CIENA CORP
Form 10-Q
September 03, 2009

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

(Mark one)

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

**For the quarterly period ended July 31, 2009**

**OR**

o **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** | **23-2725311** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **1201 Winterson Road, Linthicum, MD** | **21090** |
| (Address of Principal Executive Offices) | (Zip Code) |

**(410) 865-8500**

(Registrant s telephone number, including area code)

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

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 o NO o

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a 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 o NO þ

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

| **Class** | **Outstanding at August 28, 2009** |
|---|---|

| | |
|---|---|
| common stock, $.01 par value | 91,534,298 |

**CIENA CORPORATION**
**INDEX**
**FORM 10-Q**


| | PAGE NUMBER |
|---|---|
| PART I FINANCIAL INFORMATION | |
| Item 1. Financial Statements | 3 |
| Condensed Consolidated Statements of Operations for the Quarters and Nine Months Ended July 31, 2008 and July 31, 2009 | 3 |
| Condensed Consolidated Balance Sheets at October 31, 2008 and July 31, 2009 | 4 |
| Condensed Consolidated Statements of Cash Flows for the Nine Months Ended July 31, 2008 and July 31, 2009 | 5 |
| Notes to Condensed Consolidated Financial Statements | 6 |
| Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations | 26 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 46 |
| Item 4. Controls and Procedures | 47 |
| PART II OTHER INFORMATION | |
| Item 1. Legal Proceedings | 48 |
| Item 1A. Risk Factors | 48 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 58 |
| Item 3. Defaults Upon Senior Securities | 58 |
| Item 4. Submission of Matters to a Vote of Security Holders | 58 |
| Item 5. Other Information | 58 |
| Item 6. Exhibits | 58 |
| Signatures | 59 |

**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, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Revenues: | | | | |
| Products | $ 223,661 | $ 139,903 | $ 641,632 | $ 398,469 |
| Services | 29,518 | 24,855 | 81,162 | 77,890 |
| Total revenue | 253,179 | 164,758 | 722,794 | 476,359 |
| Cost of goods sold: | | | | |
| Products | 107,953 | 72,842 | 295,381 | 214,628 |
| Services | 19,595 | 17,251 | 57,617 | 54,503 |
| Total cost of goods sold | 127,548 | 90,093 | 352,998 | 269,131 |
| Gross profit | 125,631 | 74,665 | 369,796 | 207,228 |
| Operating expenses: | | | | |
| Research and development | 47,809 | 44,442 | 127,881 | 140,624 |
| Selling and marketing | 39,440 | 31,468 | 111,639 | 98,582 |
| General and administrative | 14,758 | 11,524 | 54,036 | 35,724 |
| Amortization of intangible assets | 8,671 | 6,224 | 23,901 | 18,852 |
| Restructuring cost | | 3,941 | | 10,416 |
| Goodwill impairment | | | | 455,673 |
| Total operating expenses | 110,678 | 97,599 | 317,457 | 759,871 |
| Income (loss) from operations | 14,953 | (22,934) | 52,339 | (552,643) |
| Interest and other income, net | 5,342 | 999 | 32,911 | 9,167 |
| Interest expense | (1,855) | (1,856) | (11,074) | (5,552) |
| Realized loss due to impairment of marketable debt investments | (5,114) | | (5,114) | |
| Loss on cost method investments | | (2,193) | | (5,328) |
| Income (loss) before income taxes | 13,326 | (25,984) | 69,062 | (554,356) |
| Provision for income taxes | 1,603 | 470 | 4,772 | 139 |
| Net income (loss) | $ 11,723 | $ (26,454) | $ 64,290 | $ (554,495) |
| Basic net income (loss) per common share | $ 0.13 | $ (0.29) | $ 0.72 | $ (6.10) |

| | | | | |
|---|---|---|---|---|
| Diluted net income (loss) per potential common share | $ 0.12 | $ (0.29) | $ 0.63 | $ (6.10) |
| Weighted average basic common shares outstanding | 90,216 | 91,364 | 88,871 | 90,970 |
| Weighted average dilutive potential common shares outstanding | 111,681 | 91,364 | 110,654 | 90,970 |

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

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

| | October 31, 2008 | July 31, 2009 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 550,669 | $ 455,732 |
| Short-term investments | 366,336 | 607,094 |
| Accounts receivable, net | 138,441 | 120,271 |
| Inventories | 93,452 | 89,600 |
| Prepaid expenses and other | 35,888 | 44,325 |
| Total current assets | 1,184,786 | 1,317,022 |
| Long-term investments | 156,171 | |
| Equipment, furniture and fixtures, net | 59,967 | 60,608 |
| Goodwill | 455,673 | |
| Other intangible assets, net | 92,249 | 68,445 |
| Other long-term assets | 75,748 | 65,151 |
| Total assets | $ 2,024,594 | $ 1,511,226 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 44,761 | $ 52,337 |
| Accrued liabilities | 96,143 | 89,571 |
| Restructuring liabilities | 1,668 | 1,917 |
| Deferred revenue | 36,767 | 43,625 |
| Total current liabilities | 179,339 | 187,450 |
| Long-term deferred revenue | 37,660 | 34,875 |
| Long-term restructuring liabilities | 2,557 | 7,570 |
| Other long-term obligations | 8,089 | 9,207 |
| Convertible notes payable | 798,000 | 798,000 |
| Total liabilities | 1,025,645 | 1,037,102 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock par value $0.01; 20,000,000 shares authorized; zero shares issued and outstanding | | |
| Common stock par value $0.01; 290,000,000 shares authorized; 90,470,803 and 91,522,101 shares issued and outstanding | 905 | 915 |
| Additional paid-in capital | 5,629,498 | 5,656,096 |

| | | |
|---|---|---|
| Accumulated other comprehensive income (loss) | (1,275) | 1,787 |
| Accumulated deficit | (4,630,179) | (5,184,674) |
| Total stockholders equity | 998,949 | 474,124 |
| Total liabilities and stockholders equity | $ 2,024,594 | $ 1,511,226 |

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

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

| | Nine Months Ended July 31, | |
|---|---|---|
| | 2008 | 2009 |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 64,290 | $ (554,495) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Amortization of discount on marketable securities | (1,827) | (858) |
| Realized loss due to impairment of marketable debt investments | 5,114 | |
| Loss on cost method investments | | 5,328 |
| Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements | 13,345 | 16,270 |
| Goodwill Impairment | | 455,673 |
| Share-based compensation costs | 24,406 | 26,075 |
| Amortization of intangible assets | 27,942 | 23,804 |
| Deferred tax provision | 1,640 | |
| Provision for inventory excess and obsolescence | 13,841 | 11,126 |
| Provision for warranty | 11,234 | 13,620 |
| Other | 3,510 | 1,529 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (32,070) | 18,128 |
| Inventories | (4,694) | (7,274) |
| Prepaid expenses and other | (616) | (1,696) |
| Accounts payable, accruals and other obligations | (7,927) | (5,799) |
| Income taxes payable | (5,515) | |
| Deferred revenue | 9,554 | 4,073 |
| Net cash provided by operating activities | 122,227 | 5,504 |
| Cash flows from investing activities: | | |
| Payments for equipment, furniture, fixtures and intellectual property | (22,947) | (17,630) |
| Restricted cash | 1,420 | (1,914) |
| Purchase of available for sale securities | (180,613) | (926,621) |
| Proceeds from maturities of available for sale securities | 820,177 | 321,554 |
| Proceeds from sale of available for sale securities | | 523,137 |
| Acquisition of business, net of cash acquired | (210,016) | |
| Net cash provided by (used in) investing activities | 408,021 | (101,474) |
| Cash flows from financing activities: | | |
| Repayment of 3.75% convertible notes payable | (542,262) | |
| Repayment of indebtedness of acquired business | (12,363) | |
| Proceeds from issuance of common stock and warrants | 5,246 | 533 |
| Net cash provided by (used in) financing activities | (549,379) | 533 |

| | | |
|---|---|---|
| Effect of exchange rate changes on cash and cash equivalents | 173 | 500 |
| Net decrease in cash and cash equivalents | (19,131) | (95,437) |
| Cash and cash equivalents at beginning of period | 892,061 | 550,669 |
| Cash and cash equivalents at end of period | $ 873,103 | $ 455,732 |
| **Supplemental disclosure of cash flow information** | | |
| Cash paid (refunded) during the period for: | | |
| Interest | $ 14,969 | $ 4,748 |
| Income taxes, net | $ 2,673 | $ 250 |
| **Non-cash investing and financing activities** | | |
| Purchase of equipment in accounts payable | $ 1,717 | $ 1,205 |
| Value of common stock issued in acquisition | $ 62,359 | $ |
| Fair value of vested options assumed in acquisition | $ 9,912 | $ |

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

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

## (1) INTERIM FINANCIAL STATEMENTS

The interim financial statements included herein for Ciena Corporation ( Ciena ) have been prepared by Ciena, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, financial statements included in this report reflect all normal recurring adjustments that Ciena considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial position of Ciena at the date of the interim balance sheets. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The October 31, 2008 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. However, Ciena believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with Ciena s audited consolidated financial statements and notes thereto included in Ciena s annual report on Form 10-K for the fiscal year ended October 31, 2008.

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

Ciena performed an evaluation of events that have occurred subsequent to the end of its fiscal period through the date that the condensed consolidated financial statements were issued. As of September 3, 2009, the date of the filing of this Form 10-Q, there have been no subsequent events that occurred during such period that would require disclosure in this Form 10-Q or would be required to be recognized in the condensed consolidated financial statements.

## (2) SIGNIFICANT ACCOUNTING POLICIES

*Use of Estimates*

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

*Cash and Cash Equivalents*

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

*Investments*

Ciena s investments generally represent investments in marketable debt securities. These investments are classified as available-for-sale and are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income. Ciena recognizes losses when it determines that declines in the fair value of its investments, below their cost basis, are other-than-temporary. In determining whether a decline in fair value is other-than-temporary, Ciena considers various factors including market price (when available), investment ratings, the financial condition and near-term prospects of the investee, the length of time and the extent to which the fair value has been less than Ciena s cost basis, and its intent and ability to hold the investment until maturity or for a period of time sufficient to allow for any anticipated recovery in market value. Ciena considers all marketable debt securities that it expects to convert to cash within one year or less to be short-term investments. All others are considered long-term investments.

*Inventories*

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

*Equipment, Furniture and Fixtures*

Equipment, furniture and fixtures are recorded at cost. Depreciation and amortization are computed using the straight-line method over useful lives of two to five years for equipment, furniture and fixtures and the shorter of useful life or lease term for leasehold improvements. Impairments of equipment, furniture and fixtures are determined in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

Internal use software and web site development costs are capitalized in accordance with Statement of Position (SOP) No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, and Emerging Issues Task Force (EITF) Issue No. 00-2, Accounting for Web Site Development Costs. Qualifying 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 life of the asset.

*Goodwill and Other Intangible Assets*

Historically, Ciena has recorded goodwill and purchased intangible assets as a result of several acquisitions. Ciena accounts for goodwill in accordance with SFAS 142, Goodwill and Other Intangible Assets, which requires Ciena to test each reporting unit s goodwill for impairment on an annual basis, which Ciena has determined to be the last business day of its fiscal September each year. Testing is required between annual tests if events occur or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. Ciena operates its business and tests its goodwill for impairment as a single reporting unit. As of July 31, 2009 Ciena had no goodwill remaining on its balance sheet. See Note 4 below.

Purchased finite-lived intangible assets are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the economic lives of the respective assets, generally three to seven years, which approximates the use of the intangible assets. Impairments of finite-lived intangible assets are determined in accordance with SFAS 144.

*Minority Equity Investments*

Ciena carries minority equity investments at cost where Ciena owns less than 20% of the voting equity and does not have the ability to exercise significant influence over the company. These types of investments are inherently high risk investments as the market for technologies or products manufactured by these companies are usually early stage at the time of investment and such markets may never be significant. Ciena could lose its entire investment in some or all of these companies. Ciena monitors these investments for impairment and makes appropriate reductions in carrying values when necessary. See Note 7 below.

*Concentrations*

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

Historically, a large percentage of Ciena s revenue has been the result of sales to a small number of communications service providers. Consolidation among Ciena s customers has increased this concentration. Consequently, Ciena s accounts receivable are concentrated among these customers. See Notes 8 and 18 below.

Additionally, Ciena s access to certain raw materials is dependent upon sole or limited source suppliers. The inability of any supplier to fulfill Ciena s supply requirements could adversely affect future results. Ciena relies on a small number of third party manufacturers, principally in China and Thailand, to perform the majority of the manufacturing for its products. Ciena is therefore exposed to risks related to the business and financial position of its manufacturers, as well as risks related to their business continuity and disaster recovery plans, that may adversely affect access to continued manufacturing capability.

*Revenue Recognition*

Ciena recognizes revenue in accordance with Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, which states that revenue is realized or realizable and earned when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is

fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to

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

Some of Ciena s communications networking equipment is integrated with software that is essential to the functionality of the equipment. Accordingly, Ciena accounts for revenue from such equipment in accordance with Statement of Position No. 97-2, Software Revenue Recognition, (SOP 97-2) and all related interpretations. SOP 97-2 incorporates additional guidance unique to software arrangements incorporated with general revenue recognition criteria, such as: revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. In instances where final acceptance of the product is specified by the customer, revenue is deferred until all acceptance criteria have been met.

Arrangements with customers may include multiple deliverables, including any combination of equipment, services and software. If multiple element arrangements include software or software-related elements that are essential to the equipment, Ciena applies the provisions of SOP 97-2 to determine the amount of the arrangement fee to be allocated to those separate units of accounting. Multiple element arrangements that include software are separated into more than one unit of accounting if the functionality of the delivered element(s) is not dependent on the undelivered element(s), there is vendor-specific objective evidence of the fair value of the undelivered element(s), and general revenue recognition criteria related to the delivered element(s) have been met. The amount of product and services revenue recognized is affected by Ciena s judgments as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence of fair value exists. Changes to the elements in an arrangement and Ciena s ability to establish vendor-specific objective evidence for those elements could affect the timing of revenue recognition. For all other deliverables, Ciena applies the provisions of Emerging Issues Task Force (EITF) No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF 00-21 allows for separation of elements into more than one unit of accounting if the delivered element(s) have value to the customer on a stand-alone basis, objective and reliable evidence of fair value exists for the undelivered element(s), and delivery of the undelivered element(s) is probable and substantially in Ciena s control. Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or using the residual method if objective evidence of fair value does not exist for the delivered element(s). The revenue recognition criteria described above are applied to each separate unit of accounting. If these criteria are not met, revenue is deferred until the criteria are met or the last element has been delivered.

*Warranty Accruals*

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

*Accounts Receivable, Net*

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

*Research and Development*

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

*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 accounts for share-based compensation expense in accordance with SFAS 123(R), as interpreted by SAB 107. SFAS 123(R) requires the measurement and recognition of compensation expense for share-based awards based on estimated fair values on the date of grant. Ciena estimates the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This model is affected by Ciena s stock price as well as estimates regarding a number of variables including expected stock price volatility over the expected term of the award and projected employee stock option exercise behaviors. Ciena estimates the fair value of each share-based award based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense to its consolidated statement of operations for those options or shares that are expected ultimately to vest. Ciena uses two attribution methods to record expense, the straight-line method for grants with only service-based vesting or the graded-vesting method, which considers each performance period or tranche separately, for all other awards. See Note 16 below.

*Income Taxes*

Ciena accounts for income taxes in accordance with SFAS 109, Accounting for Income Taxes. SFAS 109 describes an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases, and for operating loss and tax credit carry forwards. In estimating future tax consequences, SFAS 109 generally considers all expected future events other than the enactment of changes in tax laws or rates. Valuation allowances are provided, if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Ciena adopted the provisions of FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, ( FIN 48 ) at the beginning of fiscal 2008. The amount of unrecognized tax benefits determined in accordance with FIN 48 increased by $0.6 million during the third quarter of fiscal 2009 to $6.3 million, which includes $1.3 million of interest and penalties. All of the uncertain tax positions, if recognized, would decrease the effective income tax rate.

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

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

*Loss Contingencies*

Ciena is subject to the possibility of various losses arising in the ordinary course of business. These may relate to disputes, litigation and other legal actions. Ciena considers the likelihood of loss or the incurrence of a liability, as well as Ciena s ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss

contingency is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. Ciena regularly evaluates current information available to it to determine whether any accruals should be adjusted and whether new accruals are required.

*Fair Value of Financial Instruments*

The carrying value of Ciena s cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximates fair market value due to the relatively short period of time to maturity.

For those Ciena assets and liabilities that are recorded at fair value on a recurring basis, fair value is determined in accordance with SFAS 157, Fair Value Measurements, which was adopted during the first quarter of fiscal 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value, and enhances fair value measurement disclosure. See Note 7 below. In accordance with FASB Staff Position 157-2, Effective Date of FASB Statement No. 157, Ciena has not yet adopted SFAS 157 for all non-financial assets and non-financial liabilities.

For those Ciena assets and liabilities that were not previously required to be measured at fair value, Ciena has not elected the fair value option in accordance with SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115.

*Foreign Currency*

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

*Derivatives*

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

At the inception of the cash flow hedge and on an ongoing basis, Ciena assesses the hedging relationship to determine its effectiveness in offsetting changes in cash flows attributable to the hedged risk during the hedge period. The effective portion of the hedging instrument s net gain or loss is initially reported as a component of accumulated other comprehensive income (loss), and upon occurrence of the forecasted transaction, is subsequently reclassified into the operating expense line item to which the hedged transaction relates. Any net gain or loss associated with the ineffectiveness of the hedging instrument is reported in interest and other income, net. See Note 14 below.

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

Ciena calculates earnings (loss) per share (EPS) in accordance with SFAS 128, Earnings per Share. This statement requires dual presentation of basic and diluted EPS on the face of the income statement for entities with a complex capital structure and requires a reconciliation of the numerator and denominator used for the basic and diluted EPS computations. See Note 15 below.

*Software Development Costs*

SFAS 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed, requires the capitalization of certain software development costs incurred subsequent to the date technological feasibility is established and prior to the date the product is generally available for sale. The capitalized cost is then amortized straight-line over the estimated product life. Ciena defines technological feasibility as being attained at the time a working model is completed. To date, the period between achieving technological feasibility and the general availability of such software has been short, and software development costs qualifying for capitalization have been insignificant. Accordingly, Ciena has not capitalized any software development costs.

*Segment Reporting*

SFAS 131, Disclosures about Segments of an Enterprise and Related Information, establishes annual and interim reporting standards for operating segments and requires certain disclosures about the products and services an entity provides, the material countries in which it holds assets and reports revenue, and its major customers. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. Ciena s chief operating decision maker is its chief executive officer, who reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. Ciena has one business activity, and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Accordingly, Ciena considers its business to be in a single reportable segment.

*Newly Issued Accounting Standards*

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement 162. SFAS 168 replaces SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles, and establishes the FASB Accounting Standards Codification ( Codification ) as the single source of authoritative accounting principles to be applied to financial statements of nongovernmental entities in conformity with U.S. GAAP. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. Ciena will adopt this statement in its fourth quarter of fiscal 2009.

In May 2008, the FASB issued FASB Staff Position ( FSP ) APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion. FSP APB 14-1 requires that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer s nonconvertible debt borrowing rate. The resulting debt discount is amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Retrospective application to all periods presented is required except for instruments that were not outstanding during any of the periods that will be presented in the annual financial statements for the period of adoption but were outstanding during an earlier period. Ciena s existing convertible notes payable do not provide for settlement in cash upon conversion and Ciena believes the adoption of this statement will not have a material effect on its financial condition, results of operations and cash flows.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets, which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets. This pronouncement requires enhanced disclosures concerning a company s treatment of costs incurred to renew or extend the term of a recognized intangible asset. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. Ciena is currently evaluating the impact the adoption of this statement could have on its financial condition, results of operations and cash flows.

In February 2008, the FASB issued FSP FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13. This staff position amends SFAS 157 to remove certain leasing transactions from its scope. Also in February 2008 the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157. This staff position delays the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008. In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. FSP FAS 157-3 clarifies the application of SFAS No. 157 in a market that is not active, and provides guidance on the key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. Ciena is currently evaluating the impact the adoption of these staff positions could have on its financial condition, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. Ciena believes the adoption of this statement will not have a material impact on its financial condition, results of operations and cash flows.

In December 2007, the FASB issued SFAS 141(R), a revised version of SFAS 141, Business Combinations. The revision is intended to simplify existing guidance and converge rulemaking under U.S. generally accepted accounting principles with international accounting rules. This statement applies prospectively to business combinations where the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply this statement before that date. Ciena is currently evaluating the impact the adoption of this statement could have on its financial condition, results of operations and cash flows. Its effect will depend on the nature and significance of any acquisitions subject to this statement.

**(3) BUSINESS COMBINATIONS**

On March 3, 2008, Ciena acquired World Wide Packets, Inc. ( World Wide Packets or WWP ), a supplier of communications networking equipment that enables the delivery of carrier Ethernet-based services. Prior to the acquisition, World Wide Packets was a privately held company. Ciena s results of operations in this report include the operations of World Wide Packets beginning on March 3, 2008, the effective date of the acquisition.

The following unaudited pro forma financial information summarizes the results of operations as if Ciena s acquisition of World Wide Packets had been completed as of the beginning of the period presented. These pro forma amounts (in thousands, except per share data) do not purport to be indicative of the results that would have been obtained if the acquisition had occurred as of the beginning of the period presented or that may be obtained in the future.

| | Quarter Ended July 31, 2008 | Nine Months Ended July 31, 2008 |
|---|---|---|
| Pro forma revenue | $ 253,179 | $ 729,444 |
| Pro forma net income | $ 11,723 | $ 46,192 |
| Pro forma basic net income per common share | $ 0.13 | $ 0.52 |
| Pro forma diluted net income per potential common share | $ 0.12 | $ 0.46 |

**(4) GOODWILL IMPAIRMENT**

Ciena tests its single reporting unit s goodwill for impairment on an annual basis, which Ciena has determined to be the last business day of fiscal September each year. Testing is required between annual tests if events occur or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. Based on a combination of factors, including macroeconomic conditions and a sustained decline in Ciena s common stock price and market capitalization below net book value, Ciena conducted an interim impairment assessment of goodwill during the second quarter of fiscal 2009. Ciena performed the step one fair value comparison, and its market capitalization was $721.8 million and its carrying value, including goodwill, was $949.0 million. Ciena applied a 25% control premium to its market capitalization to determine a fair value of $902.2 million. Because step one indicated that Ciena s fair value was less than its carrying value, Ciena performed the step two analysis. Under the step two analysis, the implied fair value of goodwill requires valuation of a reporting unit s tangible and intangible assets and liabilities in a manner similar to the allocation of

purchase price in a business combination. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. The implied fair value of the reporting unit s goodwill was determined to be $0, and, as a result, Ciena recorded a goodwill impairment of $455.7 million, representing the full carrying value of the goodwill. The table below sets forth changes in carrying amount of goodwill for the period indicated (in thousands):

| | Total |
|---|---|
| Balance as of October 31, 2008 | $ 455,673 |
| Impairment loss | (455,673) |
| Balance as of July 31, 2009 | $ |

**(5) RESTRUCTURING COSTS**

Ciena has previously taken actions to align its workforce, facilities and operating costs with perceived market opportunities and business conditions. Ciena implemented these restructuring plans and incurred the associated liability concurrently in accordance with the provisions of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities.

On March 2, 2009, Ciena committed to certain restructuring actions, including the closure of its Acton, MA facility and a headcount reduction of approximately 200 employees, representing 9% of its global workforce. Headcount reductions were implemented across Ciena s organizations and geographies, with the timing and scope of such reductions varying by country based on local legal requirements. These headcount reductions were completed during the third fiscal quarter of 2009. Restructuring charges during the third quarter of fiscal 2009 included $0.5 million of severance and other employee-related costs and $3.4 million related to the Acton, MA facility closure.

Restructuring charges during the second quarter of fiscal 2009 include $3.5 million of severance and other employee-related costs associated with the action above and $2.9 million associated with previously restructured facilities.

During the first quarter of fiscal 2009, Ciena recorded a restructuring charge of $0.1 million related to one-time termination benefits.

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

| | Workforce reduction | Consolidation of excess facilities | Total |
|---|---|---|---|
| Balance at October 31, 2008 | $ 982 | $ 3,243 | $ 4,225 |
| Additional liability recorded | 4,098 | 6,318 | 10,416 |
| Cash payments | (4,822) | (332) | (5,154) |
| Balance at July 31, 2009 | $ 258 | $ 9,229 | $ 9,487 |
| Current restructuring liabilities | $ 258 | $ 1,659 | $ 1,917 |
| Non-current restructuring liabilities | $ 0 | $ 7,570 | $ 7,570 |

The following table sets forth the activity and balance of the restructuring liability accounts for the nine months ended July 31, 2008 (in thousands):

| | Consolidation of excess |
|---|---|

| | facilities |
|---|---|
| Balance at October 31, 2007 | $ 4,688 |
| Cash payments | (651) |
| Balance at July 31, 2008 | $ 4,037 |
| Current restructuring liabilities | $ 687 |
| Non-current restructuring liabilities | $ 3,350 |

**(6) MARKETABLE SECURITIES**

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

| | July 31, 2009 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S. government obligations | $ 606,423 | $ 466 | $ 2 | $ 606,887 |
| Publicly traded equity securities | 207 | | | 207 |
| | $ 606,630 | $ 466 | $ 2 | $ 607,094 |
| Included in short-term investments | 606,630 | 466 | 2 | $ 607,094 |
| Included in long-term investments | | | | |
| | $ 606,630 | $ 466 | $ 2 | $ 607,094 |

| | October 31, 2008 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Corporate bonds | $ 116,531 | $ 81 | $ 2,260 | $ 114,352 |
| Asset-backed obligations | 10,188 | | 7 | 10,181 |
| Commercial paper | 49,871 | 7 | 8 | 49,870 |
| U.S. government obligations | 334,195 | 949 | 40 | 335,104 |
| Certificate of deposit | 13,000 | | | 13,000 |
| | $ 523,785 | $ 1,037 | $ 2,315 | $ 522,507 |
| Included in short-term investments | 366,054 | 812 | 530 | 366,336 |
| Included in long-term investments | 157,731 | 225 | 1,785 | 156,171 |
| | $ 523,785 | $ 1,037 | $ 2,315 | $ 522,507 |

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

| | July 31, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Unrealized Losses Less Than 12 Months | | Unrealized Losses 12 Months or Greater | | Total | |
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |

| | | | | | | |
|---|---|---|---|---|---|---|
| U.S. government obligations | $ 2 | $ 46,312 | $ | $ | $ 2 | $ 46,312 |
| | $ 2 | $ 46,312 | $ | $ | $ 2 | $ 46,312 |

| | October 31, 2008 | | | | | |
|---|---|---|---|---|---|---|
| | Unrealized Losses Less Than 12 Months | | Unrealized Losses 12 Months or Greater | | Total | |
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| Corporate bonds | $ 2,260 | $ 88,176 | $ | $ | $ 2,260 | $ 88,176 |
| Asset-backed obligations | 7 | 10,181 | | | 7 | 10,181 |
| Commercial paper | 8 | 29,709 | | | 8 | 29,709 |
| U.S. government obligations | 40 | 23,438 | | | 40 | 23,438 |
| | $ 2,315 | $ 151,504 | $ | $ | $ 2,315 | $ 151,504 |

The following table summarizes final legal maturities of debt investments at July 31, 2009 (in thousands):

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Less than one year | $ 606,423 | $ 606,887 |
| Due in 1-2 years | | |
| Due in 2-3 years | | |
| | $ 606,423 | $ 606,887 |

**(7) FAIR VALUE MEASUREMENTS**

SFAS 157 defines fair value 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. SFAS 157 establishes a valuation hierarchy for disclosure of the inputs for fair value measurement. This hierarchy prioritizes the inputs into three broad levels as follows:

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

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

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

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

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

| | July 31, 2009 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| U.S. government obligations | $ | $ 606,887 | $ | $ 606,887 |
| Publicly traded equity securities | 207 | | | 207 |
| Foreign currency forward contracts | | 1,487 | | 1,487 |
| Total assets measured at fair value | $ 207 | $ 608,374 | $ | $ 608,581 |

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

As of July 31, 2009, Ciena did not hold financial assets and liabilities recorded at fair value based on Level 3 inputs.

As of the dates indicated, the assets and liabilities above were presented on Ciena s condensed consolidated balance sheet as follows (in thousands):

| | July 31, 2009 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Cash and cash equivalents | $ | $ | $ | $ |
| Short-term investments | 207 | 606,887 | | 607,094 |
| Prepaid expenses and other | | 1,487 | | 1,487 |
| Total assets measured at fair value | $ 207 | $ 608,374 | $ | $ 608,581 |

During the third quarter of fiscal 2009, a private technology company in which Ciena holds a minority equity investment completed a round of equity financing in which Ciena did not participate. This event required Ciena to perform an impairment analysis and measure the investment at fair value. In determining its fair value, Ciena utilized Level 3 inputs

including the actual recapitalization resulting from the completion of the equity financing. Based on Ciena s ownership interest and the value of its investment following the financing, Ciena recorded a non-cash loss on cost method investments of $2.2 million.

During the second quarter of fiscal 2009, this same private technology company had merged with another private technology company. This event required Ciena to perform an impairment analysis and measure the investment at fair value. In determining its fair value, Ciena utilized Level 3 inputs including the recapitalization of the combined company and the terms of the proposed equity financing described above. As a result, Ciena recorded a non-cash loss on cost method investments of $2.5 million.

During the first quarter of fiscal 2009, a separate private technology company in which Ciena held a minority equity investment was acquired by a publicly-traded company. This event required Ciena to perform an impairment analysis and measure the investment at fair value. In determining its fair value, Ciena utilized Level 2 inputs including the relevant exchange ratio for the acquisition transaction and the market price of the acquirer s common stock. As a result, Ciena recorded a non-cash loss on cost method investments of $0.6 million.

At July 31, 2009, the fair value of the outstanding $500.0 million of 0.875% convertible senior notes and $298.0 million in 0.25% convertible senior notes was $276.7 million and $214.4 million, respectively. Fair value is based on the quoted market price for the notes on the dates above.

**(8) ACCOUNTS RECEIVABLE**

As of October 31, 2008 three customers accounted for 59.0% of net accounts receivable and as of July 31, 2009 two customers accounted for 31.6% of net accounts receivable.

Ciena s allowance for doubtful accounts receivable is based on management s assessment, on a specific identification basis, of the collectibility of customer accounts. As of October 31, 2008 and July 31, 2009, allowance for doubtful accounts was $0.1 million.

**(9) INVENTORIES**

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

| | October 31, 2008 | July 31, 2009 |
|---|---|---|
| Raw materials | $ 19,044 | $ 20,202 |
| Work-in-process | 1,702 | 755 |
| Finished goods | 95,963 | 90,189 |
| | 116,709 | 111,146 |
| Provision for excess and obsolescence | (23,257) | (21,546) |
| | $ 93,452 | $ 89,600 |

Ciena writes down its inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value, based on assumptions about future demand and market conditions. During the first nine months of fiscal 2009, Ciena recorded a provision for excess and obsolete inventory of $11.1 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory generally relate to disposal activities. The following table summarizes the activity in Ciena s reserve for excess and obsolete inventory for the period indicated (in thousands):

| | Inventory Reserve |
|---|---|
| Reserve balance as of October 31, 2008 | $ 23,257 |
| Provision for excess for obsolescence | 11,126 |
| Actual inventory disposed | (12,837) |

| | |
|---|---|
| Reserve balance as of July 31, 2009 | $ 21,546 |

During the first nine months of fiscal 2008, Ciena recorded a provision for excess and obsolete inventory of $13.8 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory generally relate to disposal activities. The following table summarizes the activity in Ciena s reserve for excess and obsolete inventory for the period indicated (in thousands):

| | Inventory Reserve |
|---|---|
| Reserve balance as of October 31, 2007 | $ 26,170 |
| Provision for excess and obsolescence | 13,841 |
| Actual inventory disposed | (17,091) |
| Reserve balance as of July 31, 2008 | $ 22,920 |

**(10) PREPAID EXPENSES AND OTHER**

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

| | October 31, 2008 | July 31, 2009 |
|---|---|---|
| Interest receivable | $ 2,082 | $ 1,012 |
| Prepaid VAT and other taxes | 15,160 | 13,249 |
| Deferred deployment expense | 4,481 | 3,598 |
| Prepaid expenses | 10,557 | 15,868 |
| Restricted cash | 1,717 | 7,593 |
| Derivative Assets | | 1,487 |
| Other non-trade receivables | 1,891 | 1,518 |
| | $ 35,888 | $ 44,325 |

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

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

| | October 31, 2008 | July 31, 2009 |
|---|---|---|
| Equipment, furniture and fixtures | $ 286,940 | $ 288,765 |
| Leasehold improvements | 40,574 | 44,334 |
| | 327,514 | 333,099 |
| Accumulated depreciation and amortization | (267,547) | (272,491) |
| | $ 59,967 | $ 60,608 |

**(12) OTHER INTANGIBLE ASSETS**

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

| | October 31, 2008 | | | July 31, 2009 | | |
|---|---|---|---|---|---|---|
| | Gross Intangible | Accumulated Amortization | Net Intangible | Gross Intangible | Accumulated Amortization | Net Intangible |
| Developed technology | $ 185,833 | $ (128,255) | $ 57,578 | $ 185,833 | $ (142,691) | $ 43,142 |
| Patents and licenses | 47,370 | (37,952) | 9,418 | 47,370 | (41,829) | 5,541 |
| Customer relationships, covenants not to | 68,281 | (43,028) | 25,253 | 68,281 | (48,519) | 19,762 |

| | | | | | | |
|---|---|---|---|---|---|---|
| compete, outstanding purchase orders and contracts | | | | | | |
| | $ 301,484 | $ (209,235) | $ 92,249 | $ 301,484 | $ (233,039) | $ 68,445 |

The aggregate amortization expense of other intangible assets was $27.9 million and $23.8 million for the first nine months of fiscal 2008 and 2009, respectively. Expected future amortization of other intangible assets for the fiscal years indicated is as follows (in thousands):

| Period ended October 31, | |
|---|---|
| 2009 (remaining three months) | $ 7,625 |
| 2010 | 27,872 |
| 2011 | 13,852 |
| 2012 | 9,473 |
| 2013 | 7,217 |
| Thereafter | 2,406 |
| | $ 68,445 |

**(13) OTHER BALANCE SHEET DETAILS**

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

| | October 31, 2008 | July 31, 2009 |
|---|---|---|
| Maintenance spares inventory, net | $ 30,038 | $ 31,694 |
| Deferred debt issuance costs, net | 15,127 | 13,406 |
| Investments in privately held companies | 6,671 | 907 |
| Restricted cash | 20,436 | 16,474 |
| Other | 3,476 | 2,670 |
| | $ 75,748 | $ 65,151 |

Deferred debt issuance costs are amortized using the straight line method which approximates the effect of the effective interest rate method on the maturity of the related debt. Amortization of debt issuance costs, which is included in interest expense, was $2.3 million and $1.7 million during the first nine months of fiscal 2008 and fiscal 2009, respectively.

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

| | October 31, 2008 | July 31, 2009 |
|---|---|---|
| Warranty | $ 37,258 | $ 39,380 |
| Compensation, payroll related tax and benefits | 35,200 | 26,058 |
| Interest payable | 1,683 | 765 |
| Other | 22,002 | 23,368 |
| | $ 96,143 | $ 89,571 |

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 |
|---|---|---|---|---|
| 2008 | $33,580 | $11,234 | $ (8,452) | $ 36,362 |
| 2009 | $37,258 | $13,620 | $(11,498) | $ 39,380 |

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

| | October 31, 2008 | July 31, 2009 |
|---|---|---|
| Products | $ 13,061 | $ 14,629 |
| Services | 61,366 | 63,871 |
| | 74,427 | 78,500 |
| Less current portion | (36,767) | (43,625) |
| Long-term deferred revenue | $ 37,660 | $ 34,875 |

**(14) DERIVATIVES**

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

The effective portion of the derivative s gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and, upon occurrence of the forecasted transaction, is subsequently reclassified into the operating expense line item to which the hedged transaction relates. Ciena records the ineffective portion of the hedging instruments in interest and other income, net.

Ciena s foreign currency forward contracts are classified as follows:

| | Reclassified to Condensed Consolidated Statement of Operations (Effective Portion) | | | |
|---|---|---|---|---|
| | | | Nine Months Ended | |
| Line Item in Condensed Consolidated Statement of | Quarter Ended July 31, | | July 31, | |
| Operations | 2008 | 2009 | 2008 | 2009 |
| Research and development | $ | $ (283) | $ | $ 21 |
| Selling and marketing | | (692) | | 46 |
| | $ | $ (975) | $ | $ 67 |

| | Recognized in Other Comprehensive Income (Loss) | | | |
|---|---|---|---|---|
| | Quarter Ended July | | Nine Months Ended July | |
| Line Item in Condensed Consolidated Balance | 31, | | 31, | |
| Sheet | 2008 | 2009 | 2008 | 2009 |
| Accumulated other comprehensive income (loss) | $ | $ 2,904 | $ | $ 1,420 |
| | $ | $ 2,904 | $ | $ 1,420 |

| | Ineffective Portion | | | |
|---|---|---|---|---|
| | Quarter Ended July | | Nine Months Ended July | |
| Line Item in Condensed Consolidated Statement of | 31, | | 31, | |
| Operations | 2008 | 2009 | 2008 | 2009 |
| Other income, net | $ | $ | $ | $ |
| | $ | $ | $ | $ |

Foreign currency forward contracts outstanding at July 31, 2009 are summarized as follows (in thousands):

| Derivatives Designated as Cash Flow Hedging Instruments under SFAS 133 | Weighted Average Contract Exchange Rate | Derivative Asset Fair Value | Derivative Liability Fair Value | Total Derivative Asset Fair Value |
|---|---|---|---|---|

| | Notional Amount | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | October 31, 2008 | July 31, 2009 | October 31, 2008 | July 31, 2009 | October 31, 2008 | July 31, 2009 | October 31, 2008 | July 31, 2009 | October 31, 2008 | July 31, 2009 |
| USD Functional Currency | | | | | | | | | | |
| Receive EUR / Pay USD | | 1.3909 | $ | $ 10,840 | $ | $ 268 | $ | $ | $ | $ 268 |
| Receive INR / Pay USD | | 0.0205 | $ | $ 4,071 | $ | $ 28 | $ | $ | $ | $ 28 |
| Receive CAD / Pay USD | | 0.8258 | $ | $ 3,800 | $ | $ 464 | $ | $ | $ | $ 464 |
| EUR Functional Currency | | | | | | | | | | |
| Receive GBP / Pay EUR | | 1.0820 | | 6,243 | $ | $ 727(1) | $ | $ | $ | $ 727(1) |
| Total Fair Value | | | | | $ | $ 1,487(2) | $ | $ | $ | $ 1,487(2) |

(1) Fair value translated at exchange rates in effect as of the condensed consolidated balance sheet date.

(2) Amount is included within prepaid expenses and other on the condensed consolidated balance sheet.

**(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 dilutive potential common share ( Diluted EPS ). Basic EPS is computed using the weighted average number of common shares outstanding. Diluted

EPS is computed using the weighted average number of (i) common shares outstanding, (ii) shares issuable upon vesting of restricted stock units, (iii) shares issuable upon exercise of outstanding stock options, employee stock purchase plan options and warrants using the treasury stock method; and (iv) shares underlying the 0.25% and 0.875% convertible senior notes.

| | Quarter Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| **Numerator** | | | | |
| Net income (loss) | $ 11,723 | $ (26,454) | $ 64,290 | $ (554,495) |
| Add: Interest expense for 0.25% convertible senior notes | 467 | | 1,408 | |
| Add: Interest expense for 0.875% convertible senior notes | 1,388 | | 4,123 | |
| Net income (loss) used to calculate Diluted EPS | $ 13,578 | $ (26,454) | $ 69,821 | $ (554,495) |

| | Quarter Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| **Denominator** | | | | |
| Basic weighted average shares outstanding | 90,216 | 91,364 | 88,871 | 90,970 |
| Add: Shares underlying outstanding stock options, employees stock purchase plan options, warrants and restricted stock units | 767 | | 1,085 | |
| Add: Shares underlying 0.25% convertible senior notes | 7,590 | | 7,590 | |
| Add: Shares underlying 0.875% convertible senior notes | 13,108 | | 13,108 | |
| Dilutive weighted average shares outstanding | 111,681 | 91,364 | 110,654 | 90,970 |

| | Quarter Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| **EPS** | | | | |
| Basic EPS | $ 0.13 | $ (0.29) | $ 0.72 | $ (6.10) |
| Diluted EPS | $ 0.12 | $ (0.29) | $ 0.63 | $ (6.10) |

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

For the quarter and nine months ended July 31, 2008, the weighted average number of shares set forth in the table below, underlying outstanding stock options, employee stock purchase plan options, restricted stock units, and warrants, is considered anti-dilutive because the exercise price of these equity awards is greater than the average per share closing price on the NASDAQ Stock Market during this period. In addition, for the nine months ended July 31, 2008, the weighted average number of shares underlying Ciena s previously outstanding 3.75% convertible notes, which were repaid at maturity on February 1, 2008, is considered anti-dilutive pursuant to SFAS 128 because the

related interest expense on a per common share if converted basis exceeds Basic EPS for the period.

For the quarter and nine months ended July 31, 2009, the weighted average number of shares set forth in the table below, underlying outstanding stock options, employee stock purchase plan options, restricted stock units, and warrants, is considered anti-dilutive because Ciena incurred a net loss. In addition, the shares, representing the weighted average number of shares issuable upon conversion of Ciena s 0.25% convertible senior notes and Ciena s 0.875% convertible senior notes, are considered anti-dilutive pursuant to SFAS 128 because the related interest expense on a per common share if converted basis exceeds Basic EPS for the period.

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

| | Quarter Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| **Shares Excluded from EPS Denominator due to Anti-dilutive Effect** | | | | |
| Shares underlying stock options, restricted stock units and warrants | 5,484 | 8,249 | 4,816 | 8,161 |
| 3.75% convertible notes | | | 243 | |
| 0.25% convertible senior notes | | 7,539 | | 7,539 |
| 0.875% convertible senior notes | | 13,108 | | 13,108 |
| Total excluded due to anti-dilutive effect | 5,484 | 28,896 | 5,059 | 28,808 |

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

Ciena makes equity awards under its 2008 Omnibus Incentive Plan ( 2008 Plan ) and 2003 Employee Stock Purchase Plan ( ESPP ). These plans were approved by shareholders and are described in Ciena s annual report on Form 10-K.

*2008 Plan*

Ciena grants stock options and restricted stock units under the 2008 Plan. As of July 31, 2009, there were 3.0 million shares authorized and available for issuance thereunder.

*Stock Options*

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

| | Shares Underlying Options Outstanding | Weighted Average Exercise Price |
|---|---|---|
| Balance as of October 31, 2008 | 6,399 | $ 48.84 |
| Granted | 212 | 8.16 |
| Exercised | (86) | 1.94 |
| Canceled | (673) | 53.06 |
| Balance as of July 31, 2009 | 5,852 | $ 47.57 |

The total intrinsic value of options exercised during the first nine months of fiscal 2008 and fiscal 2009, was $14.2 million and $0.5 million, respectively. The weighted average fair values of each stock option granted by Ciena during the first nine months of fiscal 2008 and fiscal 2009 were $16.24 and $4.66, respectively.

The following table summarizes information with respect to stock options outstanding at July 31, 2009, based on Ciena s closing stock price of $11.16 per share on the last trading day of Ciena s third fiscal quarter of 2009 (shares and intrinsic value in thousands):

| | Options Outstanding at July 31, 2009 | | | | Vested Options at July 31, 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| Range of Exercise Price | Number of Shares | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Aggregate Intrinsic Value | Number of Shares | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Aggregate Intrinsic Value |
| $ 0.01 $ 16.52 | 937 | 7.05 | $ 10.33 | $ 2,926 | 631 | 6.10 | $ 11.54 | $ 1,816 |
| $16.53 $ 17.43 | 566 | 6.24 | 17.21 | | 472 | 5.81 | 17.20 | |
| $17.44 $ 22.96 | 478 | 5.61 | 21.76 | | 412 | 5.13 | 21.94 | |
| $22.97 $ 31.71 | 1,551 | 5.40 | 29.45 | | 1,238 | 4.76 | 29.77 | |
| $31.72 $ 46.97 | 964 | 6.59 | 39.38 | | 648 | 5.74 | 40.13 | |
| $46.98 $ 73.78 | 528 | 3.30 | 60.11 | | 527 | 3.30 | 60.11 | |
| $73.79 $1,046.50 | 828 | 1.58 | 160.86 | | 828 | 1.58 | 160.86 | |
| $ 0.01 $1,046.50 | 5,852 | 5.23 | $ 47.57 | $ 2,926 | 4,756 | 4.49 | $ 53.03 | $ 1,816 |

*Assumptions for Option-Based Awards*

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

| | Quarter Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Expected volatility | 53.0% | 65.0% | 53.0% | 65.0% |
| Risk-free interest rate | 3.4% 3.7% | 2.8% 3.1% | 2.7% 3.7% | 1.7% 3.1% |
| Expected life (years) | 5.1 5.3 | 5.2 5.3 | 5.1 5.3 | 5.2 5.3 |
| Expected dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |

Consistent with SFAS 123(R) and SAB 107, Ciena considered the implied volatility and historical volatility of its stock price in determining its expected volatility, and, finding both to be equally reliable, determined that a combination of both would result in the best estimate of expected volatility.

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

The expected term of employee stock options represents the weighted-average period the stock options are expected to remain outstanding. As prescribed by SAB 107, Ciena s expected term is based on specific exercise behavior of its historical grantees.

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

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

*Restricted Stock Units*

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

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

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

| | Restricted Stock Units Outstanding | Weighted Average Grant Date Fair Value Per Share | Aggregate Intrinsic Value |
|---|---|---|---|
| Balance as of October 31, 2008 | 1,849 | $ 30.85 | $ 17,773 |
| Granted | 3,340 | | |
| Vested | (897) | | |
| Canceled or forfeited | (104) | | |
| Balance as of July 31, 2009 | 4,188 | $ 14.89 | $ 46,741 |

The total fair value of restricted stock units that vested and were converted into common stock during the first nine months fiscal 2008 and fiscal 2009 was $13.6 million and $7.7 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first nine months of fiscal 2008 and fiscal 2009 was $33.37 and $6.97, respectively.

*Assumptions for Restricted Stock Unit Awards*

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

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

*2003 Employee Stock Purchase Plan*

The ESPP is a non-compensatory plan under FAS 123(R) and issuances thereunder do not result in share-based compensation expense. The following table is a summary of ESPP activity and shares available for issuance for the periods indicated (shares in thousands):

| | ESPP shares available for issuance | Intrinsic value at exercise date |
|---|---|---|
| Balance as of October 31, 2008 | 3,488 | |
| Evergreen provision | 83 | |
| Issued March 16, 2009 | (67) | $ 23 |
| Balance as of July 31, 2009 | 3,504 | |

*Share-Based Compensation Expense for Periods Reported*

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

| | Quarter Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Product costs | $ 1,042 | $ 460 | $ 2,349 | $ 1,618 |
| Service costs | 404 | 419 | 1,042 | 1,241 |
| Share-based compensation expense included in cost of sales | 1,446 | 879 | 3,391 | 2,859 |
| Research and development | 2,198 | 2,431 | 5,661 | 7,814 |
| Sales and marketing | 2,930 | 2,640 | 8,416 | 8,028 |
| General and administrative | 2,343 | 2,621 | 6,785 | 7,813 |
| Share-based compensation expense included in operating expense | 7,471 | 7,692 | 20,862 | 23,655 |
| Share-based compensation expense capitalized in inventory, net | (263) | (87) | 153 | (439) |
| Total share-based compensation | $ 8,654 | $ 8,484 | $ 24,406 | $ 26,075 |

As of July 31, 2009, total unrecognized compensation expense was: (i) $13.8 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 1.1 years; and (ii) $48.3 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.3 years.

**(17) COMPREHENSIVE INCOME (LOSS)**

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

| | Quarter Ended July 31, | | Nine Months Ended July 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Net income (loss) | $ 11,723 | $ (26,454) | $ 64,290 | $ (554,495) |
| Change in unrealized gain (loss) on available-for-sale securities, net of tax | (103) | (270) | (307) | 1,407 |
| Change in unrealized gain on derivative instruments, net of tax | | 1,334 | | 892 |
| Change in accumulated translation adjustments | 358 | 756 | 2,361 | 763 |
| Total comprehensive income (loss) | $ 11,978 | $ (24,634) | $ 66,344 | $ (551,433) |

**(18) ENTITY WIDE DISCLOSURES**

The following table reflects Ciena s geographic distribution of revenue based on the location of the purchaser, with any country accounting for greater than 10% of total revenue in the period specifically identified. Revenue attributable

to geographic regions outside of the United States and the United Kingdom is reflected as Other International revenue. For the periods below, Ciena s geographic distribution of revenue was as follows (in thousands, except percentage data):

| | Quarter Ended July 31, | | | | Nine Months Ended July 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | 2008 | %* | 2009 | %* |
| United States | $ 156,363 | 61.8 | $ 104,041 | 63.1 | $ 495,254 | 68.5 | $ 294,688 | 61.9 |
| United Kingdom | 43,105 | 17.0 | 23,439 | 14.2 | 102,846 | 14.2 | 68,737 | 14.4 |
| Other International | 53,711 | 21.2 | 37,278 | 22.7 | 124,694 | 17.3 | 112,934 | 23.7 |
| Total | $ 253,179 | 100.0 | $ 164,758 | 100.0 | $ 722,794 | 100.0 | $ 476,359 | 100.0 |

* Denotes % of total revenue

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

| | October 31, | | July 31, | |
|---|---|---|---|---|
| | 2008 | %* | 2009 | %* |
| United States | $ 49,351 | 82.3 | $ 47,301 | 78.0 |
| International | 10,616 | 17.7 | 13,307 | 22.0 |
| Total | $ 59,967 | 100.0 | $ 60,608 | 100.0 |

* Denotes % of total equipment, furniture and fixtures

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

| | Quarter Ended July 31, | | | | Nine Months Ended July 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | 2008 | %* | 2009 | %* |
| Optical service delivery | $ 199,974 | 79.0 | $ 117,226 | 71.2 | $ 593,694 | 82.1 | $ 352,921 | 74.0 |
| Carrier Ethernet service delivery | 23,687 | 9.4 | 22,677 | 13.7 | 47,938 | 6.6 | 45,548 | 9.6 |
| Services | 29,518 | 11.6 | 24,855 | 15.1 | 81,162 | 11.3 | 77,890 | 16.4 |
| Total | $ 253,179 | 100.0 | $ 164,758 | 100.0 | $ 722,794 | 100.0 | $ 476,359 | 100.0 |

* Denotes % of total revenue

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

| | Quarter Ended July 31, | | | | Nine Months Ended July 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | 2008 | %* | 2009 | %* |
| Company A | $ 29,975 | 11.8 | $ 20,005 | 12.1 | $ 77,115 | 10.7 | $ 53,244 | 11.2 |
| Company B | 27,012 | 10.7 | 18,041 | 10.9 | n/a | | n/a | |
| Company C | 64,038 | 25.3 | 22,268 | 13.6 | 193,730 | 26.8 | 94,928 | 19.9 |
| Total | $ 121,025 | 47.8 | $ 60,314 | 36.6 | $ 270,845 | 37.5 | $ 148,172 | 31.1 |

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

* Denotes % of total revenue

**(19) CONTINGENCIES**

*Foreign Tax Contingencies*

Ciena has received assessment notices from the Mexican tax authorities asserting deficiencies in payments between 2001 and 2005 related primarily to income taxes and import taxes and duties. Ciena has filed judicial petitions appealing these assessments. As of October 31, 2008 and July 31, 2009, Ciena had accrued liabilities of $1.0 million, related to these contingencies, which are reported as a component of other current accrued liabilities. As of July 31, 2009, Ciena estimates that it could be exposed to possible losses of up to $5.8 million, for which it has not accrued liabilities. Ciena has not accrued the additional income tax liabilities because it does not believe that such losses are more likely than not to be incurred. Ciena has not accrued the additional import taxes and duties because it does not believe the incurrence of such losses is probable. Ciena continues to evaluate the likelihood of probable and reasonably possible losses, if any, related to these assessments. As a result, future increases or decreases to accrued liabilities may be necessary and will be recorded in the period when such amounts are probable and estimable.

*Litigation*

On November 7, 2008, JDS Uniphase Corp. ( JDSU ) filed a complaint with the United States International Trade Commission (ITC) against Ciena and several other respondents, alleging infringement of two patents (U.S. Patent Nos. 6,658,035 and 6,687,278) relating to tunable laser chip technology. The complaint, which names Ciena as a company whose products incorporate the accused technology manufactured by certain other respondents and which technology is imported into the United States, seeks a determination and relief under Section 337 of the Tariff Act of 1930. On December 17, 2008, Ciena and certain other respondents entered into a Settlement Agreement and Agreement to be Bound with JDSU, whereby those respondents agreed, in exchange for dismissal from the investigation, to be bound by any exclusion order issued by the ITC in the investigation in favor of JDSU that takes effect against one or more of the non-settling respondents. Ciena was not required to make any payment in connection with this settlement agreement. Based on that agreement, JDSU contemporaneously filed a motion to terminate the investigation with respect to Ciena and certain other respondents. Based on the ITC staff s initial response to that motion, the parties entered into an amended settlement agreement and, on January

8, 2009, JDSU filed an amended motion to terminate. On February 3, 2009, the ITC judge issued an order granting JDSU s amended motion to terminate, which order was affirmed by the full commission on February 27, 2009. Accordingly, the ITC investigation has been terminated with respect to Ciena.

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

As a result of Ciena s June 2002 merger with ONI Systems Corp., Ciena became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI s initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI s registration statement and by engaging in manipulative practices to artificially inflate ONI s stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and all of these actions have been included in a single coordinated proceeding. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena s Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 23, 2008. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation, the ultimate outcome of the matter is uncertain.

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

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

*Some of the statements contained, or incorporated by reference, in this quarterly report discuss future events or expectations, contain projections of results of operations or financial condition, changes in the markets for our products and services, or state other forward-looking information. Ciena s forward-looking information is based on various factors and was derived using numerous assumptions. In some cases, you can identify these forward-looking statements by words like may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continue or the negative of those words and other comparable words. You should be aware that these statements only reflect our current predictions and beliefs. These statements are subject to known and unknown risks, uncertainties and other factors, and actual events or results may differ materially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly in Item 1A Risk Factors of Part II of this report below. You should review these risk factors and the rest of this quarterly report in combination with the more detailed description of our business and management s discussion and analysis of financial condition in our annual report on Form 10-K, which we filed with the Securities and Exchange Commission on December 23, 2008, for a more complete understanding of the risks associated with an investment in Ciena s securities. Ciena undertakes no obligation to revise or update any forward-looking statements.*

**Overview**

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

providers, cable operators, governments and enterprises around the globe. We are a network specialist, targeting the transition of disparate, legacy communications networks to converged, next-generation architectures, better able to handle increased traffic and deliver more efficiently a broader mix of high-bandwidth communications services. Our products, along with our service-aware operating system and unified service and transport management, enable service providers to efficiently and cost-effectively deliver critical enterprise and consumer-oriented communication services. Together with our professional support and consulting services, our product offering seeks to address holistically the business and network needs of our customers. By improving network productivity, reducing operating costs and enabling new and integrated service offerings, we create business and operational value for our customers.

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

*Effect of Decline in Market Conditions*

Our business and results of operations continue to suffer negative effects of ongoing difficult market conditions. In response to the decline in market conditions, many companies, including some of our largest communications service provider customers, have slowed spending and indicated their intention to reduce overall capital expenditures as compared to last year. As a result, we have experienced lengthening sales cycles, customer delays in network build-outs and slowing deployments in recent quarters, resulting in lower demand across our customer base in all geographies. Due to increased competition and a heightened focus by customers on pricing and return on investment in the face of these market conditions, we are seeing increased pricing pressure across our optical transport products.

These market conditions have negatively affected our revenue and earnings over the last year. Revenue for the first nine months of fiscal 2009 was $476.4 million in comparison to $722.8 million for the same period in fiscal 2008. We expect our revenue for fiscal 2009 to be significantly lower than our fiscal 2008 results and we will not be profitable for the year. The magnitude of the effect of market conditions on our results of operations is difficult to predict and significantly linked to the duration and severity of the economic downturn and the resulting level of capital expenditure by our largest customers.

*Strategy*

Despite difficult market conditions, we continue to believe in our longer-term market opportunities and the potential represented by the underlying drivers of future demand for our hardware, software and services offerings in our target markets. We believe growing consumer and enterprise use of, and increased dependence upon, a variety of broadband applications and services will continue to consume bandwidth, requiring our customers to invest in their networks and transition to more efficient, robust and economical network architectures. As a result, we intend to continue to invest in our business, prioritizing spending on key product and technology initiatives that we believe will strategically position us for longer-term growth when we emerge from this challenging period. Specifically, our ongoing development is focused upon:

- bringing to market data-optimized switching solutions and the evolution of our CoreDirector® Multiservice Optical Switch family;
- expansion of our carrier Ethernet service delivery and aggregation products;
- extension of our CN 4200 FlexSelect Advanced Service Platform, including 100G technologies and capabilities; and
- software development for unified network and service management functions.

These broader development initiatives remain focused on delivering upon our vision of transforming networks to adapt and scale, manage unpredictability and eliminate barriers to new service offerings. This vision of simplified, highly-automated networks is based on the following technologies:

- Programmable network elements, including software-programmable hardware platforms and interfaces that use our FlexiPort technology, to enable on-demand and automated support for multiple services and applications;
- Common service-aware operating system and unified transport and service management software for an integrated solution ensuring all network elements work seamlessly together for rapid delivery of services and applications; and

Optimized carrier Ethernet technology our True Carrier Ethernet for enhanced management, faster provisioning, higher reliability and support for a wider variety of services.

Through these capabilities, we seek to enable customers to automate delivery and management of a broad mix of services over networks that offer enhanced flexibility and are more cost-effective to deploy, scale and manage.

*Restructuring Activities*

During this period of market difficulty, we intend to manage our workforce and operating costs carefully to ensure that they are aligned with our business and market opportunities. During the second quarter of fiscal 2009, we took action to effect a headcount reduction of approximately 200 employees or 9% of our global workforce, with headcount reductions implemented across our organizations and geographies. As part of this action, we closed our Acton, Massachusetts research and development facility during the third quarter. We expect these steps will help better align our operating expense with market opportunities and the development strategy above. We incurred a $10.4 million charge in the first nine months of fiscal 2009, principally consisting of $4.1 million for employee-related restructuring, $3.4 million for Acton facilities-related restructuring, and $2.9 million related to the revision of previous estimates.

*Goodwill Impairment*

Based on a combination of factors, including the macroeconomic conditions described above and a sustained decline in our common stock price and market capitalization below our net book value, we conducted an interim impairment assessment of goodwill during the second quarter of fiscal 2009. The conclusion of this assessment was the write-off of all goodwill remaining on our balance sheet, resulting in an impairment charge of $455.7 million in the second quarter of fiscal 2009. This impairment charge significantly affects our operating expense and operating and net loss for fiscal 2009. It will not result in any current or future cash expenditures.

*Acquisition of World Wide Packets*

On March 3, 2008, we completed our acquisition of World Wide Packets, Inc. ( WWP ), a provider of communications network equipment that enables the cost-effective delivery of a variety of carrier Ethernet-based services. See Note 3 to the Condensed Consolidated Financial Statements included in Item 1 of Part I of this report for additional information related to this acquisition.

*Financial Results*

While revenue increased sequentially from the second quarter of fiscal 2009, our operating results, including our year-over-year revenue declines, continue to reflect the market conditions described above and the resulting decrease in demand across our customer base.

- Revenue for the third quarter of fiscal 2009 was $164.8 million, representing a 14.3% sequential increase from $144.2 million in the second quarter of fiscal 2009 and a 34.9% decrease from $253.2 million in the third quarter of fiscal 2008;
- The sequential increase in product revenue reflects an $11.7 million increase in optical service delivery revenue, primarily reflecting increased sales of CN 4200, and a $9.3 million increase in carrier Ethernet service delivery revenue, principally related to sales of switching and aggregation products in support of wireless backhaul deployments, including, in large part, 4G WiMax;
- Revenue from the U.S. for the third quarter of fiscal 2009 was $104.0 million, an increase from $91.7 million in the second quarter of fiscal 2009 and a decrease from $156.4 million in the third quarter of fiscal 2008;
- International revenue for the third quarter of fiscal 2009 was $60.7 million, an increase from $52.5 million in the second quarter of 2009 and a decrease from $96.8 million in the third quarter of fiscal 2008;
- As a percentage of revenue, international revenue was 36.9% during the third quarter of fiscal 2009, roughly flat with 36.4% in the second quarter of fiscal 2009 and down from 38.2% in the third quarter of fiscal 2008; and
- For the third quarter of fiscal 2009, three customers each accounted for greater than 10% of revenue and 36.6% in the aggregate. This compares to one customer that accounted for 27.8% of revenue in the second quarter of fiscal 2009.

Gross margin for the third quarter of fiscal 2009 was 45.3%, up from 42.1% in the second quarter of fiscal 2009, and down from 49.6% in the third quarter of fiscal 2008. Gross margin for the second quarter of fiscal 2009 was negatively affected by charges of approximately $5.8 million related to provisions for estimated losses on two committed customer sales contracts expected to result in a negative gross margin on the initial phases of the customers deployment.

Operating expense for the third quarter of fiscal 2009 was $97.6 million, a decrease from $563.7 million in the second quarter of fiscal 2009 and $110.7 million for the third quarter of fiscal 2008. Exclusive of goodwill impairment and restructuring charges described above, operating expense for the third quarter decreased by $8.0 million sequentially. This decrease was primarily related to the reduction in headcount in connection with the closure of our Acton, MA facility described above and lower overall employee-related expense. We expect operating expense, and the portion attributable to research and development, to increase from the third quarter of fiscal 2009 as we fund the technology initiatives above.

Our loss from operations for the third quarter of fiscal 2009 was $22.9 million. This compares to a $503.0 million loss from operations during the second quarter of 2009 and $15.0 million in income from operations for the third quarter of fiscal 2008. Our net loss for the third quarter of fiscal 2009 was $26.5 million, or $0.29 per share. This compares to a net loss of $503.2 million, or $5.53 per share, for the second quarter of fiscal 2009. Net loss and operating loss reflect the goodwill impairment charge during the second quarter of fiscal 2009 described above.

We generated $3.5 million in cash from operations during the third quarter of fiscal 2009, consisting of $4.6 million in cash generated from net income (adjusted for non-cash charges) and a use of cash of $1.1 million from changes in working capital. This compares with cash generated from operations of $2.9 million in the second quarter of fiscal 2009, consisting of the use of $12.4 million in cash from net income (adjusted for non-cash charges) and $15.3 million in net cash generated from changes in working capital.

At July 31, 2009, we had $455.7 million in cash and cash equivalents and $607.1 million of short-term investments in marketable debt securities.

As of July 31, 2009, headcount was 2,110, an increase from 2,104 at April 30, 2009 and a decrease from 2,210 at July 31, 2008.

**Results of Operations**

Our results of operations for the first nine months of fiscal 2008 include the operations of World Wide Packets only after the March 3, 2008 acquisition date.

*Revenue*

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

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

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

Given current market conditions and the effect of lower demand in recent quarters, as well as changes in the mix of our revenue toward products with shorter customer lead times, the percentage of our quarterly revenue relating to

orders placed in that quarter has increased in comparison to prior periods. Lower levels of backlog orders and an increase in the percentage of quarterly revenue relating to orders placed in that quarter could result in more variability and less predictability in our quarterly results.

*Cost of Goods Sold*

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

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

*Gross Margin*

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

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

*Operating Expense*

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

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

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

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

***Quarter ended July 31, 2008 compared to the quarter ended July 31, 2009***

*Revenue, cost of goods sold and gross profit*

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

| | Quarter Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Revenues: | | | | | | |
| Products | $ 223,661 | 88.3 | $ 139,903 | 84.9 | $ (83,758) | (37.4) |
| Services | 29,518 | 11.7 | 24,855 | 15.1 | (4,663) | (15.8) |
| Total revenue | 253,179 | 100.0 | 164,758 | 100.0 | (88,421) | (34.9) |
| Costs: | | | | | | |
| Products | 107,953 | 42.7 | 72,842 | 44.2 | (35,111) | (32.5) |
| Services | 19,595 | 7.7 | 17,251 | 10.5 | (2,344) | (12.0) |
| Total cost of goods sold | 127,548 | 50.4 | 90,093 | 54.7 | (37,455) | (29.4) |
| Gross profit | $ 125,631 | 49.6 | $ 74,665 | 45.3 | $ (50,966) | (40.6) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

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

| | Quarter Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Product revenue | $ 223,661 | 100.0 | $ 139,903 | 100.0 | $ (83,758) | (37.4) |
| Product cost of goods sold | 107,953 | 48.3 | 72,842 | 52.1 | (35,111) | (32.5) |
| Product gross profit | $ 115,708 | 51.7 | $ 67,061 | 47.9 | $ (48,647) | (42.0) |

* Denotes % of product revenue

** Denotes % change from 2008 to 2009

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

| | Quarter Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Services revenue | $ 29,518 | 100.0 | $ 24,855 | 100.0 | $ (4,663) | (15.8) |
| Services cost of goods sold | 19,595 | 66.4 | 17,251 | 69.4 | (2,344) | (12.0) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Services gross profit | $ 9,923 | 33.6 | $ 7,604 | 30.6 | $ (2,319) | (23.4) |

* Denotes % of services revenue

** Denotes % change from 2008 to 2009

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

| | Quarter Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Optical service delivery | $ 199,974 | 79.0 | $ 117,226 | 71.2 | $ (82,748) | (41.4) |
| Carrier Ethernet service delivery | 23,687 | 9.4 | 22,677 | 13.7 | (1,010) | (4.3) |
| Services | 29,518 | 11.6 | 24,855 | 15.1 | (4,663) | (15.8) |
| Total | $ 253,179 | 100.0 | $ 164,758 | 100.0 | $ (88,421) | (34.9) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

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

| | Quarter Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| United States | $ 156,363 | 61.8 | $ 104,041 | 63.1 | $ (52,322) | (33.5) |
| International | 96,816 | 38.2 | 60,717 | 36.9 | (36,099) | (37.3) |
| Total | $ 253,179 | 100.0 | $ 164,758 | 100.0 | $ (88,421) | (34.9) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

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

| | Quarter Ended July 31, | | | |
|---|---|---|---|---|
| | 2008 | %* | 2009 | %* |
| Company A | $ 29,975 | 11.8 | $ 20,005 | 12.1 |
| Company B | 27,012 | 10.7 | 18,041 | 10.9 |
| Company C | 64,038 | 25.3 | 22,268 | 13.6 |
| Total | $ 121,025 | 47.8 | $ 60,314 | 36.6 |

* Denotes % of total revenue

*Revenue*

**Product revenue** decreased primarily due to a $82.7 million decrease in sales of our optical service delivery products. Lower optical service delivery revenue reflects decreases of $42.2 million in sales of core switching products, $27.8 million in sales of core transport products, and $14.9 million in sales of legacy data networking and metro transport products. These decreases were partially offset by an increase of $2.2 million in sales of our CN 4200 FlexSelect Advanced Service Platform.

**Services revenue** decreased primarily due to a $5.3 million decrease in deployment services.

**United States revenue** decreased primarily due to a $49.1 million decrease in sales of our optical service delivery products. Lower optical service delivery revenue reflects decreases of $32.2 million in sales of core switching products, $13.2 million in sales of core transport products and $6.4 million in sales of legacy data networking and metro transport products. These decreases were partially offset by an increase of $2.6 million in sales of CN 4200.

**International revenue** decreased primarily due to a $33.6 million decrease in sales of our optical service delivery products. This reflects a decrease of $14.6 million in sales of core transport products, $10.0 million in sales of core switching products, and $8.5 million of legacy data networking and metro products.

*Gross profit*

**Gross profit as a percentage of revenue** decreased due to less favorable product mix, including fewer sales of core switching products as a percentage of total revenue, higher charges relating to warranty, and lower service margins. Gross profit as a percentage of revenue for fiscal 2008 reflects a $4.2 million increase in product cost of goods sold related to the revaluation of acquired WWP inventory due to purchase accounting rules.

**Gross profit on products as a percentage of product revenue** decreased due to less favorable product mix, including fewer sales of core switching products as a percentage of total revenue, and higher charges relating to warranty. Gross profit as a percentage of revenue for fiscal 2008 reflects a $4.2 million increase in product cost of goods sold related to the revaluation of acquired WWP inventory due to purchase accounting rules.

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

*Operating expense*

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

| | Quarter Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Research and development | $ 47,809 | 18.9 | $ 44,442 | 27.0 | $ (3,367) | (7.0) |
| Selling and marketing | 39,440 | 15.6 | 31,468 | 19.1 | (7,972) | (20.2) |
| General and administrative | 14,758 | 5.8 | 11,524 | 7.0 | (3,234) | (21.9) |
| Amortization of intangible assets | 8,671 | 3.4 | 6,224 | 3.7 | (2,447) | (28.2) |
| Restructuring cost | | 0.0 | 3,941 | 2.4 | 3,941 | 100.0 |
| Total operating expense | $ 110,678 | 43.7 | $ 97,599 | 59.2 | $ (13,079) | (11.8) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

**Research and development expense** benefited by $1.2 million in favorable foreign exchange rates, primarily due to the strengthening of the U.S. dollar. The resulting $3.4 million change reflects decreases of $4.3 million in employee compensation and related costs, primarily related to the workforce reduction described above, and $1.3 million in lower professional services and fees. These decreases were partially offset by a $2.2 million increase in prototype expense related to the development initiatives described above.

**Selling and marketing expense** benefited by $0.9 million in favorable foreign exchange rates primarily due to the strengthening of the U.S. dollar. The resulting $8.0 million change primarily reflects decreases of $3.6 million in employee compensation cost, $1.3 million in marketing program costs, $1.2 million in travel-related expenditures, $0.4 million in consulting services expense and a gain of $0.7 million from foreign currency forward contracts.

**General and administrative expense** benefited by $0.1 million in favorable foreign exchange rates primarily due to the strengthening of the U.S. dollar. The resulting $3.2 million net change reflects decreases of $1.6 million in employee compensation cost, $0.8 million in consulting service expense, and $0.5 million in facilities and information systems expenses.

**Amortization of intangible assets costs** decreased due to certain intangible assets reaching their useful life and becoming fully amortized prior to the third quarter of fiscal 2009.

**Restructuring costs** were related to the actions described in Overview Restructuring Activities above.

*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 | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Interest and other income, net | $5,342 | 2.1 | $ 999 | 0.6 | $(4,343) | (81.3) |
| Interest expense | $1,855 | 0.7 | $1,856 | 1.1 | $ 1 | 0.1 |
| Realized loss due to impairment of marketable | $5,114 | 2.0 | $ | | $(5,114) | (100.0) |

| | | | | | | |
|---|---|---|---|---|---|---|
| debt investments | | | | | | |
| Loss on cost method investments | $ | | $2,193 | 1.3 | $ 2,193 | 100.0 |
| Provision for income taxes | $1,603 | 0.6 | $ 470 | 0.3 | $(1,133) | (70.7) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

**Interest and other income, net** decreased due to lower interest rates and the reallocation of our funds principally to investments in U.S. treasuries.

**Interest expense** remained relatively unchanged.

**Realized loss due to impairment of marketable debt investments** reflects a loss related to commercial paper investments in SIV Portfolio plc (formerly known as Cheyne Finance plc) and Rhinebridge LLC, two structured investment vehicles (SIVs) that entered into receivership during the fourth quarter of fiscal 2007 and failed to make payment at maturity. This loss was based on the completed restructuring activities of these SIVs.

**Loss on cost method investments** for the third quarter of fiscal 2009 was primarily due to a decline in value of our investment in a privately held technology company that was determined to be other-than-temporary. See Note 7 to our Consolidated Financial Statements in Item 1 of Part I of this report.

**Provision for income taxes** decreased primarily due to decreased federal and state tax expense, and refundable federal tax credits.

***Nine months ended July 31, 2008 compared to nine months ended July 31, 2009***

*Revenue, cost of goods sold and gross profit*

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

| | Nine Months Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Revenues: | | | | | | |
| Products | $ 641,632 | 88.8 | $ 398,469 | 83.6 | $ (243,163) | (37.9) |
| Services | 81,162 | 11.2 | 77,890 | 16.4 | (3,272) | (4.0) |
| Total revenue | 722,794 | 100.0 | 476,359 | 100.0 | (246,435) | (34.1) |
| Costs: | | | | | | |
| Products | 295,381 | 40.8 | 214,628 | 45.1 | (80,753) | (27.3) |
| Services | 57,617 | 8.0 | 54,503 | 11.4 | (3,114) | (5.4) |
| Total cost of goods sold | 352,998 | 48.8 | 269,131 | 56.5 | (83,867) | (23.8) |
| Gross profit | $ 369,796 | 51.2 | $ 207,228 | 43.5 | $ (162,568) | (44.0) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

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

| | Nine Months Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Product revenue | $ 641,632 | 100.0 | $ 398,469 | 100.0 | $ (243,163) | (37.9) |
| Product cost of goods sold | 295,381 | 46.0 | 214,628 | 53.9 | (80,753) | (27.3) |
| Product gross profit | $ 346,251 | 54.0 | $ 183,841 | 46.1 | $ (162,410) | (46.9) |

* Denotes % of product revenue

** Denotes % change from 2008 to 2009

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

| | Nine Months Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Services revenue | $ 81,162 | 100.0 | $ 77,890 | 100.0 | $ (3,272) | (4.0) |
| Services cost of goods sold | 57,617 | 71.0 | 54,503 | 70.0 | (3,114) | (5.4) |
| Services gross profit | $ 23,545 | 29.0 | $ 23,387 | 30.0 | $ (158) | (0.7) |

* Denotes % of services revenue

** Denotes % change from 2008 to 2009

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

| | Nine Months Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Optical service delivery | $ 593,694 | 82.1 | $ 352,921 | 74.0 | $ (240,773) | (40.6) |
| Carrier Ethernet service delivery | 47,938 | 6.6 | 45,548 | 9.6 | (2,390) | (5.0) |
| Services | 81,162 | 11.3 | 77,890 | 16.4 | (3,272) | (4.0) |
| Total | $ 722,794 | 100.0 | $ 476,359 | 100.0 | $ (246,435) | (34.1) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

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

| | Nine Months Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| United States | $ 495,254 | 68.5 | $ 294,688 | 61.9 | $ (200,566) | (40.5) |
| International | 227,540 | 31.5 | 181,671 | 38.1 | (45,869) | (20.2) |
| Total | $ 722,794 | 100.0 | $ 476,359 | 100.0 | $ (246,435) | (34.1) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

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

| | Nine Months Ended July 31, | | | |
|---|---|---|---|---|
| | 2008 | %* | 2009 | %* |
| Company A | $ 77,115 | 10.7 | $ 53,244 | 11.2 |
| Company B | n/a | | n/a | |
| Company C | 193,730 | 26.8 | 94,928 | 19.9 |
| Total | $ 270,845 | 37.5 | $ 148,172 | 31.1 |

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

* Denotes % of total revenue

*Revenue*

**Product revenue** decreased primarily due to a $240.8 million decrease in sales of our optical service delivery products. Lower optical service delivery revenue reflects decreases of $108.2 million in sales of core switching products, $100.7 million in sales of core transport products, and $41.1 million in sales of legacy data networking

and metro transport products. These decreases were partially offset by a $9.2 million increase in sales of CN 4200. Our revenue was also affected by a $2.4 million decrease in revenue from our carrier Ethernet service delivery products. Lower carrier Ethernet service delivery revenue reflects a decrease of $12.3 million in sales of our broadband access products, partially offset by a $9.8 million increase in sales of our carrier Ethernet switching and aggregation products.

**Services revenue** decreased due to a $7.9 million decrease in deployment services, partially offset by a $4.6 million increase in maintenance and support services.

**United States revenue** decreased primarily due to a $192.9 million decrease in sales of our optical service delivery products. Lower optical service delivery revenue reflects decreases of $90.9 million in sales of core switching products, $87.5 million in sales of core transport products, and $20.8 million in sales of legacy data networking and metro transport products. This decrease was partially offset by a $6.2 million increase in sales of CN 4200. Our revenue was also affected by a $6.2 million decrease in revenue from our carrier Ethernet service delivery products. Lower carrier Ethernet service delivery revenue reflects a decrease of $12.3 million in sales of our broadband access products, partially offset by a $6.3 million increase in sales of our carrier Ethernet switching and aggregation products.

**International revenue** decreased primarily due to a $47.9 million decrease in sales of our optical service delivery products. This primarily reflects decreases of $20.3 million in sales of legacy data networking and metro transport products, $17.3 million in sales of core switching products, and $13.2 million in sales of core transport products. This decrease was partially offset by a $3.0 million increase in sales of CN 4200 and a $3.5 million increase in revenue from our carrier Ethernet service delivery products, primarily related to sales of our carrier Ethernet switching and aggregation products.

*Gross profit*

**Gross profit as a percentage of revenue** decreased due to less favorable product and geographic mix, including fewer sales of core switching products as a percentage of total revenue, increased charges related to losses on committed customer sales contracts and higher charges relating to warranty. Gross profit as a percentage of revenue for fiscal 2008 reflects a $5.3 million increase in product cost of goods sold related to the revaluation of the acquired WWP inventory due to purchase accounting rules.

**Gross profit on products as a percentage of product revenue** decreased due to less favorable product and geographic mix, including fewer sales of core switching products as a percentage of total revenue, increased charges related to losses on committed customer sales contracts and higher charges relating to warranty. Gross profit as a percentage of revenue for fiscal 2008 reflects a $5.3 million increase in product cost of goods sold related to the revaluation of the acquired WWP inventory due to purchase accounting rules.

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

*Operating expense*

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

| | Nine Months Ended July 31, | | | | Increase | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Research and development | $ 127,881 | 17.7 | $ 140,624 | 29.5 | $ 12,743 | 10.0 |
| Selling and marketing | 111,639 | 15.4 | 98,582 | 20.7 | (13,057) | (11.7) |
| General and administrative | 54,036 | 7.5 | 35,724 | 7.5 | (18,312) | (33.9) |
| Amortization of intangible assets | 23,901 | 3.3 | 18,852 | 4.0 | (5,049) | (21.1) |
| Restructuring cost | | 0.0 | 10,416 | 2.2 | 10,416 | 100.0 |
| Goodwill impairment | | 0.0 | 455,673 | 95.6 | 455,673 | 100.0 |
| Total operating expense | $ 317,457 | 43.9 | $ 759,871 | 159.5 | $ 442,414 | 139.4 |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

**Research and development expense** benefited by $5.2 million in favorable foreign exchange rates primarily due to the strengthening of the U.S. dollar. The resulting $12.7 million net increase reflects an increase in prototype expense of $8.1 million. Other increases include, $4.9 million in facilities and information systems expense, higher employee compensation cost of $3.7 million, including a $2.0 million increase in share-based compensation expense, primarily due to increased headcount, and $2.5 million in depreciation expense. These increases were partially offset by decreases of $4.4 million in consulting services expense and $1.5 million in technology related expenses.

**Selling and marketing expense** benefited by $3.0 million in favorable foreign exchange rates primarily due to the strengthening of the U.S. dollar. The resulting $13.1 million net change reflects decreases of $6.7 million in employee compensation cost, $2.7 million in travel-related costs, $2.0 million in consulting services expense and $1.5 million in marketing program costs. These decreases were partially offset by a $0.9 million increase in facilities and information systems expense.

**General and administrative expense** benefited by $0.5 million in favorable foreign exchange rates primarily due to the strengthening of the U.S. dollar. The resulting $18.3 million net change reflects decreases of $4.8 million in employee compensation cost, $3.2 million in consulting services expense, $1.7 million in facilities and information systems expense, and $0.6 million in technology-related expense. Expense for the first nine months of fiscal 2008 included $7.7 million associated with the settlement of patent litigation.

**Amortization of intangible assets costs** decreased due to certain intangible assets reaching their useful life and becoming fully amortized prior to the third quarter of fiscal 2009.

**Restructuring cost** was primarily related to the actions described in Overview Restructuring Activities above.

**Goodwill impairment** reflects the impairment described in Overview - Goodwill Impairment above.

*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 | |
|---|---|---|---|---|---|---|
| | 2008 | %* | 2009 | %* | (decrease) | %** |
| Interest and other income, net | $ 32,911 | 4.6 | $ 9,167 | 1.9 | $ (23,744) | (72.1) |
| Interest expense | $ 11,074 | 1.5 | $ 5,552 | 1.2 | $ (5,522) | (49.9) |
| Realized loss due to impairment of marketable debt investments | $ 5,114 | 0.7 | $ | | $ (5,114) | (100.0) |
| Loss on cost method investments | $ | | $ 5,328 | 1.1 | $ 5,328 | 100.0 |
| Provision for income taxes | $ 4,772 | 0.7 | $ 139 | | $ (4,633) | (97.1) |

* Denotes % of total revenue

** Denotes % change from 2008 to 2009

**Interest and other income, net** decreased due to lower interest rates and lower average cash and investment balances. Lower cash balances primarily relate to the repayment at maturity of the $542.3 million principal outstanding on our 3.75% convertible notes during the first quarter of fiscal 2008 and our use of $210.0 million in cash consideration and related expenses associated with our acquisition of WWP in the second quarter of fiscal 2008.

**Interest expense** decreased primarily due to the repayment of 3.75% convertible notes at maturity at the end of the first quarter of fiscal 2008.

**Realized loss due to impairment of marketable debt investments** reflects a loss related to commercial paper investments in SIV Portfolio plc (formerly known as Cheyne Finance plc) and Rhinebridge LLC, two structured investment vehicles (SIVs) that entered into receivership during the fourth quarter of fiscal 2007 and failed to make payment at maturity. This loss is based on the completed restructuring activities of these SIVs.

**Loss on cost method investments** for the first nine months of fiscal 2009 was due to the decline in value of our investments in two privately held technology companies that were determined to be other-than-temporary. See Note 7 to our Consolidated Financial Statements in Item 1 of Part I of this report.

**Provision for income taxes** decreased primarily due to decreased federal and state tax expense, and refundable federal tax credits.

**Liquidity and Capital Resources**

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

| | October 31, 2008 | July 31, 2009 | Increase (decrease) |
|---|---|---|---|
| Cash and cash equivalents | $ 550,669 | $ 455,732 | $ (94,937) |
| Short-term investments | 366,336 | 607,094 | 240,758 |

| | | | |
|---|---|---|---|
| Long-term investments | 156,171 | | (156,171) |
| Total cash and cash equivalents and investments | $ 1,073,176 | $ 1,062,826 | $ (10,350) |

The decrease in total cash and cash equivalents, and investments during the first nine months of fiscal 2009 was primarily related to the purchase of capital assets, slightly offset by cash generated from operating activities described in Operating Activities below. Based on past performance and current expectations, we believe that our cash and cash equivalents, investments and cash generated from operations will satisfy our working capital needs, capital expenditures, and other liquidity requirements associated with our existing operations through at least the next 12 months.

The following sections review the significant activities that had an impact on our cash during the first nine months of fiscal 2009.

***Operating Activities***

The following tables set forth (in thousands) components of our $5.5 million of cash generated from operating activities during the period:

*Net loss*

| | Nine Months Ended July 31, 2009 |
|---|---|
| Net loss | $ (554,495) |

Our net loss during the first nine months of fiscal 2009 included the significant non-cash items summarized in the following table (in thousands):

| | Nine Months Ended July 31, 2009 |
|---|---|
| Loss on cost method investments | $ 5,328 |
| Depreciation of equipment, furniture and fixtures; and amortization of leasehold improvements | 16,270 |
| Goodwill impairment | 455,673 |
| Share-based compensation costs | 26,075 |
| Amortization of intangible assets | 23,804 |
| Provision for inventory excess and obsolescence | 11,126 |
| Provision for warranty | 13,620 |
| Total significant non-cash charges | $ 551,896 |

*Accounts Receivable, Net*

Cash provided by accounts receivable, net of allowance for doubtful accounts, during the first nine months of fiscal 2009 was $18.1 million. Our days sales outstanding (DSOs) increased from 52 days for the first nine months of fiscal 2008 to 68 days for the first nine months of fiscal 2009. Our DSOs increased due to a proportionately higher volume of shipments made later in the third quarter of fiscal 2009 and a higher incidence of customer payment delays.

The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2008 through the end of the third quarter of fiscal 2009:

| | October 31, 2008 | July 31, 2009 | Increase (decrease) |
|---|---|---|---|
| Accounts receivable, net | $ 138,441 | $ 120,271 | $ (18,170) |

*Inventory*

Cash consumed by inventory during the first nine months of fiscal 2009 was $7.3 million. Our inventory turns decreased from 3.7 turns during the first nine months of fiscal 2008 to 3.2 turns for the first nine months of fiscal 2009.

During the first nine months of fiscal 2009, changes in inventory reflect an $11.1 million reduction related to a non-cash provision for excess and obsolescence. The following table sets forth (in thousands) changes to the components of our inventory from the end of fiscal 2008 through the end of the third quarter of fiscal 2009:

| | October 31, 2008 | July 31, 2009 | Increase (decrease) |
|---|---|---|---|
| Raw materials | $ 19,044 | $ 20,202 | $ 1,158 |
| Work-in-process | 1,702 | 755 | (947) |
| Finished goods | 95,963 | 90,189 | (5,774) |
| Gross inventory | 116,709 | 111,146 | (5,563) |
| Provision for inventory excess and obsolescence | (23,257) | (21,546) | 1,711 |
| Inventory | $ 93,452 | $ 89,600 | $ (3,852) |

*Accounts payable, accruals and other obligations*

Cash used in operations to pay accounts payable, accruals and other obligations during the first nine months of fiscal 2009 was $5.8 million.

During the first nine months of fiscal 2009, we had non-operating cash accounts payable reductions of $1.1 million related to equipment payments. Changes in accrued liabilities reflect non-cash provisions of $13.6 million related to warranties. The following table sets forth (in thousands) changes in our accounts payable, accruals and other obligations from the end of fiscal 2008 through the end of the third quarter of fiscal 2009:

| | October 31, 2008 | July 31, 2009 | Increase (decrease) |
|---|---|---|---|
| Accounts payable | $ 44,761 | $ 52,337 | $ 7,576 |
| Accrued liabilities | 96,143 | 89,571 | (6,572) |
| Restructuring liabilities | 4,225 | 9,487 | 5,262 |
| Other long-term obligations | 8,089 | 9,207 | 1,118 |
| Accounts payable, accruals and other obligations | $ 153,218 | $ 160,602 | $ 7,384 |

*Interest Payable on Convertible Notes*

Interest on our outstanding 0.25% convertible senior notes, due May 1, 2013, is payable on May 1 and November 1 of each year. We paid $0.4 million in interest on our 0.25% convertible notes during the first nine months of fiscal 2009.

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 our 0.875% convertible notes during the first nine months of fiscal 2009.

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

The following table reflects (in thousands) the balance of interest payable and the change in this balance from the end of fiscal 2008 through the end of the third quarter of fiscal 2009:

| | October 31, 2008 | July 31, 2009 | Increase (decrease) |
|---|---|---|---|
| Accrued interest payable | $ 1,683 | $ 765 | $ (918) |

*Deferred revenue*

Deferred revenue increased by $4.1 million during the first nine months of fiscal 2009. Product deferred revenue represents payments received in advance of shipment and payments received in advance of our ability to recognize revenue. Services deferred revenue is related to payment for service contracts that will be recognized over the contract term. The following table reflects (in thousands) the balance of deferred revenue and the change in this balance from the end of fiscal 2008 through the end of the third quarter of fiscal 2009:

| | October 31, 2008 | July 31, 2009 | Increase (decrease) |
|---|---|---|---|
| Products | $ 13,061 | $ 14,629 | $ 1,568 |
| Services | 61,366 | 63,871 | 2,505 |
| Total deferred revenue | $ 74,427 | $ 78,500 | $ 4,073 |

***Investing Activities***

During the first nine months of fiscal 2009, we had net sales and maturities of approximately $844.7 million of available for sale securities. Investing activities also included the purchase of approximately $17.6 million in equipment. At the end of the third quarter of fiscal 2009, we had outstanding accounts payable for equipment of $1.2 million, which represents a reduction of $1.1 million from the end of fiscal 2008.

**Contractual Obligations**

During the first nine months of fiscal 2009, we did not experience material changes, outside of the ordinary course of business, in our contractual obligations from those reported in our annual report on Form 10-K for the fiscal year ended October 31, 2008. The following is a summary of our future minimum payments under contractual obligations as of July 31, 2009 (in thousands):

| | Total | Less than one year | One to three years | Three to five years | Thereafter |
|---|---|---|---|---|---|
| Interest due on convertible notes | $ 37,980 | $ 5,120 | $ 10,240 | $ 9,495 | $ 13,125 |
| Principal due at maturity on convertible notes | 798,000 | | | 298,000 | 500,000 |
| Operating leases (1) | 66,453 | 14,586 | 24,474 | 15,893 | 11,500 |
| Purchase obligations (2) | 69,820 | 69,820 | | | |
| Total (3) | $ 972,253 | $ 89,526 | $ 34,714 | $ 323,388 | $ 524,625 |

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

(2) Purchase obligations

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

(3) As of July 31, 2009, we also had approximately $6.3 million of other long-term obligations in our condensed consolidated balance sheet for unrecognized tax positions that are not included in this table because the periods of cash settlement with the respective tax authority cannot be reasonably estimated.

Some of our commercial commitments, including some of the future minimum payments set forth above, are secured by standby letters of credit. The following is a summary of our commercial commitments secured by standby letters of credit by commitment expiration date as of July 31, 2009 (in thousands):

| | Total | Less than one year | One to three years | Three to five years | Thereafter |
|---|---|---|---|---|---|
| Standby letters of credit | $ 15,971 | $ 12,242 | $ 3,032 | $ 697 | $ |

**Off-Balance Sheet Arrangements**

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

**Critical Accounting Policies and Estimates**

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

other things, these estimates form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. To the extent that there are material differences between our estimates and actual results, our consolidated financial statements will be affected.

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 in accordance with SAB No. 104, Revenue Recognition, which states that revenue is realized or realizable and earned when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery. We assess whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. We assess collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer s payment history. In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are to be performed.

Some of our communications networking equipment is integrated with software that is essential to the functionality of the equipment. Accordingly, we account for revenue from such equipment in accordance with SOP No. 97-2, Software Revenue Recognition, and all related interpretations. SOP 97-2 incorporates additional guidance unique to software arrangements incorporated with general accounting guidance, such as: revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. In instances where final acceptance of the product is specified by the customer, revenue is deferred until all acceptance criteria have been met.

Arrangements with customers may include multiple deliverables, including any combination of equipment, services and software. If multiple element arrangements include software or software-related elements that are essential to the equipment, we apply the provisions of SOP 97-2 to determine the amount of the arrangement fee to be allocated to those separate units of accounting. Multiple element arrangements that include software are separated into more than one unit of accounting if the functionality of the delivered element(s) is not dependent on the undelivered element(s), there is vendor-specific objective evidence of the fair value of the undelivered element(s), and general revenue recognition criteria related to the delivered element(s) have been met. The amount of product and services revenue recognized is affected by our judgments as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence of fair value exists. Changes to the elements in an arrangement and our ability to establish vendor-specific objective evidence for those elements could affect the timing of revenue recognition. For all other deliverables, we apply the provisions of EITF 00-21, Revenue Arrangements with Multiple Deliverables. EITF 00-21 allows for separation of elements into more than one unit of accounting if the delivered element(s) have value to the customer on a stand-alone basis, objective and reliable evidence of fair value exists for the undelivered element(s), and delivery of the undelivered element(s) is probable and substantially within our control. Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or using the residual method if objective evidence of fair value does not exist for the delivered element(s). The revenue recognition criteria described above are applied to each separate unit of accounting. If these criteria are not met, revenue is deferred until the criteria are met or the last element has been delivered.

Our total deferred revenue for products was $13.1 million and $14.6 million as of October 31, 2008 and July 31, 2009, 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 $61.4 million and $63.9 million as of October 31, 2008 and July 31, 2009, respectively.

***Share-Based Compensation***

We recognize share-based compensation expense in accordance with SFAS 123(R), Share-Based Payments, as interpreted by SAB 107. SFAS 123(R) requires the measurement and recognition of compensation expense for share-based awards based on estimated fair values on the date of grant. We estimate the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This option pricing model requires that we make several estimates, including the option s expected term and the price volatility of the underlying stock. The expected term of employee stock options represents the weighted-average period the stock options are expected to remain outstanding. As prescribed by SAB

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

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. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the measure of estimated fair value of our share-based compensation. See Note 16 to our Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to share-based compensation and the amount of share-based compensation expense we incurred for the periods covered in this report. As of July 31, 2009, total unrecognized compensation expense was: (i) $13.8 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 1.1 years; and (ii) $48.3 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.3 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.

***Reserve for Inventory Obsolescence***

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. Upon recognition of the write down, a new lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. We recorded charges for excess and obsolete inventory of $13.8 million and $11.1 million in the first nine months of fiscal 2008

and 2009, respectively. These charges were primarily related to excess inventory due to a change in forecasted product sales. In an effort to limit our exposure to delivery delays and to satisfy customer needs we purchase inventory based on forecasted sales across our product lines. In addition, part of our research and development strategy is to promote the convergence of similar features and functionalities across our product lines. Each of these practices exposes us to the risk that our customers will not order products for which we have forecasted sales, or will purchase less than we have forecasted. Historically, we have experienced write downs due to changes in strategic direction, discontinuance of a product and declines in market conditions. If actual market conditions worsen or differ from those we have assumed, if there is a sudden and significant decrease in demand for our products, or if there is a higher incidence of inventory obsolescence due to a rapid change in technology, we may be required to take additional inventory write-downs, and our gross margin could be adversely affected. Our inventory net of allowance for excess and obsolescence was $93.5 million and $89.6 as of October 31, 2008 and July 31, 2009, respectively.

***Restructuring***

As part of our restructuring costs, we provide for the estimated cost of the net lease expense for facilities that are no longer being used. The provision is equal to the fair value of the minimum future lease payments under our contracted lease obligations, offset by the fair value of the estimated sublease payments that we may receive. As of July 31, 2009, our accrued restructuring liability related to net lease expense and other related charges was $9.2 million. The total minimum lease payments for these restructured facilities are $15.3 million. These lease payments will be made over the remaining lives of our leases, which range from nine months to ten years. If actual market conditions are different than those we have projected, we will be required to recognize additional restructuring costs or benefits associated with these facilities.

***Allowance for Doubtful Accounts***

Our allowance for doubtful accounts 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, management considers each individual customer account receivable in order to determine collectibility. In doing so, we consider creditworthiness, payment history, account activity and communication with such customer. If a customer s financial condition changes, or if actual defaults are higher than our historical experience, we may be required to take a charge for an allowance for doubtful accounts which could have an adverse impact on our results of operations. Our accounts receivable net of allowance for doubtful accounts was $138.4 million and $120.3 million as of October 31, 2008 and July 31, 2009, respectively. Our allowance for doubtful accounts as of October 31, 2008 and July 31, 2009 was $0.1 million.

***Goodwill***

As discussed in Overview above, during the second quarter of fiscal 2009, we conducted an interim impairment assessment which resulted in the write-off of all goodwill remaining on our balance sheet. As a result, as of October 31, 2008 and July 31, 2009, our consolidated balance sheet included $455.7 million and $0 in goodwill, respectively.

Goodwill represents the excess purchase price over amounts assigned to tangible or identifiable intangible assets acquired and liabilities assumed from our acquisitions. In accordance with SFAS 142, we test our goodwill for impairment on an annual basis, which we have determined to be the last business day of fiscal September each year. We also test our goodwill for impairment between annual tests if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. SFAS 142 requires a two-step method for determining goodwill impairment. Step one is to compare the fair value of the reporting unit with the unit s carrying amount, including goodwill. If this test indicates that the fair value is less than the carrying value, then step two is required to compare the implied fair value of the reporting unit s goodwill with the carrying amount of the reporting unit s goodwill. A non-cash goodwill impairment charge 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.

We determine the fair value of our single reporting unit to be equal to our market capitalization plus a control premium. Market capitalization is determined by multiplying the shares outstanding on the assessment date by the average market price of our common stock over a 10-day period before and a 10-day period after each assessment date. We use this 20-day duration to consider inherent market fluctuations that may affect any individual closing price. We believe that our market capitalization alone does not fully capture the fair value of our business as a whole, or the substantial value that an acquirer would obtain from its ability to obtain control of our business. As such, in determining fair value, we add a control premium which seeks to give effect to the increased consideration a potential acquirer would be required to pay in order to gain sufficient ownership to set policies, direct operations and make decisions related to our company to our market capitalization.

*Interim Impairment Assessment Second Quarter of Fiscal 2009*

Based on a combination of factors, including the macroeconomic conditions described above and a sustained decline in our common stock price and market capitalization below our net book value, we conducted an interim impairment assessment of goodwill during the second quarter of fiscal 2009. We performed the step one fair value

comparison during the second quarter of fiscal 2009. Our market capitalization was $721.8 million and our carrying value, including goodwill, was $949.0 million. We applied a 25% control premium to market capitalization to determine a fair value of $902.2 million. Because step one indicated that the fair value was less than our carrying value, we performed the step two analysis. Under

the step two analysis, the implied fair value of goodwill requires valuation of a reporting unit s tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. The implied fair value of the reporting unit s goodwill was determined to be $0, and, as a result, we recorded a goodwill impairment of $455.7 million, representing the full carrying value of the goodwill.

***Long-lived Assets (excluding goodwill)***

Our long-lived assets, excluding goodwill, include: equipment, furniture and fixtures; finite-lived intangible assets; and maintenance spares. As of October 31, 2008 and July 31, 2009 these assets totaled $182.3 million and $160.7 million, net, respectively. We account for the impairment or disposal of these long-lived assets in accordance with the provisions of SFAS 144. In accordance with SFAS 144, we test long-lived assets for impairment whenever events or changes in circumstances indicate that the assets carrying amount is not recoverable from its undiscounted cash flows. Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products that involve new technologies and uncertainties around customer acceptance of new products. These and other assumptions are used to forecast future, undiscounted cash flows. Our long-lived assets are part of a single reporting unit which represents the lowest level for which we identify cash flows.

Due to effects on our business of difficult macroeconomic conditions, further exacerbated by significant disruptions in the financial and credit markets globally, we have experienced lengthening sales cycles and slowing deployments resulting in lower demand. As a result of these conditions, we performed an impairment analysis of all our long-lived assets during the second quarter of fiscal 2009. Based on our estimate of future, undiscounted cash flows as of April 30, 2009, no impairment was required. If actual market conditions differ or our forecasts change, we may be required to record a non-cash impairment charge related to long-lived assets in future periods. Such charges would have the effect of decreasing our earnings or increasing our losses in such period.

***Investments***

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

As of July 31, 2009, we held a minority investment of $0.9 million in a privately held technology company that is reported in other assets. The market for technologies or products manufactured by this company is in the early stage and markets may never materialize or become significant. This investment is inherently high risk and we could lose our entire investment. We monitor this investment for impairment and make appropriate reductions in carrying value when necessary. If market conditions, the expected financial performance, or the competitive position of this company deteriorates, we may be required to record a non-cash charge in future periods due to an impairment of the value of our investment.

During the first nine months of fiscal 2009, we recorded losses of $5.3 million related to a decline in value, determined to be other-than temporary, associated with two of our investments in privately held technology companies. One of the privately held companies was purchased by a publicly traded entity. As a result, this investment is now recorded as a trading security.

***Deferred Tax Valuation Allowance***

As of July 31, 2009, we have recorded a valuation allowance fully offsetting our net deferred tax assets of $1.2 billion. We calculated the valuation allowance in accordance with the provisions of SFAS 109, Accounting for Income Taxes, which requires an assessment of both positive and negative evidence regarding the realizability of

these deferred tax assets, when measuring the need for a valuation allowance. 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 carry forwards, 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 its reversal. Due to our recent quarterly losses, the uncertain macroeconomic environment, and limited visibility into our future results, management does not believe such sufficient positive evidence exists as of July 31, 2009 and determined to maintain 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 release of valuation allowance may be recorded as a tax benefit increasing net income, an adjustment to acquisition intangibles, or an adjustment to paid-in capital, based on tax ordering requirements.

***Warranty***

Our liability for product warranties, included in other accrued liabilities, was $37.3 million and $39.4 million as of October 31, 2008 and July 31, 2009, respectively. We provide warranties for our products 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 $11.2 million and $13.6 million for the first nine months of fiscal 2008 and 2009, respectively. The provision for warranty claims may fluctuate on a quarterly basis depending upon the mix of products and customers in that period. If actual product failure rates, material replacement costs, service or labor costs differ from our estimates, revisions to the estimated warranty provision would be required. An increase in warranty claims or the related costs associated with satisfying these warranty obligations could increase our cost of sales and negatively affect our gross margin.

***Uncertain Tax Positions***

Effective at the beginning of the first quarter of 2008, we adopted FIN 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109, which changes accounting for income taxes. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, Accounting for Income Taxes. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the effect of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

***Loss Contingencies***

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

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

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

*Interest Rate Sensitivity.* We maintain a short-term and long-term investment portfolio. See Notes 6 and 7 to the Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information relating to these investments and their fair value. These available-for-sale securities are subject to interest rate risk and will fall in

value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10 percentage points from current levels, the fair value of the portfolio would decline by approximately $17.8 million.

*Foreign Currency Exchange Risk.* As a global concern, we face exposure to adverse movements in foreign currency exchange rates. Because our sales are primarily denominated in U.S. dollars, the impact of foreign currency fluctuations on revenue has not been material. Our primary exposures to foreign currency exchange risk are related to non-U.S. dollar denominated operating expense in Canadian Dollars ( CAD ), British Pounds ( GBP ), Euros ( EUR ) and Indian Rupees ( INR ). During the first nine months of fiscal 2009, approximately 80% of our operating expense, exclusive of our goodwill impairment and restructuring costs, was U.S. dollar denominated.

To reduce variability in non-U.S. dollar denominated operating expense, during the first quarter of fiscal 2009, we entered into foreign currency forward contracts. We use these derivatives to partially offset our market exposure to fluctuations in certain foreign currencies. We do not enter into derivatives for speculative or trading purposes. These derivatives are designated as cash flow hedges and have maturities of less than one year. The effective portion of the derivative s gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and, upon occurrence of the forecasted transaction, is subsequently reclassified into the operating expense line item to which the hedged transaction relates. We record the ineffectiveness of the hedging instruments in interest and other income, net on our condensed consolidated statements of operations. As of July 31, 2009, we recorded a gain of $1.5 million associated with these derivatives, all of which was reported as a component of accumulated other comprehensive income (loss).

Favorable foreign exchange translations, net of hedging, benefited total research and development, sales and marketing, and general and administrative expenses by approximately $4.3 million and $8.9 million for the quarter and nine months ending July 31, 2009, respectively, compared with the corresponding periods of fiscal 2008. This favorable foreign exchange translation was due to the strengthening of the U.S. dollar. These foreign currency forward contracts are not designed to provide foreign currency protection over the long-term. In designing a specific approach, we consider several factors, including offsetting exposures, significance of exposures, costs associated with entering into a particular instrument, and potential effectiveness.

Our foreign currency forward contracts are summarized as follows (in thousands):

| | | Expected maturity or transaction date | | | | |
|---|---|---|---|---|---|---|
| | Total | Less than one year | One to three years | Three to five years | Thereafter | Fair Value |
| USD Functional Currency: | | | | | | |
| Receive EUR / Pay USD | | | | | | |
| Notional amount | $ 10,840 | $ 10,840 | $ | $ | $ | $ 268 |
| Weighted avg. contract exchange rate | 1.3909 | | | | | |
| Receive INR / Pay USD | | | | | | |
| Notional amount | $ 4,071 | $ 4,071 | $ | $ | $ | $ 28 |
| Weighted avg. contract exchange rate | 0.0205 | | | | | |
| Receive CAD / Pay USD | | | | | | |
| Notional amount | $ 3,800 | $ 3,800 | $ | $ | $ | $ 464 |
| Weighted avg. contract exchange rate | 0.8258 | | | | | |
| EUR Functional Currency: | | | | | | |

| | | | |
|---|---|---|---|
| Receive GBP / Pay EUR | | | |
| Notional amount | 6,243 | 6,243 | $ 727(1) |
| Weighted avg. contract exchange rate | 1.0820 | | |
| Total fair value | | | $ 1,487(2) |

(1) Fair value translated at exchange rates in effect as of the balance sheet date.

(2) Amount is included within prepaid expenses and other on the condensed consolidated balance sheet.

As of July 31, 2009, our assets and liabilities related to non-dollar denominated currencies were primarily related to intercompany payables and receivables. We do not enter into foreign exchange forward or option contracts for trading purposes.

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

**Disclosure Controls and Procedures**

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

**Changes in Internal Control over Financial Reporting**

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

**PART II OTHER INFORMATION**

***Item 1. Legal Proceedings***

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

As a result of our June 2002 merger with ONI Systems Corp., we became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI s initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI s registration statement and by engaging in manipulative practices to artificially inflate ONI s stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and all of these actions have been included in a single coordinated proceeding. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena s Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 23, 2008. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation, the ultimate outcome of the matter is uncertain.

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

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

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

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

We achieved considerable annual revenue growth over the last few fiscal years, in part due to favorable conditions in our markets. Starting in the second half of fiscal 2008, however, our business began to experience the effects of worsening macroeconomic conditions and significant disruptions in the financial and credit markets globally. Many companies, including some of our largest communications service provider customers, have slowed spending and indicated an intention to reduce their overall capital expenditures this year. We have experienced lengthening sales cycles, customer delays in network buildouts and slowing deployments, resulting in lower demand across our customer base in all geographies. As a result, our revenue and profitability have been negatively affected. Continued weakness in our markets and the broader economy may cause our customers to delay or cancel network infrastructure

projects.

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

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

increased competition for fewer network projects and sales opportunities;

pricing pressure that may adversely affect revenue and gross margin;

higher overhead costs as a percentage of revenue;

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

customer financial difficulty and increased risk of doubtful accounts receivable.

Our business and financial results are closely tied to the prospects, performance, and financial condition of our largest communications service provider customers and are significantly affected by market or industry-wide changes, including reductions in enterprise and consumer spending, that affect their businesses and their level of infrastructure-related spending. We are uncertain as to how long current unfavorable macroeconomic and industry conditions will persist and the magnitude of their effects on our business and results of operations. As a result of these market conditions, we expect revenue for fiscal 2009 to be significantly lower than our fiscal 2008 results and that we will not be profitable for the year. The extent of this year s revenue decline and the magnitude of the effect on our result of operations for fiscal 2009 are difficult to predict and significantly linked to the duration and severity of the current economic downturn and the resulting level of capital expenditure of our largest customers.

**A small number of 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 relatively small number of communications service providers. Five customers accounted for greater than 60% of our revenue in each of fiscal 2007 and 2008. Consequently, our financial results are closely correlated with the spending of a relatively small number of communications service providers. The terms of our frame contracts generally do not obligate these customers to purchase any minimum or specific amounts of equipment or services. Because their spending may be unpredictable and sporadic, our revenue and operating results can fluctuate on a quarterly basis. Reliance upon a relatively small number of customers increases our exposure to changes in their network and purchasing strategies. Some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce the number of vendors from which they purchase equipment. These strategies may present challenges to our business and could benefit our larger competitors. Our concentration in revenue has increased in recent years, in part, as a result of consolidations among a number of our largest customers. Consolidations may increase the likelihood of temporary or indefinite reductions in customer spending or changes in network strategy that could harm our business and operating results. The loss of one or more large service providers as customers, or significant reductions in their spending, would have a material adverse effect on our business, financial condition and results of operations.

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

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

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

broader economic and market conditions affecting us and our customers;

changes in capital spending by large communications service providers;

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

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

the level of pricing pressure we encounter.

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

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

The markets in which we compete for sales of networking equipment, software and services are extremely competitive, particularly the market for sales to large communications service providers. The level of competition and pricing pressure that we face increases substantially during periods of macroeconomic weakness, constrained spending or fewer network projects. As a result of current market conditions, we have experienced significant competition and increased pricing pressure, particularly for our optical transport products. We face particularly intense competition in our efforts to attract additional large carrier customers in new geographies and secure new market opportunities with existing carrier customers. In an effort to secure these new opportunities or displace incumbent equipment vendors, we have, at times, entered into contracts with customers that result in negative gross margins.

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

We also compete with a number of smaller companies that provide significant competition for a specific product, application, customer segment or geographic market. Due to the narrower focus of their efforts, these competitors may achieve commercial availability of their products more quickly or may be more attractive to customers.

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

significant price competition, particularly from competitors in Asia;

customer financing assistance;

early announcements of competing products and extensive marketing efforts;

competitors offering equity ownership positions to customers;

competitors offering to repurchase our equipment from existing customers;

marketing and advertising assistance; and

intellectual property assertions and disputes.

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

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

We rely upon third party contract manufacturers to perform the majority of the manufacturing of our products and components. In recent years we have transitioned a significant portion of our product manufacturing to overseas suppliers in Asia, with much of the manufacturing taking place in China and Thailand. Some of our contract manufacturers ship products

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

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

We depend on third party suppliers for our product components and subsystems, as well as for equipment used to manufacture and test our products. Our products include key optical and electronic components for which reliable, high-volume supply is often available from sole or limited sources. We have previously encountered shortages in availability for important components that have affected our ability to deliver products in a timely manner. Our business would be negatively affected if one or more of our suppliers were to experience any significant disruption in their operations affecting the price, quality, availability or timely delivery of components. Current unfavorable economic conditions, including a lack of liquidity, may adversely affect the business of our suppliers or the terms on which we purchase components. We may be unable to secure the components or subsystems that we require in sufficient quantity and quality on reasonable terms. The loss of a source of supply, or lack of sufficient availability of key components, could require us to redesign products that use those components, which would increase our costs and negatively affect our product gross margin and results of operations. Difficulties with suppliers could also result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships.

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

The market for communications networking equipment is characterized by rapidly evolving technologies and changes in market demand. We continually invest in research and development to enhance our existing products, create new products and develop or acquire new technologies. Our current development efforts are focused upon the evolution of our CoreDirector Multiservice Optical Switch family, the expansion of our carrier Ethernet service delivery and aggregation products, and the extension of our CN 4200 converged optical service delivery portfolio, including 100G technologies and capabilities. There is often a lengthy period between commencing these development initiatives and bringing a new or revised product to market. During this time, technology preferences, customer demand and the market for our products may move in directions we had not anticipated. There is no guarantee that new products or enhancements will achieve market acceptance or that the timing of market adoption will be as predicted. There is a significant possibility, therefore, that some of our development decisions, including our acquisitions or investments in technologies, will not turn out as anticipated, and that our investment in some projects will be unprofitable. There is also a possibility that we may miss a market opportunity because we failed to invest, or invested too late, in a technology, product or enhancement. Changes in market demand or investment priorities may also cause us to discontinue existing or planned development for new products or features, which can have a disruptive effect on our relationships with customers. If we fail to make the right investments or fail to make them at the right time, our competitive position may suffer and our revenue and profitability could be harmed.

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

Our future success will depend in large part on our ability to maintain and expand our sales to large communications service providers. These sales typically involve lengthy sales cycles, protracted and sometimes difficult contract negotiations, and extensive product testing and network certification. We are sometimes required to agree to contract terms or conditions that negatively affect pricing, payment terms and the timing of revenue recognition in order to consummate a sale. As a result of current market conditions, these customers may request extended payment terms, vendor or third-party financing and other alternative purchase structures. These terms may, in turn, negatively affect our revenue and results of operations and increase our susceptibility to quarterly fluctuations in our results. Service providers may ultimately insist upon terms and conditions

that we deem too onerous or not in our best interest. Moreover, our purchase agreements generally do not require that a customer guarantee any minimum purchase level and customers often have the right to modify, delay, reduce or cancel previous orders. As a result, we may incur substantial expense and devote time and resources to potential relationships that never materialize or result in lower than anticipated sales.

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

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

increased costs to address or remediate software or hardware defects;

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

increased inventory obsolescence and warranty expense;

delays in collecting accounts receivable; and

cancellation or reduction in orders from customers.

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

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

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

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

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

Our products are based on complex technology, and we can experience unanticipated delays in developing, manufacturing or deploying them. Each step in the development life cycle of our products presents serious risks of failure, rework or delay, any one of which could affect the cost-effective and timely development of our products. Intellectual property disputes, failure of critical design elements, and other execution risks may delay or even prevent the release of these products. Delays in product development may affect our reputation with customers and the timing

and level of demand for our products. If we do not develop and successfully introduce products in a timely manner, our competitive position may suffer and our business, financial condition and results of operations would be harmed.

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

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

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

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

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

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

we may suffer delays in recognizing revenue;

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

our relationship with customers could suffer.

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

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

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

From time to time we have been subject to litigation and other third party intellectual property claims, primarily alleging patent infringement. We have also been subject to third party claims arising as a result of our indemnification obligations to customers or resellers that purchase our products or as a result of alleged infringement relating to third

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

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

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

International operations are subject to inherent risks, including:

effects of changes in currency exchange rates;

greater difficulty in collecting accounts receivable and longer collection periods;

difficulties and costs of staffing and managing foreign operations;

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

less protection for intellectual property rights in some countries;

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

social, political and economic instability;

higher incidence of corruption;

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

natural disasters, epidemics and acts of war or terrorism.

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

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

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

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

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

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

fluctuations in currency exchange rates and tax compliance in India.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- significant integration costs;
- integration and rationalization of operations, products, technologies and personnel;
- diversion of management s attention;
- difficulty completing projects of the acquired company and costs related to in-process projects;
- the loss of key employees;
- ineffective internal controls over financial reporting;
- dependence on unfamiliar suppliers or manufacturers;
- exposure to unanticipated liabilities, including intellectual property infringement claims; and
- adverse tax or accounting effects including amortization expense related to intangible assets and charges associated with impairment of goodwill;

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

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

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

**Governmental regulations affecting the import or export of products, and environmental regulations relating to our products, could negatively affect our revenues.**

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

addition, our operations 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 building and selling our products, make it difficult to obtain supply of compliant components or require us to write off non-compliant inventory, which could have a material adverse effect on our business and operating results.

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

At July 31, 2009, we had $160.7 million in long-lived assets, which includes $68.4 million of intangible assets on our balance sheet. Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products. Our assumptions are used to forecast future, undiscounted cash flows. Given the current economic environment, uncertainties regarding the duration and severity of these conditions, forecasting future business is difficult and subject to modification. If actual market conditions differ or our forecasts change, we may be required to assess long-lived assets and could record an impairment charge. Any impairment charge relating to long-lived assets would have the effect of decreasing our earnings or increasing our losses in such period. If we are required to take a substantial impairment charge, our operating results could be materially adversely affected in such period.

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

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we include in our annual report a report containing management s assessment of the effectiveness of our internal controls over financial reporting as of the end of our fiscal year and a statement as to whether or not such internal controls are effective. Compliance with these requirements has resulted in, and is likely to continue to result in, significant costs and the commitment of time and operational resources. Changes in our business will necessitate ongoing modifications to our internal control systems, processes and information systems. Increases in our global operations or expansion into new regions could pose additional challenges to our internal control systems as these operations become more significant. We cannot be certain that our current design for internal control over financial reporting will be sufficient to enable management or our independent registered public accounting firm to determine that our internal controls are effective for any period, or on an ongoing basis. If we or our independent registered public accounting firms are unable to assert that our internal controls over financial reporting are effective, our business may be harmed. Market perception of our financial condition and the trading price of our stock may be adversely affected, and customer perception of our business may suffer.

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

At July 31, 2009, indebtedness on our outstanding convertible notes totaled $798.0 million in aggregate principal. Our indebtedness and repayment obligations could have important negative consequences, including:

- increasing our vulnerability to adverse economic and industry conditions;
- limiting our ability to obtain additional financing, particularly in light of unfavorable conditions in the credit markets;
- reducing the availability of cash resources for other purposes, including capital expenditures;
- limiting our flexibility in planning for, or reacting to, changes in our business and the markets in which we compete; and
- placing us at a possible competitive disadvantage to competitors that have better access to capital resources.

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

**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. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, with such volatility often unrelated to the operating performance of these companies. Divergence between our

actual or anticipated financial results and published expectations of analysts can cause significant swings in our stock price. Our stock price can also be affected by announcements that we, our competitors, or our customers may make, particularly announcements related to acquisitions or other significant transactions. Our common stock is included in a number of widely-followed market indices, including the S&P 500 Index, and any change in the composition of these indices to exclude our company would adversely affect our stock price. These factors, as well as conditions affecting the general economy or financial markets, may materially adversely affect the market price of our common stock in the future.

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

Not applicable.

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

Not applicable.

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

Not applicable

***Item 5. Other Information***

Not applicable.

***Item 6. Exhibits***

| Exhibit | Description |
|---|---|
| 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 |

**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 3, 2009

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

Date: September 3, 2009

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