.0	\$495,889	100.0	\$58,447	13.4
Product cost of goods sold	247,768	56.6	275,003	55.5	27,235	11.0
Product gross profit	\$189,674	43.4	\$220,886	44.5	\$31,212	16.5

\* Denotes % of product revenue

\*\* Denotes % change from 2013 to 2014

	Quarter Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Service revenue	\$100,914	100.0	\$107,673	100.0	\$6,759	6.7
Service cost of goods sold	62,367	61.8	64,586	60.0	2,219	3.6
Service gross profit	\$38,547	38.2	\$43,087	40.0	\$4,540	11.8

\* Denotes % of services revenue

\*\* Denotes % change from 2013 to 2014

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

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

Gross profit on services as a percentage of services revenue increased, primarily due to increased maintenance and consulting services revenues, including our Network Transformation Solutions offerings, and increased margin due to improved efficiencies for managed spares projects.

#### Operating Expense

We expect operating expense to increase in fiscal 2014 from the level reported for fiscal 2013 to support the growth of our business and fund our research and development initiatives. However, we expect fiscal 2014 operating expense as a percentage of revenue to decline as compared to fiscal 2013. Operating expense consists of the component elements described below.

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

Selling 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 consists of the amortization of purchased technology and customer relationships from our acquisitions.



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

Table of Contents

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

	Quarter Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Research and development	\$93,069	17.3	\$97,685	16.2	\$4,616	5.0
Selling and marketing	75,613	14.0	81,919	13.6	6,306	8.3
General and administrative	32,066	6.0	36,285	6.0	4,219	13.2
Amortization of intangible assets	12,440	2.3	11,019	1.8	(1,421)	(11.4)
Restructuring costs	202	—	63	—	(139)	(68.8)
Total operating expenses	\$213,390	39.6	\$226,971	37.6	\$13,581	6.4

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

Research and development expense benefited by \$2.8 million as a result of foreign exchange rates, primarily due to strengthening of the U.S. dollar in relation to the Canadian Dollar. The \$4.6 million increase in research and development expense consisted of a \$2.4 million increase in employee compensation and related costs, a \$1.0 million increase in prototype expense and a \$1.0 million increase in facilities and information technology costs. Our prioritization of expense reflects the research and development strategy described in "Strategy" above.

Selling and marketing expense increased by \$6.3 million, primarily reflecting increases of \$4.2 million in employee compensation and related costs and \$1.4 million increase in freight and logistics costs for demonstration equipment.

General and administrative expense increased by \$4.2 million, reflecting increases of \$2.6 million in legal fees associated with patent litigation costs, \$0.8 million in employee compensation and related costs and \$0.8 million in provisions for doubtful accounts receivable.

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

Restructuring costs primarily reflect certain severance and related expense associated with headcount reductions and restructuring activities to align our workforce and resources with market opportunities and research and development initiatives. Restructuring costs for fiscal 2013 also include the consolidation of certain facilities located within Maryland associated with the transition of our headquarters facility.

Other items

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

	Quarter Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Interest and other income (loss), net	\$(3,167)	(0.6)	\$(6,328)	(1.0)	\$(3,161)	99.8
Interest expense	\$10,972	2.0	\$11,508	1.9	\$536	4.9
Provision for income taxes	\$1,923	0.4	\$3,006	0.5	\$1,083	56.3

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

Interest and other income (loss), net reflects a \$2.5 million non-cash loss related to the change in fair value of the embedded redemption feature associated with our 4.0% convertible senior notes due March 15, 2015 (the "2015 Notes").

Interest expense remained relatively unchanged.

Provision for income taxes increased primarily due to foreign tax expense, which is largely a result of higher income from our Brazilian operations.

Nine months ended July 31, 2013 compared to the nine months ended July 31, 2014



Table of Contents

## Revenue

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

	Nine Months Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Revenue:						
Converged Packet Optical	\$836,303	55.8	\$1,072,272	63.2	\$235,969	28.2
Packet Networking	161,658	10.8	187,699	11.1	26,041	16.1
Optical Transport	181,186	12.1	100,729	5.9	(80,457)	(44.4)
Software and Services	320,014	21.3	336,626	19.8	16,612	5.2
Consolidated revenue	\$1,499,161	100.0	\$1,697,326	100.0	\$198,165	13.2

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

Converged Packet Optical revenue increased significantly, reflecting a \$203.2 million increase in sales of our 6500 Packet-Optical Platform, largely driven by service provider demand for high-capacity, optical transport for coherent 40G and 100G network infrastructures. In addition, sales of our 5430 reconfigurable switching system and the OTN configuration for the 5410 Reconfigurable Switching System increased by \$43.6 million and \$6.4 million respectively. These increases were partially offset by a \$17.2 million decrease in sales of our CoreDirector® Multiservice Optical Switches. The strong performance of this segment, particularly as compared to the expected declines in Optical Transport segment revenue, reflects the preference of network operators to adopt next-generation architectures that enable the convergence of high-capacity, coherent optical transport with integrated OTN switching and control plane functionality.

Packet Networking revenue increased, reflecting an increase of \$36.1 million in sales of our 3000 and 5000 families of service delivery and aggregation switches. This increase was partially offset by decreases of \$3.3 million in sales of our older, stand-alone broadband products and \$6.4 million in sales of our 5410 Service Aggregation Switch. Segment revenue benefited from the expansion of Ethernet business services by our North American service provider customers and sales of service delivery and aggregation products in support of their related network initiatives. Optical Transport revenue decreased, reflecting sales decreases of \$33.4 million in other stand-alone transport products, \$26.0 million of 5100/5200 Advanced Services Platform and \$21.1 million in our 4200 Advanced Services Platform. Revenue for our Optical Transport segment, which currently consists principally of stand-alone WDM and SONET/SDH-based transport platforms, has experienced meaningful declines in annual revenue in recent years, reflecting network operators' transition toward next-generation converged network architectures as described above. Software and Services revenue increased, reflecting increases of \$8.1 million in maintenance and support services revenue, \$4.4 million in software sales, \$2.1 million in networking transformation consulting revenue and \$2.0 million for installation and deployment services revenue.

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

	Nine Months Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
United States	\$891,233	59.4	\$1,009,433	59.5	\$118,200	13.3
International	607,928	40.6	687,893	40.5	79,965	13.2
Total	\$1,499,161	100.0	\$1,697,326	100.0	\$198,165	13.2

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014



Table of Contents

United States revenue reflects increases of \$126.6 million in Converged Packet Optical sales, \$26.6 million in Packet Networking sales and \$17.7 million in Services and Software sales. In particular, during the first nine months of fiscal 2014, we benefited from the spending patterns and decisions of our largest service provider customers as they adopted converged, next generation network architectures that align well with our OP<sup>n</sup> Architecture and solutions offering. These increases were partially offset by a \$52.7 million decrease in Optical Transport sales.

International revenue reflects an increase of \$109.3 million in Converged Packet Optical sales. This increase was partially offset by decreases of \$27.7 million in Optical Transport sales and \$1.1 million in Software and Services revenue.

## 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:

	Nine Months Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Total revenue	\$1,499,161	100.0	\$1,697,326	100.0	\$198,165	13.2
Total cost of goods sold	865,632	57.7	969,811	57.1	104,179	12.0
Gross profit	\$633,529	42.3	\$727,515	42.9	\$93,986	14.8

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

	Nine Months Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Product revenue	\$1,203,716	100.0	\$1,389,651	100.0	\$185,935	15.4
Product cost of goods sold	683,730	56.8	777,851	56.0	94,121	13.8
Product gross profit	\$519,986	43.2	\$611,800	44.0	\$91,814	17.7

\* Denotes % of product revenue

\*\* Denotes % change from 2013 to 2014

	Nine Months Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Service revenue	\$295,445	100.0	\$307,675	100.0	\$12,230	4.1
Service cost of goods sold	181,902	61.6	191,960	62.4	10,058	5.5
Service gross profit	\$113,543	38.4	\$115,715	37.6	\$2,172	1.9

\* Denotes % of services revenue

\*\* Denotes % change from 2013 to 2014

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

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

- Gross profit on services as a percentage of services revenue decreased primarily due to higher spares usage costs in support of our maintenance contracts and an increase in deployment costs.

Operating Expense

39

---

Table of Contents

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

	Nine Months Ended July 31,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Research and development	\$282,981	18.9	\$302,674	17.8	\$19,693	7.0
Selling and marketing	216,676	14.4	243,929	14.4	\$27,253	12.6
General and administrative	91,157	6.1	98,264	5.8	\$7,107	7.8
Amortization of intangible assets	37,332	2.5	34,951	2.1	(2,381 )	(6.4 )
Restructuring costs	6,741	0.4	178	—	(6,563 )	(97.4 )
Total operating expenses	\$634,887	42.3	\$679,996	40.1	\$45,109	7.1

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

Research and development expense benefited by \$12.5 million, as a result of foreign exchange rates, primarily due to strengthening of the U.S. dollar in relation to the Canadian Dollar. The increase of \$19.7 million primarily reflects increases of \$7.2 million in professional services expense, \$6.2 million in employee compensation and related costs, \$5.3 million in prototype expense and \$1.3 million in facilities and information technology costs.

Selling and marketing expense increased \$27.3 million, primarily reflecting increases of \$23.1 million in employee compensation and related costs, \$2.9 million of travel and related costs and \$1.2 million in facilities and information technology costs.

General and administrative expense increased \$7.1 million, reflecting increases of \$4.6 million in legal fees associated with patent litigation costs, \$1.8 million in employee compensation and related costs and \$0.7 million of consulting and audit fees.

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

Restructuring costs primarily reflect certain severance and related expense associated with headcount reductions and restructuring activities to align our workforce and resources with market opportunities and research and development initiatives. Restructuring costs for fiscal 2013 also include the consolidation of certain facilities located within Maryland associated with the transition of our headquarters facility.

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,				Increase	
	2013	%*	2014	%*	(decrease)	%**
Interest and other income (loss), net	\$(6,020 )	(0.4 )	\$(14,231 )	(0.8 )	\$(8,211 )	136.4
Interest expense	\$33,096	2.2	\$33,556	2.0	\$460	1.4
Loss on extinguishment of debt	\$28,630	1.9	\$—	0.0	\$(28,630 )	(100.0 )
Provision for income taxes	\$6,530	0.4	\$9,666	0.6	\$3,136	48.0

\* Denotes % of total revenue

\*\* Denotes % change from 2013 to 2014

Interest and other income (loss), net reflects a \$5.5 million non-cash loss related to the change in fair value of the embedded redemption feature associated with our 2015 Notes and a \$2.3 million loss related to foreign exchange rates on assets and liabilities denominated in a currency other than the relevant functional currency, net of hedging activity. Interest expense remained relatively unchanged.

Loss on extinguishment of debt for fiscal 2013 reflects a non-cash loss of \$28.6 million relating to the exchange transactions during the first quarter of fiscal 2013. Upon issuance, the 4.0% convertible senior notes due December 15, 2020 (the "2020 Notes") were recorded at a fair value of \$213.6 million. The exchange transactions resulted in the retirement of outstanding 2015 Notes with a carrying value of \$187.9 million and the write-off of unamortized debt





Table of Contents

issuance costs of \$2.3 million and \$0.6 million relating to the redemption feature on the 2015 Notes, which was accounted for as a separate embedded derivative.

Provision for income taxes increased primarily due to foreign tax expense, which is largely a result of higher income from our Brazilian operations.

## Segment Profit

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

	Quarter Ended July 31,		Increase (decrease)	%*
	2013	2014		
Segment profit:				
Converged Packet Optical	\$66,952	\$104,020	\$37,068	55.4
Packet Networking	\$7,620	\$14,566	\$6,946	91.2
Optical Transport	\$29,459	\$8,900	\$(20,559)	(69.8)
Software and Services	\$31,121	\$38,802	\$7,681	24.7

\* Denotes % change from 2013 to 2014

Converged Packet Optical segment profit increased, primarily due to increased sales volume and improved gross margin, partially offset by increased research and development expense. The increased sales volume is largely driven by service provider demand for convergence of high-capacity, coherent 40G and 100G network infrastructures with integrated OTN switching and control plane functionality. The improved gross margin is primarily due to sales reflecting a greater mix of higher-margin packet platforms with software content within the segment.

Packet Networking segment profit increased slightly due to increased sales volume and improved gross margin, partially offset by increased research and development expense. Packet Networking revenue benefited from the expansion of Ethernet business services by our North American service provider customers and sales of service delivery and aggregation products in support of their related network initiatives. Gross margin improved due to sales reflecting a greater mix of higher-margin platforms with software content within the segment.

Optical Transport segment profit decreased, primarily due to reduced sales volume and lower gross margin. The decrease in gross margin is primarily due to an increase in obsolete and excess inventory expense for the discontinuance of certain parts and components used in the manufacture of our Optical Transport products, including our Corestream® Agility Optical Transport platform. Revenue for our Optical Transport segment, which currently consists principally of stand-alone WDM and SONET/SDH-based transport platforms, has experienced meaningful declines in annual revenue in recent years, reflecting network operators' transition toward next-generation network architectures as described above.

Software and Services segment profit increased primarily due to higher sales for software and consulting services, including our Network Transformation Solutions offerings, and increased margin due to improved efficiencies for managed spares projects. These increases were partially offset by higher software research and development expenses.

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

Table of Contents

	Nine Months Ended July 31,			
	2013	2014	Increase (decrease)	%*
Segment profit:				
Converged Packet Optical	\$171,598	\$279,299	\$107,701	62.8
Packet Networking	\$15,259	\$23,147	\$7,888	51.7
Optical Transport	\$71,459	\$29,259	\$(42,200)	(59.1)
Software and Services	\$92,232	\$93,136	\$904	1.0

\* Denotes % change from 2013 to 2014

Converged Packet Optical segment profit increased, primarily due to increased sales volume and improved gross margin, partially offset by increased research and development expense. The increased sales volume is largely driven by service provider demand for convergence of high-capacity, coherent 40G and 100G network infrastructures with integrated OTN switching and control plane functionality. The improved gross margin is primarily due to sales reflecting a greater mix of higher-margin packet platforms with software content within the segment.

Packet Networking segment profit increased due to increased sales volume and improved gross margin, partially offset by increased research and development expense. Packet Networking revenue benefited from the expansion of Ethernet business services by our North American service provider customers and sales of service delivery and aggregation products in support of their related network initiatives. Gross margin improved due to sales reflecting a greater mix of higher-margin platforms with software content within the segment.

Optical Transport segment profit decreased, primarily due to reduced sales volume and lower gross margin, partially offset by lower research and development expense. The decrease in gross margin is primarily due to an increase in obsolete and excess inventory expense for the discontinuance of certain parts and components used in the manufacture of our Optical Transport products, including our Corestream® Agility Optical Transport platform. Revenue for our Optical Transport segment, which currently consists principally of stand-alone WDM and SONET/SDH-based transport platforms, has experienced meaningful declines in annual revenue in recent years, reflecting network operators' transition toward next-generation network architectures as described above.

Software and Services segment profit increased slightly due to higher sales for software and consulting services, including our Network Transformation Solutions offerings. These increases were offset by higher spares usage costs in support of our maintenance contracts, increases in deployment costs and higher software research and development expense.

#### Liquidity and Capital Resources

At July 31, 2014, our principal sources of liquidity were cash and cash equivalents, short-term investments and long-term investments in marketable debt securities, representing U.S. treasuries and commercial paper, and our ABL Credit Facility. The following table sets forth changes in our cash and cash equivalents and investments in marketable debt securities (in thousands):

	October 31, 2013	July 31, 2014	Increase (decrease)
Cash and cash equivalents	\$346,487	\$532,884	\$186,397
Short-term investments in marketable debt securities	124,979	120,250	(4,729)
Long-term investments in marketable debt securities	15,031	65,019	49,988
Total cash and cash equivalents and investments in marketable debt securities	\$486,497	\$718,153	\$231,656

The change in total cash and cash equivalents and investments in marketable debt securities during the first nine months of fiscal 2014 was primarily related to the \$246 million in net proceeds from our Term Loan as described in "Overview" above and the following:

• \$16.0 million cash generated from operations, consisting of \$171.7 million provided by net loss (adjusted for non-cash charges) and \$155.7 million used in working capital;

- \$36.0 million used for purchases of equipment, furniture, and fixtures and intellectual property;

42

---

Table of Contents

\$10.8 million used in settlement of foreign currency forward contracts, net;  
 \$2.3 million used in relation to payment of capital lease obligations; and  
 \$17.5 million provided by stock issuances under our employee stock purchase plan and exercise of stock options.  
 As of July 31, 2014, letters of credit totaling \$56.0 million were collateralized by our ABL Credit Facility. There were no borrowings outstanding under the ABL Credit Facility as of July 31, 2014. See "ABL Credit Facility" below for additional information.

We regularly evaluate our liquidity position, debt obligations, and anticipated cash needs to fund our operating plans and may consider capital raising and other market opportunities that may be available to us. Based on past performance and current expectations, we believe that our cash, cash equivalents, investments and other sources of liquidity, including our Credit Facility, will satisfy the working capital needs, capital expenditures, the repayment of our outstanding 4.0% convertible senior notes due March 15, 2015 and other liquidity requirements associated with our operations through at least the next 12 months.

The following sections set forth the components of our \$16.0 million of cash generated from operating activities during the first nine months of fiscal 2014:

Net loss (adjusted for non-cash charges)

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

	Nine months ended July 31, 2014
Net loss	\$(9,934 )
Adjustments for non-cash charges:	
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	41,463
Share-based compensation costs	34,204
Amortization of intangible assets	43,931
Provision for inventory excess and obsolescence	22,026
Provision for warranty	18,720
Other	21,254
Net loss (adjusted for non-cash charges)	\$ 171,664

### Working Capital

#### Accounts Receivable, Net

Cash used by an increase in accounts receivable during the first nine months of fiscal 2014, net of a \$2.7 million provision for doubtful accounts, was \$55.7 million. This reflects both increases in our revenues and days sales outstanding (DSOs). Our DSOs increased from 78 days for the first nine months of fiscal 2013 to 86 days for the first nine months of fiscal 2014. The increase in DSOs primarily reflects growth in certain new international customers whose contracts have longer payment terms.

The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2013 through the end of the third quarter of fiscal 2014:

	October 31, 2013	July 31, 2014	Increase (decrease)
Accounts receivable, net	\$488,578	\$541,573	\$52,995

#### Inventory

Cash used by an increase in inventory during the first nine months of fiscal 2014 was \$66.0 million. The increase in inventory reflects our decision to carry more finished goods inventory for our Converged Packet Optical products to reduce our lead times for shipments to customers and higher deferred cost of goods sold for shipments awaiting acceptance. Our inventory turns decreased from 3.9 turns during the first nine months of fiscal 2013 to 3.5 turns during the first nine months of fiscal 2014. Our inventory balance, as reported on our Condensed Consolidated Balance Sheet, increased by \$44.0 million during the first nine months of fiscal 2014. This change reflects our \$66.0 million cash usage for inventory, partially offset by a \$22.0

Table of Contents

million 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 2013 through the end of the third quarter of fiscal 2014:

	October 31, 2013	July 31, 2014	Increase (decrease)
Raw materials	\$53,274	\$61,429	\$8,155
Work-in-process	7,773	8,268	495
Finished goods	153,855	172,321	18,466
Deferred cost of goods sold	75,764	103,701	27,937
Gross inventory	290,666	345,719	55,053
Provision for inventory excess and obsolescence	(41,563 )	(52,627 )	(11,064 )
Inventory	\$249,103	\$293,092	\$43,989

## Prepaid expense and other

Cash used by an increase in prepaid expense and other during the first nine months of fiscal 2014 was \$26.7 million primarily related to higher product demonstration equipment, prepaid value added tax and deferred deployment expense.

## Accounts payable, accruals and other obligations

Utilization of cash resources for accounts payable, accruals and other obligations during the first nine months of fiscal 2014 was \$34.8 million, reflecting, among other things, the timing of the annual payment under our cash incentive compensation plan to employees with respect to amounts earned for fiscal 2013. Changes in accrued liabilities reflect a \$18.7 million non-cash provision related to warranties. Changes in accounts payable reflect a decrease of \$1.9 million for investing activities related to equipment purchases.

The following table sets forth (in thousands) changes in our accounts payable, accruals and other obligations from the end of fiscal 2013 through the end of the third quarter of fiscal 2014:

	October 31, 2013	July 31, 2014	Increase (decrease)
Accounts payable	\$254,849	\$236,630	\$(18,219 )
Accrued liabilities	271,656	267,846	(3,810 )
Other long-term obligations	34,753	37,206	2,453
Accounts payable, accruals and other obligations	\$561,258	\$541,682	\$(19,576 )

## Interest Paid on Convertible Notes, ABL Credit Facility and Term Loan

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 \$3.8 million in interest on these convertible notes during the first nine months of fiscal 2014.

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 2014.

Interest on our outstanding 3.75% convertible senior notes, due October 15, 2018, is payable on April 15 and October 15 of each year. We paid \$6.6 million in interest on these convertible notes during the first nine months of fiscal 2014.

Interest on our outstanding 4.0% convertible senior notes, due December 15, 2020, is payable on June 15 and December 15 of each year. We paid \$7.5 million in interest on these convertible notes during the first nine months of fiscal 2014.

Interest on our outstanding Term Loan, due July 15, 2019, is payable periodically based on the underlying market index rate selected for borrowing. We paid \$0.1 million in interest on this term loan during the third quarter of fiscal 2014.



Table of Contents

During the first nine months of fiscal 2014, we utilized the ABL Credit Facility to collateralize certain standby letters of credit. We paid \$1.1 million in commitment fees, interest expense and other administrative charges relating to the ABL Credit Facility during the first nine months of fiscal 2014.

## Deferred revenue

Deferred revenue increased by \$27.5 million during the first nine months of fiscal 2014. Product deferred revenue represents either payments received in advance of shipment or payments received after shipment but before revenue recognition. Services deferred revenue is related to payment for service contracts for which revenue 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 2013 through the first nine months of fiscal 2014:

	October 31, 2013	July 31, 2014	Increase (decrease)
Products	\$36,671	\$57,590	\$20,919
Services	75,499	82,078	6,579
Total deferred revenue	\$112,170	\$139,668	\$27,498

## ABL Credit Facility

On July 15, 2014, we amended our ABL Credit Facility to, among other things:

- increase the total commitment from \$150 million to \$200 million;
- extend the maturity date from August 13, 2015 to December 31, 2016 (and eliminate the December 15, 2014 maturity date acceleration feature);
- reduce from \$200 million to \$150 million the minimum aggregate amount of unrestricted cash and cash equivalents that we are required to maintain at all times;
- reduce the interest rate on borrowings from LIBOR plus an applicable margin ranging from 200 basis points to 250 basis points, to an applicable margin ranging from 150 basis points to 200 basis points, with the actual margin determined based on Ciena's utilization of the credit facility; and
- amend the borrowing base to include, among other items, up to \$50 million in eligible cash.

We principally use the liquidity available under the ABL Credit Facility to support the issuance of letters of credit that arise in the ordinary course of our business and thereby to reduce our use of cash required to collateralize these instruments.

## Contractual Obligations

During the third quarter of fiscal 2014, we entered into a Term Loan Credit Agreement that provides for senior secured term loans in an aggregate principal amount of \$250 million as described in "Overview" above. The following is a summary of our future minimum payments under contractual obligations as of July 31, 2014 (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Principal due at maturity on convertible notes (1)	\$1,254,627	\$187,500	\$500,000	\$350,000	\$217,127
Principal due on term loan	250,000	2,500	5,000	242,500	—
Interest due on convertible notes	128,437	32,500	50,000	34,687	11,250
Interest due on term loan (2)	44,105	9,373	17,544	17,188	—
Operating leases (3)	159,339	33,009	55,337	24,906	46,087
Purchase obligations (4)	190,637	190,637	—	—	—

Edgar Filing: CIENA CORP - Form 10-Q

Capital leases	2,863	2,079	784	—	—
Other obligations	5,715	2,900	2,815	—	—
Total (5)	\$2,035,723	\$460,498	\$631,480	\$669,281	\$274,464

---

45

---

Table of Contents

- (1) Includes the accretion of the principal amount on the 2020 Notes payable at maturity at a rate of 1.85% per year compounded semi-annually, commencing December 27, 2012.
- (2) Interest on the term loan is variable and was calculated using the rate in effect on the balance sheet date.
- (3) Does not include variable insurance, taxes, maintenance and other costs required by the applicable operating lease. These costs are not expected to have a material future impact.
- Purchase obligations relate to purchase order commitments to our contract manufacturers and component suppliers
- (4) for inventory. In certain instances, we are permitted to cancel, reschedule or adjust these orders. Consequently, only a portion of the amount reported above relates to firm, non-cancelable and unconditional obligations.
- As of July 31, 2014, we also had approximately \$12.4 million of other long-term obligations in our Condensed
- (5) Consolidated Balance Sheet for unrecognized tax positions that are not included in this table because the timing of any cash settlement with the respective tax authority cannot be reasonably estimated.

Some of our commercial commitments, including some of the future minimum payments in operating leases set forth above and certain commitments to customers, are secured by standby letters of credit collateralized under our ABL Credit Facility or restricted cash. Restricted cash balances are included in other current assets or other long-term assets depending upon the duration of the underlying letter of credit obligation. The following is a summary of our commercial commitments secured by standby letters of credit by commitment expiration date as of July 31, 2014 (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Standby letters of credit	\$55,975	\$23,432	\$11,923	\$3,659	\$16,961

**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 share-based compensation, bad debts, inventories, intangible and other long-lived assets, income taxes, warranty obligations, restructuring, derivatives and hedging, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Among other things, these estimates form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. To the extent that there are material differences between our estimates and actual results, our consolidated financial statements will be affected.

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

**Revenue Recognition**

We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine

the existence of an arrangement. Shipping documents and evidence of customer acceptance, when applicable, are used to verify delivery or services rendered. We assess whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. We assess collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are to be performed. Shipping and handling fees billed to customers are included in revenue, with the associated expenses included in product cost of goods sold.

## Table of Contents

We apply the percentage-of-completion method to long-term arrangements where we are required to undertake significant production, customizations or modification engineering, and reasonable and reliable estimates of revenue and cost are available. Utilizing the percentage-of-completion method, we recognize revenue based on the ratio of actual costs incurred to date to total estimated costs expected to be incurred. In instances that do not meet the percentage-of-completion method criteria, recognition of revenue is deferred until there are no uncertainties regarding customer acceptance. Unbilled percentage-of-completion revenues recognized are accumulated in the contracts in progress account included in accounts receivable, net. Billings in excess of revenues recognized to date on these contracts are recorded within deferred revenue.

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

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

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each delivered element, with revenue recognized for each delivered element when the revenue recognition criteria are met. We determine the selling price for each deliverable based upon the selling price hierarchy for multiple-deliverable arrangements. Under this hierarchy, we use vendor-specific objective evidence ("VSOE") of selling price, if it exists, or third party evidence ("TPE") of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, we use our best estimate of selling price ("BESP") for that deliverable. For multiple element software arrangements where VSOE of undelivered maintenance does not exist, revenue for the entire arrangement is recognized over the maintenance term.

VSOE, when determinable, is established based on our pricing and discounting practices for the specific product or service when sold separately. In determining whether VSOE exists, 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 BESP based upon management-approved pricing guidelines, which consider multiple factors including the type of product or service, gross margin objectives, competitive and market conditions, and the go-to-market strategy, all of which can affect pricing practices.

Our total deferred revenue for products was \$36.7 million and \$57.6 million as of October 31, 2013 and July 31, 2014, 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 \$75.5 million and \$82.1 million as of October 31, 2013 and July 31, 2014, respectively.

## Share-Based Compensation

We estimate the fair value of our restricted stock unit awards based on the fair value of our common stock on the date of grant. Our outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. We recognize the estimated fair value of service-based awards, net of estimated forfeitures, as share-based expense ratably over the vesting period on a straight-line basis. Awards with performance-based vesting conditions require the achievement of certain financial or other performance criteria or targets as a condition to the vesting, or acceleration of vesting. We recognize the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, using

graded vesting, which considers each performance period or tranche separately, based upon our determination of whether it is probable that the performance targets will be achieved. At each reporting period, we reassess the probability of achieving the performance targets and the performance period required to meet those targets. Determining whether the performance targets will be achieved involves judgment, and the estimate of expense may be revised periodically based on changes in the probability of achieving the performance targets. Revisions are reflected in the period in which the estimate is changed. If any performance goals are not met, no compensation cost is ultimately recognized against that goal and, to the extent previously recognized, compensation cost is reversed.

Because share-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures. We estimate forfeitures at the time of grant and revise these estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the measurement 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

## Table of Contents

July 31, 2014, total unrecognized compensation expense was \$64.5 million, which relates to unvested restricted stock units and this expense is expected to be recognized over a weighted-average period of 1.5 years.

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

### Incentive Compensation Expense

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

For fiscal 2014, the Compensation Committee has approved an annual cash incentive arrangement generally applicable to full-time employees excluding commissioned salespersons, with the aggregate amount of any awards payable dependent upon the achievement of certain financial and operational goals for fiscal 2014. Given that the awards are generally contingent upon achieving annual objectives, the payment of cash incentive awards is not expected to be made until after fiscal year-end results are finalized. As a result, the expense that we accrue for incentive compensation in any interim period in fiscal 2014 is based upon estimates of expected financial results for the year and expected performance against relevant operating objectives. Because assessing actual performance against many of these objectives cannot generally occur until at or near fiscal year-end, determining the amount of expense that we incur in our interim financial statements for incentive compensation involves the judgment of management. Amounts accrued are subject to change in future interim periods if actual future financial results or operational performance are higher or lower than expected. We incurred an aggregate of \$33.7 million of expense in the first nine months of fiscal 2014 associated with our cash incentive bonus plan for fiscal 2014.

### 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. In an effort to limit our exposure to delivery delays and to satisfy customer needs we purchase inventory based on forecasted sales across our product lines. In addition, part of our research and development strategy is to promote the convergence of similar features and functionalities across our product lines. Each of these practices exposes us to the risk that our customers will not order products for which we have forecasted sales, or will purchase less than we have forecasted. Historically, we have experienced write-downs due to discontinuance of a product, changes in our strategic direction and declines in market conditions. We recorded charges for excess and obsolete inventory of \$15.3 million and \$22.0 million in the first nine months of fiscal 2013 and 2014, respectively. The charges in fiscal 2014 primarily related to engineering design changes and the discontinuance of certain parts and components used in the manufacture of our Optical Transport products, including our Corestream® Agility Optical Transport platform, and Converged Packet

Optical products. Our inventory net of allowance for excess and obsolescence was \$249.1 million and \$293.1 million as of October 31, 2013 and July 31, 2014, 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



## Table of Contents

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 \$488.6 million and \$541.6 million as of October 31, 2013 and July 31, 2014, respectively. Our allowance for doubtful accounts was \$2.0 million and \$2.7 million as of October 31, 2013 and July 31, 2014, respectively.

### Long-lived Assets

Our long-lived assets include: equipment, furniture and fixtures, finite-lived intangible assets and maintenance spares. As of October 31, 2013 and July 31, 2014, these assets totaled \$366.9 million and \$315.0 million, net, respectively. We test long-lived assets for impairment whenever events or changes in circumstances indicate that the asset's carrying amount is not recoverable from its undiscounted cash flows. Our long-lived assets are assigned to asset groups that represents the lowest level for which we identify cash flows. We measure impairment loss as the amount by which the carrying amount of the asset or asset group exceeds its fair value.

### Deferred Tax Valuation Allowance

As of July 31, 2014, we have recorded a valuation allowance offsetting substantially all our net deferred tax assets of \$1.5 billion. When measuring the need for a valuation allowance, we assess both positive and negative evidence regarding the realizability of these deferred tax assets. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. In determining net deferred tax assets and valuation allowances, management is required to make judgments and estimates related to projections of profitability, the timing and extent of the utilization of net operating loss carryforwards, applicable tax rates, transfer pricing methodologies and tax planning strategies. The valuation allowance is reviewed quarterly and is maintained until sufficient positive evidence exists to support a reversal. Because evidence such as our operating results during the most recent three-year period is afforded more weight than forecasted results for future periods, our cumulative loss during this three-year period represents sufficient negative evidence regarding the need for nearly a full valuation allowance. We will release this valuation allowance when management determines that it is more likely than not that our deferred tax assets will be realized. Any future release of valuation allowance may be recorded as a tax benefit increasing net income or as an adjustment to paid-in capital, based on tax ordering requirements.

### Warranty

Our liability for product warranties, included in other accrued liabilities, was \$56.3 million and \$57.4 million as of October 31, 2013 and July 31, 2014, 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 \$15.1 million and \$18.7 million for the first nine months of fiscal 2013 and 2014, respectively. See Note 11 to the Condensed Consolidated Financial Statements included in Item 1 of Part I of this report. 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 our warranty obligations could increase our cost of sales and negatively affect our gross margin.

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

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

**Interest Rate Sensitivity.** We currently hold investments in U.S. Government obligations and commercial paper with varying maturities. See Notes 4 and 5 to our Condensed Consolidated Financial Statements for information relating to investments and fair value. These investments are sensitive to interest rate movements and their fair value will decline as interest rates rise and increase as interest rates decline. The estimated impact on these investments of a 100 basis point (1.0%) increase in interest rates across the yield curve from rates in effect as of the balance sheet date would be a \$1.5 million decline in value.

Our earnings and cash flows from operations may be exposed to changes in interest rates because of the floating rate of interest in our Term Loan. See Note 13 to our Condensed Consolidated Financial Statements for information relating to the

## Table of Contents

**Term Loan.** The Term Loan bears interest at LIBOR plus a spread of 300 basis points subject to a minimum LIBOR rate of 0.75%. As of July 31, 2014, the interest rate in effect on our Term Loan was 3.75%. A 100 basis point increase in the LIBOR rate as of our most recent LIBOR rate setting would result in an increase of \$1.3 million in annualized interest expense on our Term Loan recognized in our Condensed Consolidated Financial Statements. Ciena may consider the use of interest rate derivatives to hedge such exposure in the future.

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

With regard to operating expense, our primary exposure to foreign currency exchange risk relates to operating expense incurred in Canadian Dollars, British Pounds, Euros and Indian Rupees. During the first nine months of fiscal 2014, approximately 47.8% of our operating expense was non-U.S. dollar denominated. If these or other currencies strengthen, costs reported in U.S. dollars will increase. During the first nine months of fiscal 2014, research and development expense benefited approximately \$12.5 million, net of hedging, due to the strengthening of the U.S. dollar in relation to the Canadian Dollar and the Indian Rupee in comparison to the first nine months of fiscal 2013. 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 (loss), net.

From time to time, Ciena also uses foreign currency forwards to hedge certain balance sheet exposures. These forwards are not designated as hedges for accounting purposes, and any net gain or loss associated with these derivatives is reported in interest and other income (loss), net. See Note 2 and Note 12 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

**Convertible Notes Outstanding.** The fair market value of each of our outstanding convertible notes is subject to interest rate and market price risk due to the convertible feature of the notes and other factors. Generally the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. The fair market value of the notes may also increase as the market price of our stock rises and decrease as the market price of the stock falls. Interest rate and market value changes affect the fair market value of the notes, and may affect the prices at which we would be able to repurchase such notes were we to do so. These changes do not impact our financial position, cash flows or results of operations. For additional information on the fair value of our outstanding notes, see Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

## Item 4. Controls and Procedures

### Disclosure Controls and Procedures

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

### Changes in Internal Control over Financial Reporting

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

PART II — OTHER INFORMATION

50

---

Table of Contents

## Item 1. Legal Proceedings

On May 29, 2008, Graywire, LLC filed a complaint in the United States District Court for the Northern District of Georgia against Ciena and four other defendants, alleging, among other things, that certain of the parties' products infringe U.S. Patent 6,542,673 (the "673 Patent"), relating to an identifier system and components for optical assemblies. The complaint seeks injunctive relief and damages. In July 2009, upon request of Ciena and certain other defendants, the U.S. Patent and Trademark Office ("PTO") granted the defendants' inter partes application for reexamination with respect to certain claims of the '673 Patent, and the district court granted the defendants' motion to stay the case pending reexamination of all of the patents-in-suit. In December 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims of the '673 Patent, to which Ciena and other defendants filed an appeal. On March 16, 2012, the PTO on appeal rejected multiple claims of the '673 Patent, including the two claims on which Ciena is alleged to infringe. Subsequently, the plaintiff requested a reopening of the prosecution of the '673 Patent, which request was denied by the PTO on April 29, 2013. Thereafter, on May 28, 2013, the plaintiff filed an amendment with the PTO in which it canceled the claims of the '673 Patent on which Ciena is alleged to infringe. The case currently remains stayed, and there can be no assurance as to whether or when the stay will be lifted.

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

## Item 1A. Risk Factors

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

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

Our revenue and results of operations can fluctuate significantly and unpredictably from quarter to quarter. Our budgeted expense levels are based on the opportunities for growth which we see in our business, and depend in part on our projections of future revenue and gross margin. Substantial reductions in expense can take time to implement. Uncertainty or lack of visibility into customer spending, changes in economic or market conditions and other factors that affect customer spending, can make it difficult to forecast future revenue and margins. Consequently, our level of operating expense or inventory may be high relative to revenue, which could harm our profitability and cash flow. Additional factors that contribute to fluctuations in our revenue and operating results include:

- broader macroeconomic conditions, including weakness and volatility in global markets, that affect our customers;
- changes in capital spending by large communications service providers;
- order volume and timing;
- backlog levels and the percentage of a given quarter's revenue generated from orders placed during that quarter;
- the level of competition and pricing pressure we encounter;
- the impact of commercial concessions or unfavorable commercial terms required to maintain incumbency or secure new opportunities with key customers;
- the level of start-up costs we incur to support initial deployments, gain new customers or enter new markets;
  - the timing of revenue recognition on sales;
- the mix of revenue by product segment, geography and customer in any particular quarter;
- seasonal effects in our business; and
- our level of success in improving manufacturing efficiencies and achieving cost reductions in our supply chain.

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

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 17.9% of fiscal 2013 revenue, and our largest ten customers contributed 59.4% of fiscal 2013 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 affecting their businesses. Our

## Table of Contents

Reliance upon a relatively small number of service provider customers also increases our exposure to changes in their network and purchasing strategies. Our service provider customers have previously undertaken, and may undertake in the future, procurement initiatives to support their network strategy, which initiatives may include reductions in capital expenditure, commercial concessions from suppliers and reductions in the number of direct suppliers of networking technology. By way of example, in September 2014, we announced that Ciena had been selected by AT&T as a participating vendor in its Domain 2.0 supplier program. Our commercial arrangement relating to this opportunity includes certain commercial concessions that we expect to have a significant, short-term adverse impact on our revenue and gross margin. We expect these concessions primarily to affect our fourth quarter of fiscal 2014, with a proportionately lesser impact on our first quarter of fiscal 2015, and thereafter having a less significant impact on our quarterly results. Because the terms of our framework contracts, including with respect to our Domain 2.0 opportunity, do not obligate customers to purchase any minimum or guaranteed order quantities, spending by service provider customers can be unpredictable and sporadic. A significant change or reduction in spending by our key customers, the loss of one or more of our large service provider customers, or market or industry factors adversely affecting service providers generally, could have a material adverse effect on our business, financial condition and results of operations.

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

We face a competitive market for sales of communications networking equipment, software and services, and this level of competition could result in pricing pressure, reduced demand, lower gross margins and loss of market share that could harm our business and results of operations. Competition is particularly intense, both in the U.S. and abroad, as we and our competitors aggressively seek to displace incumbent equipment vendors at large service providers and secure new customers. In an effort to maintain our incumbency and secure additional customer opportunities, we have in the past, and may in the future, agree to aggressive pricing, commercial concessions and other unfavorable terms that reduce our revenue and result in low or negative gross margins on a particular order or group of orders. We expect this level of competition to continue or potentially increase, as multinational equipment vendors seek to promote adoption of competing architectural approaches for next-generation networks and retain incumbent positions with large customers globally. We also expect our competitive landscape to broaden. As network technologies, features and layers converge, and demands for software programmability of networks increase, we expect that our business will overlap more directly with additional networking suppliers, including IP router vendors, system integrators, software vendors and other information technology vendors.

Competition in our markets, generally, is based on any one or a combination of the following factors: product features; functionality and performance; price; services offerings; manufacturing capability and lead-times; incumbency and existing business relationships; scalability and flexibility of products to meet the immediate and future network; and service requirements of network operators. A small number of very large companies have historically dominated our industry, many of which have substantially greater financial and marketing resources, broader product offerings and more established relationships with service providers and other customer segments than we do. 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 in a particular product niche. If competitive pressures increase or we fail to compete successfully in our markets, our business and results of operations could suffer.

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

Our business and operating results could be materially adversely affected by reduced customer spending in response to unfavorable or uncertain macroeconomic and market conditions, globally or with respect to a particular region where we operate. Broad macroeconomic weakness and market volatility have previously resulted in sustained periods

of decreased demand for our products and services that have adversely affected our operating results. Macroeconomic and market conditions could be adversely affected by a variety of political, economic or other factors in the United States and elsewhere that could adversely affect spending levels, as well as create volatility or deteriorating conditions in the markets in which we operate. Continuation of, or an increase in, macroeconomic uncertainty or weakness could result in:

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



Table of Contents

customer financial difficulty, including longer collection cycles and difficulties collecting accounts receivable or write-offs of receivables; and  
increased risk of charges relating to excess and obsolete inventories and the write-off of other intangible assets.

Reductions in customer spending in response to unfavorable or uncertain macroeconomic and market conditions, globally or with respect to a particular region where we operate, would adversely affect our business and results of operations.

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

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

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

The market for communications networking equipment is characterized by rapidly evolving technologies and changes in market demand. We continually invest in research and development to sustain or enhance our existing products and to develop or acquire new product technologies. There is often a lengthy period between commencing these development initiatives and bringing new or improved products 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. There is also a possibility that we may miss a market opportunity because we failed to invest, or invested too late, in a technology, product or enhancement sought by our customers. Changes in market demand or investment priorities may also cause us to discontinue existing or planned development for new products or features, which can have a disruptive effect on our relationships with customers. If we fail to make the right investments or fail to make them at the right time, our competitive position may suffer, and our revenue and profitability could be harmed. 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 sales initiatives, particularly with large service provider customers, often involve lengthy sales cycles that may include extensive product testing, laboratory or network certification, network or region-specific product certification and homologation requirements. These sales also often involve protracted and sometimes difficult contract negotiations in which we may deem it necessary to agree to unfavorable contractual or commercial terms that adversely affect pricing, expose us to penalties for delays or non-performance, and require us to assume a disproportionate amount of risk. We may also be requested to provide deferred payment terms, vendor or third-party financing or other alternative purchase structures that extend the timing of payment and revenue recognition. Some of our large existing customers are pursuing purchasing strategies or adopting procurement approaches intended to drive further pricing reductions, seek additional commercial concessions and consolidate their number of direct suppliers of networking technology. To maintain incumbency with key customers for existing

Table of Contents

and future business opportunities, we may be required to offer discounted pricing or offer less favorable commercial terms as compared to our historical business arrangements with these customers. Our purchase agreements generally do not include minimum purchase commitments, and customers often have the right to modify, delay, reduce or cancel previous orders. These terms may negatively affect our revenue and results of operations and increase our susceptibility to quarterly fluctuations in our financial results. Alternatively, service providers may insist upon terms and conditions that we deem too onerous or not in our best interest, and we may be unable to reach a commercial agreement. As a result, we may incur substantial expense and devote time and resources to potential sales opportunities that never materialize or result in lower than anticipated sales.

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

Our products are based on complex technology, and we can experience unanticipated delays in developing and manufacturing these solutions. Delays in these and other product development efforts may affect our reputation with customers, affect our ability to seize market opportunities and impact the timing and level of demand for our products. Each step in the development life cycle of our products presents serious risks of failure, rework or delay, any one of which could adversely affect the cost-effective and timely development of our products. We may encounter delays relating to engineering development activities and software, design, sourcing and manufacture of critical components, and the development of prototypes. In addition, intellectual property disputes, failure of critical design elements, and other execution risks may delay or even prevent the release of these products. If we do not successfully develop products in a timely manner, our competitive position may suffer and our business, financial condition and results of operations could be harmed.

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

The development and production of sophisticated hardware and software for communications network equipment is complicated. Some of our products can be fully tested only when deployed in communications networks or when carrying traffic with other equipment. As a result, undetected defects or errors, and product quality, interoperability, reliability and performance problems are often more acute for initial deployments of new products and product enhancements. We are in the process of launching a number of new platforms. Unanticipated product performance problems can relate to the design, manufacturing and installation of our products. Undetected errors can also arise as a result of defects in components, software or manufacturing, installation or maintenance services supplied by third parties, and technology acquired from or licensed by third parties. Unanticipated security vulnerabilities relating to our products or the activities of our supply chain, including any actual or perceived exposure of our solutions to malicious software or cyber-attacks, would adversely affect our business and reputation. Product performance, reliability, security and quality problems can negatively affect our business, and may result in some or all of the following effects:

- damage to our reputation, declining sales and order cancellations;
- increased costs to remediate defects or replace products;
- payment of liquidated damages, contractual or similar penalties, or other claims for performance failures or delays;
- increased warranty expense or estimates resulting from higher failure rates, additional field service obligations or other rework costs related to defects;
- increased inventory obsolescence;
- costs and claims that may not be covered by liability insurance coverage or recoverable from third parties; and
- delays in recognizing revenue or collecting accounts receivable.

These and other consequences relating to undetected errors affecting the quality, reliability and security of our products could negatively affect our business and results of operations.

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

In order to sell our products into new geographic markets, diversify our customer base and broaden the application for our solutions in communications networks, we continue to promote sales initiatives and foster strategic channel sales relationships, including our recently announced packet optical distribution relationship with Ericsson. We seek to expand our geographic reach and increase market share in international markets, including Brazil, the Middle East and India. We also intend to pursue opportunities to diversify our customer base beyond our traditional customers.

Specifically, we are targeting sales opportunities with enterprises, wireless operators, cable operators, submarine network operators, content service providers, cloud infrastructure providers, research and education institutions, and federal, state and local governments. To succeed in some of these geographic markets and customer segments we believe that we need to leverage strategic sales channels and distribution arrangements successfully, and we expect these relationships to be an important part of our business. Our efforts may ultimately

## Table of Contents

be unsuccessful, and difficulties selling into these target markets through third party channels could limit our growth and harm our results of operations.

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

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

- the impact of economic conditions in countries outside the United States;
- effects of changes in currency exchange rates;
- greater difficulty in collecting accounts receivable and longer collection periods;
- difficulty and cost of staffing and managing foreign operations;
- less protection for intellectual property rights in some countries;
- adverse tax and customs consequences, particularly as related to transfer-pricing issues;
- social, political and economic instability;
- higher incidence of corruption or unethical business practices that could expose us to liability or damage our reputation;
- trade protection measures, export compliance, domestic preference procurement requirements, qualification to transact business and additional regulatory requirements; and
- natural disasters, epidemics and acts of war or terrorism.

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

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

To avoid delays and meet customer demand for shorter delivery terms, we place orders with our contract manufacturers and component suppliers based in part on forecasts of customer demand. During fiscal 2014, we have increased inventory levels for our 6500 Packet Optical Platform in order to reduce customer lead times and meet forecasted volumes. Our practice of buying inventory based on forecasted demand exposes us to the risk that our customers ultimately may not order the products we have forecast, or will purchase fewer products than forecast. As a result, we may purchase inventory in anticipation of sales that ultimately do not occur. Market uncertainty can also limit our visibility into customer spending plans and compound the difficulty of forecasting inventory at appropriate levels. Moreover, our customer purchase agreements generally do not include any minimum purchase commitment, and customers often have the right to modify, reduce or cancel purchase quantities. As features and functionalities converge across our product lines, and we introduce new products with overlapping feature sets, it is increasingly possible that customers may forgo purchases of certain products we have inventoried in favor of other products with similar functionality. We may also be exposed to the risk of inventory write offs as a result of certain supply chain initiatives, including consolidation and transfer of key manufacturing activities. If we are required to write off or write down a significant amount of inventory, our results of operations for the period would be materially adversely affected.

Our intellectual property rights may be difficult and costly to enforce.

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

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

## Table of Contents

We may incur significant costs in response to claims by others that we infringe their intellectual property rights. From time to time third parties may assert claims or initiate litigation or other proceedings related to patent, copyright, trademark and other intellectual property rights to technologies and related standards that are relevant to our business. The rate of infringement assertions by patent assertion entities is increasing, particularly in the United States.

Generally, these patent owners neither manufacture nor use the patented invention directly, and simply seek to derive value from their ownership through royalties from patent licensing programs.

We could be adversely affected by litigation, other proceedings or claims against us, as well as claims against our manufacturers, suppliers or customers, alleging infringement of third party proprietary rights by our products and technology, or components thereof. 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, could require us to:

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

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

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

We rely on a number of third party service partners, both domestic and international, to complement our global service and support resources. We rely upon these partners for certain installation, maintenance and support functions. In addition, as network operators seek to increasingly rely on vendors to perform additional services relating to the design, construction and operation of their networks, the scope of work performed by our support partners is likely to increase and may include areas where we have less experience providing or managing such services. We must successfully identify, assess, train and certify qualified service partners in order to ensure the proper installation, deployment and maintenance of our products, as well as the skillful performance of other services associated with expanded solutions offerings, including site assessment and construction related services. Vetting and certification of these partners can be costly and time-consuming, and certain partners may not have the same operational history, financial resource and scale as Ciena. Moreover, certain service partners may provide similar services for other companies, including our competitors. We may not be able to manage effectively our relationships with our service partners and cannot be certain that they will be able to deliver services in the manner or time required or that we will be able to maintain the continuity of their services. We may also be exposed to a number of risks or challenges relating to the performance of our service partners, including:

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

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

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

We have entered into agreements with strategic supply partners that permit us to distribute their products or technology. We may rely upon these relationships to add complementary products or technologies, diversify our product portfolio, or address a particular customer or geographic market. We may enter into additional original equipment manufacturer (OEM), resale or similar strategic arrangements in the future. We may incur unanticipated costs or difficulties relating to our resale of third party



Table of Contents

products. Our third party relationships could expose us to risks associated with the business, financial condition, intellectual property rights and supply chain continuity of such partners, as well as delays in their development, manufacturing or delivery of products or technology. We may also be required by customers to assume warranty, indemnity, service and other commercial obligations, including potential liability to customers, greater than the commitments, if any, made to us by our technology partners. Some of our strategic supply partners are relatively small companies with limited financial resources. If they are unable to satisfy their obligations to us or our customers, we may have to expend our own resources to satisfy these obligations. Exposure to these risks could harm our reputation with key customers and negatively affect our business and our results of operations.

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

In the course of our sales to customers and resale channel partners, we may have difficulty collecting receivables and our business and results of operations could be exposed to risks associated with uncollectible accounts. Lack of liquidity in the capital markets, macroeconomic weakness and market volatility may increase our exposure to these credit risks. Our attempts to monitor these situations carefully and to take appropriate measures to protect ourselves may not be sufficient, and it is possible that we may have to write down or write off accounts receivable. Such write-downs or write-offs could negatively affect our operating results for the period in which they occur, and, if large, could have a material adverse effect on our revenue and operating results.

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

We rely upon a number of internal business processes and information systems to support key business functions, and the efficient operation of these processes and systems is critical to managing our business. Our business processes and information systems need to be sufficiently scalable to support the growth of our business and may require modifications or upgrades that expose us to a number of operational risks. We expect during fiscal 2015 to undertake a significant and costly reengineering of our enterprise resource planning platform that will impact multiple locations, functions and processes. We are also currently pursuing initiatives to transform and optimize our business operations through the reengineering of certain other processes, investment in automation, and engagement of strategic partners or resources to assist with certain business functions. These changes may be costly and disruptive to our operations, and could impose substantial demands on management time.

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

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

In the ordinary course of our business, we maintain on our network systems certain information that is confidential, proprietary or otherwise sensitive in nature. This information includes intellectual property, financial information and

confidential business information relating to Ciena and our customers, suppliers and other business partners. We also produce networking equipment solutions and software used by network operators to ensure security and reliability in their management and transmission of data. Our customers, particularly those in regulated industries, are increasingly focused on the security features of our technology solutions, and maintaining the security of information sensitive to Ciena and our business partners is critical to our business and reputation. Companies in the technology industry have been increasingly subject to a wide variety of security incidents, cyber-attacks and other attempts to gain unauthorized access to networks or sensitive information. Our network systems and storage applications, and the technology solutions that we offer to end customers, may be subject to unauthorized access by hackers or breached due to operator error, malfeasance or other system disruptions. In some cases, it is difficult to anticipate or immediately detect such incidents and the damage caused thereby. If an actual or perceived breach of network security occurs in our network or in the network of a business partner, the market perception of our products could be harmed. While we continually work to safeguard our products and internal network systems to mitigate these potential risks, there is no assurance that such actions will be sufficient to prevent cyber attacks or security breaches. Security incidents

## Table of Contents

involving access or improper use our systems, networks or products could compromise confidential or otherwise protected information, destroy or corrupt data, or otherwise disrupt our operations. These security events could also negatively impact our reputation and our competitive position and could result in litigation with third parties, regulatory action, loss of business, potential liability and increased remediation costs, any of which could have a material adverse effect on our financial condition and results of operations.

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

At July 31, 2014, indebtedness on our outstanding convertible notes totaled approximately \$1.2 billion in aggregate principal, including the accretion of principal at maturity on our 2020 Notes. We are also a party to credit agreements relating to a \$200 million senior secured asset-based revolving credit facility and a \$250 million senior secured term loan. The agreements governing these credit facilities include customary remedies, including with respect to collateral securing the loans, that would apply should we default, and include customary covenants that limit our ability to, among other things, pay cash dividends, incur debt, create liens and encumbrances, redeem or repurchase stock, enter into certain acquisition transactions, repay indebtedness, make investments or dispose of assets.

Our indebtedness could have important negative consequences, including:

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

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

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

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

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

We have recently undertaken and expect to undertake in the future a number of significant facilities transitions affecting a number of our largest employee populations. The leases of our “Lab 10” building on the Carling Campus in Ottawa, Canada will expire in fiscal 2018 and our development facility in Gurgaon, India will expire in fiscal 2017. We are currently considering facilities and development alternatives in advance of the expiration of these leases. Both locations include sophisticated research and development lab equipment and significant headcount including key engineering personnel. Locating appropriate alternative space for our engineering operations may be costly, and there

can be no assurance that the transition of key engineering functions to a successor facility will not be disruptive or adversely affect productivity. Significant facilities transitions could be disruptive to our operations and may result in unanticipated expense and adverse effects on our cash position and cash flows.

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

We have previously taken steps, including reductions in force, office closures, and internal reorganizations to reduce the size and cost of our operations, improve efficiencies, or realign our organization and staffing to better match our market opportunities and our technology development initiatives. We may take similar steps in the future as we seek to realize operating synergies, optimize our operations to achieve our target operating model and profitability objectives, or better reflect changes in the strategic direction of our business. These changes could be disruptive to our business, including our research and

## Table of Contents

development efforts, and could result in significant expense, including accounting charges for inventory and technology-related write-offs, workforce reduction costs and charges relating to consolidation of excess facilities. Substantial expense or charges resulting from restructuring activities could adversely affect our results of operations and use of cash in those periods in which we undertake such actions.

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

Competition to attract and retain highly skilled technical, engineering and other personnel with experience in our industry is intense, and our employees have been the subject of targeted hiring by our competitors. We may experience difficulty retaining and motivating existing employees and attracting qualified personnel to fill key positions. Because we rely upon equity awards as a significant component of compensation, particularly for our executive team, a lack of positive performance in our stock price, reduced grant levels, or changes to our compensation program may adversely affect our ability to attract and retain key employees. In addition, none of our executive officers is bound by an employment agreement for any specific term. The loss of members of our management team or other key personnel could be disruptive to our business, and, were it necessary, it could be difficult to replace members of our management team or other key personnel. 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. Due to our increased global presence, a larger percentage of our revenue, operating expense and assets and liabilities are non-U.S. dollar denominated and therefore subject to foreign currency fluctuation. We face exposure to currency exchange rates as a result of the growth in our non-U.S. dollar denominated operating expense in Canada, Europe, Asia and Latin America. From time to time, we may hedge against currency exposure associated with anticipated foreign currency cash flows. There can be no assurance that any hedging instruments will be effective, and losses associated with these instruments and the adverse effect of foreign currency exchange rate fluctuation may negatively affect our results of operations.

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

We integrate third party software and other technology into our embedded operating system, network management system tools and other products. Licenses for this technology may not be available or continue to be available to us on commercially reasonable terms. Third party licensors may insist on unreasonable financial or other terms in connection with our use of such technology. Our failure to comply with the terms of any license, including free open source software, may result in our inability to continue to use such license, which may result in significant costs and require us to obtain or develop a substitute technology. As networks become more open and software programmable, we expect that communications networking solutions vendors, including Ciena, will increasingly contribute to and use technology developed by standards settings bodies or other industry forums that seek to promote the integration of network layers and functions. This may increase risks associated with our use or reliance upon third party or open source software. Difficulty obtaining and maintaining third party technology licenses may disrupt development of our products and increase our costs.

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 could dilute our current stockholders, 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 attention;
- difficulty completing projects of the acquired company and costs related to in-process projects;
- 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.

Table of Contents

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

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

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

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

The United States and various foreign governments have imposed controls, license requirements and other restrictions on the usage, import or export of some of the technologies that we sell. Government regulation of usage, import or export of our products, technology within our products, or our failure to obtain required approvals for our products, could harm our international and domestic sales and adversely affect our revenue and costs of sales. Failure to comply with such regulations could result in enforcement actions, fines, penalties or restrictions on export privileges. In addition, costly tariffs on our equipment, restrictions on importation, trade protection measures and domestic preference requirements of certain countries could limit our access to these markets and harm our sales. For example, India's government has implemented security regulations applicable to network equipment vendors, and has previously imposed significant tariffs on certain communications equipment. These and other regulations could adversely affect the sale or use of our products, substantially increase our cost of sales and adversely affect our business and revenue.

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

Our operations are regulated under various federal, state, local and international laws relating to the environment and potential climate change. If we were to violate or become liable under these laws or regulations, we could incur fines, costs related to damage to property or personal injury, and costs related to investigation or remediation activities. Our product design efforts and the manufacturing of our products are also subject to evolving requirements relating to the presence of certain materials or substances in our equipment, including regulations that make producers for such products financially responsible for the collection, treatment and recycling of certain products. For example, our operations and financial results may be negatively affected by environmental regulations, such as the Waste Electrical and Electronic Equipment (WEEE) and Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) that have been adopted by the European Union. Compliance with these and similar environmental regulations may increase our cost of designing, manufacturing, selling and removing our products. These regulations may also make it difficult to obtain supply of compliant components or may require us to write off non-compliant inventory, which could have an adverse effect on 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, 2014, our balance sheet includes \$315.0 million in long-lived assets, which includes \$141.9 million of intangible assets. Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products. These assumptions are used to forecast future, undiscounted cash flows upon which our estimates are based. Periods of significant uncertainty or instability of macroeconomic conditions can make forecasting future business difficult. If actual market conditions differ or our forecasts change, we may be required to reassess long-lived assets and could record an impairment charge. Any impairment charge relating to long-lived assets would have the effect of decreasing our earnings or increasing our losses in such period. If we are required to take a substantial impairment charge, our operating results would be materially adversely affected in such period.



Table of Contents

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

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we include in our annual report a report containing management's assessment of the effectiveness of our internal controls over financial reporting as of the end of our fiscal year and a statement as to whether or not such internal controls are effective. Compliance with these requirements has resulted in, and is likely to continue to result in, significant costs and the commitment of time and operational resources. Changes in our business, including certain initiatives to transform business processes, to invest in information systems or to transition certain functions to third party resources or providers, will necessitate modifications to our internal control systems, processes and information systems as we optimize our business and operations. Our increased global operations and expansion into new regions could pose additional challenges to our internal control systems. We cannot be certain that our current design for internal control over financial reporting, or any additional changes to be made, will be sufficient to enable management to determine that our internal controls are effective for any period, or on an ongoing basis. If we are unable to assert that our internal controls over financial reporting are effective, market perception of our financial condition and the trading price of our stock may be adversely affected, and customer perception of our business may suffer.

Our stock price is volatile.

Our common stock price has experienced substantial volatility in the past and may remain volatile in the future. Volatility in our stock price can arise as a result of a number of the factors discussed in this "Risk Factors" section. During fiscal 2013, our closing stock price ranged from a high of \$27.67 per share to a low of \$13.16 per share. The stock market has experienced significant price and volume fluctuation that has affected the market price of many technology companies, with such volatility often unrelated to the operating performance of these companies. Divergence between our actual or anticipated financial results and published expectations of analysts, or the expectations of the market generally, can cause significant swings in our stock price. Our stock price could 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 certain market indices, and any change in the composition of these indices to exclude our company would adversely affect our stock price. These and other factors affecting macroeconomic conditions or financial markets may materially adversely affect the market price of our common stock in the future.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Table of Contents

Item 6. Exhibits

10.1	Third Amendment to Credit Agreement, dated July 15, 2014 by and among Ciena Corporation, Inc. Ciena Communications, Inc., Ciena Government Solutions, Inc. Ciena Canada, Inc., Deutsche Bank AG New York Branch, as administrative agent and collateral agent, and the lenders party thereto.
10.2	Amended and Restated Security Agreement, dated July 15, 2014, by and among Ciena Corporation, Inc., Ciena Communications, Inc., Ciena Government Solutions, Inc., each other assignor from time to time party thereto, and Deutsche Bank AG New York Branch, as Collateral Agent.
10.3	Amended and Restated Pledge Agreement, dated July 15, 2014, by and among Ciena Corporation, Inc., Ciena Communications, Inc., Ciena Government Solutions, Inc., each other pledgor from time to time party thereto, and Deutsche Bank AG New York Branch, as Pledgee.
10.4	Amended and Restated Canadian Security Agreement, dated July 15, 2014, by and among Ciena Canada, Inc., each other assignor from time to time party thereto, and Deutsche Bank AG New York Branch, as Collateral Agent.
10.5	Credit Agreement, dated July 15, 2014, by and among Ciena Corporation, Inc., the lenders party thereto, Bank of America, N.A., as Administrative Agent, Deutsche Bank Securities, Inc., as Syndication Agent, and JPMorgan Chase Bank, N.A. and Morgan Stanley Senior Funding, Inc., as Co-Documentation Agents.
10.6	Guaranty, dated July 15, 2014, by and among Ciena Corporation, Inc., Ciena Communications, Inc., Ciena Government Solutions, Inc., each other guarantor from time to time party thereto, and Bank of America, N.A., as Administrative Agent.
10.7	Term Loan Security Agreement, dated July 15, 2014, by and among Ciena Corporation, Inc., Ciena Communications, Inc., Ciena Government Solutions, Inc., each other grantor from time to time party thereto, and Bank of America, N.A., as Collateral Agent.
10.8	Term Loan Pledge Agreement, dated July 15, 2014, by and among Ciena Corporation, Inc., Ciena Communications, Inc., Ciena Government Solutions, Inc., each other pledgor from time to time party thereto, and Bank of America, N.A., as Pledgee.
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



Table of Contents

SIGNATURES

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

Ciena Corporation

Date: September 8, 2014

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

Date: September 8, 2014

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