FINISAR CORP
Form 10-Q/A
February 10, 2005

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q/A
Amendment No. 1

(Mark One)

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the Quarterly Period Ended October 31, 2004** **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 000-27999

Finisar Corporation
(Exact name of Registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**94-3038428** *(I.R.S. Employer Identification No.)*
1308 Moffett Park Drive **Sunnyvale, California** *(Address of principal executive offices)*	**94089** *(Zip Code)*

Registrant s telephone number, including area code:
408-548-1000

Common Stock, $.001 par value
(Title of Class)

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

At November 30, 2004, there were 223,671,196 shares of the registrant s common stock, $.001 par value, issued and outstanding.

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Explanatory Note

We are filing this Amendment No. 1 to our Quarterly Report on Form 10-Q for the period ended October 31, 2004 to restate and amend portions of our original Quarterly Report for this period (the Original Report). This Amendment No. 1 amends and restates the following items from the Original Report: (i)Part I, Item I Financial Statements, (ii) Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations, and (iii) Part I, Item 4 Controls and Procedures. The disclosures set forth in these items in the Original Report, that are amended by this Amendment No. 1 include:

the restatement of our financial results for the three and six months ended October 31, 2004 to reflect a $1.8 million reduction in cost of revenues related to certain intercompany transactions which overstated our consolidated cost of revenues for the three and six months ended October 31, 2004;

amendments to Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations, to reflect the restatement of our financial results; and

amendments to Part I, Item 4, Controls and Procedures, to describe changes in our disclosure controls and procedures and our internal controls over financial reporting to address a material weakness.

The restatement has no affect on our net cash used in operating activities or on our cash and cash equivalents or short-term investments or on the unaudited condensed consolidated statements of cash flows for the periods restated.

For convenience of reference, we have included in this Amendment No. 1 the items of the Original Report that are not affected by this Amendment. All information in this Amendment No. 1 speaks as of the date of the filing of the Original Report and does not reflect any subsequent information or events, except for the revisions to the items described above.

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For the Quarter Ended October 31, 2004

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FINISAR CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	October 31,2004 (As restated)	April 30, 2004
	(In thousands, except share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 29,377	$ 69,872
Short-term investments	74,870	73,526
Restricted investments	3,722	6,329
Accounts receivable, trade (net)	38,087	28,481
Accounts receivable, other	12,044	11,314
Inventories	38,306	34,717
Prepaid expenses	6,072	4,736
Deferred income taxes	285	2,045
Total current assets	202,763	231,020
Property, plant, equipment and improvements, net	104,000	107,736
Restricted investments, long-term	7,165	8,921
Purchased intangibles, net	41,612	47,961
Goodwill	67,069	60,620
Minority investments	24,434	24,227
Other assets	15,618	14,220
Total assets	$ 462,661	$ 494,705
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 28,360	$ 29,460
Accrued compensation	4,823	4,376
Other accrued liabilities	10,820	14,464
Non-cancelable purchase obligations	6,091	7,038
Income tax payable	577	790
Current portion of other long-term liabilities	2,000	2,000
Total current liabilities	52,671	58,128
Long-term liabilities:		
Convertible notes, net of unamortized portion of beneficial conversion feature of $18,628 and $20,757 at October 31, 2004 and April 30, 2004, respectively	247,892	229,493

Other long-term liabilities	149	2,194
Deferred income taxes	285	2,045
Total long-term liabilities	248,326	233,732
Commitments and contingent liabilities		
Stockholders equity:		
Common stock, $0.001 par value, 223,524,926 shares issued and outstanding at October 31, 2004 and 222,531,335 shares issued and outstanding at April 30, 2004	224	222
Additional paid-in capital	1,261,319	1,259,759
Notes receivable from stockholders		(481)
Deferred stock compensation	(41)	(162)
Accumulated other comprehensive income	677	710
Accumulated deficit	(1,100,515)	(1,057,203)
Total stockholders equity	161,664	202,845
Total liabilities and stockholders equity	$ 462,661	$ 494,705

See accompanying notes

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FINISAR CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
	(Unaudited, in thousands, except per share data)		(Unaudited, in thousands, except per share data)	
	(As restated)		(As restated)	
Revenues	$ 71,005	$ 42,776	$ 132,882	$ 82,207
Cost of revenues	49,499	32,041	95,203	68,503
Impairment of acquired developed technology	3,656		3,656	
Amortization of acquired developed technology	6,086	4,656	11,652	9,312
Gross profit	11,764	6,079	22,371	4,392
Operating expenses:				
Research and development	17,043	13,695	33,118	34,610
Sales and marketing	7,570	4,557	14,721	8,857
General and administrative	4,995	4,356	9,677	8,309
Amortization of deferred stock compensation	24	(49)	121	(353)
Aquired in-process research and development	318		318	
Amortization of purchased intangibles	170	143	313	286
Restructuring costs		187		2,372
Other acquisition costs		149		194
Total operating expenses	30,120	23,038	58,268	54,275
Loss from operations	(18,356)	(16,959)	(35,897)	(49,883)
Interest income	560	656	1,152	1,525
Interest expense	(3,552)	(15,682)	(6,915)	(22,059)
Other expense, net	192	(555)	(1,596)	(3,135)
Loss before income taxes	(21,156)	(32,540)	(43,256)	(73,552)
Provision for income taxes	37	33	56	246
Net loss	$ (21,193)	$ (32,573)	$ (43,312)	$ (73,798)
Loss per share basic and diluted	$ (0.09)	$ (0.15)	$ (0.19)	$ (0.35)
Shares used in loss per share calculation basic and diluted	223,380	215,826	223,155	211,357

See accompanying notes.

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FINISAR CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended October 31,	
	2004	2003
	(Unaudited, in thousands)	
	(As restated)	
Operating Activities:		
Net loss	$ (43,312)	$ (73,798)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	14,053	18,248
Amortization of deferred stock compensation	121	(353)
Aquired in-process research and development	318	
Amortization of purchased intangibles	313	286
Amortization of acquired developed technology	11,652	9,312
Amortization of beneficial conversion feature	2,129	8,088
Loss on conversion of convertible notes		10,763
Loss on sale of equipment	1,039	
Pro-rata share of losses in a minority investment (equity method)	793	473
Amortization of premium (discount) on restricted securities	(146)	(115)
Other than temporary decline in market value of marketable securities		528
Loss on retirement of assets	280	42
Impairment of minority investment		1,631
Impairment of goodwill and intangible assets	3,656	
Gain on debt extinguishment		(86)
Non-employee option expense	16	891
Other non-cash charges		823
Total non-cash adjustment in operating activities	34,224	50,531
Changes in operating assets and liabilities:		
Accounts receivable	(9,268)	(927)
Inventories	(3,454)	14,751
Other assets	(5,233)	(991)
Accounts payable	(1,100)	(5,454)
Accrued compensation	447	909
Other accrued liabilities	2,738	(1,315)
Total change in operating assets and liabilities	(15,870)	6,973
Net cash used in operating activities	(24,958)	(16,294)

Investing activities:		
Purchases of property, plant, equipment and improvements	(10,916)	(3,551)
Sale of property, plant, equipment and improvements	743	
Sale/(purchase) of short-term investments	(2,083)	8,422
Maturity of restricted securities	5,156	
Purchase of minority investments	(1,000)	1,684
Acquisition of product line assets	(6,168)	
Net cash (used in)/provided by investing activities	(14,268)	6,555
Financing activities:		
Payment received on stockholder note receivable	467	279
Payments on other long-term liabilities	(2,022)	
Proceeds from convertible debt offering net of issuance costs		130,903
Repurchase of convertible notes		(1,860)
Proceeds from exercise of stock options and stock purchase plan net of repurchase of unvested shares	286	3033
Net cash (used in)/provided by financing activities	(1,269)	132,355
Net (decrease)/increase in cash and cash equivalents	(40,495)	122,616
Cash and cash equivalents at beginning of period	69,872	40,918
Cash and cash equivalents at end of period	$ 29,377	$ 163,534
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 4,528	$ 2,762
Cash paid for taxes	$ 19	$ 239
Supplemental schedule of non-cash investing and financing activities:		
Issuance of common stock upon conversion of convertible notes	$	$ 33,513
Issuance of common stock on achievement of milestones	$ 256	$ 147

See accompanying notes.

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FINISAR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Summary of Significant Accounting Policies

Description of Business

Finisar Corporation was incorporated in the state of California on April 17, 1987. In November 1999, Finisar Corporation reincorporated in the state of Delaware. Finisar Corporation designs, manufactures, and markets fiber optic subsystems (primarily transceivers) and components and network test and monitoring systems for high-speed data communications.

Interim Financial Information and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements as of October 31, 2004, and for the three and six month periods ended October 31, 2004 and 2003, have been prepared in accordance with U.S generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission, and include the accounts of Finisar Corporation and its wholly-owned subsidiaries (collectively, Finisar or the Company). Intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company s financial position at October 31, 2004 and its operating results and cash flows for the six-month periods ended October 31, 2004 and 2003. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited financial statements and notes for the fiscal year ended April 30, 2004.

The balance sheet at April 30, 2004 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

Fiscal Periods

The Company maintains its financial records on the basis of a fiscal year ending on April 30, with fiscal quarters ending on the Sunday closest to the end of the period (thirteen-week periods). For ease of reference, all references to period end dates have been presented as though the period ended on the last day of the calendar month. The first three quarters of fiscal 2005 will end on August 1, 2004, October 31, 2004 and January 30, 2005, respectively. The first three quarters of fiscal 2004 ended on July 27, 2003, October 26, 2003 and January 25, 2004, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Revenue Recognition

The Company s revenue transactions consist predominately of sales of products to customers. The Company follows SEC Staff Accounting Bulletin (SAB) No. 104 *Revenue Recognition*. Specifically, the Company recognizes revenue when persuasive evidence of an arrangement exists, title and risk of loss have passed to the customer, generally upon shipment, the price is fixed or determinable and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, we invoice and charge for each separate element based on the list price for such element.

At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with sales, recorded as a component of cost of revenues. The Company s customers and distributors generally do not have return rights.

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However, the Company has established an allowance for estimated customer returns, based on historical experience, which is netted against revenue.

Segment Reporting

Statement of Financial Accounting Standards (SFAS) No. 131 *Disclosures about Segments of an Enterprise and Related Information* establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company has determined that it operates in two segments consisting of optical subsystems and components and network test and monitoring systems.

Concentrations of Credit Risk

Financial instruments which potentially subject Finisar to concentrations of credit risk include cash, cash equivalents, short-term and restricted investments and accounts receivable. Finisar places its cash, cash equivalents and short-term and restricted investments with high-credit quality financial institutions. Such investments are generally in excess of FDIC insurance limits. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Generally, Finisar does not require collateral or other security to support customer receivables. Finisar performs periodic credit evaluations of its customers and maintains an allowance for potential credit losses based on historical experience and other information available to management. Losses to date have been within management s expectations. At October 31, 2004, one optical subsystems and components customer represented 23.2% of total accounts receivable. At April 30, 2004, one optical subsystems and components customer represented 12.2% of total accounts receivable.

Current Vulnerabilities Due to Certain Concentrations

Finisar sells products primarily to customers located in North America. During the three and six months ended October 31, 2004, sales to one optical subsystems and components customer represented 30.0% and 29.0% of total revenues, respectively. During the three and six months ended October 31, 2003, sales to one optical subsystems and components customer represented 22.8% and 19.8% of total revenues, respectively. No other customer represented more than 10% of sales in any of these periods.

Foreign Currency Translation

The functional currency of our foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rate on the balance sheet dates. Revenues and expenses are translated using average exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in the determination of net loss.

Research and Development

Research and development expenditures are charged to operations as incurred.

Advertising Costs

Advertising costs are expensed as incurred. Advertising is used infrequently in marketing the Company s products. Advertising costs were $222,000 and $379,000 in the three and six months ended October 31, 2004, respectively. Advertising costs were $36,000 and $82,000 in the three and six months ended October 31, 2003, respectively.

Shipping and Handling Costs

The Company records costs related to shipping and handling in cost of sales for all periods presented.

Cash and Cash Equivalents

Finisar s cash equivalents consist of money market funds and highly liquid short-term investments with qualified financial institutions. Finisar considers all highly liquid investments with an original maturity from the date of purchase of three months or less to be cash equivalents.

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Investments

Short-Term

Short-term investments consist of interest bearing securities with maturities of greater than 90 days from the date of purchase and an equity security. Pursuant to SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities*, the Company has classified its short-term investments as available-for-sale. Available-for-sale securities are stated at market value, which approximates fair value, and unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized. A decline in the market value of the security below cost, that is deemed other than temporary, is charged to earnings, resulting in the establishment of a new cost basis for the security.

Restricted Investments

Restricted investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and investments held in escrow under the terms of the Company s convertible subordinated notes. In accordance with SFAS 115, the Company has classified its restricted investments as held-to-maturity. Held-to-maturity securities are stated at amortized cost.

Other

The Company uses the cost method of accounting for investments in companies that do not have a readily determinable fair value in which it holds an interest of less than 20% and over which it does not have the ability to exercise significant influence. For entities in which the Company holds an interest of greater than 20% or in which the Company does have the ability to exercise significant influence, the Company uses the equity method. In determining if and when a decline in the market value of these investments below their carrying value is other-than-temporary, the Company evaluates the market conditions, offering prices, trends of earnings and cash flows, price multiples, prospects for liquidity and other key measures of performance. The Company s policy is to recognize an impairment in the value of its minority equity investments when clear evidence of an impairment exists, such as (a) the completion of a new equity financing that may indicate a new value for the investment, (b) the failure to complete a new equity financing arrangement after seeking to raise additional funds or (c) the commencement of proceedings under which the assets of the business may be placed in receivership or liquidated to satisfy the claims of debt and equity stakeholders. The Company s minority investments in private companies are generally made in exchange for preferred stock with a liquidation preference that is intended to help protect the underlying value of its investment.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, accrued compensation and other accrued liabilities, approximate fair value because of their short maturities. As of October 31, 2004 and April 30, 2004, the fair value of the Company s convertible subordinated debt was approximately $236.0 million and $230.2 million, respectively.

Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

The Company permanently writes down the cost of inventory that the Company specifically identifies and considers obsolete or excessive to fulfill future sales estimates. The Company defines obsolete inventory as inventory that will no longer be used in the manufacturing process. Excess inventory is generally defined as inventory in excess of projected usage, and is determined using management s best estimate of future demand at the time, based upon information then available to the Company. The Company uses a twelve-month historical usage model to compute excess inventory and, in addition to the historical usage model, the Company also considers: (1) forecast demand (2) parts and subassemblies that can be used in alternative finished products, (3) parts and subassemblies that are unlikely to be engineered out of the Company s products, and (4) known design changes which would reduce the

Company s ability to use the inventory as planned.

Property, Equipment and Improvements

Property, equipment and improvements are stated at cost, net of accumulated depreciation and amortization. Property, plant, equipment and improvements are depreciated on a straight-line basis over the estimated useful lives of the assets, generally three years to seven years except for buildings, which are depreciated over 40 years. Land is carried at acquisition cost and not depreciated. Leased land is depreciated over the life of the lease.

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Goodwill and Other Intangible Assets

Goodwill and other intangible assets result from acquisitions accounted for under the purchase method. Amortization of intangibles has been provided on a straight-line basis over periods ranging from one to nine years. The amortization of goodwill ceased with the adoption of SFAS No. 142 beginning in the first quarter of fiscal 2003.

Accounting for the Impairment of Long-Lived Assets

The Company periodically evaluates whether changes have occurred to long-lived assets that would require revision of the remaining estimated useful life of the property, improvements and assigned intangible assets or render them not recoverable. If such circumstances arise, the Company uses an estimate of the undiscounted value of expected future operating cash flows to determine whether the long-lived assets are impaired. If the aggregate undiscounted cash flows are less than the carrying amount of the assets, the resulting impairment charge to be recorded is calculated based on the excess of the carrying value of the assets over the fair value of such assets, with the fair value determined based on an estimate of discounted future cash flows.

Stock-Based Compensation

Finisar accounts for employee stock option grants in accordance with Accounting Principles Board (APB) Opinion No. 25 *Accounting for Stock Issued to Employees* and complies with the disclosure provisions of SFAS No. 123 *Accounting for Stock-Based Compensation* and SFAS No. 148 *Accounting for Stock-based Compensation Transition and Disclosure*. The Company accounts for stock issued to non-employees in accordance with provisions of SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18, *Accounting for Equity Investments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services*.

The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to employee stock benefits, including shares issued under the Company s stock option plans and Employee Stock Purchase Plan (collectively options). For purposes of these pro forma disclosures, the estimated fair value of the options is assumed to be amortized to expense over the options vesting periods and the amortization of deferred compensation has been added back. Pro forma information follows (in thousands, except per share amounts):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004 (As restated)	2003	2004 (As restated)	2003
Net loss-as reported	$ (21,193)	$ (32,573)	$ (43,312)	$ (73,798)
Add: Stock-based employee compensation included in net loss	40	(49)	137	(353)
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	(5,211)	(10,503)	(9,598)	(19,500)
Net loss-pro forma	$ (26,364)	$ (43,125)	$ (52,773)	$ (93,651)
Basic and diluted net loss per share-as reported	$ (0.09)	$ (0.15)	$ (0.19)	$ (0.35)
Basic and diluted net loss per share-pro forma	$ (0.12)	$ (0.20)	$ (0.24)	$ (0.44)

The fair value of the Company s stock option grants prior to the Company s initial public offering was estimated at the date of grant using the minimum value option valuation model. The fair value of the Company s stock options grants subsequent to the initial public offering was determined using the Black-Scholes valuation model based on the actual stock closing price on the day previous to the date of grant. These option valuation models were developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions. Because Finisar s stock-based awards have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock-based awards.

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The fair value of these options at the date of grant was estimated using the following weighted-average assumptions for the three and six month periods ended October 31, 2004: for stock options grants we used risk-free interest rates of 3.30% and 3.71%, respectively; a volatility factor of 1.17 and 1.19, respectively; a weighted-average expected life of the option of 3.85 for both periods; and a dividend yield of 0% for both periods.

The fair value of these options at the date of grant was estimated using the following weighted-average assumptions for the three and six month periods ended October 31, 2003: for stock options grants we used risk-free interest rates of 2.80% and 2.69%, respectively; a volatility factor of 1.29 and 1.31, respectively; a weighted-average expected life of the option of 3.91 for both periods; and a dividend yield of 0% for both periods.

Net Loss Per Share

Basic and diluted net loss per share is presented in accordance with SFAS No. 128 *Earnings Per Share* for all periods presented. Basic net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from options and warrants (under the treasury stock method), convertible redeemable preferred stock (on an if-converted basis) and convertible notes (on an as-if-converted basis) outstanding during the period.

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004 (As restated)	2003	2004 (As restated)	2003
Numerator:				
Net loss	$ (21,193)	$ (32,573)	$ (43,312)	$ (73,798)
Denominator for basic net loss per share:				
Weighted-average shares outstanding-total	223,413	216,960	223,283	212,747
Weighted-average shares outstanding-subject to repurchase	(33)	(815)	(128)	(1,070)
Weighted-average shares outstanding-performance stock		(319)		(320)
Weighted-average shares outstanding-basic and diluted	223,380	215,826	223,155	211,357
Basic and diluted net loss per share	$ (0.09)	$ (0.15)	$ (0.19)	$ (0.35)
Common stock equivalents related to potentially dilutive securities excluded from computation above because they are anti-dilutive:				
Employee stock options	4,142	11,039	4,337	7,300
Stock subject to repurchase	33	815	128	1,070
Convertible debt	58,647	24,340	58,647	23,507
Warrents assumed in acquisition	964	1,040	964	1,040
Performance stock				1

Potentially dilutive securities	63,786	37,234	64,076	32,918

Excluded from the above listing of potentially dilutive securities are the shares of common stock to be issued upon conversion of the convertible promissory note issued during the three months ended October 31, 2004 as consideration for the purchase of assets of Data Transit Corp. (see Note 2). Due to the uncertainty surrounding the timing of conversion, and the fact that conversion price is not fixed, the Company is unable at this time to accurately estimate the number of shares of common stock that will be issued upon conversion of this convertible promissory note.

Comprehensive Income

SFAS No. 130 *Reporting Comprehensive Income* establishes rules for reporting and display of comprehensive income and its components. SFAS No. 130 requires unrealized gains or losses on the Company s available-for-sale securities and foreign currency translation adjustments to be included in comprehensive income.

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The components of comprehensive loss for the three and six months ended October 31, 2004 and 2003 are as follows (in thousands):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004 (As restated)	2003	2004 (As restated)	2003
Net loss	$ (21,193)	$ (32,573)	$ (43,312)	$ (73,798)
Foreign currency translation adjustment	(62)	(88)	59	131
Change in unrealized gain (loss) on securities, net of reclassification adjustments for realized gain (loss)	(98)	(201)	(92)	146
Comprehensive loss	$ (21,353)	$ (32,862)	$ (43,345)	$ (73,521)

The components of accumulated other comprehensive income, net of taxes, were as follows (in thousands):

	October 31,2004	April 30, 2004
Net unrealized losses on available-for-sale securities	$ (123)	$ (31)
Cumulative translation adjustment	800	741
Accumulated other comprehensive income	$ 677	$ 710

2. Acquisition of Assets of Data Transit Corp.

On August 6, 2004, the Company completed the purchase of substantially all of the assets of Data Transit Corp. in exchange for a cash payment of $500,000 and the issuance of a convertible promissory note in the original principal amount of $16,270,000. Transaction costs totalled $682,000. The original principal amount of the convertible promissory note is adjustable downward by up to $3,188,375 should the acquired business fail to achieve certain business integration milestones. The principal balance of the note bears interest at 8% per annum and is due and payable, if not sooner converted, on the second anniversary of its issuance. Generally, the terms of the convertible promissory note provide for automatic conversion of the outstanding principal and interest into shares of the Company s common stock on a biweekly basis, commencing on the later of the effectiveness of a registration statement covering the resale of the shares or one year after the closing date. The conversion price is the average closing bid price of the stock for the three days preceding the date of conversion. The amount of principal and interest to be converted on each conversion date is based on the average trading volume of the Company s common stock over the preceding 14 days. The Company agreed to file a registration statement with the Securities and Exchange Commission to cover the resale of the shares of common stock issuable upon conversion of the convertible promissory note. In reliance on the exemption from registration set forth in Section 4(2) of the Securities Act of 1933 (the Securities Act), the issuance of the convertible promissory note and the shares of the Company s common stock issuable upon conversion of the convertible promissory note were not registered under the Securities Act.

The following is a summary of the initial purchase price allocation for this asset acquisition, including $682,000 of transaction costs (in thousands):

	Acquired intangible assets				
Net Tangible Assets	**Developed Technology**	**In-process Research & Development**	**Tradename**	**Goodwill**	**Total**
$ 1,708	$ 8,514	$ 318	$ 758	$ 6,154	$ 17,452

The amounts allocated to in-process research and development (IPRD) were determined through established valuation techniques in the high-technology industry and were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed. Research and development costs to bring the products from the acquired assets to technological feasibility are not expected to have a material impact on the Company s future results of operations or cash flows. Goodwill represents the excess of purchase consideration over the fair value of the assets, including identifiable intangible assets, net of the fair value of liabilities assumed. Intangible assets related to the acquisition, excluding goodwill, are amortized to expense on a straight-line basis over their estimated useful lives ranging from one to nine years.

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3. Loans Related to Acquisition of Assets from New Focus, Inc.

In partial consideration for the purchase of certain assets of New Focus, Inc. for a total value of $12.1 million in May 2002, the Company delivered to New Focus a non-interest bearing convertible promissory note in the principal amount of $6.75 million. On August 9, 2002, the note was converted into 4,027,446 shares of common stock. Payments of $1.4 million in August 2003, and $2.0 million in September 2004, were made to pay down minimum commitments to New Focus under a royalty arrangement entered into in connection with the acquisition. The remaining minimum commitment with respect to royalty payments totalling $2.0 million will be paid in August 2005. Because such payments are not fixed in time, they were not discounted as otherwise required under APB Opinion No. 21.

4. Inventories

Inventories consist of the following (in thousands):

	October 31, 2004	April 30, 2004
Raw materials	$ 20,296	$ 20,072
Work-in-process	8,557	8,512
Finished goods	9,453	6,133
	$ 38,306	$ 34,717

During the three and six months ended October 31, 2004, the Company recorded negative charges of $2.5 million and $7.8 million, respectively, for excess and obsolete inventory, and consumed inventory components that were previously written-off in prior periods with an approximate original cost of $4.9 million and $9.2 million, respectively. As a result, cost of revenue associated with the sale of this inventory was zero.

During the three and six months ended October 31, 2003, the Company recorded charges of $5.1 million and $16.6 million, respectively, for excess and obsolete inventory, and sold inventory components that were previously written-off in prior periods with an approximate original cost of $3.9 million and $7.9 million, respectively. As a result, cost of revenue associated with the sale of this inventory was zero.

5. Property, Plant, Equipment and Improvements

Property, plant, equipment and improvements consist of the following (in thousands):

	October 31, 2004	**April 30, 2004**
Land	$ 18,788	$ 18,788
Buildings	21,440	21,271
Computer equipment	30,496	27,712
Office equipment, furniture and fixtures	3,113	3,542
Machinery and equipment	98,072	94,002
Leasehold improvements	7,607	6,858

		179,516		172,173
Accumulated depreciation and amortization		(75,516)		(64,437)
Property, plant, equipment and improvements, net	$	104,000	$	107,736

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6. Income Taxes

The Company recorded a provision for income taxes of $37,000 and $56,000 for the quarter and six months, respectively ended October 31, 2004 compared to $33,000 and $24,000 for the quarter and six months, respectively, ended October 31, 2003. The provisions for income taxes primarily consisted of state minimum taxes.

Realization of deferred tax assets is dependent upon future taxable income, if any, the amount and timing of which are uncertain. Accordingly, the net deferred tax assets as of October 31, 2004 have been fully offset by a valuation allowance. The Company does not expect to record any tax benefit for future operating losses that may be sustained in fiscal 2005.

A portion of the valuation allowance at October 31, 2004 related to stock option deductions that are not currently realizable and will be credited to paid-in capital if and when realized. The remaining portion of the valuation allowance, when realized, will first reduce unamortized goodwill, then other non-current intangible assets of acquired subsidiaries and then income tax expense. There can be no assurance that deferred tax assets subject to the valuation allowance will be realized.

Utilization of the Company s net operating loss and tax credit carryforwards may be subject to a substantial annual limitation due to the ownership change limitations set forth by the Internal Revenue Code Section 382 and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss and tax credit carryforwards before utilization.

7. Deferred Stock Compensation

In connection with the grant of certain stock options to employees, Finisar recorded deferred stock compensation prior to the Company s initial public offering, representing the difference between the deemed value of the Company s common stock for accounting purposes and the option exercise price of these options at the date of grant. During fiscal 2001 and fiscal 2002, the Company recorded additional deferred compensation related to the assumption of stock options associated with companies acquired during those years. Deferred stock compensation is presented as a reduction of stockholders equity, with graded amortization recorded over the five-year vesting period. The amortization expense relates to options awarded to employees in all operating expense categories. The following table summarizes the amount of deferred stock compensation expense which Finisar has recorded and the amortization it has recorded and expects to record in future periods in connection with grants of certain stock options to employees during fiscal 1999 and 2000 and assumptions of stock options associated with companies acquired during fiscal 2001 and 2002. Amounts to be recorded in future periods could decrease if options for which accrued but unvested compensation have been recorded are forfeited (in thousands):

	Deferred Stock Compensation Generated	Amortization Expense
Fiscal year ended April 30, 1999	$ 2,403	$ 427
Fiscal year ended April 30, 2000	12,959	5,530
Fiscal year ended April 30, 2001	21,217	13,543
Fiscal year ended April 30, 2002	1,065	11,963
Fiscal year ended April 30, 2003	(6,855)	(1,719)
Fiscal year ended April 30, 2004	(988)	(105)
Fiscal year ending April 30, 2005		162

Total	$	29,801	$	29,801

8. Purchased Intangible Assets Including Goodwill

During fiscal 2004, the Company recorded additional goodwill in the optical subsystems and components reporting unit in the amount of $147,000 as a result of achievement of certain milestones specified in the acquisition agreement under which the Company acquired Transwave Fiber, Inc. (Transwave), and $40.6 million in conjunction with the acquisition of the Honeywell VCSEL Optical Products business unit.

During the first quarter of fiscal 2005, the Company recorded additional goodwill in the optical subsystems and components reporting unit in the amount of $256,000 as a result of achievement of certain milestones specified in the Transwave acquisition agreement. During the first quarter of fiscal 2005, the Company recorded an additional $7,000 in conjunction with the acquisition of the Honeywell VCSEL Optical Products business unit.

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During the second quarter of fiscal 2005, as a result of the acquisition of assets from Data Transit Corp., the Company recorded goodwill in the Network Test and Monitoring Systems business unit in the amount of $6.2 million as well as additional purchased technology and trade name assets in the amount of $8.5 million and $758,000, respectively. The Company also recorded an additional $32,000 of goodwill in conjunction with the acquisition of the Honeywell VCSEL Optical Products business unit.

The following table reflects the changes in the carrying amount of goodwill by reporting unit (in thousands):

	Optical Subsystems and Components	Network Test and Monitoring Systems	Consolidated Total
Balance at April 30, 2004	$ 44,620	$ 16,000	$ 60,620
Addition related to acquisition of a Subsidiary	39	6,154	6,193
Addition related to achievement of Milestones	256		256
Balance at October 31, 2004	$ 44,915	$ 22,154	$ 67,069

The following table reflects intangible assets subject to amortization as of October 31, 2004 and April 30, 2004 (in thousands):

	October 31,2004		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	$ 112,901	$ (72,789)	$ 40,112
Trade name	3,625	(2,125)	1,500
Totals	$ 116,526	$ (74,914)	$ 41,612

	April 30, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	$ 104,387	$ (57,481)	$ 46,906
Trade name	2,867	(1,812)	1,055
Totals	$ 107,254	$ (59,293)	$ 47,961

During the second quarter of fiscal 2005, the Company determined that the remaining intangible assets related to certain purchased passive optical technology, related to the Company s acquisition of certain assets of New Focus, Inc., had a fair value of zero. Accordingly, an impairment charge of $3.7 million was recorded against the remaining net book value of these assets.

Estimated remaining amortization expense for each of the next five fiscal years ending April 30, is as follows (dollars in thousands):

Year	**Amount**
Remaining 2005	$ 10,958
2006	16,939
2007	4,511
2008	3,648
2009	2,749

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9. Available-For-Sale Investments

The following is a summary of the Company s available-for-sale investments as of October 31, 2004 and April 30, 2004 (in thousands):

Investment Type	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
As of October 31, 2004				
Debt:				
Corporate	$ 48,020	$ 38	$ (79)	$ 47,979
Government agency	35,126	24	(109)	35,041
Municipal	481	3	0	484
Total	$ 83,627	$ 65	$ (188)	$ 83,504
Reported as:				
Cash equivalents	$ 8,634	$	$	$ 8,634
Short-term investments	74,993	65	(188)	74,870
	$ 83,627	$ 65	$ (188)	$ 83,504

Investment Type	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
As of April 30, 2004				
Debt:				
Corporate	$ 84,822	$ 123	$ (71)	$ 84,874
Government agency	35,199	36	(120)	35,115
Municipal	1,854	5	(4)	1,855
Total	$ 121,875	$ 164	$ (195)	$ 121,844
Reported as:				
Cash equivalents	$ 48,318	$	$	$ 48,318
Short-term investments	73,557	164	(195)	73,526
	$ 121,875	$ 164	$ (195)	$ 121,844

The gross realized gains for the three and six months ended October 31, 2004 were $28,000 and $49,000, respectively. The gross realized gains for the three and six months ended October 31, 2003 were $432,000 and $795,000, respectively. The gross realized losses were immaterial for each of these periods. Realized gains and losses were calculated based on the specific identification method.

Restricted Securities

The Company has purchased and pledged to a collateral agent, as security for the exclusive benefit of the holders of the Company s 5 1/4% and 2 1/2% convertible subordinated notes, U.S. government securities, which will be sufficient upon receipt of scheduled

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principal and interest payments thereon, to provide for the payment in full of the first eight scheduled interest payments due on each series of notes. These restricted securities are classified as held to maturity and are held on the Company s consolidated balance sheet at amortized cost. The following table summarizes the Company s restricted securities as of October 31, 2004 and April 30, 2004 (in thousands):

Investment Type	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
As of October 31, 2004				
Government agency	$ 10,887	$	$ (63)	$ 10,824
Classified as:				
Short term - less than 1 year	$ 3,722	$	$ (13)	$ 3,709
Long term - 1 to 3 years	7,165		(50)	7,115
Total	$ 10,887	$	$ (63)	$ 10,824

Investment Type	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
As of April 30, 2004				
Government agency	$ 15,250	$ 22	$ (85)	$ 15,187
Classified as:				
Short term - less than 1 year	$ 6,329	$ 22	$ (4)	$ 6,347
Long term - 1 to 3 years	8,921		(81)	8,840
Total	$ 15,250	$ 22	$ (85)	$ 15,187

Cost Method Investments

Included in minority investments at October 31, 2004 and April 30, 2004 are cost method investments of $17.5 million and $16.5 million, respectively. Minority investments at April 30, 2004 represents the carrying value of the Company s minority investments in four privately held companies accounted for under the cost method. During the quarter ended October 31, 2004, the Company made an investment of $1.0 million in a privately held company accounted for under the cost method.

Equity Method Investments

Included in minority investments at October 31, 2004 and April 30, 2004 are $6.9 million and $7.7 million respectively, representing the carrying value of the Company s minority investment in one private company, Quintessence Photonics, accounted for under the equity method. During the three and six months ended October 31, 2004, the Company recorded expenses of $432,000 and $793,000, respectively, representing its share of the loss of the investee, which was classified as other income/(expense), net. During the three and six months ended October 31, 2003, the Company recorded expenses of $269,000 and $473,000, respectively.

10. Segments and Geographic Information

The Company designs, develops, manufactures and markets optical subsystems, components and test and monitoring systems for high-speed data communications. The Company views its business as having two principal operating segments, consisting of optical subsystems and components and network test and monitoring systems. Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for storage area networks (SAN), local area networks (LAN), and metropolitan access networks (MAN) applications. Optical subsystems also include multiplexers, demultiplexers and optical add/drop modules used in MAN applications. Optical components consist primarily of packaged lasers and photodetectors which are incorporated in transceivers primarily for LAN and SAN applications. Network test and monitoring systems include products designed to test the reliability and performance

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of equipment for a variety of protocols including Fibre Channel, Gigabit Ethernet, 10 Gigabit Ethernet, iSCSI, SAS, and SATA. These test and monitoring systems are sold to both manufacturers and end-users of the equipment.

The Company s operating segments report to the President and Chief Executive Officer. Where appropriate, the Company charges specific costs to these segments where they can be identified and allocates certain manufacturing costs, research and development, sales and marketing and general and administrative costs to these operating segments, primarily on the basis of manpower levels or a percentage of sales. The Company does not allocate income taxes, non-operating income, acquisition related costs, stock compensation, interest income and interest expense to its operating segments. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. There are no intersegment sales.

Information about reportable segment revenues and income are as follows (in thousands):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004 (As restated)	2003	2004 (As restated)	2003
Revenues:				
Optical subsystems and components	$ 59,912	$ 36,432	$ 113,662	$ 70,620
Network test and monitoring systems	11,093	6,344	19,220	11,587
Total revenues	$ 71,005	$ 42,776	$ 132,882	$ 82,207
Depreciation and amortization expense:				
Optical subsystems and components	$ 7,789	$ 6,557	$ 14,161	$ 18,118
Network test and monitoring systems	239	24	422	130
Operating loss:				
Optical subsystems and components	(7,695)	(10,671)	(18,370)	(35,860)
Network test and monitoring systems	(407)	(311)	(1,468)	(1,321)
Operating loss before unallocated amounts	(8,102)	(10,982)	(19,838)	(37,181)
Unallocated amounts:				
Amortization of acquired developed technology	(9,742)	(4,656)	(15,308)	(9,312)
Amortization of deferred stock compensation	(24)	49	(121)	353
Amortization of other intangibles	(170)	(143)	(313)	(286)
Impairment of goodwill and intangible assets				
Non-employee option expense		(891)		(891)
Restructuring costs		(187)		(2,372)
Other acquisition costs		(149)		(194)
Interest income (expense), net	(2,992)	(15,026)	(5,762)	(20,534)
Acquired In-Process R&D	(318)		(318)	
Other non-operating income (expense), net	192	(555)	(1,596)	(3,135)
Loss before income tax and cumulative effect of accounting change to adopt FAS 142	$ (21,156)	$ (32,540)	$ (43,256)	$ (73,552)

The following is a summary of total assets by segment (in thousands):

	October 31, 2004	April 30, 2004
Optical subsystems and components	$ 284,005	$ 302,128
Network test and monitoring systems	68,466	50,261
Other	110,190	142,316
	$ 462,661	$ 494,705

Short-term, restricted and minority investments are the primary components of other assets in the above table.

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The following is a summary of operations within geographic areas based on the location of the entity purchasing the Company s products (in thousands):

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Revenues from sales to unaffiliated customers:				
United States	$ 48,692	$ 33,471	$ 88,327	$ 62,860
Rest of the world	22,313	9,305	44,555	19,347
	$ 71,005	$ 42,776	$ 132,882	$ 82,207

Revenues generated in the U.S. are all from sales to customers located in the United States.

The following is a summary of long-lived assets within geographic areas based on the location of the assets (in thousands):

	October 31, 2004	April 30, 2004
Long-lived assets		
United States	$ 226,218	$ 230,225
Malaysia	24,015	21,668
Rest of the world	2,499	2,871
	$ 252,732	$ 254,764

The following is a summary of capital expenditures by reportable segment (in thousands):

	Six Months Ended October 31,	
	2004	2003
Optical subsystems and components	$ 11,025	$ 3,989
Network test and monitoring systems	$ 467	$ 34

11. Warranty

The Company offers a one-year limited warranty for all of its products. The specific terms and conditions of these warranties vary depending upon the product sold. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs based on revenue recognized. Factors that affect the Company s warranty liability include the number of units sold, historical and anticipated rates of warranty claims and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company s warranty liability during the following period were as follows (in thousands):

		Six Months Ended October 31, 2004
Beginning balance	$	984
Additions during the period based on product sold		628
Settlements		(89)
Changes in liability for pre-existing warranties including expirations		(289)
Ending balance	$	1,234

12. Restructuring and Assets Impairments

As of October 31, 2004, $554,000 of committed facilities payments, net of anticipated sublease income, remains accrued and is expected to be fully utilized by fiscal 2006. This amount relates to restructuring activities in fiscal 2003 and remains in other accrued liabilities for payment in future periods as follows (in thousands):

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Fiscal year 2003 actions	Facilities				Severance				Total			
	Hayward	Demeter	Germany	Total	Hayward	Demeter	Germany	Total	Hayward	Demeter	Germany	Total
Fiscal year 2003 actions												
Total charges	3,056	4,492		7,548	1,174	656		1,830	4,230	5,148		9,378
Reversal of charge		(1,199)		(1,199)						(1,199)		(1,199)
Cash payments	(984)	(1,087)		(2,071)	(1,174)	(656)		(1,830)	(2,158)	(1,743)		(3,901)
Non-cash charges	(1,351)	(2,373)		(3,724)					(1,351)	(2,373)		(3,724)
Balance from fiscal year 2003 actions to April 30, 2004	721	(167)		554					721	(167)		554
Fiscal year 2004 actions												
Total charges		546	849	1,395		701	276	977		1,247	1,125	2,372
Reversal of charge		(791)		(791)						(791)		(791)
Cash payments	(167)	412	(849)	(604)		(701)	(276)	(977)	(167)	(289)	(1,125)	(1,581)
Balance from fiscal year 2004 actions to April 30, 2004	(167)	167							(167)	167		
Total accrual balance at October 31, 2004	554			554					554			554

13. Pending Litigation

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased the Company s common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, Jerry S. Rawls, the Company s President and Chief Executive Officer, Frank H. Levinson, the Company s Chairman of the Board and Chief Technical Officer, Stephen K. Workman, the Company s Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for the Company s initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as subsequently amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934, on the grounds that the prospectuses incorporated in the registration statements for the offerings failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of the Company s stock sold in the offerings and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of the Company s stock sold in the offerings to those customers in exchange for which the customers agreed to purchase additional shares of the Company s stock in the aftermarket at pre-determined prices. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, the Court denied the Company s motion to dismiss the complaint. In July 2004, the Company and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs will dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all the related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers will be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, the Company would be responsible to pay its pro rata portion of the shortfall, up to the amount of the self-insured retention under its insurance policy, which may be up to $2 million. The timing and amount of payments that the Company could be required to make under the proposed settlement will depend on several factors, principally the timing and amount of any payment by the insurers pursuant to the $1 billion guaranty. The settlement is subject to approval of the Court, which cannot be assured. If the settlement is not approved by the Court, the Company intends to defend the lawsuit vigorously. However, the litigation is in the preliminary stage, and the Company cannot predict its outcome. The litigation process is inherently uncertain. If litigation proceeds and its outcome is adverse to the Company and if the Company is required to pay significant monetary damages, the Company s business would be significantly harmed.

14. Pending Acquisition of Infineon Fiber Optics Business

On April 29, 2004, the Company entered into an agreement with Infineon Technologies AG to acquire Infineon s fiber optics business unit, based in Berlin, Germany. On October 11, 2004, the Company entered into an amended and restated purchase agreement under which the terms of the acquisition were modified. Under the amended agreement, the purchase price for the business unit is approximately 109,850,000 shares of Finisar common stock. The transaction involves the

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acquisition of facilities, product lines, employees, equipment and intellectual property, including approximately 450 patent families. The shares of the Company s common stock to be issued to Infineon in connection with the acquisition were valued at approximately $142.8 million on the date of the agreement and would represent approximately 33% of the outstanding shares of the Company s common stock on a post-transaction basis. The transaction is expected to be completed in the first calendar quarter of 2005, subject to approval by the Company s stockholders and other closing conditions.

If the acquisition is consummated, it will be accounted for as a purchase and, accordingly, the results of operations of the Infineon fiber optics business unit (beginning with the closing date of the acquisition) and the estimated fair value of assets acquired and liabilities assumed will be included in the Company s consolidated financial statements beginning with the quarter in which the closing takes place.

15. Guarantees and Indemnifications

In November 2002, the FASB issued Interpretation No. 45 *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligations it assumes under that guarantee. As permitted under Delaware law and in accordance with the Company s Bylaws, the Company indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company s request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The Company may terminate the indemnification agreements with its officers and directors upon 90 days written notice, but termination will not affect claims for indemnification relating to events occurring prior to the effective date of termination. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that may enable it to recover a portion of any future amounts paid.

The Company enters into indemnification obligations under its agreements with other companies in its ordinary course of business, including agreements with customers, business partners, and insurers. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company s activities or the use of the Company s products. These indemnification provisions generally survive termination of the underlying agreement. In some cases, the maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited.

The Company believes the fair value of these indemnification agreements is minimal. Accordingly, the Company has not recorded any liabilities for these agreements as of October 31, 2004. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements.

16. Sales of Accounts Receivable

On October 29, 2005, the Company entered into an agreement with Silicon Valley Bank to sell certain trade receivables. In these non-recourse sales, the Company removes the sold receivables from its books and records no liability related to the sale, as the Company has assessed that the sales should be accounted for as true sales in accordance with SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* During the quarter ended October 31, 2004, the Company sold approximately $4.0 million of its trade receivables to Silicon Valley Bank under the terms of this agreement.

17. Restatement of Financial Statements

In reviewing the Company s inventory accounts in preparation for the close of the third fiscal quarter ended January 30, 2005, the Company s management discovered that, in October 2004, an intra-company transfer of inventory was erroneously charged to cost of revenues, resulting in an overstatement of cost of revenues in the amount of $1,786,000 for both the three and six months ended October 31, 2004 and an overstatement of accounts payable as of October 31, 2004 by the same amount. We have recorded corrections to reduce cost of revenues for both periods by $1,786,000 and to reduce accounts payable as of October 31, 2004 by the same amount.

Presented below are the condensed consolidated financial statements of the Company at the date or for the periods specified below (1) as originally reported in the Quarterly Report on Form 10-Q for the three and six months ended October 31, 2004 that the Company initially filed with the Securities and Exchange Commission on December 10, 2004, and (2) as restated in this Amendment No. 1.

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FINISAR CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	October 31, 2004	
	(In thousands, except share and per share data)	
	(As originally reported)	(As restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 29,377	$ 29,377
Short-term investments	74,870	74,870
Restricted investments	3,722	3,722
Accounts receivable, trade (net)	38,087	38,087
Accounts receivable, other	12,044	12,044
Inventories	38,306	38,306
Prepaid expenses	6,072	6,072
Deferred income taxes	285	285
Total current assets	202,763	202,763
Property, plant, equipment and improvements, net	104,000	104,000
Restricted investments, long-term	7,165	7,165
Purchased intangibles, net	41,612	41,612
Goodwill	67,069	67,069
Minority investments	24,434	24,434
Other assets	15,618	15,618
Total assets	$ 462,661	$ 462,661
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 30,146	$ 28,360
Accrued compensation	4,823	4,823
Other accrued liabilities	10,820	10,820
Non-cancelable purchase obligations	6,091	6,091
Income tax payable	577	577
Current portion of other long-term liabilities	2,000	2,000
Total current liabilities	54,457	52,671
Long-term liabilities:		
Convertible notes, net of unamortized portion of beneficial conversion feature of $18,628 and $20,757 at October 31, 2004 and April 30, 2004, respectively	247,892	247,892
Other long-term liabilities	149	149

Deferred income taxes	285	285
Total long-term liabilities	248,326	248,326
Commitments and contingent liabilities		
Stockholders equity:		
Common stock, $0.001 par value, 223,524,926 shares issued and outstanding at October 31, 2004 and 222,531,335 shares issued and outstanding at April 30, 2004	224	224
Additional paid-in capital	1,261,319	1,261,319
Notes receivable from stockholders		
Deferred stock compensation	(41)	(41)
Accumulated other comprehensive income	677	677
Accumulated deficit	(1,102,301)	(1,100,515)
Total stockholders equity	159,878	161,664
Total liabilities and stockholders equity	$ 462,661	$ 462,661

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FINISAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended October 31, 2004 (Unaudited, in thousands, except per share data)		Six Months Ended October 31, 2004 (Unaudited, in thousands, except per share data)	
	(As originally reported)	(As restated)	(As originally reported)	(As restated)
Revenues	$ 71,005	$ 71,005	$ 132,882	$ 132,882
Cost of revenues	51,285	49,499	96,989	95,203
Impairment of acquired developed technology	3,656	3,656	3,656	3,656
Amortization of acquired developed technology	6,086	6,086	11,652	11,652
Gross profit	9,978	11,764	20,585	22,371
Operating expenses:				
Research and development	17,043	17,043	33,118	33,118
Sales and marketing	7,570	7,570	14,721	14,721
General and administrative	4,995	4,995	9,677	9,677
Amortization of deferred stock compensation	24	24	121	121
Aquired in-process research and development	318	318	318	318
Amortization of purchased intangibles	170	170	313	313
Restructuring costs				
Other acquisition costs				
Total operating expenses	30,120	30,120	58,268	58,268
Loss from operations	(20,142)	(18,356)	(37,683)	(35,897)
Interest income	560	560	1,152	1,152
Interest expense	(3,552)	(3,552)	(6,915)	(6,915)
Other expense, net	192	192	(1,596)	(1,596)
Loss before income taxes	(22,942)	(21,156)	(45,042)	(43,256)
Provision for income taxes	37	37	56	56
Net loss	$ (22,979)	$ (21,193)	$ (45,098)	$ (43,312)
Loss per share basic and diluted	$ (0.10)	$ (0.09)	$ (0.20)	$ (0.19)
Shares used in loss per share calculation basic and diluted	223,380	223,380	223,155	223,155

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

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ substantially from those anticipated in these forward-looking statements as a result of many factors, including those set forth below under Factors That Could Affect Our Future Performance. The following discussion should be read together with our consolidated financial statements and related notes thereto included elsewhere in this report.

Overview

We were incorporated in 1987 and funded our initial product development efforts largely through revenues derived under research and development contracts. After shipping our first products in 1991, we continued to finance our operations principally through internal cash flow and periodic bank borrowings until November 1998. At that time we raised $5.6 million of net proceeds from the sale of equity securities and bank borrowings to fund the continued growth and development of our business. In November 1999, we received net proceeds of $151.0 million from the initial public offering of shares of our common stock, and in April 2000 we received $190.6 million from an additional public offering of shares of our common stock. In October 2001, we sold $125 million aggregate principal amount of 5 1/4% convertible subordinated notes due October 15, 2008, and in October 2003, we sold $150 million aggregate principal amount of 2 1/2% convertible subordinated notes due October 15, 2010.

Since October 2000, we have acquired a number of companies and certain businesses and assets of other companies in order to broaden our product offerings and provide new sources of revenue, production capabilities and access to advanced technologies that we believe will enable us to reduce our product costs and develop innovative and more highly integrated product platforms while accelerating the timeframe required to develop such products.

In October 2002, we sold our subsidiary, Sensors Unlimited, Inc. to a new company organized by a management group led by Dr. Greg Olsen, then an officer and director of Finisar and a former majority owner of Sensors Unlimited. The intellectual property developed after the acquisition of Sensors Unlimited was transferred to other operations within Finisar. In November 2002, we discontinued a product line at our Demeter Technologies subsidiary that was not making a significant contribution to our operating results and was no longer considered a key part of our product strategy. Certain assets of Demeter Technologies were sold in conjunction with the product line discontinuation. In April 2003, we acquired Genoa Corporation and announced the closure of Demeter Technologies and the consolidation of all active device development and wafer fabrication operations into the Genoa facility. The consolidation was completed in fiscal 2004. During the second quarter of fiscal 2004, we completed the closure of our German facility. The intellectual property, technical know-how and certain assets related to the German operations were consolidated with our operations in Sunnyvale, California, during the second quarter of fiscal 2004.

The principal strategic goal of most of our acquisitions to date related to our optical subsystems and components business has been to gain access to leading-edge technology for the manufacture of optical components in order to improve the performance and reduce the cost of our optical subsystem products. We have also sold these optical components on a stand-alone basis to other manufacturers; however, prior to our acquisition of Honeywell International Inc. s VCSEL Optical Products business unit in March 2004, the sale of these components into this so-called merchant market had not been a strategic priority, and our revenues from the sale of optical subsystems and components consisted predominantly of subsystems sales. As a result of the Honeywell acquisition, we are now selling vertical cavity surface emitting lasers, or VCSELs, in the merchant market, and we intend to evaluate opportunities to increase the sale of these and other components in the merchant market. The principal strategic goal of most of our acquisitions to date related to our network test and monitoring business has been to broaden our product portfolio and to gain access to new distribution channels. The acquisition of assets and intellectual property of Data Transit, Inc., in August 2004, was the most recent example of decisions made in pursuit of this strategy. As a result of this acquisition, we expanded our product offerings for SAN test, analysis and monitoring tools to include additional products which test and monitor storage networks using the SAS and SATA protocols.

To date, our revenues have been principally derived from sales of our optical subsystems to networking and storage systems manufacturers and sales of our network performance test systems to these manufacturers as well as end users. Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for SANs, LANs, and MAN applications. A large proportion of our sales are concentrated with a relatively small number of customers. Although we are attempting to expand our customer base, we expect that significant customer concentration will continue for the foreseeable future.

We recognize revenue when persuasive evidence of an arrangement exists, title and risk of loss pass to the customer, which is generally upon shipment, the price is fixed or determinable and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, we allocate revenue to the separate elements based upon each element s fair value as determined by the list price for such element.

We sell our products through our direct sales force, with the support of our manufacturers representatives, directly to domestic customers and indirectly through distribution channels to international customers. The evaluation and qualification cycle prior to the initial sale for our optical subsystems may span a year or more, while the sales cycle for our test and monitoring systems is usually considerably shorter.

The market for optical subsystems and components is characterized by declining average selling prices resulting from factors such as industry over-capacity, increased competition, the introduction of new products and the growth in unit volumes as manufacturers continue to deploy network and storage systems. We anticipate that our average selling prices will continue to decrease in future periods, although the timing and amount of these decreases cannot be predicted with any certainty.

Our cost of revenues consists of materials, salaries and related expenses for manufacturing personnel, manufacturing overhead, warranty expense, inventory adjustments for obsolete and excess inventory and the amortization of acquired developed technology associated with acquisitions that we have made. Historically, we have outsourced the majority of our assembly operations. However, in fiscal 2002, we commenced manufacturing of our optical subsystem products at our subsidiary in Ipoh, Malaysia. We conduct component manufacturing, manufacturing engineering, supply chain management, quality assurance and documentation control at our facilities in Sunnyvale, California and Richardson, Texas and at our subsidiaries facilities in Fremont, California, Shanghai, China and Ipoh, Malaysia. With the transition of most of our production to Malaysia and the added manufacturing infrastructure associated with several acquisitions completed during the past two years, our cost structure has become more fixed, making it more difficult to reduce costs during periods when demand for our products is weak, product mix is unfavorable or selling prices are generally lower. While we undertook measures to reduce our operating costs during fiscal 2003 and 2004, there can be no assurance that we will be able to reduce our cost of revenues enough to achieve or sustain profitability during periods of weak demand or when average selling prices are low.

Our gross profit margins vary among our product families, and are generally higher on our network test and monitoring systems than on our optical subsystems and components. Our overall gross margins have fluctuated from period to period as a result of overall revenue levels, shifts in product mix, the introduction of new products, decreases in average selling prices and our ability to reduce product costs.

Research and development expenses consist primarily of salaries and related expenses for design engineers and other technical personnel, the cost of developing prototypes and fees paid to consultants. We charge all research and development expenses to operations as incurred. We believe that continued investment in research and development is critical to our long-term success.

Sales and marketing expenses consist primarily of commissions paid to manufacturers representatives, salaries and related expenses for personnel engaged in sales, marketing and field support activities and other costs associated with the promotion of our products.

General and administrative expenses consist primarily of salaries and related expenses for administrative, finance and human resources personnel, professional fees, and other corporate expenses.

In connection with the grant of stock options to employees between August 1, 1998 and October 15, 1999, we recorded deferred stock compensation representing the difference between the deemed value of our common stock for accounting purposes and the exercise price of these options at the date of grant. In connection with the assumption of stock options previously granted to employees of companies we acquired, we recorded deferred compensation representing the difference between the fair market value of our common stock on the date of closing of each acquisition and the exercise price of the unvested portion of options granted by those companies which we assumed. Deferred stock compensation is presented as a reduction of stockholder s equity, with accelerated amortization recorded over the vesting period, which is typically three to five years. The amount of deferred stock compensation expense to be recorded in future periods could decrease if options for which accrued but unvested compensation has been recorded are forfeited prior to vesting and could increase if we modify the terms of an option grant resulting in a new measurement date.

Acquired in-process research and development represents the amount of the purchase price in a business combination allocated to research and development projects underway at the acquired company that had not reached the technologically feasible stage as of the closing of the acquisition and for which we had no alternative future use.

A portion of the purchase price in a business combination is allocated to goodwill and intangibles. Prior to May 1, 2002, goodwill and purchased intangibles were amortized over their estimated useful lives. Subsequent to May 1, 2002, goodwill and intangible assets with indefinite lives are no longer amortized but subject to annual impairment testing.

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Restructuring costs generally include termination costs for employees associated with a formal restructuring plan and the cost of facilities or other unusable assets abandoned or sold.

Other acquisition costs primarily consist of incentive payments for employee retention included in certain of the purchase agreements of companies we acquired and costs incurred in connection with transactions that were not completed.

Other income and expenses generally consist of bank fees, gains or losses as a result of the periodic sale of assets and other-than-temporary decline in the value of investments.

Recent and Pending Acquisitions

Acquisition of Honeywell VCSEL Optical Products Business

On March 1, 2004, we completed the acquisition of Honeywell International Inc. s VCSEL Optical Products business unit for a purchase price and transaction expenses totaling approximately $80.9 million in cash and $1.2 million in our common stock. The acquisition was accounted for under the purchase method of accounting. The results of operations of this business unit, which we now refer to as our Advanced Optical Components Division, are included in our consolidated financial statements beginning on March 1, 2004.

Acquisition of Assets of Data Transit Corp.

On August 6, 2004, we completed the purchase of substantially all of the assets of Data Transit Corp. in exchange for a cash payment of $500,000 and the issuance of a convertible promissory note in the original principal amount of $16,270,000. Transaction costs totalled $682,000. The original principal amount of the convertible promissory note is adjustable downward by up to $3,188,375 should the acquired business fail to achieve certain business integration milestones. The principal balance of the note bears interest at 8% per annum and is due and payable, if not sooner converted, on the second anniversary of its issuance. Generally, the terms of the convertible promissory note provide for automatic conversion of the outstanding principal and interest into shares of our common stock on a biweekly basis, commencing on the later of the effectiveness of a registration statement covering the resale of the shares or one year after the closing date. The conversion price is the average closing bid price of the stock for the three days preceding the date of conversion. The amount of principal and interest to be converted on each conversion date is based on the average trading volume of our common stock over the preceding 14 days. We agreed to file a registration statement with the Securities and Exchange Commission to cover the resale of the shares of common stock issuable upon conversion of the convertible promissory note. In reliance on the exemption from registration set forth in Section 4(2) of the Securities Act of 1933 (the Securities Act), the issuance of the convertible promissory note and the shares of our common stock issuable upon conversion of the convertible promissory note were not registered under the Securities Act.

Pending Acquisition of Infineon Fiber Optics Business

On April 29, 2004, we entered into an agreement with Infineon Technologies AG to acquire Infineon s fiber optics business unit, based in Berlin, Germany. On October 11, 2004, we entered into an amended and restated purchase agreement under which the terms of the acquisition were modified. Under the amended agreement, the purchase price for the business unit is approximately 109,850,000 shares of Finisar Common Stock. The transaction involves the acquisition of facilities, product lines, employees, equipment and intellectual property, including approximately 450 patent families. The shares of Finisar Common Stock to be issued to Infineon in connection with the acquisition were valued at approximately $142.8 million on the date of the agreement and would represent approximately 33% of the outstanding shares of Finisar Common Stock on a post-transaction basis. The transaction is expected to be completed in the first calendar quarter of 2005, subject to approval by our stockholders and other closing conditions.

If the acquisition is consummated, it will be accounted for as a purchase and, accordingly, the results of operations of the Infineon fiber optics business unit (beginning with the closing date of the acquisition) and the estimated fair value of assets acquired and liabilities assumed will be included in our consolidated financial statements beginning with the quarter in which the closing takes place.

The Infineon fiber optics business unit had net sales of approximately $66.1 million for the six months ended March 31, 2004 and approximately $116.9 million for the year ended September 30, 2003, and net losses of approximately $34.0 million and $75.5 million in the same periods. If the acquisition is consummated, our future results of operations will be substantially influenced by the results of operations of the new business unit. The operating results of the combined company will be affected by our success in achieving our strategic objectives and realizing potential operating benefits, including cost savings. We will face a number of significant challenges in integrating the technologies, operations and personnel of the two companies and realizing potential cost and revenue

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synergies in a timely and efficient manner and our failure to do so effectively could have a material adverse effect on the business and operating results of the combined company. For additional information regarding the pending acquisition, see Factors That Could Affect our Future Performance.

Critical Accounting Policies

There have been no material changes to our critical accounting policies, which are included in our Annual Report on Form 10-K for the year ended April 30, 2004.

Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the periods indicated:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004 (As restated)	2003	2004 (As restated)	2003
Revenues:				
Optical subsystems and components	84.4%	85.2%	85.5%	85.9%
Network test and monitoring subsystems	15.6%	14.8%	14.5%	14.1%
Total revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	69.7%	74.9%	71.6%	83.4%
Impairment of acquired developed technology	5.2%	0.0%	2.7%	0.0%
Amortization of acquired developed technology	8.5%	10.9%	8.8%	11.3%
Gross profit (loss)	16.6%	14.2%	16.9%	5.3%
Operating expenses:				
Research and development	24.1%	32.0%	24.9%	42.1%
Sales and marketing	10.7%	10.7%	11.1%	10.8%
General and administrative	7.1%	10.2%	7.3%	10.1%
Amortization of deferred stock compensation	0.1%	(0.1)%	0.1%	(0.4)%
Aquired in-process research and development	0.2%	0.0%	0.2%	0.0%
Amortization of purchased intangibles	0.2%	0.3%	0.2%	0.3%
Restructuring costs	0.0%	0.4%	0.0%	2.9%
Other acquisition costs	0.0%	0.3%	0.0%	0.2%
Total operating expenses	42.4%	53.8%	43.8%	66.0%
Loss from operations	(25.8)%	(39.6)%	(26.9)%	(60.7)%
Interest income	0.8%	1.5%	0.9%	1.8%
Interest expense	(5.0)%	(36.6)%	(5.2)%	(26.8)%
Other income (expense), net	0.3%	(1.3)%	(1.2)%	(3.8)%
Loss before income taxes	(29.7)%	(76.0)%	(32.4)%	(89.5)%
Provision for income taxes	0.1%	0.1%	0.1%	0.3%

Net loss	(29.8)%	(76.1)%	(32.5)%	(89.8)%

Revenues. Revenues increased $28.2 million, or 65.9%, to $71.0 million in the three months ended October 31, 2004 compared to $42.8 million in the three months ended October 31, 2003. This increase reflected a $23.5 million, or 64.6%, increase in sales of optical subsystems and components, to $59.9 million in the three months ended October 31, 2004 compared to $36.4 million in the three months ended October 31, 2003, as well as a $4.7 million, or 74.6%, increase in sales of network test and monitoring systems, to $11.1 million in the three months ended October 31, 2004 compared to $6.4 million in the three months ended October 31, 2003.

Revenues increased $50.7 million, or 61.6%, to $132.9 million in the six months ended October 31, 2004 compared to $82.2 million in the six months ended October 31, 2003. This increase reflected a $43.1 million, or 60.9%, increase in sales of optical subsystems and components, to $113.7 million in the six months ended October 31, 2004 compared to $70.6 million in the six months ended October 31, 2003, as well as a $7.6 million, or 65.5%, increase in sales of network test and monitoring systems, to $19.2 million in the six months ended October 31, 2004 compared to $11.6 million in the three months ended October 31, 2003.

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Sales of optical subsystems and components and network test and monitoring systems represented 84.4% and 15.6%, respectively, of total revenues in the three months ended October 31, 2004, compared to 85.2% and 14.810%, respectively, in the three months ended October 31, 2003. Sales of optical subsystems and components and network test and monitoring systems represented 85.5% and 14.5%, respectively, of total revenues in the six months ended October 31, 2004, compared to 85.9% and 14.1%, respectively, in the six months ended October 31, 2003.

The increase in revenues from the sale of optical subsystems and components was primarily the result of an increase in volume of units sold to new and existing customers, partially offset by a decrease in average selling prices. The increase also reflected additional revenue totalling $8.1 million and $17.5 million in the three and six months ended October 31, 2004, respectively, from sales by our Advanced Optical Components division, acquired from Honeywell International, Inc. on March 2, 2004. The increase in revenues from the sale of network test and monitoring systems was due to increased demand for new test equipment used in the development of Fibre Channel SANs operating at 2 Gbps and additional revenue totalling approximately $3.0 million in the three months ended October 31, 2004, from sales of products acquired from product lines acquired from Data Transit.

Gross Profit. Gross profit increased $5.7 million, or 93.5%, to $11.8 million in the three months ended October 31, 2004 compared to $6.1 million in the three months ended October 31, 2003. Gross profit increased $18.0 million, or 409.4%, to $22.4 million in the six months ended October 31, 2004 compared to $4.4 million in the six months ended October 31, 2003. Gross profit as a percentage of total revenue was 16.6% in the three months ended October 31, 2004 compared to 14.2% in the three months ended October 31, 2003. Gross profit as a percentage of total revenue was 16.9% in the six months ended October 31, 2004 compared to 5.3% in the six months ended October 31, 2003. The increase in gross profit for the three months ended October 31, 2004 was primarily due to a $2.9 million reduction in inventory reserve charges, reductions in material costs and an increase in unit sales, which spread our fixed overhead costs over a higher production volume, offset by a $5.1 million increase in amortization of acquired developed technology. The increase in gross profit for the six months ended October 31, 2004 was primarily due to a $12.9 million reduction in inventory reserve charges, reductions in material costs and an increase in unit sales, which spread our fixed overhead costs over a higher production volume, offset by a $6.0 million increase in amortization of acquired developed technology.

The charge for slow moving, obsolete and unusable inventory decreased to a negative $1.7 million in the three months ended October 31, 2004 compared to $1.2 million in the three months ended October 31, 2003. In the three months ended October 31, 2004, the negative charge of $1.7 million was comprised of a $5.3 million charge for potential slow-moving, obsolete and unusable inventory, offset by consumption of $4.3 million of previously reserved inventory and reductions in reserves for non-cancellable purchase orders. The charge for slow moving, obsolete and unusable inventory decreased to a negative $4.2 million for the six months ended October 31, 2004 compared to $8.7 million in 2003. For the six months ended October 31, 2004, the negative charge of $4.3 million was comprised of a $7.8 million charge for potential slow-moving, obsolete and unusable inventory, offset by consumption of $9.2 million of previously reserved inventory and reductions in reserves for non-cancellable purchase orders.

Amortization of Acquired Developed Technology. Amortization of acquired developed technology is associated with several acquisitions completed during fiscal years 2001 through October 2004. Amortization of acquired developed technology increased $5.1 million, or 108.5%, to $9.8 million in the three months ended October 31, 2004 compared to $4.7 million in the three months ended October 31, 2003 and increased $6.0 million, or 64.5%, to $15.3 million in the six months ended October 31, 2004 compared to $9.3 million in the six months ended October 31, 2003. The increase for the three and six months were primarily due to an impairment charge of $3.7 million recorded in October 2004 to write-off the remaining net book value of certain passive optical technology associated with our acquisition of assets of New Focus, Inc. in May 2002. Our acquisitions of the Honeywell VCSEL Optical Products business unit in March 2004 and our purchase of assets of Data Transit in August 2004 also contributed to the increases.

Research and Development Expenses. Research and development expenses increased $3.3 million, or 24.1%, to $17.0 million in the three months ended October 31, 2004 compared to $13.7 million in the three months ended October 31, 2003. The increase was primarily due to accelerated depreciation of $1.0 million recorded on equipment that was sold, expenses associated with the operations of the Honeywell VCSEL Optical Products business acquired in March 2004, and additional spending to develop higher speed optical subsystems and components. Research and development expenses decreased $1.5 million, or 4.3%, to $33.1 million in the six months ended October 31, 2004 compared to $34.6 million in the six months ended October 31, 2003. Research and development expenses decreased as a percentage of revenue to 24.1% in the three months ended October 31, 2004 compared to 32.0% in the three months ended October 31, 2003 and decreased as a percentage of revenue to 24.9% in the six months ended October 31, 2004 compared to 42.1% in the six months ended October 31, 2003 due to increased revenue as a result of increased unit sales.

Sales and Marketing Expenses. Sales and marketing expenses increased $3.0 million, or 65.2%, to $7.6 million in the three months ended October 31, 2004 compared to $4.6 million in the three months ended October 31, 2003. Sales and marketing expenses

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increased $5.8 million, or 65.2%, to $14.7 million in the six months ended October 31, 2004 compared to $8.9 million in the six months ended October 31, 2003. The increases were primarily due to increases in salaries and commissions related to our increased revenues. Sales and marketing expenses as a percentage of revenues was unchanged at 10.7% in the three months ended October 31, 2004 and 2003. Sales and marketing expense as a percentage of revenues increased to 11.1% in the six months ended October 31, 2004, compared to 10.8% in the six months ended October 31, 2003.

General and Administrative Expenses. General and administrative expenses increased $639,000, or 13.6%, to $5.0 million in the three months ended October 31, 2004 compared to $4.6 million in the three months ended October 31, 2003. General and administrative expenses increased $1.4 million, or 16.9%, to $9.7 million in the six months ended October 31, 2004 compared to $8.3 million in the six months ended October 31, 2003. This increase was primarily related to additional expenses associated with the acquisition of the Honeywell VCSEL Optical Products business in March 2004 and an increase in legal expenses associated with efforts to license our intellectual property. General and administrative expenses decreased as a percent of revenues to 7.1% in the three months ended October 31, 2004 compared to 10.2% in the three months ended October 31, 2003 and decreased as a percent of revenues to 7.3% in the six months ended October 31, 2004 compared to 10.1% in the six months ended October 31, 2003 due to increased revenue as a result of increased unit sales.

Amortization of Deferred Stock Compensation. Amortization of deferred stock compensation increased $73,000 to $24,000 in the three months ended October 31, 2004 compared to a benefit of $49,000 in the three months ended October 31, 2003. Amortization of deferred stock compensation increased $474,000 to $121,000 in the six months ended October 31, 2004 compared to a benefit of $353,000 in the six months ended October 31, 2003. This increase was related to the termination of employees in the three and six months ended October 31, 2003, with deferred compensation associated with their stock options and the effects of the graded vested method of amortization which accelerates the amortization of deferred compensation.

Restructuring Costs. During the three months ended July 31, 2003, we completed the process of consolidating our facilities and operations located at our Demeter subsidiary in El Monte, California into our facilities in Fremont, California. During the three months ended October 31, 2003, we completed the process of closing our facility in Munich Germany, in order to reduce future operating costs. As a result of these restructuring activities, charges of $187,000 and $2.4 million were incurred in the three and six months ended October 31. 2003, respectively. These restructuring charges included $977,000 of severance, approximately $645,000 of fees associated with the early termination of our facilities lease in Germany, approximately $450,000 for remaining payments for excess leased equipment and approximately $300,000 of miscellaneous costs incurred to effect the closures. There was no similar charge in the three or six months ended October 31, 2004.

Interest Income. Interest income decreased $96,000, or 14.6%, to $560,000 in the three months ended October 31, 2004 compared to $656,000 in the three months ended October 31, 2003. Interest income decreased $374,000, or 24.5%, to $1.1 million in the six months ended October 31, 2004 compared to $1.5 million in the six months ended October 31, 2003. The decreases in interest income reflects lower cash, cash equivalents and short-term investments as well as lower interest rates.

Interest Expense. Interest expense decreased $12.1 million, or 77.1%, to $3.6 million in the three months ended October 31, 2004 compared to $15.7 million in the three months ended October 31, 2003. Included in interest expense in the three months ended October 31, 2003 was a non-cash charge of $8.4 million associated with the exchange of $17.8 million in principal amount of our convertible notes for common stock in privately negotiated transactions concluded during this three-month period. Also, amortization of the discount on our convertible notes decreased $4.6 million, to $1.1 million in the three months ended October 31, 2004, compared to $5.7 million in the three months ended October 31, 2003, due to the reduction in the outstanding principal amount of our convertible notes.

Interest expense decreased $15.2 million, or 68.8%, to $6.9 million in the six months ended October 31, 2004 compared to $22.1 million in the six months ended October 31, 2003. Included in interest expense in the six months ended October 31, 2003 was a non-cash charge of $10.8 million associated with the exchange of $22.8 million in principal amount of our convertible notes for common stock in privately negotiated transactions concluded during this six-month period. Also, amortization of the discount on our convertible notes decreased $6.0 million, to $2.1 million in the six months ended October 31, 2004, compared to $8.1 million in the six months ended October 31, 2003, due to the reduction in balance of our convertible notes.

Other Income (Expense), net. Other income (expense), net, increased $747,000, to net income of $192,000 in the three months ended October 31, 2004 compared to net expense of $555,000 in the three months ended October 31, 2003. Other income (expense), net, increased $1.5 million, or 48.4%, to net expense of $1.6 million in the six months ended October 31, 2004 compared to net expense of $3.1 million in the six months ended October 31, 2003. In the six months ended October 31, 2003, we recorded an impairment charge of $1.6 million for our minority equity investments in two development stage companies due primarily to funding efforts which suggested that the value of our investment has been impaired. No similar charges were recorded in the six months ended October 31, 2004.

Provision for Income Taxes. We recorded a provision for income taxes of $37,000 for the three months ended October 31, 2004 compared to $33,000 for the three months ended October 31, 2003. The provision for income taxes primarily consisted of state minimum taxes.

Realization of deferred tax assets is dependent upon future taxable income, if any, the amount and timing of which are uncertain. Accordingly, the net deferred tax assets as of October 31, 2004 have been fully offset by a valuation allowance. We do not expect to record any tax benefit for future operating losses that may be sustained in fiscal 2005.

A portion of the valuation allowance at October 31, 2004 related to stock option deductions that are not currently realizable and will be credited to paid-in capital if and when realized. The remaining portion of the valuation allowance, when realized, will first reduce unamortized goodwill, then other non-current intangible assets of acquired subsidiaries and then income tax expense. There can be no assurance that deferred tax assets subject to the valuation allowance will be realized.

Utilization of our net operating loss and tax credit carryforwards may be subject to a substantial annual limitation due to the ownership change limitations set forth by the Internal Revenue Code Section 382 and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss and tax credit carryforwards before utilization.

Liquidity and Capital Resources

At October 31, 2004, our cash, cash equivalents and short-term investments were $104.2 million compared to $143.4 million at April 30, 2004. Restricted securities, used to secure future interest payments on our convertible debt were $10.9 million at October 31, 2004 compared to $15.2 million at April 30, 2004. At October 31, 2004, total short and long-term debt was $250.0 million, compared to $233.7 million at April 30, 2004, reflecting the issuance of the convertible note associated with the acquisition of assets from Data Transit.

Net cash used by operating activities totaled $25.0 million in the six months ended October 31, 2004, compared to $16.3 million in the six months ended October 31, 2003. The use of cash in operating activities in the six months ended October 31, 2004 was primarily a result of operating losses of $43.3 million, and working capital uses of cash of $15.9 million, partially offset by $34.2 million of non-cash charges. The use of cash in operating activities in the six months ended October 31, 2003 was primarily a result of operating losses of $73.8 million, partially offset by $50.5 million of non-cash charges, and working capital in-flows of cash of $7.0 million.

Net cash used in investing activities totaled $14.3 million in the six months ended October 31, 2004, compared to net cash provided by investing activities of $6.6 million in the six months ended October 31, 2003. The use of cash for investing activities in the six months ended October 31, 2004 consisted primarily of payments related to our purchase of the assets of Honeywell s VCSEL Optical Products business unit of $5.7 million and payments related to our purchase of assets of Data Transit Corp. of $500,000. Net cash used also consisted of purchases of plant, property and equipment of $10.9 million. Cash provided by investing activities for the six months ended October 31, 2003 consisted primarily of sales of short-term investments and loan repayments from a company in which we have a minority investment, offset by purchases of property, plant and equipment.

Net cash used in financing activities totaled $1.3 million in the six months ended October 31, 2004 and consisted primarily of $2.0 million of payments on other long-term liabilities offset by proceeds of $286,000 from the exercise of employee stock options, net of repurchase of unvested shares, and by proceeds of $467,000 from payments received on stockholder notes receivable. Net cash provided by financing activities totaled $132.4 million in the six months ended October 31, 2003, and consisted primarily of $130.9 million of proceeds from issuance of our subordinated convertible notes due 2010, $3.0 million of proceeds from the exercise of employee stock options, net of repurchase of unvested shares, and proceeds of $279,000 from payments received on stockholder notes receivable, offset by the extinguishment of $1.9 million of debt due under our subordinated convertible notes due 2008.

We believe that our existing balances of cash, cash equivalents and short-term investments and cash flow expected to be generated from our future operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may, however, require additional financing to fund our operations in the future. The significant contraction in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, our business, financial condition and results of operation will be adversely affected.

Contractual Obligations and Commercial Commitments

Future minimum payments under long-term debt and operating leases are as follows as of October 31, 2004 (in thousands):

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		Payments Due by Period			
Contractual Obligations	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term debt	$ 268,520	$ 2,000	$ 16,270	$ 100,250	$ 150,000
Operating leases	8,790	4,550	4,063	177	
Total contractual cash obligations	$ 277,310	$ 6,550	$ 20,333	$ 100,427	$ 150,000

Long-term debt consists of a convertible promissory note of $16.3 million due, if not sooner converted, on August 6, 2006, convertible notes of $100.25 million due October 15, 2008, and $150.0 million due October 15, 2010 redeemable by us, in whole or in part, at any time after October 15, 2004. Long-term debt also includes a minimum commitment with respect to royalty payments of $2.0 million related to our acquisition of certain assets of New Focus (see Note 3).

Operating leases consist of base rents for facilities we occupy at various locations.

The following table summarizes our commercial commitments as of October 31, 2004 (in thousands):

		Amount of Commitment Expiration per Period			
Commercial Commitments	Total Amount Committed	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Standby repurchase obligations	$ 6,091	$ 6,091			

Standby repurchase obligations consist of materials purchased and held by subcontractors on our behalf to fulfil the subcontractors purchase order obligations at their facilities. Total commercial commitments of $6.1 million has been expensed and recorded on the balance sheet as non-cancellable purchase obligations.

Off-Balance-Sheet Arrangements

At October 31, 2004 and April 30, 2004, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Factors That Could Affect Our Future Performance

OUR FUTURE PERFORMANCE IS SUBJECT TO A VARIETY OF RISKS. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCUR, OUR BUSINESS COULD BE HARMED AND THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE. YOU SHOULD ALSO REFER TO THE OTHER INFORMATION CONTAINED IN THIS REPORT, INCLUDING OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES.

We are subject to a number of special risks as a result of our planned acquisition of the fiber optics business unit of Infineon Technologies AG

On April 29, 2004, we entered into an agreement with Infineon Technologies AG to acquire Infineon s fiber optics business unit, based in Berlin, Germany. Under the purchase agreement, which was amended in October 11, 2004, the purchase price of the business unit is approximately 109,850,000 shares of Finisar Common Stock. If the conditions to closing are satisfied and the acquisition is consummated, our future results of operation will be substantially influenced by the operations of the new business unit, and we will be subject to a number of risks and uncertainties, including the following:

The Infineon fiber optics business unit has sustained substantial operating losses and we expect that the combined company will continue to experience losses in the future due to significant transaction and integration costs and operating expenses. The combination of the two businesses will significantly increase the rate at which we will utilize our available cash resources. If we are not successful in generating significant revenues and achieving substantial cost savings through the restructuring and integration of the two businesses, these operating losses will continue and will adversely affect our operating results and liquidity.

We will face a number of significant challenges in integrating the technologies, operations and personnel of Finisar and the Infineon fiber optics business unit in a timely and efficient manner, and our failure to do so effectively could have a material adverse effect on our business and operating results.

We may not achieve the strategic objectives and other anticipated potential benefits of the acquisition, and our failure to achieve these strategic objectives could have a material adverse effect on our revenues, expenses and operating results.

Transaction costs associated with the acquisition will be included as part of the total purchase cost for accounting purposes. In addition, we may incur charges to operations in amounts that are not currently estimable, in the quarter in which the acquisition is completed or in following quarters, to reflect costs associated with restructuring and integrating the two companies. These costs could adversely affect our future liquidity and operating results.

Immediately following completion of the acquisition, Infineon will own approximately 33% of the capital stock of Finisar. The issuance of these shares in connection with the acquisition will cause a significant reduction in the relative percentage interest of current Finisar stockholders, and, following such issuance, Infineon will be able to substantially influence the outcome of matters requiring approval by our stockholders. In addition, this concentration of ownership could have the effect of delaying or preventing a change in control or otherwise discouraging a potential acquirer from attempting to obtain control of us.

As a result of the acquisition, Finisar will become a substantiality larger and more geographically dispersed organization, and if our management is unable to effectively manage the combined company after the acquisition, our operating results will suffer.

The acquisition will increase the cost and complexity of complying with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 with regard to the evaluation and attestation of our internal control systems.

Before consummating the acquisition, we must obtain stockholder approval for the issuance of the shares. The Infineon fiber optics business unit, the terms of the transaction and the risks related to the acquisition will be described in greater detail in the proxy statement for the meeting of stockholders at which such approval will be sought.

We have incurred significant net losses, our future revenues are inherently unpredictable, our operating results are likely to fluctuate from period to period, and if we fail to meet the expectations of securities analysts or investors, our stock price could decline significantly

We incurred net losses of $113.8 million, $619.8 million and $218.7 million in our fiscal years ended April 30, 2004, 2003 and 2002, respectively, and $43.3 million in the six months ended October 31, 2004. Our operating results for future periods are subject to numerous uncertainties, and we cannot assure you that we will be able to achieve or sustain profitability.

Our quarterly and annual operating results have fluctuated substantially in the past and are likely to fluctuate significantly in the future due to a variety of factors, some of which are outside of our control. Accordingly, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indications of future performance. Some of the factors that could cause our quarterly or annual operating results to fluctuate include market acceptance of our products, market demand for the products manufactured by our customers, the introduction of new products and manufacturing processes, manufacturing yields, competitive pressures and customer retention.

We may experience a delay in generating or recognizing revenues for a number of reasons. Orders at the beginning of each quarter typically represent a small percentage of expected revenues for that quarter and are generally cancelable at any time. Accordingly, we depend on obtaining orders during each quarter for shipment in that quarter to achieve our revenue objectives. Failure to ship these products by the end of a quarter may adversely affect our operating results. Furthermore, our customer agreements typically provide that the customer may delay scheduled delivery dates and cancel orders within specified timeframes without significant penalty. Because we base our operating expenses on anticipated revenue trends and a high percentage of our expenses are fixed in the short term, any delay in generating or recognizing forecasted revenues could significantly harm our business. It is likely that in some future quarters our operating results will again decrease from the previous quarter or fall below the expectations of securities analysts and investors. In this event, it is likely that the trading price of our common stock would significantly decline.

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We may have insufficient cash flow to meet our debt service obligations, including payments due on our subordinated convertible notes

We will be required to generate cash sufficient to pay our indebtedness and other liabilities, including all amounts due on our outstanding 2 1/2% and 5 1/4% convertible subordinated notes due 2010 and 2008, respectively, and to conduct our business operations. We may not be able to cover our anticipated debt service obligations from our cash flow. This may materially hinder our ability to make payments on the notes. Our ability to meet our future debt service obligations will depend upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. Accordingly, we cannot assure you that we will be able to make required principal and interest payments on the notes when due.

We may not be able to obtain additional capital in the future, and failure to do so may harm our business

We believe that our existing balances of cash, cash equivalents and short-term investments will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may, however, require additional financing to fund our operations in the future or to repay the principal of our outstanding 2 1/2% and 5 1/4% convertible subordinated notes due 2010 and 2008, respectively. The significant contraction in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we continue to experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, we could be required to significantly reduce or restructure our business operations.

Failure to accurately forecast our revenues could result in additional charges for obsolete or excess inventories or non-cancelable purchase commitments

We base many of our operating decisions, and enter into purchase commitments, on the basis of anticipated revenue trends which are highly unpredictable. Some of our purchase commitments are not cancelable, and in some cases we are required to recognize a charge representing the amount of material or capital equipment purchased or ordered which exceeds our actual requirements. In the past, we have sometimes experienced significant growth followed by a significant decrease in customer demand such as occurred in fiscal 2001, when revenues increased by 181% followed by a decrease of 22% in fiscal 2002. Based on projected revenue trends during these periods, we acquired inventories and entered into purchase commitments in order to meet anticipated increases in demand for our products which did not materialize. As a result, we recorded significant charges for obsolete and excess inventories and non-cancelable purchase commitments which contributed to substantial operating losses in fiscal 2002. Should revenue in future periods again fall substantially below our expectations, or should we fail again to accurately forecast changes in demand mix, we could be required to record additional charges for obsolete or excess inventories or non-cancelable purchase commitments.

Our operating expenses may need to be further reduced which could impact our future growth

We experienced a significant decline in revenues and operating results during fiscal 2002. While revenues recovered to some extent in fiscal 2003 and fiscal 2004, they have not yet reached levels required to operate on a profitable basis due primarily to higher fixed expenses related to a number of acquisitions, low gross margins and continued high levels of spending for research and development in anticipation of future revenue growth. While we continue to expect future revenue growth, we have taken steps to reduce our operating expenses in order to conserve our cash, and we may be required to take further action to reduce expenses. These expense reduction measures may adversely affect our ability to market our products, introduce new and improved products and increase our revenues, which could adversely affect our business and cause the price of our stock to decline. In order to be successful in the future, we must reduce our operating and product expenses, while at the same time completing our key product development programs and penetrating new customers.

We are dependent on widespread market acceptance of two product families, and our revenues will decline if the market does not continue to accept either of these product families

We currently derive substantially all of our revenue from sales of our optical subsystems and components and network test and monitoring systems. We expect that revenue from these products will continue to account for substantially all of our revenue for the foreseeable future. Accordingly, widespread acceptance of these products is critical to our future success. If the market does not continue to accept either our optical subsystems and components or our network test and monitoring systems, our revenues will decline significantly. Factors that may affect the market acceptance of our products include the continued growth of the markets for LANs, SANs, and MANs and, in particular, Gigabit Ethernet and Fibre Channel-based technologies, as well as the performance, price and total cost of ownership of our products and the availability, functionality and price of competing products and technologies.

Many of these factors are beyond our control. In addition, in order to achieve widespread market acceptance, we must differentiate ourselves from our competition through product offerings and brand name recognition. We cannot assure you that we will be successful in making this differentiation or achieving widespread acceptance of our products. Failure of our existing or future products to maintain and achieve widespread levels of market acceptance will significantly impair our revenue growth.

We depend on large purchases from a few significant customers, and any loss, cancellation, reduction or delay in purchases by these customers could harm our business

A small number of customers have accounted for a significant portion of our revenues. For example, sales to our top three customers represented 39% of our revenues in fiscal 2004, and sales to Cisco Systems represented 22%. The Infineon fiber optics business also has depended upon a small number of customers for a significant portion of its revenues. Our success will depend on our continued ability to develop and manage relationships with significant customers. Although we are attempting to expand our customer base, we expect that significant customer concentration will continue for the foreseeable future.

The markets in which we sell our products are dominated by a relatively small number of systems manufacturers, thereby limiting the number of our potential customers. Our dependence on large orders from a relatively small number of customers makes our relationship with each customer critically important to our business. We cannot assure you that we will be able to retain our largest customers, that we will be able to attract additional customers or that our customers will be successful in selling their products that incorporate our products. We have in the past experienced delays and reductions in orders from some of our major customers. In addition, our customers have in the past sought price concessions from us, and we expect that they will continue to do so in the future. Cost reduction measures that we have implemented during the past several quarters, and additional action we may take to reduce costs, may adversely affect our ability to introduce new and improved products which may, in turn, adversely affect our relationships with some of our key customers. Further, some of our customers may in the future shift their purchases of products from us to our competitors or to joint ventures between these customers and our competitors. The loss of one or more of our largest customers, any reduction or delay in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may make could significantly harm our business.

Because we do not have long-term contracts with our customers, our customers may cease purchasing our products at any time if we fail to meet our customers needs

Typically, we do not have long-term contracts with our customers. As a result, our agreements with our customers do not provide any assurance of future sales. Accordingly:

- our customers can stop purchasing our products at any time without penalty;
- our customers are free to purchase products from our competitors; and
- our customers are not required to make minimum purchases.

Sales are typically made pursuant to individual purchase orders, often with extremely short lead times. If we are unable to fulfill these orders in a timely manner, it is likely that we will lose sales and customers.

Our market is subject to rapid technological change, and to compete effectively we must continually introduce new products that achieve market acceptance

The markets for our products are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards with respect to the protocols used in data communications networks. We expect that new technologies will emerge as competition and the need for higher and more cost-effective bandwidth increases. Our future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address these changes as well as current and potential customer requirements. The introduction of new and enhanced products may cause our customers to defer or cancel orders for existing products. In addition, a slowdown in demand for existing products ahead of a new product introduction could result in a write-down in the value of inventory on hand related to existing products. We have in the past experienced a slowdown in demand for existing products and delays in new product development and such delays may occur in the future. To the extent customers defer or cancel orders for existing products due to a slowdown in demand or in the expectation of a new product release or if there is any delay in development or introduction of our new products or enhancements of

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our products, our operating results would suffer. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, or to license these technologies from third parties. Product development delays may result from numerous factors, including:

- changing product specifications and customer requirements;
- unanticipated engineering complexities;
- expense reduction measures we have implemented, and others we may implement, to conserve our cash and attempt to accelerate our return to profitability;
- difficulties in hiring and retaining necessary technical personnel;
- difficulties in reallocating engineering resources and overcoming resource limitations; and
- changing market or competitive product requirements.

The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation and highly skilled engineering and development personnel, as well as the accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product announcements by competitors, technological changes or emerging industry standards. Any failure to respond to technological change would significantly harm our business.

Continued competition in our markets may lead to a reduction in our prices, revenues and market share

The markets for optical components and subsystems and network test and monitoring systems for use in LANs, SANs and MANs are highly competitive. Our current competitors include a number of domestic and international companies, many of which have substantially greater financial, technical, marketing and distribution resources and brand name recognition than we have. Other companies, including some of our customers, may enter the market for optical subsystems and network test and monitoring systems. We may not be able to compete successfully against either current or future competitors. Increased competition could result in significant price erosion, reduced revenue, lower margins or loss of market share, any of which would significantly harm our business. For optical subsystems, we compete primarily with Agilent Technologies, Inc., Infineon, JDS Uniphase Corporation, Luminent, Inc., Molex, Optical Communications Products, Inc., Picolight, Inc., Premise Networks and Stratos International Inc. For network test and monitoring systems, we compete primarily with Ancot Corporation, I-Tech Corporation, Network Associates, Inc. and Xyratex International. Our competitors continue to introduce improved products with lower prices, and we will have to do the same to remain competitive. In addition, some of our current and potential customers may attempt to integrate their operations by producing their own optical components and subsystems and network test and monitoring systems or acquiring one of our competitors, thereby eliminating the need to purchase our products. Furthermore, larger companies in other related industries, such as the telecommunications industry, may develop or acquire technologies and apply their significant resources, including their distribution channels and brand name recognition, to capture significant market share.

Decreases in average selling prices of our products may reduce gross margins

The market for optical subsystems is characterized by declining average selling prices resulting from factors such as increased competition, overcapacity, the introduction of new products and increased unit volumes as manufacturers continue to deploy network and storage systems. We have in the past experienced, and in the future may experience, substantial period-to-period fluctuations in operating results due to declining average selling prices. We anticipate that average selling prices will decrease in the future in response to product introductions by competitors or us, or by other factors, including price pressures from significant customers. Therefore, in order to achieve and sustain profitable operations, we must continue to develop and introduce on a timely basis new products that incorporate features that can be sold at higher average selling prices. Failure to do so could cause our revenues and gross margins to decline, which would result in additional operating losses and significantly harm our business.

We may be unable to reduce the cost of our products sufficiently to enable us to compete with others. Our cost reduction efforts may not allow us to keep pace with competitive pricing pressures and could adversely affect our margins. In order to remain

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competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes. We may not be successful in redesigning our products or delivering our products to market in a timely manner. We cannot assure you that any redesign will result in sufficient cost reductions to allow us to reduce the price of our products to remain competitive or improve our gross margin.

Shifts in our product mix may result in declines in gross margins

Our gross profit margins vary among our product families, and are generally higher on our network test and monitoring systems than on our optical subsystems. Our gross margins are generally lower for newly introduced products and improve as unit volumes increase. Our overall gross margins have fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices for older products and our ability to reduce product costs, and these fluctuations are expected to continue in the future.

Past and future acquisitions could be difficult to integrate, disrupt our business, dilute stockholder value and harm our operating results

Since October 2000, we have completed the acquisition of six privately-held companies and certain businesses and assets from four other companies, including our recently completed acquisition of the VCSEL Optical Products business unit from Honeywell International Inc. and certain assets of the test and monitoring business of Data Transit Corp. In addition, we have entered into a definitive agreement to acquire the fiber optics business unit of Infineon. We continue to review opportunities to acquire other businesses, product lines or technologies that would complement our current products, expand the breadth of our markets or enhance our technical capabilities, or that may otherwise offer growth opportunities, and we from time to time make proposals and offers, and take other steps, to acquire businesses, products and technologies. Several of our past acquisitions, as well as our pending acquisition of the Infineon fiber optics business unit, have been material, and acquisitions that we may complete in the future may be material. In seven of our ten acquisitions, we issued stock as all or a portion of the consideration. We are obligated to release additional shares from escrow and to issue additional shares in connection with one of the acquisitions upon the occurrence of certain contingencies and the achievement of certain milestones, and we will issue additional shares in connection with the pending acquisition of the Infineon fiber optics business unit. The issuance of stock in these and any future transactions has or would dilute stockholders percentage ownership.

Other risks associated with acquiring the operations of other companies include:

- problems assimilating the purchased operations, technologies or products;
- unanticipated costs associated with the acquisition;
- diversion of management s attention from our core business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience; and
- potential loss of key employees of purchased organizations.

Several of our past acquisitions have not been successful. During fiscal 2003, we sold some of the assets acquired in two prior acquisitions, discontinued a product line and closed one of our acquired facilities. As a result of these activities, we incurred significant restructuring charges and charges for the write-down of assets associated with those acquisitions. We cannot assure you that we will be successful in overcoming future problems encountered in connection with our past or future acquisitions, and our inability to do so could significantly harm our business. In addition, to the extent that the economic benefits associated with any of our acquisitions diminish in the future, we may be required to record additional write downs of goodwill, intangible assets or other assets associated with such acquisitions, which would adversely affect our operating results.

Our customers often evaluate our products for long and variable periods, which causes the timing of our revenues and results of operations to be unpredictable

The period of time between our initial contact with a customer and the receipt of an actual purchase order may span a year or more. During this time, customers may perform, or require us to perform, extensive and lengthy evaluation and testing of our products before purchasing and using them in their equipment. Our customers do not typically share information on the duration or magnitude of these qualification procedures. The length of these qualification processes also may vary substantially by product and customer, and, thus, cause our results of operations to be unpredictable. While our potential customers are qualifying our products and before they place an order with us, we may incur substantial research and development and sales and marketing expenses and expend significant management effort. Even after incurring such costs we ultimately may not sell any products to such potential customers. In addition, these qualification processes often make it difficult to obtain new customers, as customers are reluctant to expend the resources necessary to qualify a new supplier if they have one or more existing qualified sources. Once our products have been qualified, the agreements that we enter into with our customers typically contain no minimum purchase commitments. Failure of our customers to incorporate our products into their systems would significantly harm our business.

We depend on facilities located outside of the United States to manufacture a substantial portion of our products, which subjects us to additional risks

In addition to our principal manufacturing facility in Malaysia, we operate a smaller facility in China and also rely on two contract manufacturers located outside of the United States. Upon completion of our pending acquisition of the Infineon fiber optics business unit, we will operate additional facilities in Germany and the Czech Republic. Each of these facilities and manufacturers subjects us to additional risks associated with international manufacturing, including:

- unexpected changes in regulatory requirements;
- legal uncertainties regarding liability, tariffs and other trade barriers;
- inadequate protection of intellectual property in some countries;
- greater incidence of shipping delays;
- greater difficulty in overseeing manufacturing operations;
- greater difficulty in hiring technical talent needed to oversee manufacturing operations;
- potential political and economic instability;
- currency fluctuations; and
- the outbreak of infectious diseases such as severe acute respiratory syndrome, or SARS, which could result in travel restrictions or the closure of our facilities or the facilities of our customers and suppliers.

Any of these factors could significantly impair our ability to source our contract manufacturing requirements internationally.

Our business and future operating results are subject to a wide range of uncertainties arising out of the continuing threat of terrorist attacks and ongoing military action in the Middle East

Like other U.S. companies, our business and operating results are subject to uncertainties arising out of the continuing threat of terrorist attacks on the United States and ongoing military action in the Middle East, including the potential worsening or extension of the current global economic slowdown, the economic consequences of the war in Iraq or additional terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. In particular, due to these uncertainties we are subject to:

- increased risks related to the operations of our manufacturing facilities in Malaysia and China;

- greater risks of disruption in the operations of our Asian contract manufacturers and more frequent instances of shipping delays; and the risk that future tightening of immigration controls may adversely affect the residence status of non-U.S. engineers and other key technical employees in our U.S. facilities or our ability to hire new non-U.S. employees in such facilities.

We may lose sales if our suppliers fail to meet our needs

We currently purchase several key components used in the manufacture of our products from single or limited sources. We depend on these sources to meet our needs. Moreover, we depend on the quality of the products supplied to us over which we have limited control. We have encountered shortages and delays in obtaining components in the past and expect to encounter shortages and delays in the future. If we cannot supply products due to a lack of components, or are unable to redesign products with other components in a timely manner, our business will be significantly harmed. We generally have no long-term contracts for any of our components. As a result, a supplier can discontinue supplying components to us without penalty. If a supplier discontinued supplying a component, our business may be harmed by the resulting product manufacturing and delivery delays. We are also subject to potential delays in the development by our suppliers of key components which may affect our ability to introduce new products.

We use rolling forecasts based on anticipated product orders to determine our component requirements. Lead times for materials and components that we order vary significantly and depend on factors such as specific supplier requirements, contract terms and current market demand for particular components. If we overestimate our component requirements, we may have excess inventory, which would increase our costs. If we underestimate our component requirements, we may have inadequate inventory, which could interrupt our manufacturing and delay delivery of our products to our customers. Any of these occurrences would significantly harm our business.

We have made and may continue to make strategic investments which may not be successful and may result in the loss of all or part of our invested capital

Through the second quarter of fiscal 2005, we recorded minority equity investments in early-stage technology companies, totaling $44.5 million. Our investments in these early stage companies were primarily motivated by our desire to gain early access to new technology. We intend to review additional opportunities to make strategic equity investments in pre-public companies where we believe such investments will provide us with opportunities to gain access to important technologies or otherwise enhance important commercial relationships. We have little or no influence over the early-stage companies in which we have made or may make these strategic, minority equity investments. Each of these investments in pre-public companies involves a high degree of risk. We may not be successful in achieving the financial, technological or commercial advantage upon which any given investment is premised, and failure by the early-stage company to achieve its own business objectives or to raise capital needed on acceptable economic terms could result in a loss of all or part of our invested capital. In fiscal 2003, we wrote off $12.0 million in two investments which became impaired. In fiscal 2004, we wrote off $1.6 million in two additional investments, and we may be required to write off all or a portion of the $24.4 million in such investments remaining on our balance sheet as of October 31, 2004 in future periods.

We are subject to pending legal proceedings

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased our common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, Jerry S. Rawls, our President and Chief Executive Officer, Frank H. Levinson, our Chairman of the Board and Chief Technical Officer, Stephen K. Workman, our Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for our initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, the court denied our motion to dismiss the complaint. In July 2004, we and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs will dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers will be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, we would be responsible to pay our pro rata portion of the shortfall, up to the amount of the self-insured retention under our insurance policy, which may be up to $2 million. The timing and amount of payments that we could be required to make under the proposed settlement will depend on several factors, principally the timing and amount of any payment by the insurers pursuant to the

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$1 billion guaranty. The settlement is subject to approval of the Court, which cannot be assured. If the settlement is not approved by the Court, we intend to defend the lawsuit vigorously. However, the litigation is in the preliminary stage, and we cannot predict its outcome. The litigation process is inherently uncertain. If litigation proceeds and its outcome is adverse to us and if we are required to pay significant monetary damages, our business would be significantly harmed.

The new requirements of Section 404 of the Sarbanes-Oxley Act will increase our operating expenses, and our potential inability to fully comply with the requirements of the Section 404 could adversely affect the market price of our common stock

Rules adopted by the Securities and Exchange Commission pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require annual review and evaluation of our internal control systems, and attestation of these systems by our independent auditors. We are currently undergoing a through review of our internal control systems and procedures and implementing improvements that will be necessary in order us to comply with the requirements of Section 404 by the end of our fiscal year ending April 30, 2005. This evaluation process has required us to hire additional personnel and engage outside advisory services and will result in additional accounting and legal expenses, all of which will cause our operating expenses to increase. In addition, the evaluation and attestation processes required by Section 404 are new and untested, and we have encountered a number of problems and delays in completing the implementation of improvements in our internal controls. As a result, we may be unable to fully comply with the requirements of Section 404 by the April 30, 2005 deadline. Our inability to complete the implementation of required improvements in our internal controls by April 30, 2005 or to obtain a timely and favorable attestation by our independent auditors could result in a loss of investor confidence in our financial management and the reliable of our financial statements and cold adversely affect the market price of our common stock.

Because of competition for technical personnel, we may not be able to recruit or retain necessary personnel

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, technical, sales and marketing, finance and manufacturing personnel. In particular, we may need to increase the number of technical staff members with experience in high-speed networking applications as we further develop our product lines. Competition for these highly skilled employees in our industry is intense. Our failure to attract and retain these qualified employees could significantly harm our business. The loss of the services of any of our qualified employees, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel could hinder the development and introduction of and negatively impact our ability to sell our products. In addition, employees may leave our company and subsequently compete against us. Moreover, companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices. We have been subject to claims of this type and may be subject to such claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation. We could incur substantial costs in defending ourselves against these claims, regardless of their merits.

Our products may contain defects that may cause us to incur significant costs, divert our attention from product development efforts and result in a loss of customers

Networking products frequently contain undetected software or hardware defects when first introduced or as new versions are released. Our products are complex and defects may be found from time to time. In addition, our products are often embedded in or deployed in conjunction with our customers products which incorporate a variety of components produced by third parties. As a result, when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relation problems or loss of customers, all of which would harm our business.

Our failure to protect our intellectual property may significantly harm our business

Our success and ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements to establish and protect our proprietary rights. We license certain of our proprietary technology, including our digital diagnostics technology, to customers who include current and potential competitors, and we rely largely on provisions of our licensing agreements to protect our intellectual property rights in this technology. Although a number of patents have been issued to us, we have obtained a number of other patents as a result of our acquisitions, and we have filed applications for additional patents, we cannot assure you that any patents will issue as a result of pending patent applications or that our issued patents will be upheld. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of a competitive advantage and decreased revenues. Despite our efforts to protect our proprietary rights, existing patent, copyright, trademark and trade secret laws afford only limited protection. In addition, the laws of some foreign

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countries do not protect our proprietary rights to the same extent as do the laws of the United States. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may not be able to prevent misappropriation of our technology or deter others from developing similar technology. Furthermore, policing the unauthorized use of our products is difficult. Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. This litigation could result in substantial costs and diversion of resources and could significantly harm our business.

Claims that we infringe third-party intellectual property rights could result in significant expenses or restrictions on our ability to sell our products

The networking industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We have been involved in the past in patent infringement lawsuits. From time to time, other parties may assert patent, copyright, trademark and other intellectual property rights to technologies and in various jurisdictions that are important to our business. Any claims asserting that our products infringe or may infringe proprietary rights of third parties, if determined adversely to us, could significantly harm our business. Any claims, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could significantly harm our business. Royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. In addition, our agreements with our customers typically require us to indemnify our customers from any expense or liability resulting from claimed infringement of third party intellectual property rights. In the event a claim against us was successful and we could not obtain a license to the relevant technology on acceptable terms or license a substitute technology or redesign our products to avoid infringement, our business would be significantly harmed.

Our executive officers and directors and entities affiliated with them own a large percentage of our voting stock, and Infineon will acquire a large block of our common stock upon consummation of the pending acquisition, which will result in a substantial concentration of control and could have the effect of delaying or preventing a change in our control

As of November 30, 2004, our executive officers, directors and entities affiliated with them beneficially owned approximately 35.9 million shares of our common stock, or approximately 16.0% of the outstanding shares. These stockholders, acting together, may be able to substantially influence the outcome of matters requiring approval by stockholders, including the election or removal of directors and the approval of mergers or other business combination transactions. In addition, upon the consummation of the pending acquisition of Infineon s fiber optics business unit, Infineon will hold approximately 33% of our outstanding common stock. Accordingly, following the acquisition, Infineon will be able to substantially influence the outcome of matters requiring stockholder approval, and Infineon, our executive officers, directors and entities affiliated with them, voting together, would be able to effectively control the outcome of such matters. This concentration of ownership could have the effect of delaying or preventing a change in control or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could have an adverse effect on the market price of our common stock or prevent our stockholders from realizing a premium over the market price for their shares of common stock.

The conversion of our outstanding convertible subordinated notes would result in substantial dilution to our current stockholders.

We currently have outstanding $5^1/4$ convertible subordinated notes due 2008 in the principal amount of \$100,250,000 and $2^1/2$ convertible subordinated notes due 2010 in the principal amount of \$150,000,000. The $5^1/4$ notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of our common stock at a conversion price of \$5.52 per share. The $2^1/2$ notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of our common stock at a conversion price of \$3.705 per share. An aggregate of 58,647,020 shares of common stock would be issued upon the conversion of all outstanding convertible subordinated notes at these exchange rates, which would significantly dilute the voting power and ownership percentage of our existing stockholders. We have previously entered into privately negotiated transactions with certain holders of our convertible subordinated notes for the repurchase of notes in exchange for a greater number of shares of our common stock than would have been issued had the principal amount of the notes been converted at the original conversion rate specified in the notes, thus resulting in more dilution. Although we do not currently have any plans to enter into similar transactions in the future, if we were to do so there would be additional dilution to the voting power and percentage ownership of our existing stockholders.

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Delaware law, our charter documents and our stockholder rights plan contain provisions that could discourage or prevent a potential takeover, even if such a transaction would be beneficial to our stockholders

Some provisions of our certificate of incorporation and bylaws, as well as provisions of Delaware law, may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable. These include provisions:

- authorizing the board of directors to issue additional preferred stock;
- prohibiting cumulative voting in the election of directors;
- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholder actions by written consent;
- creating a classified board of directors pursuant to which our directors are elected for staggered three-year terms;
- permitting the board of directors to increase the size of the board and to fill vacancies;
- requiring a super-majority vote of our stockholders to amend our bylaws and certain provisions of our certificate of incorporation; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law which limit the right of a corporation to engage in a business combination with a holder of 15% or more of the corporation s outstanding voting securities, or certain affiliated persons.

In addition, in September 2002, our board of directors adopted a stockholder rights plan under which our stockholders received one share purchase right for each share of our common stock held by them. Subject to certain exceptions, the rights become exercisable when a person or group (other than certain exempt persons) acquires, or announces its intention to commence a tender or exchange offer upon completion of which such person or group would acquire, 20% or more of our common stock without prior board approval. Should such an event occur, then, unless the rights are redeemed or have expired, our stockholders, other than the acquirer, will be entitled to purchase shares of our common stock at a 50% discount from its then-Current Market Price (as defined) or, in the case of certain business combinations, purchase the common stock of the acquirer at a 50% discount. Because the acquisition of the Infineon fiber optics business unit was approved by our board of directors, the rights will not become exercisable as a result of the issuance of our common stock to Infineon.

Although we believe that these charter and bylaw provisions, provisions of Delaware law and our stockholder rights plan provide an opportunity for the board to assure that our stockholders realize full value for their investment, they could have the effect of delaying or preventing a change of control, even under circumstances that some stockholders may consider beneficial.

Our business and future operating results may be adversely affected by events outside of our control

Our business and operating results are vulnerable to events outside of our control, such as earthquakes, fire, power loss, telecommunications failures and uncertainties arising out of terrorist attacks in the United States and overseas. Our corporate headquarters and a portion of our manufacturing operations are located in California. California in particular has been vulnerable to natural disasters, such as earthquakes, fires and floods, and other risks which at times have disrupted the local economy and posed physical risks to our property. We are also dependent on communications links with our overseas manufacturing locations and would be significantly harmed if these links were interrupted for any significant length of time. We presently do not have adequate redundant, multiple site capacity if any of these events were to occur, nor can we be certain that the insurance we maintain against these events would be adequate.

Our stock price has been and is likely to continue to be volatile

The trading price of our common stock has been and is likely to continue to be subject to large fluctuations. Our stock price may increase or decrease in response to a number of events and factors, including:

trends in our industry and the markets in which we operate;

changes in the market price of the products we sell;

changes in financial estimates and recommendations by securities analysts;

acquisitions and financings;

quarterly variations in our operating results;

the operating and stock price performance of other companies that investors in our common stock may deem comparable; and

purchases or sales of blocks of our common stock.

Part of this volatility is attributable to the current state of the stock market, in which wide price swings are common. This volatility may adversely affect the prices of our common stock regardless of our operating performance.

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

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. We place our investments with high credit issuers in short-term securities with maturities ranging from overnight up to 36 months or have characteristics of such short-term investments. The average maturity of the portfolio will not exceed 18 months. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity. We have no investments denominated in foreign country currencies and therefore our investments are not subject to foreign exchange risk.

We invest in equity instruments of privately held companies for business and strategic purposes. These investments are included in other long-term assets and are accounted for under the cost method when our ownership interest is less than 20% and we do not have the ability to exercise significant influence. For entities in which we hold greater than a 20% ownership interest, or where we have the ability to exercise significant influence, we use the equity method. We recorded losses of $432,000 and $793,000 in the three and six months ended October 31, 2004, respectively, and $269,000 and $473,000 in the three and six months ended October 31, 2003 for investments accounted for under the equity method. For these non-quoted investments, our policy is to regularly review the assumptions underlying the operating performance and cash flow forecasts in assessing the carrying values. We identify and record impairment losses when events and circumstances indicate that such assets are impaired. We recognized no impairment in the quarter ended October 31, 2004. If our investment in a privately-held company becomes marketable equity securities upon the company s completion of an initial public offering or its acquisition by another company, our investment would be subject to significant fluctuations in fair market value due to the volatility of the stock market. There has been no material change in our interest rate exposure since April 30, 2004.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

In connection with a review of accrued liability accounts in preparation for the close of our third fiscal quarter ended January 30, 2005, management discovered that, in October 2004, an intra-company transfer of inventory was erroneously charged to cost of revenues, resulting in an overstatement of cost of revenues in the amount of $1,786,000 for both the three and six month periods ended October 31, 2004 and an overstatement of accounts payable as of October 31, 2004 by the same amount. The error was the result of a change in configuration of our Oracle information system that was made improperly and the failure of our review procedures to detect the initial error.

We have recorded corrections to reduce cost of revenues for both periods by $1,786,000 and to reduce accounts payable as of October 31, 2004 by the same amount. These corrections are reflected in the restated financial statements included in this Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended October 31, 2004.

In connection with our conclusion to restate our financial statements for the quarter ended October 31, 2004, we also considered the disclosure controls and procedures and internal control over financial reporting in place during the quarter. According to the Public Company Accounting Oversight Board s Auditing Standard No. 2, a material weakness is defined as a significant deficiency, or combination of significant deficiencies, that results in

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more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. We have concluded that controls in place at October 31, 2004 did not adequately prevent or detect the error in our financial statements and that, as such, a material weakness existed at that time. We subsequently made changes in our disclosure controls and our internal controls over financial reporting designed to address these deficiencies. Specifically, management has instituted additional procedures which require our Controller to review all configuration changes to our information system that affect general ledger posting and we have implemented an additional layer of review and approval procedures for all balance sheet reconciliations. We believe these control improvements have corrected the material weakness.

Prior to the initial filing of our Quarterly Report on Form 10-Q for the quarter ended October 31, 2004, we completed an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Act of 1934, as amended. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of October 31, 2004. However, as a result of our decision to restate our financial statements, we completed, prior to the filing of this amendment, a second evaluation. Based on this second evaluation, our principal executive officer and principal financial officer concluded that, solely as a result of the material weakness described above, the Company s disclosure controls and procedures were not effective as of October 31, 2004. However, management believes that the disclosure control and internal control improvements described above that were implemented subsequent to October 31, 2004 have corrected the material weakness that was identified. Based on its second evaluation, our principal executive officer and principal accounting officer concluded that our disclosure controls and procedures were effective as of the date of filing this Amendment No. 1.

Internal Control over Financial Reporting

We did not make any changes in our internal control over financial reporting, as that term is defined in rule 13a-15(f) under the Exchange Act, during the quarter ended October 31, 2004 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, as explained above, we made changes to our internal control over financial reporting to address a material weakness identified subsequent to the end of the quarter.

Rules adopted by the Securities and Exchange Commission pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 require annual review and evaluation of our internal control systems, and attestation of these systems by our independent auditors. We are currently undergoing a thorough review of our internal control systems and procedures and implementing improvements that will be necessary in order for us to comply with the requirements of Section 404 by the end of our fiscal year ending April 30, 2005. The evaluation and attestation requirements of Section 404 will require significant documentation and testing of our internal control environment. These efforts may reveal the need for remediation and realignment of our control processes and additional testing to provide evidence that the remediated controls are effective and functioning as intended. As a result, we may be unable to fully comply with the requirements of Section 404 by the April 30, 2005 deadline.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased our common stock from

November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, Jerry S. Rawls, our President and Chief Executive Officer, Frank H. Levinson, our Chairman of the Board and Chief Technical Officer, Stephen K. Workman, our Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for our initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as subsequently amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934, on the grounds that the prospectuses incorporated in the registration statements for the offerings failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of our stock sold in the offerings and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of our stock sold in the offerings to those customers in exchange for which the customers agreed to purchase additional shares of our stock in the aftermarket at pre-determined prices. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, the Court denied our motion to dismiss the complaint. In July 2004, we and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs will dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers will be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, we would be responsible to pay our pro rata portion of the shortfall, up to the amount of the self-insured retention under our insurance policy, which may be up to $2 million. The timing and amount of payments that we could be required to make under the proposed settlement will depend on several factors, principally the timing and amount of any payment by the insurers pursuant to the $1 billion guaranty. The settlement is subject to approval of the Court, which cannot be assured. If the settlement is not approved by the Court, we intend to defend the lawsuit vigorously. However,

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the litigation is in the preliminary stage, and we cannot predict its outcome. The litigation process is inherently uncertain. If litigation proceeds and its outcome is adverse to us and if we are required to pay significant monetary damages, our business would be significantly harmed.

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

On August 6, 2004, we completed the purchase of substantially all of the assets of Data Transit Corp. for a cash payment of $500,000 and the issuance of a convertible promissory note in the original principal amount of $16,270,000. The original principal amount of the note is adjustable downward by up to $3,188,375 should the acquired business fail to achieve certain business integration milestones. The principal balance of the note bears interest at 8% per annum and is due and payable, if not sooner converted, on the second anniversary of its issuance. Generally, the terms of the convertible promissory note provide for automatic conversion of the outstanding principal and interest into shares of the Company s common stock on a biweekly basis, commencing on the later of the effectiveness of a registration statement covering the resale of the shares or one year after the closing date. The conversion price is the average closing bid price of the stock for the three days preceding the date of conversion. We agreed to file a registration statement with the Securities and Exchange Commission to cover the resale of the shares of common stock issuable upon conversion of the convertible promissory note. The issuance of the convertible promissory note and the shares of the Company s common stock issuable upon conversion thereof were not registered under the Securities Act of 1933 (the Securities Act) in reliance on the exemption from registration set forth in Section 4(2) of the Securities Act.

Item 6. ***Exhibits***

The following exhibits are filed herewith:

31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer 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

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment No 1. to Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

FINISAR CORPORATION

By: /s/ JERRY S. RAWLS
Jerry S. Rawls
Chief Executive Officer

By: /s/ STEPHEN K. WORKMAN
Stephen K. Workman
Senior Vice President, Finance and Chief Financial Officer

Dated: February 10, 2005

EXHIBIT INDEX

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