

CIENA CORP
Form 10-Q
March 10, 2011

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

(Mark one)

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

For the quarterly period ended January 31, 2011

OR

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

For the transition period from _____ to _____

Commission file number: 0-21969

Ciena Corporation

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

23-2725311

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

1201 Winterson Road, Linthicum, MD

(Address of Principal Executive Offices)

21090

(Zip Code)

(410) 865-8500

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(do not check if smaller reporting company)

Smaller reporting

company

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

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

Class
common stock, \$.01 par value

Outstanding at March 4, 2011
95,005,508

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Table of Contents**PART I FINANCIAL INFORMATION*****Item 1. Financial Statements***

CIENA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Quarter Ended January 31,	
	2010	2011
Revenue:		
Products	\$ 149,054	\$ 352,427
Services	26,822	80,881
Total revenue	175,876	433,308
Cost of goods sold:		
Products	76,669	214,401
Services	19,047	50,401
Total cost of goods sold	95,716	264,802
Gross profit	80,160	168,506
Operating expenses:		
Research and development	50,033	95,790
Selling and marketing	34,237	57,092
General and administrative	12,763	38,314
Acquisition and integration costs	27,031	24,185
Amortization of intangible assets	5,981	28,784
Restructuring costs	(21)	1,522
Change in fair value of contingent consideration		(3,289)
Total operating expenses	130,024	242,398
Loss from operations	(49,864)	(73,892)
Interest and other income (loss), net	(773)	6,265
Interest expense	(1,828)	(9,550)
Loss before income taxes	(52,465)	(77,177)
Provision for income taxes	868	1,879
Net loss	\$ (53,333)	\$ (79,056)
Basic net loss per common share	\$ (0.58)	\$ (0.84)
Diluted net loss per potential common share	\$ (0.58)	\$ (0.84)
Weighted average basic common shares outstanding	92,321	94,496

Weighted average dilutive potential common shares outstanding	92,321	94,496
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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

	October 31, 2010	January 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 688,687	\$ 625,820
Accounts receivable, net	343,582	369,718
Inventories	261,619	267,346
Prepaid expenses and other	147,680	135,058
Total current assets	1,441,568	1,397,942
Equipment, furniture and fixtures, net	120,294	123,956
Other intangible assets, net	426,412	389,275
Other long-term assets	129,819	138,471
Total assets	\$ 2,118,093	\$ 2,049,644
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 200,617	\$ 202,236
Accrued liabilities	193,994	186,039
Deferred revenue	75,334	78,575
Total current liabilities	469,945	466,850
Long-term deferred revenue	29,715	26,901
Other long-term obligations	16,435	18,147
Convertible notes payable	1,442,705	1,442,619
Total liabilities	1,958,800	1,954,517
Commitments and contingencies		
Stockholders' equity:		
Preferred stock - par value \$0.01; 20,000,000 shares authorized; zero shares issued and outstanding		
Common stock - par value \$0.01; 290,000,000 shares authorized; 94,060,300 and 94,935,342 shares issued and outstanding	941	949
Additional paid-in capital	5,702,137	5,717,268
Accumulated other comprehensive income	1,062	813
Accumulated deficit	(5,544,847)	(5,623,903)
Total stockholders' equity	159,293	95,127

Total liabilities and stockholders' equity	\$ 2,118,093	\$ 2,049,644
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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

	Three Months Ended January 31,	
	2010	2011
Cash flows from operating activities:		
Net loss	\$ (53,333)	\$ (79,056)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of premium on marketable securities	365	
Change in fair value of embedded redemption feature		(7,130)
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	5,871	14,543
Share-based compensation costs	8,282	9,864
Amortization of intangible assets	7,631	37,137
Provision for inventory excess and obsolescence	950	2,645
Provision for warranty	3,060	1,093
Other	471	851
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	12,627	(26,451)
Inventories	(8,295)	(8,372)
Prepaid expenses and other	9,204	(4,912)
Accounts payable, accruals and other obligations	12,672	(4,300)
Deferred revenue	4,966	427
Net cash provided by (used in) operating activities	4,471	(63,661)
Cash flows from investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(7,009)	(17,265)
Restricted cash	(5,520)	(3,505)
Purchase of available for sale securities	(63,591)	
Proceeds from maturities of available for sale securities	179,739	
Proceeds from sales of available for sale securities	18,000	
Deposit on business acquisition	(38,450)	
Receipt of contingent consideration related to business acquisition		16,394
Net cash provided by (used in) investing activities	83,169	(4,376)
Cash flows from financing activities:		
Proceeds from issuance of common stock and warrants	83	5,275
Net cash provided by financing activities	83	5,275
Effect of exchange rate changes on cash and cash equivalents	(248)	(105)
Net increase (decrease) in cash and cash equivalents	87,723	(62,762)

Cash and cash equivalents at beginning of period	485,705	688,687
Cash and cash equivalents at end of period	\$ 573,180	\$ 625,820

Supplemental disclosure of cash flow information

Cash paid during the period for interest	\$ 2,560	\$ 2,458
Cash paid during the period for income taxes, net	\$ 736	\$ 1,698

Non-cash investing and financing activities

Purchase of equipment in accounts payable	\$ 3,294	\$ 3,815
Fixed assets acquired under capital leases	\$	\$ 1,456

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

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CIENA CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) INTERIM FINANCIAL STATEMENTS

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

On March 19, 2010, Ciena completed its acquisition of substantially all of the optical networking and Carrier Ethernet assets of Nortel's Metro Ethernet Networks (MEN Business). Ciena's results of operations for the first quarter of fiscal 2010 do not include the results of the MEN Business. See Note 3 below.

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

(2) SIGNIFICANT ACCOUNTING POLICIES*Use of Estimates*

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

Cash and Cash Equivalents

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

Investments

Ciena has certain minority equity investments in privately held technology companies that are classified as other assets. These investments are carried at cost because Ciena owns less than 20% of the voting equity and does not have the ability to exercise significant influence over these companies. These investments involve a high degree of risk as the markets for the technologies or products manufactured by these companies are usually early stage at the time of Ciena's investment and such markets may never be significant. Ciena could lose its entire investment in some or all of these companies. Ciena monitors these investments for impairment and makes appropriate reductions in carrying values when necessary.

Table of Contents*Inventories*

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

Segment Reporting

Ciena's chief operating decision maker, its chief executive officer, evaluates performance and allocates resources based on multiple factors, including segment profit (loss) information for the following product categories: (i) Packet-Optical Transport; (ii) Packet-Optical Switching; (iii) Carrier Ethernet Service Delivery; and (iv) Software and Services. Operating segments are defined as components of an enterprise: that engage in business activities which may earn revenue and incur expense; for which discrete financial information is available; and for which such information is evaluated regularly by the chief operating decision maker for purposes of allocating resources and assessing performance. Ciena considers the four product categories above to be its operating segments for reporting purposes. See Note 19.

Long-lived Assets

Long-lived assets include: equipment, furniture and fixtures; intangible assets; and maintenance spares. Ciena tests long-lived assets for impairment whenever triggering events or changes in circumstances indicate that the assets carrying amount is not recoverable from its undiscounted cash flows. An impairment loss is measured as the amount by which the carrying amount of the asset or asset group exceeds its fair value. Ciena's long-lived assets are assigned to asset groups which represent the lowest level for which cash flows can be identified.

Equipment, Furniture and Fixtures

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

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

Intangible Assets

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

Maintenance Spares

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

Table of Contents*Concentrations*

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

Historically, a large percentage of Ciena's revenue has been the result of sales to a small number of communications service providers. Consolidation among Ciena's customers has increased this concentration. Consequently, Ciena's accounts receivable are concentrated among these customers. See Notes 8 and 19 below.

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

Revenue Recognition

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

Ciena applies the percentage of completion method to long-term arrangements where it is required to undertake significant production, customizations or modification engineering, and reasonable and reliable estimates of revenue and cost are available. Utilizing the percentage of completion method, Ciena recognizes revenue based on the ratio of actual costs incurred to date to total estimated costs expected to be incurred. In instances that do not meet the percentage of completion method criteria, recognition of revenue is deferred until there are no uncertainties regarding customer acceptance.

Software revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. In instances where final acceptance criteria of the software is specified by the customer, revenue is deferred until there are no uncertainties regarding customer acceptance.

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

Accounting for multiple element arrangements entered into prior to fiscal 2011

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

element(s) have value to the customer on a stand-alone basis, objective and reliable evidence of fair value exists for the undelivered element(s), and delivery of the undelivered element(s) is probable and substantially in Ciena's control. Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or using the residual method if objective evidence of fair value does not exist for the delivered element(s). The revenue recognition criteria described above are applied to each separate unit of accounting. If these criteria are not met, revenue is deferred until the criteria are met or the last element has been delivered.

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

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

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

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

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

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

Warranty Accruals

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

Accounts Receivable, Net

Ciena's allowance for doubtful accounts is based on its assessment, on a specific identification basis, of the collectibility of customer accounts. Ciena performs ongoing credit evaluations of its customers and generally has not required collateral or other forms of security from its customers. In determining the appropriate balance for Ciena's allowance for doubtful accounts, management considers each individual customer account receivable in order to

determine collectibility. In doing so, management considers creditworthiness, payment history, account activity and communication with such customer. If a customer's financial condition changes, Ciena may be required to record an allowance for doubtful accounts, which would negatively affect its results of operations.

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

Advertising Costs

Ciena expenses all advertising costs as incurred.

Legal Costs

Ciena expenses legal costs associated with litigation defense as incurred.

Share-Based Compensation Expense

Ciena measures and recognizes compensation expense for share-based awards based on estimated fair values on the date of grant. Ciena estimates the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This model is affected by Ciena's stock price as well as estimates regarding a number of variables including expected stock price volatility over the expected term of the award and projected employee stock option exercise behaviors. Ciena estimates the fair value of each share-based award based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense to its consolidated statement of operations for those options or shares that are expected ultimately to vest. Ciena uses two attribution methods to record expense, the straight-line method for grants with service-based vesting and the graded-vesting method, which considers each performance period or tranche separately, for all other awards. See Note 17 below.

Income Taxes

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

In the ordinary course of business, transactions occur for which the ultimate outcome may be uncertain. In addition, tax authorities periodically audit Ciena's income tax returns. These audits examine significant tax filing positions, including the timing and amounts of deductions and the allocation of income tax expenses among tax jurisdictions. Ciena is currently under audit in India for 2007. Management does not expect the outcome of this audit to have a material adverse effect on the Company's consolidated financial position, result of operations or cash flows. Ciena's major tax jurisdictions and the earliest open tax years are as follows: United States (2007), United Kingdom (2005), Canada (2005) and India (2007). However, limited adjustments can be made to Federal tax returns in earlier years in order to reduce net operating loss carryforwards. Ciena classifies interest and penalties related to uncertain tax positions as a component of income tax expense. All of the uncertain tax positions, if recognized, would decrease the effective income tax rate.

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

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

Loss Contingencies

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

Fair Value of Financial Instruments

The carrying value of Ciena's cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximates fair market value due to the relatively short period of time to maturity. For information related to the fair value of Ciena's convertible notes, see Note 15 below.

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

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

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

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

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

Restructuring

From time to time, Ciena takes actions to align its workforce, facilities and operating costs with perceived market opportunities and business conditions. Ciena implements these restructuring plans and incurs the associated liability concurrently. Generally accepted accounting principles require that a liability for the cost associated with an exit or disposal activity be recognized in the period in which the liability is incurred, except for one-time employee termination benefits related to a service period of more than 60 days, which are accrued over the service period. See Note 5 below.

Foreign Currency

Some of Ciena's foreign branch offices and subsidiaries use the U.S. dollar as their functional currency, because Ciena, as the U.S. parent entity, exclusively funds the operations of these branch offices and subsidiaries. For those

subsidiaries using the local currency as their functional currency, assets and liabilities are translated at exchange rates in effect at the balance sheet date, and the statement of operations is translated at a monthly average rate. Resulting translation adjustments are recorded directly to a separate component of stockholders' equity. Where the monetary assets and liabilities are transacted in a currency other than the entity's functional currency, re-measurement adjustments are recorded in other income. The net gain (loss) on foreign currency re-measurement and exchange rate changes is immaterial for separate financial statement presentation.

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Derivatives

Ciena's 4.0% convertible senior notes include a redemption feature that is accounted for as a separate embedded derivative. The embedded redemption feature is recorded at fair value on a recurring basis and these changes are included in interest and other income, net on the Condensed Consolidated Statement of Operations.

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

Ciena calculates basic earnings per share (EPS) by dividing earnings attributable to common stock by the weighted-average number of common shares outstanding for the period. Diluted EPS includes other potential dilutive common stock that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. Ciena uses a dual presentation of basic and diluted EPS on the face of its income statement. A reconciliation of the numerator and denominator used for the basic and diluted EPS computations is set forth in Note 16.

Software Development Costs

Ciena develops software for sale to its customers. Generally accepted accounting principles require the capitalization of certain software development costs that are incurred subsequent to the date technological feasibility is established and prior to the date the product is generally available for sale. The capitalized cost is then amortized straight-line over the estimated life of the product. Ciena defines technological feasibility as being attained at the time a working model is completed. To date, the period between Ciena achieving technological feasibility and the general availability of such software has been short, and software development costs qualifying for capitalization have been insignificant. Accordingly, Ciena has not capitalized any software development costs.

(3) BUSINESS COMBINATIONS

Acquisition of MEN Business

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

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

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

On October 19, 2010, Nortel issued a public announcement that it had entered into a sale agreement of its Carling campus with Public Works and Government Services Canada (PWGSC) and had been directed to exercise its early termination rights under the Carling lease, shortening the lease term from ten years to five years. As a result, and based on this change in circumstances and expected outcome probability, during the fourth quarter of fiscal 2010 Ciena recorded an unrealized gain of \$13.8 million resulting in a fair value of \$30.2 million for the contingent consideration right. During the first quarter of fiscal 2011, Ciena received notice of early termination from Nortel and the corresponding payment of \$33.5 million described above, resulting in a gain of \$3.3 million.

Given the structure of the transaction as an asset carve-out from Nortel, this transaction has resulted in a costly and complex integration. During fiscal 2010, Ciena incurred \$101.4 million in transaction, consulting and third party service fees, \$8.5 million in restructuring expense, and an additional \$12.4 million in costs primarily related to purchases of capitalized information technology equipment. During the first quarter of fiscal 2011, Ciena incurred \$24.2 million in transaction, consulting and third party service fees, \$1.5 million in restructuring expense, and an additional \$4.1 million primarily related to purchases of capitalized information technology equipment.

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

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

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

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

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

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

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

Customer relationships, outstanding purchase orders and contracts represent agreements with existing customers of the MEN Business. These intangible assets are expected to have estimated useful lives of nine months to seven years, with the exception of \$14.6 million related to a contract asset for acquired in-process projects to be billed by Ciena and recognized as a reduction in revenue. As of January 31, 2011, Ciena has billed \$13.4 million of these contract assets. The remaining \$1.2 million will be billed during the second quarter of fiscal 2011. Trade name represents acquired product trade names that are expected to have a useful life of nine months.

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

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

The following unaudited pro forma financial information summarizes the results of operations for the period indicated as if Ciena's acquisition of the MEN Business had been completed as of the beginning of the period presented. These pro forma amounts (in thousands) do not purport to be indicative of the results that would have actually been obtained if the acquisition occurred as of the beginning of the periods presented or that may be obtained in the future.

	Quarter Ended January 31, 2010
Pro forma revenue	\$ 431,912
Pro forma net loss	\$ (224,370)

(4) GOODWILL

As of October 31, 2010 and January 31, 2011, Ciena did not have any goodwill on its Consolidated Balance Sheets.

(5) RESTRUCTURING COSTS

Ciena has committed to certain restructuring actions principally affecting Ciena's North America global product group and EMEA's global field and supply chain organizations. On November 16, 2010, Ciena announced a headcount reduction affecting approximately 50 employees in North America related to this restructuring plan. The action in North America resulted in a restructuring charge of \$0.8 and the previously announced EMEA action resulted in a restructuring charge of \$0.7 in the first quarter of fiscal 2011. The following table sets forth the activity and balance of the restructuring liability accounts for the three months ended January 31, 2011 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2010	\$ 1,576	\$ 6,392	\$ 7,968
Additional liability recorded	1,522		1,522
Cash payments	(2,112)	(501)	(2,613)
Balance at January 31, 2011	\$ 986	\$ 5,891	\$ 6,877

Current restructuring liabilities	\$ 986	\$ 1,182	\$ 2,168
Non-current restructuring liabilities	\$	\$ 4,709	\$ 4,709

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

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	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2009	\$ 170	\$ 9,435	\$ 9,605
Additional liability recorded	(21)		(21)
Cash payments	(82)	(752)	(834)
Balance at January 31, 2010	\$ 67	\$ 8,683	\$ 8,750
Current restructuring liabilities	\$ 67	\$ 1,499	\$ 1,566
Non-current restructuring liabilities	\$	\$ 7,184	\$ 7,184

To consolidate Ciena's global distribution centers and related operations, on February 28, 2011, Ciena proposed changes in its distribution model that may affect 50 to 60 roles related to its supply chain operations and workforce in Monkstown, Northern Ireland. Execution of any specific reorganization or headcount reduction is subject to local legal requirements, including notification and consultation processes with employees and employee representatives. If these proposals move forward, Ciena expects this action to result in a restructuring charge in the range of \$2.0 million to \$3.0 million in the remainder of fiscal 2011.

(6) MARKETABLE SECURITIES

As of October 31, 2010 and January 31, 2011, Ciena did not have any investments in marketable debt securities.

(7) FAIR VALUE MEASUREMENTS

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

	January 31, 2011			Total
	Level 1	Level 2	Level 3	
Assets:				
Embedded redemption feature	\$	\$	\$ 11,350	\$ 11,350
Total assets measured at fair value	\$	\$	\$ 11,350	\$ 11,350

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

	January 31, 2011			Total
	Level 1	Level 2	Level 3	
Assets:				
Other long-term assets	\$	\$	\$ 11,350	\$ 11,350
Total assets measured at fair value	\$	\$	\$ 11,350	\$ 11,350

Ciena's Level 3 assets included in other long-term assets reflect the embedded redemption feature contained within Ciena's 4.0% convertible senior notes. See Note 15 below. The embedded redemption feature is bifurcated from Ciena's 4.0% convertible senior notes using the with-and-without approach. As such, the total value of the embedded redemption feature is calculated as the difference between the value of the 4.0% convertible senior notes (the Hybrid

Instrument) and the value of an identical instrument without the embedded redemption feature (the Host Instrument). Both the Host Instrument and the Hybrid Instrument are valued using a modified binomial model. The modified binomial model utilizes a risk free interest rate, an implied volatility of Ciena s stock, the recovery rates of bonds and the implied default intensity of the 4.0% convertible senior notes.

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

	Level 3
Balance at October 31, 2010	\$ 34,415
Issuances	
Settlements	(30,195)
Changes in unrealized gain (loss)	7,130
Transfers into Level 3	
Transfers out of Level 3	
Balance at January 31, 2011	\$ 11,350

(8) ACCOUNTS RECEIVABLE

As of October 31, 2010 and January 31, 2011, no customers accounted for greater than 10% of net trade accounts receivable. Allowance for doubtful accounts was \$0.1 million and \$0.4 million as of October 31, 2010 and January 31, 2011, respectively. Ciena has not historically experienced a significant amount of bad debt expense.

Table of Contents**(9) INVENTORIES**

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

	October 31, 2010	January 31, 2011
Raw materials	\$ 30,569	\$ 27,618
Work-in-process	6,993	5,346
Finished goods	177,994	186,899
Deferred cost of goods sold	76,830	78,107
	292,386	297,970
Provision for excess and obsolescence	(30,767)	(30,624)
	\$ 261,619	\$ 267,346

Ciena writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated net realizable value based on assumptions about future demand and market conditions. During the first three months of fiscal 2011, Ciena recorded a provision for excess and obsolescence of \$2.6 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory relate to disposal activities.

The following table summarizes the activity in Ciena's reserve for excess and obsolete inventory for the periods indicated (in thousands):

Three months ended January 31,	Balance at beginning of period	Provisions	Disposals	Balance at end of period
2010	\$24,002	\$950	\$1,608	\$23,344
2011	\$30,767	\$2,645	\$2,788	\$30,624

(10) PREPAID EXPENSES AND OTHER

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

	October 31, 2010	January 31, 2011
Prepaid VAT and other taxes	\$ 46,352	\$ 51,494
Deferred deployment expense	6,918	7,205
Product demonstration equipment, net	29,449	41,967
Prepaid expenses	15,087	12,230
Restricted cash	12,994	13,082
Contingent consideration	30,195	
Other non-trade receivables	6,685	9,080
	\$ 147,680	\$ 135,058

Prepaid expenses and other as of January 31, 2011 include \$42.0 million related to product demonstration equipment, net. Depreciation of product demonstration equipment was \$2.1 million for the first three months of fiscal 2011.

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

	October 31, 2010	January 31, 2011
Equipment, furniture and fixtures	\$ 360,908	\$ 375,737
Leasehold improvements	49,595	50,825
	410,503	426,562
Accumulated depreciation and amortization	(290,209)	(302,606)
	\$ 120,294	\$ 123,956

Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements was \$5.9 million and \$12.4 million for the first three months of fiscal 2010 and 2011, respectively.

(12) OTHER INTANGIBLE ASSETS

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

	October 31, 2010			January 31, 2011		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Developed technology	\$ 417,833	\$ (186,129)	\$ 231,704	\$ 417,833	\$ (198,195)	\$ 219,638
Patents and licenses	45,388	(45,167)	221	45,388	(45,202)	186
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	323,573	(129,086)	194,487	323,573	(154,122)	169,451
Total other intangible assets	\$ 786,794	\$ (360,382)	\$ 426,412	\$ 786,794	\$ (397,519)	\$ 389,275

The amortization expense of finite-lived other intangible assets was \$7.6 million and \$37.1 million for the first three months of fiscal 2010 and 2011, respectively. Expected future amortization of finite-lived other intangible assets for the fiscal years indicated is as follows (in thousands):

	Period ended October 31,
2011 (remaining nine months)	\$ 59,532
2012	73,564
2013	71,145
2014	56,987
2015	52,714
Thereafter	75,333
	\$ 389,275

(13) OTHER BALANCE SHEET DETAILS

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

	October 31, 2010	January 31, 2011
Maintenance spares inventory, net	\$ 53,654	\$ 53,252
Deferred debt issuance costs, net	28,853	27,483
Embedded redemption feature	4,220	11,350
Restricted cash	37,796	41,213
Other	5,296	5,173
	\$ 129,819	\$ 138,471

Deferred debt issuance costs are amortized using the straight line method, which approximates the effect of the effective interest rate method, through the maturity of the related debt. Amortization of debt issuance costs, which is included in interest expense, was \$0.6 million and \$1.3 million during the first three months of fiscal 2010 and fiscal 2011, respectively.

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

	October 31, 2010	January 31, 2011
Warranty	\$ 54,372	\$ 48,565
Compensation, payroll related tax and benefits	39,391	34,938
Vacation	20,412	21,854
Current restructuring liabilities	2,784	2,168
Interest payable	4,345	10,172
Other	72,690	68,342
	\$ 193,994	\$ 186,039

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

Three months ended	Beginning			Balance at
January 31,	Balance	Provisions	Settlements	end of
				period
2010	\$40,196	3,060	(4,819)	\$38,437
2011	\$54,372	1,093	(6,900)	\$48,565

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

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

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

	October 31, 2010	January 31, 2011
Products	\$ 31,187	\$ 40,044
Services	73,862	65,432
	105,049	105,476
Less current portion	(75,334)	(78,575)
Long-term deferred revenue	\$ 29,715	\$ 26,901

(14) FOREIGN CURRENCY FORWARD CONTRACTS

Ciena has previously used, and may in the future use, foreign currency forward contracts to reduce variability in non-U.S. dollar denominated expected cash flows. As of October 31, 2010 and January 31, 2011, there were no foreign currency forward contracts outstanding and Ciena did not enter into any foreign currency forward contracts during the first three months of fiscal 2011.

(15) CONVERTIBLE NOTES PAYABLE

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

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Description	January 31, 2011	
	Carrying Value	Fair Value
0.25% Convertible Senior Notes due May 1, 2013	\$ 216,210	\$ 208,643
4.0% Convertible Senior Notes due March 15, 2015 ⁽¹⁾	376,409	489,332
0.875% Convertible Senior Notes due June 15, 2017	500,000	433,600
3.75% Convertible Senior Notes due October 15, 2018	350,000	455,875
	\$ 1,442,619	\$ 1,587,450

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

The fair value reported above is based on the quoted market price for the notes on the date above.

(16) EARNINGS (LOSS) PER SHARE CALCULATION

The following table (in thousands except per share amounts) is a reconciliation of the numerator and denominator of the basic net income (loss) per common share (Basic EPS) and the diluted net income (loss) per potential common share (Diluted EPS). Basic EPS is computed using the weighted average number of common shares outstanding. Diluted EPS is computed using the weighted average number of (i) common shares outstanding, (ii) shares issuable upon vesting of restricted stock units, (iii) shares issuable upon exercise of outstanding stock options, employee stock purchase plan options and warrants using the treasury stock method; and (iv) shares underlying Ciena's outstanding convertible notes.

Numerator

	Quarter Ended January 31,	
	2010	2011
Net loss	\$ (53,333)	\$ (79,056)

Denominator

	Quarter Ended January 31,	
	2010	2011
Basic weighted average shares outstanding	92,321	94,496
Dilutive weighted average shares outstanding	92,321	94,496

EPS

	Quarter Ended January 31,	
	2010	2011
Basic EPS	\$ (0.58)	\$ (0.84)
Diluted EPS	\$ (0.58)	\$ (0.84)

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

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Weighted average shares excluded from EPS Denominator due to anti-dilutive effect	Quarter Ended January 31,	
	2010	2011
Shares underlying stock options, restricted stock units and warrants	7,494	6,447
0.25% Convertible Senior Notes due May 1, 2013	7,539	5,470
4.0% Convertible Senior Notes due March 15, 2015		18,396
0.875% Convertible Senior Notes due June 15, 2017	13,108	13,108
3.75% Convertible Senior Notes due October 15, 2018		17,355
Total excluded due to anti-dilutive effect	28,141	60,776

(17) SHARE-BASED COMPENSATION EXPENSE

Ciena grants equity awards under its 2008 Omnibus Incentive Plan (2008 Plan) and 2003 Employee Stock Purchase Plan (ESPP). These plans were approved by shareholders and are described in Ciena's annual report on Form 10-K. In connection with its acquisition of the MEN Business, Ciena also adopted the 2010 Inducement Equity Award Plan (2010 Plan), pursuant to which it has made awards to eligible persons as described below.

2008 Plan

Ciena has previously granted stock options and restricted stock units under its 2008 Plan. Pursuant to Board and stockholder approval, effective April 14, 2010, Ciena amended its 2008 Plan to (i) increase the number of shares available for issuance by five million shares; and (ii) reduce from 1.6 to 1.31 the fungible share ratio used for counting full value awards, such as restricted stock units, against the shares remaining available under the 2008 Plan. As of January 31, 2011, there were approximately 4.1 million shares authorized and remaining available for issuance under the 2008 Plan.

2010 Inducement Equity Award Plan

On December 8, 2009, the Compensation Committee of the Board of Directors approved the 2010 Plan. The 2010 Plan is intended to enhance Ciena's ability to attract and retain certain key employees transferred to Ciena in connection with its acquisition of the MEN Business. The 2010 Plan authorizes the issuance of restricted stock or restricted stock units representing up to 2.25 million shares of Ciena common stock. Upon the March 19, 2011 termination of the 2010 Plan, any shares then remaining available shall cease to be available for issuance under the 2010 Plan or any other existing Ciena equity incentive plan. As of January 31, 2011, there were approximately 0.8 million shares authorized and available for issuance under the 2010 Plan.

Stock Options

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

	Shares Underlying Options	Weighted Average Exercise Price
Balance as of October 31, 2010	5,002	\$ 40.96
Granted		
Exercised	(229)	15.01
Canceled	(123)	107.86
Balance as of January 31, 2011	4,650	\$ 40.47

The total intrinsic value of options exercised during the first three months of fiscal 2010 and fiscal 2011, was \$0.3 million and \$1.4 million, respectively. The weighted average fair value of each stock option granted by Ciena during the first three months of fiscal 2010 was \$6.91. There were no stock options granted by Ciena during the first three months of fiscal 2011.

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The following table summarizes information with respect to stock options outstanding at January 31, 2011, based on Ciena's closing stock price of \$23.50 per share on the last trading day of Ciena's first fiscal quarter of 2011 (shares and intrinsic value in thousands):

Range of Exercise Price	Options Outstanding at January 31, 2011				Vested Options at January 31, 2011			
	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
\$ 0.01 - \$ 16.52	725	5.94	\$ 11.15	\$ 8,952	553	5.21	\$ 11.47	\$ 6,651
\$ 16.53 - \$ 17.43	408	4.61	17.20	2,570	387	4.45	17.20	2,437
\$ 17.44 - \$ 22.96	381	4.22	21.76	663	360	4.04	21.84	599
\$ 22.97 - \$ 31.71	1,378	3.91	29.43		1,326	3.79	29.47	
\$ 31.72 - \$ 46.90	840	5.27	39.36		735	5.05	39.59	
\$ 46.91 - \$ 73.78	435	1.84	59.74		435	1.84	59.74	
\$ 73.79 - \$ 586.25	483	0.68	135.09		483	0.68	135.09	
\$ 0.01 - \$ 586.25	4,650	4.03	\$ 40.47	\$ 12,185	4,279	3.72	\$ 42.12	\$ 9,687

Assumptions for Option-Based Awards

Ciena recognizes the fair value of service-based options as share-based compensation expense on a straight-line basis over the requisite service period. Ciena did not grant any option-based awards during the first quarter of fiscal 2011. During the first quarter of fiscal 2010, Ciena estimated the fair value of each option award on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions:

	Quarter Ended January 31, 2010
Expected volatility	61.9%
Risk-free interest rate	2.4 - 2.9%
Expected life (years)	5.3 - 5.5
Expected dividend yield	0.0%

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

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

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

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

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

estimated forfeitures.

Restricted Stock Units

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

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

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

	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value
Balance as of October 31, 2010	5,191	\$ 13.81	\$71,681
Granted	1,510		
Vested	(507)		
Canceled or forfeited	(313)		
Balance as of January 31, 2011	5,881	\$ 15.16	\$89,119

The total fair value of restricted stock units that vested and were converted into common stock during the first three months of fiscal 2010 and fiscal 2011 was \$5.4 million and \$10.8 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first three months of fiscal 2010 and fiscal 2011 was \$11.01 and \$19.25, respectively.

Assumptions for Restricted Stock Unit Awards

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

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

2003 Employee Stock Purchase Plan

In March 2003, Ciena stockholders approved the 2003 Employee Stock Purchase Plan (the "ESPP"), which has a ten-year term. Ciena stockholders subsequently approved an amendment increasing the number of shares available to 3.6 million and adopting an "evergreen" provision. On December 31 of each year, the number of shares available under the ESPP will increase by up to 0.6 million shares, provided that the total number of shares available at that time shall

not exceed 3.6 million. Under the ESPP, eligible employees may enroll in a six-month offer period during certain open enrollment periods. The six-month offer periods begin on December 21 and June 21 of each year with an initial stub period running from October 1, 2010 through December 20, 2010. The purchase price is equal to 85% of the lower of the fair market value of Ciena common stock on the day preceding each offer period or the last day of each offer period. The current ESPP is considered compensatory for purposes of share-based compensation expense. During the first quarter of fiscal 2011, Ciena estimated the fair value of each ESPP option on the first date of the offer period using the Black-Scholes option-pricing model, with the following weighted average assumptions:

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	Quarter Ended January 31, 2011
Expected volatility	39.8 - 49.1%
Risk-free interest rate	.19 - .64%
Expected life (years)	.25 - .50
Expected dividend yield	0.0%

The following table is a summary of ESPP activity and shares available for issuance for the periods indicated (shares and intrinsic value in thousands):

	ESPP shares available for issuance	Intrinsic value at stock issuance date
Balance as of October 31, 2010	3,498	
Issued on December 20, 2010	(139)	\$ 1,117
Evergreen at December 31, 2010	212	
Balance as of January 31, 2011	3,571	

Share-Based Compensation Expense for Periods Reported

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

	Quarter Ended January 31,	
	2010	2011
Product costs	\$ 379	\$ 574
Service costs	430	503
Share-based compensation expense included in cost of sales	809	1,077
Research and development	2,387	2,571
Sales and marketing	2,458	2,991
General and administrative	2,576	3,001
Acquisition and integration costs		160
Share-based compensation expense included in operating expense	7,421	8,723
Share-based compensation expense capitalized in inventory, net	52	64
Total share-based compensation	\$ 8,282	\$ 9,864

As of January 31, 2011, total unrecognized compensation expense was \$77.0 million: (i) \$3.8 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 0.7 year; and (ii) \$73.1 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.7 years.

(18) COMPREHENSIVE LOSS

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

	Quarter Ended January 31,	
	2010	2011
Net loss	\$ (53,333)	\$ (79,056)
Change in unrealized gain (loss) on available-for-sale securities	(186)	183
Change in accumulated translation adjustments	(633)	(432)
Total comprehensive loss	\$ (54,152)	\$ (79,305)

Table of Contents**(19) SEGMENT AND ENTITY WIDE DISCLOSURES***Segment Reporting*

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

Packet-Optical Transport includes optical transport solutions that increase network capacity and enable more rapid delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the cost effective and efficient transport of voice, video and data traffic in core networks, as well as regional, metro and access networks. Our principal products in this segment include the ActivFlex 6500 Packet-Optical Platform (ActivFlex 6500); ActivFlex 6110 Multiservice Optical Platform (ActivFlex 6110); ActivSpan 5200 (ActivSpan 5200); ActivSpan Common Photonic Layer (CPL); Optical Multiservice Edge 1000 series (OME 1000); and Optical Metro 3500 (OM 3500) from the MEN Business. This segment includes sales of our ActivSpan 4200® FlexSelect® Advanced Services Platform (ActivSpan 4200) and our Corestream® Agility Optical Transport System (Corestream) from Ciena's pre-acquisition portfolio. This segment also includes sales from legacy SONET/SDH products and legacy data networking products, as well as certain enterprise-oriented transport solutions that support storage and LAN extension, interconnection of data centers, and virtual private networks. This segment also includes operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Packet-Optical Switching includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Our principal products in this segment include our CoreDirector® Multiservice Optical Switch, CoreDirector FS; and our ActivEdge 5430 Reconfigurable Switching System, our packet-oriented configuration for the 5400 family. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed service services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Carrier Ethernet Service Delivery includes the ActivEdge 3900 family of service delivery switches and service aggregation switches, as well as the ActivEdge 5000 series and ActivFlex 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have principally been deployed to support wireless backhaul infrastructures and business data services. Employing sophisticated Carrier Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment includes the metro Ethernet routing switch (MERS) product line from the MEN Business and our legacy broadband products, including our CNX-5 Broadband DSL System (CNX-5), that transitions legacy voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Software and Services includes our integrated network and service management software designed to automate and simplify network management and operation, while increasing network performance and functionality. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network troubles. This segment also includes a broad range of consulting and support services, including installation and deployment, maintenance support, consulting, network design and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Condensed Consolidated Statement of Operations.

Reportable segment asset information is not disclosed because it is not reviewed by the chief operating decision maker for purposes of evaluating performance and allocating resources.

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

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	2010	Quarter Ended January 31, %*	2011	%*
Revenue:				
Packet-Optical Transport	\$ 83,470	47.5	\$ 286,481	66.1
Packet-Optical Switching	23,398	13.3	35,274	8.1
Carrier Ethernet Service Delivery	40,439	23.0	27,628	6.4
Software and Services	28,569	16.2	83,925	19.4
Consolidated revenue	\$ 175,876	100.0	\$ 433,308	100.0

* Denotes % of total revenue

Segment Profit (Loss)

Segment profit (loss) is determined based on internal performance measures used by the chief executive officer to assess the performance of each operating segment in a given period. In connection with that assessment, the chief executive officer excludes the following items: selling and marketing costs; general and administrative costs; acquisition and integration costs; amortization of intangible assets; restructuring costs; change in fair value of contingent consideration; interest and other income (net), interest expense, equity investment gains or losses and provisions (benefit) for income taxes.

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

	Quarter Ended January 31 2010	2011
Segment profit (loss):		
Packet-Optical Transport	\$ 20,123	\$ 39,026
Packet-Optical Switching	(2,038)	12,877
Carrier Ethernet Service Delivery	8,882	2,393
Software and Services	3,160	18,420
Total segment profit (loss)	30,127	72,716
Other non performance items:		
Selling and marketing	(34,237)	(57,092)
General and administrative	(12,763)	(38,314)
Acquisition and integration costs	(27,031)	(24,185)
Amortization of intangible assets	(5,981)	(28,784)
Restructuring costs	21	(1,522)
Change in fair value of contingent consideration		3,289
Interest and other financial charges, net	(2,601)	(3,285)
(Provision) benefit for income taxes	(868)	(1,879)
Consolidated net income (loss)	\$ (53,333)	\$ (79,056)

Entity Wide Reporting

The following table reflects Ciena's geographic distribution of revenue based on the location of the purchaser, with any country accounting for greater than 10% of total revenue in the period specifically identified. Revenue attributable to geographic regions outside of the United States and the United Kingdom is reflected as Other International revenue.

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

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	2010	Quarter Ended January 31,		2011	%*
			%*		
United States	\$ 123,912	70.4	\$ 220,349	50.9	
Canada	n/a		44,485	10.3	
United Kingdom	18,590	10.6	n/a		
Other International	33,374	19.0	168,474	38.8	
Total	\$ 175,876	100.0	\$ 433,308	100.0	

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

* Denotes % of total revenue

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

	October 31,		January 31,	
	2010	%*	2011	%*
United States	\$ 63,675	52.9	\$ 63,732	51.4
Canada	45,103	37.5	47,831	38.6
Other International	11,516	9.6	12,393	10.0
Total	\$ 120,294	100.0	\$ 123,956	100.0

* Denotes % of total equipment, furniture and fixtures

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

	2010	Quarter Ended January 31,		2011	%*
			%*		
Company A	\$ 42,515	24.2	\$ 60,837	14.1	
Company B	n/a		47,822	11.0	
Total	\$ 42,515	24.2	\$ 108,659	25.1	

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

* Denotes % of total revenue

(20) CONTINGENCIES*Foreign Tax Contingencies*

Ciena has received assessment notices from the Mexican tax authorities asserting deficiencies in payments between 2001 and 2005 related primarily to income taxes and import taxes and duties. Ciena has filed judicial petitions appealing these assessments. As of October 31, 2010 and January 31, 2011, Ciena had accrued liabilities of

\$1.4 million and \$1.5 million, respectively, related to these contingencies, which are reported as a component of other current accrued liabilities. As of January 31, 2011, Ciena estimates that it could be exposed to possible losses of up to \$5.8 million, for which it has not accrued liabilities. Ciena has not accrued the additional income tax liabilities because it does not believe that such losses are more likely than not to be incurred. Ciena has not accrued the additional import taxes and duties because it does not believe the incurrence of such losses are probable. Ciena continues to evaluate the likelihood of probable and reasonably possible losses, if any, related to these assessments. As a result, future increases or decreases to accrued liabilities may be necessary and will be recorded in the period when such amounts are estimable and more likely than not (for income taxes) or probable (for non-income taxes).

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

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

As a result of its June 2002 merger with ONI Systems Corp., Ciena became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI's initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI's registration statement and by engaging in manipulative practices to artificially inflate ONI's stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters' alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and all of these actions have been included in a single coordinated proceeding. On October 6, 2009, the Court entered an opinion granting final approval to a settlement among the plaintiffs, issuer defendants and underwriter defendants, and directing that the Clerk of the Court close these actions. Notices of appeal of the opinion granting final approval have been filed. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena's Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 22, 2010. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation and because the settlement remains subject to appeal, the ultimate outcome of the matter is uncertain.

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

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

Some of the statements contained, or incorporated by reference, in this quarterly report discuss future events or expectations, contain projections of results of operations or financial condition, changes in the markets for our products and services, or state other forward-looking information. Ciena's forward-looking information is based on various factors and was derived using numerous assumptions. In some cases, you can identify these forward-looking statements by words like may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continue or the negative of those words and other comparable words. You should be aware that these statements only reflect our current predictions and beliefs. These statements are subject to known and unknown risks, uncertainties and other factors, and actual events or results may differ materially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly in Item 1A Risk Factors of Part II of this report below. You should review these risk factors and the rest of this quarterly report in combination with the more detailed description of our business and management's discussion and analysis of financial condition in our annual report on Form 10-K, which we filed with the Securities and Exchange Commission on December 22, 2010, for a more complete understanding of the risks associated with an investment in Ciena's securities. Ciena undertakes no obligation to revise or update any forward-looking statements.

Overview

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

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

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

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

Integration Activities and Costs

Given the relative size of the MEN Business and the structure of the MEN Acquisition as an asset carve-out from Nortel, our integration activities have been costly and complex. From the date of the acquisition through the first quarter of fiscal 2011, we have incurred \$125.6 million in transaction, consulting and third party service fees, \$10.0 million in severance expense, and an additional \$16.5 million, primarily related to purchases of capitalized information technology equipment. We have also incurred inventory obsolescence charges and may incur additional expenses related to, among other things, facilities restructuring. We anticipate that we will incur approximately \$26 million to \$30 million in additional integration costs during the remainder of fiscal 2011. Any material delays or difficulties in integrating the MEN Business or additional, unanticipated expense may harm our business and results of operations.

Since the closing of the MEN Acquisition, we have also incurred significant transition services expense related to operational and business support services performed by an affiliate of Nortel. These services have included finance and accounting functions, supply chain and logistics management, maintenance and product support services, order management and fulfillment, trade compliance, and information technology services. We have also incurred, and expect to continue to incur through the second quarter of fiscal 2011, additional operating expense as we reduce our reliance upon transition support services. The wind down and transfer of critical transition services is a complex undertaking that presents a number of operational risks that could adversely affect our business and results of operations. By way of example, we integrated the MEN Business operations onto a single, Ciena enterprise resource planning system during the second quarter of fiscal 2011. While this system transition will significantly reduce our reliance upon transition services in future periods, accomplishing this important integration achievement necessitated a temporary shut-down of supply chain operations early in our second quarter of fiscal 2011, which may impact our operations and results for that period.

Restructuring Activities

Since the MEN Acquisition, we have undertaken a number of restructuring activities intended to reduce operating expense and better align our workforce and operating costs with market opportunities and product development and business strategies for the combined operations. On November 16, 2010, we announced a headcount reduction affecting approximately 50 employees, principally in our global product group in North America. During the first quarter of fiscal 2011, we incurred approximately \$1.5 million in restructuring costs related to this action and the previously announced restructuring activities in EMEA. To consolidate our global distribution centers and related operations, on February 28, 2011, we proposed changes in our distribution model that may affect 50 to 60 roles related to our supply chain operations and workforce in Monkstown, Northern Ireland. Execution of any specific

reorganization or headcount reduction is subject to local legal requirements, including notification and consultation processes with employees and employee representatives. If these proposals move forward, we expect this action to result in a restructuring charge in the range of \$2.0 million to \$3.0 million in the remainder of fiscal 2011. As we look to manage operating expense and complete integration activities for the combined operations, we will continue to assess the allocation of our headcount and other resources toward key growth opportunities for our business and evaluate additional cost reduction measures.

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Due to the relative scale of its operations, the MEN Acquisition has materially affected our operations, financial results and liquidity. Our revenue and operating expense have increased materially compared to periods prior to the MEN Acquisition. As a result of the MEN Acquisition, we recorded \$492.4 million in other intangible assets that will be amortized over their useful lives and increase our operating expense. See Critical Accounting Policies and Estimates- Long-lived Assets below for information relating to these items. Under acquisition accounting rules, we revalued the acquired finished goods inventory of the MEN Business to fair value upon closing. This revaluation increased marketable inventory carrying value by \$62.3 million, of which \$48.0 million and \$9.6 million was recognized in cost of goods sold during fiscal 2010 and the first quarter of fiscal 2011 respectively, adversely affecting our gross margin. See Note 3 of the Condensed Consolidated Financial Statements found under Item 1 of this report. These and other effects on our financial statements described below and elsewhere in this report may make period to period comparisons difficult.

Competitive Landscape

We continue to encounter a competitive marketplace, in part, due to our increased market share, technology leadership and global presence resulting from the MEN Acquisition. Following the MEN Acquisition, we have experienced increased customer activity and been afforded increased consideration and opportunities to participate in competition for network builds and upgrades, including in emerging geographies and new markets or applications for our products. For example, we have made early progress in the sale of our products for application in submarine networks and with sales to customers in the Middle East. Securing opportunities in new markets or geographies often requires that we agree to aggressive or less favorable commercial terms and conditions, including pricing that adversely affects gross margins, or financial commitments, that may require collateralized standby letters of credit resulting in an increase in our restricted cash. Competition has also intensified as we and our competitors more aggressively seek to secure market share, particularly in connection with new network build opportunities, and displace incumbent equipment vendors at large carrier customers. We expect this level of competition, particularly in North America, to continue and potentially increase, as larger, foreign equipment vendors seek to gain entry into the U.S. market, and other competitors seek to retain incumbent positions with customers.

Strategy

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

We believe our solutions portfolio is particularly well positioned to address the networking and business priorities of our customers within these market dynamics and a sensitive capital expenditure environment. Key components of our corporate strategy to capitalize on these market opportunities are set forth below:

Maintain and extend technology leadership in converged optical Ethernet networking to drive sales across product portfolio. We intend to extend our technology leadership and leverage our next generation, coherent transport technology to drive sales of our Packet-Optical Switching and Carrier Ethernet Service Delivery products. We intend to expand our data-optimized, ActivFlex 5400 family of Reconfigurable Switching Systems, to enable an end-to-end Optical Transport Network (OTN) and Ethernet-based architecture that offers better cost per bit, more flexibility, and higher reliability for network operators. We also seek to expand our Carrier Ethernet Service Delivery portfolio, including high-capacity (terabit scale) Ethernet metro aggregation switches, for mobile backhaul and business Ethernet services. We also intend to enhance our embedded and network management software to create a common network management software platform across our expanded product portfolio and enable service level management across network layers, rapid service provisioning and increased automation.

Diversify our customer segments and customer application of our products. Historically, service providers have represented the largest portion of our revenue, with their application of our products largely supporting terrestrial, wireline networks. Part of our strategy is to seek opportunities to address new customer segments, and increase our sales to wireless providers, cable and multiservice operators, enterprises, government agencies and research and educational institutions. We are also seeking to sell our product and service solutions to support additional network applications, including in submarine networks, content delivery networks, business Ethernet services and mobile backhaul.

Expand our geographic reach. We seek to build upon the broader global presence of our business provided by the MEN Acquisition through expansion of our geographic reach and market share in growing markets including Brazil, the Middle East, Russia and India. We intend to penetrate new geographies through a combination of direct resources and third party channels, such as resellers, service providers and integrators, for marketing, selling and distributing our solutions. We also intend, through cross-selling and other sales initiatives, to increase sales of our Packet-Optical Switching and Carrier Ethernet Service Delivery products in international markets. We also seek to build the Ciena brand globally through additional marketing initiatives.

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Leverage our consultative, network specialist approach. We believe that by offering an expanded portfolio of professional services that meets the business needs of our customers, we bring strategic value to customer relationships beyond the sale of our next-generation communications networking products. By understanding and addressing their network infrastructure needs, the competitive landscape, and the evolving and challenging markets in which our customers compete, we believe our customized solutions offering, including advanced services, creates additional business and operational value for our customers, enabling them to better compete in a challenging environment.

Successfully complete the integration of the MEN Business and achieve desired operating leverage. We remain focused on the successful completion of remaining integration activities. A number of these are complex, including the rationalization of our supply chain, third party manufacturers and facilities, the development of a common network management system across our integrated portfolio, and the winding down of transition services. We seek to leverage the longer-term opportunities, including improved operating efficiencies and leverage, presented by these activities.

Financial Results

Revenue for the first quarter of fiscal 2011 was \$433.3 million, which represented a sequential increase of 3.8% from \$417.6 million in the fourth quarter of fiscal 2010. Additional revenue-related details reflecting sequential changes in quarterly revenue from the fourth quarter of fiscal 2010 include:

Product revenue for the first quarter of fiscal 2011 increased by \$11.0 million, principally reflecting increases of \$13.9 million in Packet-Optical Switching revenue and \$4.1 million in Packet-Optical Transport revenue.

These increases were partially offset by decreases of \$4.6 million in sales of integrated network and service management software and \$2.4 million in sales of Carrier Ethernet Service Delivery products.

Service revenue for the first quarter of fiscal 2011 increased by \$4.7 million.

Revenue from the United States for the first quarter of fiscal 2011 was \$220.3 million, an increase from \$210.1 million in the fourth quarter of fiscal 2010.

International revenue for the first quarter of fiscal 2011 was \$213.0, an increase from \$207.6 million in the fourth quarter of fiscal 2010.

As a percentage of revenue, international revenue was 49.1% during the first quarter of fiscal 2011, a slight decrease from 49.7% during the fourth quarter of fiscal 2010.

For the first quarter of fiscal 2011, two customers accounted for greater than 10% of revenue, representing 25.1% of total revenue. This compares to one customer that accounted for 15.2% of total revenue in the fourth quarter of fiscal 2010.

Gross margin for the first quarter of fiscal 2011 was 38.9%, a decrease from 40.3% in the fourth quarter of fiscal 2010. Gross margin for the first quarter of fiscal 2011 was adversely affected by sales of lower margin common equipment within our Packet-Optical Transport product segment as part of our strategy to gain new customers, enter new markets or capture market share for our 40G and 100G coherent optical transport technology.

Operating expense was \$242.4 million for the first quarter of fiscal 2011, a decrease from \$249.6 million in the fourth quarter of fiscal 2010. First quarter operating expense reflects lower costs associated with research and development, variable sales compensation, amortization of intangible assets and restructuring. These lower costs were partially offset by increases in general and administrative expense, acquisition and integration expense and a lower gain related to our contingent refund right associated with the Carling lease describe below.

Our loss from operations for the first quarter of fiscal 2011 was \$73.9 million. This compares to an \$81.2 million loss from operations during the fourth quarter of fiscal 2010. Our net loss for the first quarter of fiscal 2011 was \$79.1 million, or \$0.84 per share. This compares to a net loss of \$80.3 million, or \$0.86 per share, for the fourth quarter of fiscal 2010. These losses continue to reflect the effect of acquisition and integration costs and transaction service expense, the magnitude and timing of which is described above.

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During the first quarter of fiscal 2011, we received \$33.5 million related to the early termination of the Carling lease, of which \$17.1 million reduced cash used from operations below and \$16.4 million reduced cash used in investing activities. We used \$63.7 million in cash from operations during the first quarter of fiscal 2011, consisting of \$20.1 million from net losses (adjusted for non-cash charges) and \$43.6 million in cash used for changes in working capital. Use of cash for the first quarter of fiscal 2011 reflects cash payments of \$24.5 million of acquisition and integration-related expense and restructuring costs, of which \$25.7 million was reflected in net losses (adjusted for non-cash charges) and \$1.2 million was reflected in changes in working capital. This compares with the use of \$25.8 million in cash from operations during the fourth quarter of fiscal 2010, consisting of \$27.8 million from net losses (adjusted for non-cash charges) and cash provided of \$2.0 million from changes in working capital. Use of cash for the fourth quarter of fiscal 2010 reflects cash payments of \$12.7 million associated with acquisition and integration-related expense and restructuring costs, of which \$22.6 million was reflected in net losses (adjusted for non-cash charges) and \$9.9 million was reflected in changes in working capital.

As of January 31, 2011, we had \$625.8 million in cash and cash equivalents. This compares to \$688.7 million in cash and cash equivalents at October 31, 2010.

As of January 31, 2011, headcount was 4,254, an increase from 4,201 at October 31, 2010 and 2,197 at January 31, 2010.

Consolidated Results of Operations

Our results of operations for the first quarter of 2010 do not include the operations of the MEN Business as the MEN Acquisition was completed on March 19, 2010. Our internal organizational structure and the management of our business and results of operations are presented based upon the following operating segments:

Packet-Optical Transport includes optical transport solutions that increase network capacity and enable more rapid delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the cost effective and efficient transport of voice, video and data traffic in core networks, as well as regional, metro and access networks. Our principal products in this segment include the ActivFlex 6500 Packet-Optical Platform (ActivFlex 6500); ActivFlex 6110 Multiservice Optical Platform (ActivFlex 6110); ActivSpan 5200 (ActivSpan 5200); ActivSpan Common Photonic Layer (CPL); Optical Multiservice Edge 1000 series (OME 1000); and Optical Metro 3500 (OM 3500) from the MEN Business. This segment includes sales of our ActivSpan 4200® FlexSelect® Advanced Services Platform (ActivSpan 4200) and our Corestream® Agility Optical Transport System (Corestream) from Ciena's pre-acquisition portfolio. This segment also includes sales from legacy SONET/SDH products and legacy data networking products, as well as certain enterprise-oriented transport solutions that support storage and LAN extension, interconnection of data centers, and virtual private networks. This segment also includes operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Packet-Optical Switching includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Our principal products in this segment include our CoreDirector® Multiservice Optical Switch, CoreDirector FS; and our ActivEdge 5430 Reconfigurable Switching System, our packet-oriented configuration for the 5400 family. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed service services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Carrier Ethernet Service Delivery includes the ActivEdge 3900 family of service delivery switches and service aggregation switches, as well as the ActivEdge 5000 series and ActivFlex 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have principally been deployed to support wireless backhaul infrastructures and business data services. Employing

sophisticated Carrier Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment includes the metro Ethernet routing switch (MERS) product line from the MEN Business and our legacy broadband products, including our CNX-5 Broadband DSL System (CNX-5), that transitions legacy voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and

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enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Condensed Consolidated Statement of Operations.

Software and Services includes our integrated network and service management software designed to automate and simplify network management and operation, while increasing network performance and functionality. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network troubles. This segment also includes a broad range of consulting and support services, including installation and deployment, maintenance support, consulting, network design and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Condensed Consolidated Statement of Operations.

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

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

	2010	Quarter Ended January 31, %*	2011	%*	Increase (decrease)	%**
Revenue:						
Packet-Optical Transport	\$ 83,470	47.5	\$ 286,481	66.1	\$ 203,011	243.2
Packet-Optical Switching	23,398	13.3	35,274	8.1	11,876	50.8
Carrier Ethernet Service Delivery	40,439	23.0	27,628	6.4	(12,811)	(31.7)
Software and Services	28,569	16.2	83,925	19.4	55,356	193.8
Consolidated revenue	\$ 175,876	100.0	\$ 433,308	100.0	\$ 257,432	146.4

* Denotes % of total revenue

** Denotes % change from 2010 to 2011

Packet-Optical Transport revenue for the first quarter of fiscal 2011 reflects the addition of \$223.1 million in revenue from the MEN Business, including \$148.9 million from sales of our ActivFlex 6500, largely driven by service provider demand for high-capacity, optical transport, including coherent 40G and 100G network infrastructures. Packet-Optical Transport revenue also benefited from the addition of \$36.5 million of ActivSpan 5200, \$10.5 million of ActivFlex 6110, \$9.9 million of CPL, and \$17.5 million in legacy transport products from the MEN Business. These increases were offset by year-over-year revenue decreases of \$9.6 million in Corestream and \$7.7 million in ActivSpan 4200.

Packet-Optical Switching revenue increased reflecting a \$10.3 million increase in CoreDirector revenue and \$1.6 million from initial sales of ActivFlex 5430, our ultra high-capacity, multi-terabit platform that can be configured to support any mix of OTN, SONET/SDH and Ethernet/MPLS. Packet-Optical Switching revenue has historically reflected sales of our CoreDirector platform, which has a concentrated customer base. Our Packet-Optical Switching revenue reflects the initial stages of the platform transition to the ActivFlex 5430 switching system. As a result of these factors, revenue for this segment can fluctuate considerably depending upon individual customer purchasing decisions.

Carrier Ethernet Service Delivery revenue decreased reflecting a \$20.3 million decrease in sales of our ActivEdge 3900 service-delivery switches and ActivEdge 5000 service aggregation switches. Carrier Ethernet Service Delivery revenue benefited from \$6.3 million in initial revenue from the introduction of ActivEdge 5410 Service Aggregation Switch, our high-capacity, Carrier Ethernet configuration for the 5400 family to support wireless backhaul, Ethernet business services, and residential broadband applications. Segment

revenue also benefited from the addition of \$3.2 million in sales of the MERS product line. Quarterly revenue for these products remains subject to fluctuation due to customer concentration and the effect of the timing of customer buying cycles for the relatively nascent technology adoption of our next-generation products within this segment.

Software and Services revenue increased primarily due to the addition of approximately \$50.3 million in segment revenue from the MEN Business. On a combined basis, increased segment revenue reflects increases of \$38.1 million in maintenance support revenue, \$15.1 million in installation, deployment and consulting services.

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

	Quarter Ended January 31,				Increase (decrease)	%**
	2010	%*	2011	%*		
United States	\$ 123,912	70.4	\$ 220,349	50.9	\$ 96,437	77.8
International	51,964	29.6	212,959	49.1	160,995	309.8
Total	\$ 175,876	100.0	\$ 433,308	100.0	\$ 257,432	146.4

* Denotes % of total revenue

** Denotes % change from 2010 to 2011

United States revenue increased primarily due to a \$75.0 million increase in sales of Packet-Optical Transport products, an \$8.3 million increase in Packet-Optical Switching revenue, and a \$27.6 million increase in services revenue. Increased Packet-Optical Transport and services revenue principally reflect the addition of the MEN Business. These increases offset a \$14.3 million decrease in Carrier Ethernet Service Delivery sales.

International revenue increased primarily due to a \$128.1 million increase in Packet-Optical Transport revenue, a \$26.5 million increase in services revenue, and a \$3.5 million increase in sales of Packet-Optical Switching products. Increased Packet-Optical Transport and services revenue principally reflect the addition of the MEN Business.

While our concentration in revenue has lessened somewhat as a result of the MEN Acquisition, a sizable portion of our revenue continues to come from sales to a small number of service providers, particularly within our Packet-Optical Switching and Carrier-Ethernet Service Delivery businesses. As a result, our results are significantly affected by spending levels and the business challenges encountered by our largest customers. Moreover, our contracts do not have terms that obligate these customers to purchase any minimum or specific amounts of equipment or services. Our concentration of revenue can be adversely affected by consolidation activity among our large customers. In addition, some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce the number of vendors from which they purchase equipment, which could further affect our concentration of revenue where we participate in these efforts. For the first quarter of fiscal 2011, two customers accounted for greater than 10% of revenue, representing 25.1% of total revenue. This compares to one customer that accounted for 24.2% of total revenue in the first quarter of fiscal 2010.

Cost of Goods Sold and Gross Profit

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

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

Gross profit as a percentage of revenue, or gross margin, continues to be susceptible to quarterly fluctuation due to a number of factors. Gross margin can vary significantly depending upon the mix and concentration of revenue by segment or product line, the concentration of lower margin common equipment sales within a segment or product line, geographic mix and the mix of customers and services in a given fiscal quarter. Gross margin can also be affected by our introduction of new products, charges for excess and obsolete inventory, changes in warranty costs and sales volume. Gross margin can also be adversely affected by the competitive environment and level of pricing pressure we encounter. The combination of the recent period of uncertain market conditions, recent constraints on customer capital expenditures and increased competition has resulted in a heightened customer focus on pricing and return on network

investment, as customers address network traffic growth and strive to increase revenue and profit. Our exposure to pricing pressure has been most severe in metro and core applications for our Packet-Optical Transport platforms, which we expect will comprise a greater percentage of our overall revenue as a result of the MEN Acquisition. As a result, and in an effort to retain or secure customers, enter new markets or capture market share, in the past we have and in the future we may agree to pricing or other unfavorable commercial terms that result in lower or negative gross margins on a particular order or group of orders. These arrangements would adversely affect our gross margins and results of operations. We expect that gross margins will also be subject to fluctuation based on our level of success in driving cost reductions and rationalizing our supply chain and third party contract manufacturers as part of the MEN Acquisition integration activities.

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

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

	2010	Quarter Ended January 31, %*	2011	%*	Increase (decrease)	%**
Total revenue	\$ 175,876	100.0	\$ 433,308	100.0	\$ 257,432	146.4
Total cost of goods sold	95,716	54.4	264,802	61.1	169,086	176.7
Gross profit	\$ 80,160	45.6	\$ 168,506	38.9	\$ 88,346	110.2

* Denotes % of total revenue

** Denotes % change from 2010 to 2011

	2010	Quarter Ended January 31, %*	2011	%*	Increase (decrease)	%**
Product revenue	\$ 149,054	100.0	\$ 352,427	100.0	\$ 203,373	136.4
Product cost of goods sold	76,669	51.4	214,401	60.8	137,732	179.6
Product gross profit	\$ 72,385	48.6	\$ 138,026	39.2	\$ 65,641	90.7

* Denotes % of product revenue

** Denotes % change from 2010 to 2011

	2010	Quarter Ended January 31, %*	2011	%*	Increase (decrease)	%**
Service revenue	\$ 26,822	100.0	\$ 80,881	100.0	\$ 54,059	201.5
Service cost of goods sold	19,047	71.0	50,401	62.3	31,354	164.6
Service gross profit	\$ 7,775	29.0	\$ 30,480	37.7	\$ 22,705	292.0

* Denotes % of service revenue

** Denotes % change from 2010 to 2011

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

Gross profit on products as a percentage of product revenue was adversely affected by an increased concentration of revenue from our Packet-Optical Transport segment, resulting from the MEN Acquisition, and sales of lower margin common equipment within this segment as part of our strategy to gain new customers, enter new markets or capture market share for our 40G and 100G coherent optical transport technology. Gross profit was also affected by a number of items relating to the MEN Acquisition that increased costs of goods sold during the first quarter of fiscal 2011. These items include increased amortization of intangible assets and

the required revaluation of acquired finished goods inventory of the MEN Business to fair value as described above.

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Gross profit on services as a percentage of services revenue increased due to higher concentration of maintenance support and professional services as a percentage of revenue, and improved operational efficiencies.

Operating Expense

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

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

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

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

Increased operating expense for the first quarter of fiscal 2011 principally reflects the increased scale of our business resulting from the MEN Acquisition. The table below (in thousands, except percentage data) sets forth the changes in operating expense for the periods indicated:

	Quarter Ended January 31,				Increase	
	2010	%*	2011	%*	(decrease)	%**
Research and development	\$ 50,033	28.4	\$ 95,790	22.1	\$ 45,757	91.5
Selling and marketing	34,237	19.5	57,092	13.2	22,855	66.8
General and administrative	12,763	7.3	38,314	8.8	25,551	200.2
Acquisition and integration costs	27,031	15.4	24,185	5.6	(2,846)	(10.5)
Amortization of intangible assets	5,981	3.4	28,784	6.6	22,803	381.3
Restructuring costs	(21)	0.0	1,522	0.4	1,543	
Change in fair value of contingent consideration		0.0	(3,289)	(0.8)	(3,289)	100.0
Total operating expenses	\$ 130,024	74.0	\$ 242,398	55.9	\$ 112,374	86.4

* Denotes % of total revenue

** Denotes % change from 2010 to 2011

Research and development expense was adversely affected by \$2.8 million in foreign exchange rates, primarily due to the weakening of the U.S. dollar in relation to the Canadian dollar. The \$45.8 million increase primarily reflects increases of \$27.0 million in employee compensation and related costs, \$7.8 million in facilities and information systems, \$7.2 million in professional services and fees, and \$4.0 million in depreciation expense.

Selling and marketing expense benefited by \$0.7 million in foreign exchange rates primarily due to the strengthening of the U.S. dollar in relation to the Euro. The \$22.9 million increase primarily reflects increases of \$14.2 million in employee compensation and related costs, \$2.9 million in facilities and information systems, \$2.0 million in travel-related expenditures, \$1.5 million in professional services and fees, and \$1.3 million in channel marketing programs expense and trade show costs.

General and administrative expense increased by \$8.8 million in consulting expense, \$8.2 million in facilities and information systems expense and \$7.8 million in employee compensation and related costs.

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

Amortization of intangible assets increased due to the acquisition of additional intangible assets as a result of the MEN Acquisition. See Note 3 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report.

Restructuring costs primarily reflect the headcount reductions and restructuring activities described in Note 5 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report.

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

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

	Quarter Ended January 31,				Increase (decrease)	%**
	2010	%*	2011	%*		
Interest and other income (loss), net	\$ (773)	(0.4)	\$6,265	1.4	\$7,038	910.5
Interest expense	\$1,828	1.0	\$9,550	2.2	\$7,722	422.4
Provision for income taxes	\$ 868	0.5	\$1,879	0.4	\$1,011	116.5

* Denotes % of total revenue

** Denotes % change from 2010 to 2011

Interest and other income (loss), net increased as a result of a \$7.1 million non-cash gain related to the change in fair value of the embedded redemption feature associated with our 4.0% convertible senior notes due March 15, 2015. See Notes 7 and 15 to the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report for more information regarding the issuance of these convertible notes and the fair value of the redemption feature contained therein.

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

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

Segment Profit (Loss)

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

	Quarter Ended January 31,		Increase (decrease)	%*
	2010	2011		
Segment profit (loss):				
Packet-Optical Transport	\$20,123	\$39,026	\$18,903	93.9
Packet-Optical Switching	(2,038)	12,877	14,915	731.8
Carrier Ethernet Service Delivery	8,882	2,393	(6,489)	(73.1)
Software and Services	3,160	18,420	15,260	482.9

* Denotes % change from 2010 to 2011

Packet-Optical Transport segment profit was significantly affected by the MEN Acquisition. Segment profit increased due to higher sales volume, partially offset by lower product gross margin and increased research and development costs.

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

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

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

Table of Contents**Liquidity and Capital Resources**

At January 31, 2011, our principal source of liquidity was cash and cash equivalents. The following table summarizes our cash and cash equivalents (in thousands):

	October 31, 2010	January 31, 2011	Increase (decrease)
Cash and cash equivalents	\$ 688,687	\$ 625,820	\$ (62,867)

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

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

- \$63.7 million cash used from operations, consisting of \$43.6 million for changes in working capital and \$20.1 million from net losses (adjusted for non-cash charges). Use of cash reflects cash payments of \$24.5 million of acquisition and integration-related expense and restructuring costs, of which \$25.7 million was reflected in net losses (adjusted for non-cash charges) and \$1.2 million was reflected in changes in working capital,
- \$17.3 million for equipment, furniture, fixtures and intellectual property; and
- \$3.5 million transferred to restricted cash related to collateral for our standby letters of credit.

These decreases were partially offset by receipts of \$5.3 million from the exercise of employee stock purchase plans and stock options.

Based on past performance and current expectations, we believe that our cash and cash equivalents and cash generated from operations will satisfy our working capital needs, capital expenditures, and other liquidity requirements associated with our existing operations through at least the next 12 months. As expected, the investment in working capital for the first three months of fiscal 2011 reflects the increased scale of business as the result of the MEN Acquisition. We regularly evaluate our liquidity position and the anticipated cash needs of the business to fund our operating plans as well as any capital raising opportunities that may be available to us.

The following sections set forth the components of our \$63.7 million of cash used by operating activities during the first three months of fiscal 2011:

Net loss (adjusted for non-cash charges)

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

	Three months ended January 31, 2011
Net loss	\$ (79,056)
Adjustments for non-cash charges:	
Change in fair value of embedded redemption feature	(7,130)
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	14,543
Share-based compensation costs	9,864
Amortization of intangible assets	37,137
Provision for inventory excess and obsolescence	2,645
Provision for warranty	1,093
Other	851

Net losses (adjusted for non-cash charges)	\$	(20,053)
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Cash used by accounts receivable, net of \$0.4 million in allowance for doubtful accounts, during the first three months of fiscal 2011 was \$26.5 million primarily due to higher sales volume. Our days sales outstanding (DSOs) increased from 54 days for the first three months of fiscal 2010 to 77 days for the first three months of fiscal 2011. Our DSOs increased due to a larger proportion of sales occurring later in our first quarter of fiscal 2011. The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2010 through the end of the first quarter of fiscal 2011:

	October 31, 2010	January 31, 2011	Increase (decrease)
Accounts receivable, net	\$ 343,582	\$ 369,718	\$ 26,136

Inventory

Cash consumed by inventory during the first three months of fiscal 2011 was \$8.4 million due to increased inventory levels to support a higher sales volume. Our inventory turns were 3.2 turns during the first three months of fiscal 2010 and the first three months of fiscal 2011. During the first three months of fiscal 2011, changes in inventory reflect a \$2.6 million reduction related to a non-cash provision for excess and obsolescence. The following table sets forth (in thousands) changes to the components of our inventory from the end of fiscal 2010 through the end of the first quarter of fiscal 2011:

	October 31, 2010	January 31, 2011	Increase (decrease)
Raw materials	\$ 30,569	\$ 27,618	\$ (2,951)
Work-in-process	6,993	5,346	(1,647)
Finished goods	177,994	186,899	8,905
Deferred cost of goods sold	76,830	78,107	1,277
Gross inventory	292,386	297,970	5,584
Provision for inventory excess and obsolescence	(30,767)	(30,624)	143
Inventory	\$ 261,619	\$ 267,346	\$ 5,727

Prepaid expense and other

Cash used in operations related to prepaid expense and other during the first three months of fiscal 2011 was \$4.9 million. This usage was primarily related to increases in product demonstration units and value added tax receivables, partially offset by the receipt of the contingent refund receivable related to the Carling Lease termination.

Accounts payable, accruals and other obligations

Cash used in operations related to accounts payable, accruals and other obligations during the first three months of fiscal 2011 was \$4.3 million. Between the end of fiscal 2010 and the first quarter of fiscal 2011, the change in unpaid equipment purchases was \$1.4 million. Changes in accrued liabilities reflect non-cash provisions of \$1.1 million related to warranties. The following table sets forth (in thousands) changes in our accounts payable, accruals and other obligations from the end of fiscal 2010 through the end of the first quarter of fiscal 2011:

	October 31, 2010	January 31, 2011	Increase (decrease)
Accounts payable	\$ 200,617	\$ 202,236	\$ 1,619
Accrued liabilities	193,994	186,039	(7,955)
Other long-term obligations	16,435	18,147	1,712

Accounts payable, accruals and other obligations	\$ 411,046	\$ 406,422	\$ (4,624)
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Interest Payable on Convertible Notes

Interest on our outstanding 0.25% convertible senior notes, due May 1, 2013, is payable on May 1 and November 1 of each year. We paid \$0.3 million in interest on these convertible notes during the first three months of fiscal 2011.

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Interest on our outstanding 4.0% convertible senior notes, due March 15, 2015, is payable on March 15 and September 15 of each year.

Interest on our outstanding 0.875% convertible senior notes, due June 15, 2017, is payable on June 15 and December 15 of each year. We paid \$2.2 million in interest on these convertible notes during the first three months of fiscal 2011.

Interest on our outstanding 3.75% convertible senior notes, due October 15, 2018, is payable on April 15 and October 15 of each year. Our initial interest payment on these notes will be due on April 15, 2011.

For additional information about our convertible notes, see Note 15 to the Condensed Consolidated Financial Statements under Item 1 of Part I of this report

Deferred revenue

Deferred revenue increased by \$0.4 million during the first three months of fiscal 2011. Product deferred revenue represents payments received in advance of shipment and payments received in advance of our ability to recognize revenue. Services deferred revenue is related to payment for service contracts that will be recognized over the contract term. The following table reflects (in thousands) the balance of deferred revenue and the change in this balance from the end of fiscal 2010 through the end of the first quarter of fiscal 2011:

	October 31, 2010	January 31, 2011	Increase (decrease)
Products	\$ 31,187	\$ 40,044	\$ 8,857
Services	73,862	65,432	(8,430)
Total deferred revenue	\$ 105,049	\$ 105,476	\$ 427

Contractual Obligations

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

	Total	Less than one year	One to three years	Three to five years	Thereafter
Interest due on convertible notes	\$ 202,289	\$ 33,040	\$ 65,811	\$ 57,500	\$ 45,938
Principal due at maturity on convertible notes	1,441,210		216,210	375,000	850,000
Operating leases (1)	99,395	27,711	43,278	22,240	6,166
Purchase obligations (2)	272,960	272,960			
Total (3)	\$ 2,015,854	\$ 333,711	\$ 325,299	\$ 454,740	\$ 902,104

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

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

(3) As of January 31, 2011, we also had approximately \$8.0 million of other long-term obligations in our condensed consolidated balance sheet for unrecognized tax positions that are not included in this table because the timing or amount of any cash settlement with the respective tax authority cannot be reasonably estimated.

Some of our commercial commitments, including some of the future minimum payments set forth above, are secured by standby letters of credit. The following is a summary of our commercial commitments secured by standby letters of credit by commitment expiration date as of January 31, 2011 (in thousands):

	Total	Less than one year	One to three years	Three to five years
Standby letters of credit	\$ 53,298	\$ 48,715	\$ 3,629	\$ 954

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

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expense, and related disclosure of contingent assets and liabilities. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. On an ongoing basis, we reevaluate our estimates, including those related to bad debts, inventories, intangible assets, income taxes, warranty obligations, restructuring, derivatives and hedging, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Among other things, these estimates form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. To the extent that there are material differences between our estimates and actual results, our consolidated financial statements will be affected.

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

Revenue Recognition

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

We apply the percentage of completion method to long-term arrangements where it is required to undertake significant production, customizations or modification engineering, and reasonable and reliable estimates of revenue and cost are available. Utilizing the percentage of completion method, we recognize revenue based on the ratio of actual costs incurred to date to total estimated costs expected to be incurred. In instances that do not meet the percentage of completion method criteria, recognition of revenue is deferred until there are no uncertainties regarding customer acceptance.

Software revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. In instances where final acceptance criteria of the software is specified by the customer, revenue is deferred until there are no uncertainties regarding customer acceptance.

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

Accounting for multiple element arrangements entered into prior to fiscal 2011

Arrangements with customers may include multiple deliverables, including any combination of equipment, services and software. If multiple element arrangements include software or software-related elements that are essential to the equipment, we allocate the arrangement fee among separate units of accounting. Multiple element arrangements that include software are separated into more than one unit of accounting if the functionality of the delivered element(s) is not dependent on the undelivered element(s), there is vendor-specific objective evidence (VSOE) of the fair value of the undelivered element(s), and general revenue recognition criteria related to the delivered element(s) have been met. The amount of product and services revenue recognized is affected by our judgment as to whether an arrangement includes multiple elements and, if so, whether VSOE of fair value exists. VSOE is established based on our standard pricing and discounting practices for the specific product or service when

sold separately. In determining VSOE, we require that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range. Changes to the elements in an arrangement and our ability to establish VSOE for those elements could affect the timing of revenue recognition. For all other multiple element arrangements, we separate the elements into more than one unit of accounting if the delivered element(s) have value to the customer on a stand-alone basis, objective and reliable evidence of fair value exists for the undelivered element(s), and delivery of the undelivered element(s) is probable and substantially in our control. Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or using the residual method if objective evidence of fair value does not exist for the delivered element(s). The revenue recognition criteria described above are applied to each separate unit of accounting. If these criteria are not met, revenue is deferred until the criteria are met or the last element has been delivered.

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

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

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

VSOE is established based on our standard pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, which exists across certain of our service offerings, we require that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range. We have generally been unable to establish TPE of selling price because our go-to-market strategy differs from that of others in our markets, and the extent of customization and differentiated features and functions varies among comparable products or services from our peers. We determine BESP based upon management-approved pricing guidelines, which consider multiple factors including the type of product or service, gross margin objectives, competitive and market conditions, and the go-to-market strategy; all of which can affect pricing practices.

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

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

Our total deferred revenue for products was \$31.2 million and \$40.1 million as of October 31, 2010 and January 31, 2011, respectively. Our services revenue is deferred and recognized ratably over the period during which

the services are to be performed. Our total deferred revenue for services was \$73.9 million and \$65.4 million as of October 31, 2010 and January 31, 2011, respectively.

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We record acquisitions using the purchase method of accounting. All of the assets acquired, liabilities assumed, contractual contingencies and contingent consideration are recognized at their fair value as of the acquisition date. The excess of the purchase price over the estimated fair values of the net tangible and net intangible assets acquired is recorded as goodwill. The application of the purchase method of accounting for business combinations requires management to make significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration between assets that are depreciated and amortized from goodwill. These assumptions and estimates include a market participant's use of the asset and the appropriate discount rates for a market participant. Our estimates are based on historical experience, information obtained from the management of the acquired companies and, when appropriate, includes assistance from independent third-party appraisal firms. Our significant assumptions and estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and unpredictable. In addition, unanticipated events and circumstances may occur which may affect the accuracy or validity of such estimates. During fiscal 2010, we completed the MEN Acquisition for a purchase price of \$676.8 million. As a result of the purchase price allocation to the assets acquired and liabilities assumed, as well as contingent consideration, there was no value assigned to goodwill. See Note 3 to the Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

Share-Based Compensation

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

We estimate the fair value of our restricted stock unit awards based on the fair value of our common stock on the date of grant. Our outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. We recognize the estimated fair value of service-based awards, net of estimated forfeitures, as share-based expense ratably over the vesting period on a straight-line basis. Awards with performance-based vesting conditions require the achievement of certain financial or other performance criteria or targets as a condition to the vesting, or acceleration of vesting. We recognize the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon our determination of whether it is probable that the performance targets will be achieved. At each reporting period, we reassess the probability of achieving the performance targets and the performance period required to meet those targets. Determining whether the performance targets will be achieved involves judgment, and the estimate of expense may be revised periodically based on changes in the probability of achieving the performance targets. Revisions are reflected in the period in which the estimate is changed. If any performance goals are not met, no compensation cost is ultimately recognized against that goal, and, to the extent previously recognized, compensation cost is reversed.

Because share-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures. We estimate forfeitures at the time of grant and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the measure of estimated fair value of our share-based compensation. See Note 17 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to share-based compensation and the amount of share-based compensation expense we incurred for the periods

covered in this report. As of January 31, 2011, total unrecognized compensation expense was \$77.0 million: (i) \$3.8 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 0.7 year; and (ii) \$73.1 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.7 years.

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

Reserve for Inventory Obsolescence

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. Upon recognition of the write down, a new lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. We recorded charges for excess and obsolete inventory of \$1.0 million and \$2.6 million in the first three months of fiscal 2010 and 2011, respectively. During fiscal 2010 and the first quarter of fiscal 2011, these charges were primarily related to excess inventory due to a change in forecasted sales across our product line. In an effort to limit our exposure to delivery delays and to satisfy customer needs we purchase inventory based on forecasted sales across our product lines. In addition, part of our research and development strategy is to promote the convergence of similar features and functionalities across our product lines. Each of these practices exposes us to the risk that our customers will not order products for which we have forecasted sales, or will purchase less than we have forecasted. Historically, we have experienced write downs due to changes in strategic direction, discontinuance of a product and declines in market conditions. If actual market conditions worsen or differ from those we have assumed, if there is a sudden and significant decrease in demand for our products, or if there is a higher incidence of inventory obsolescence due to a rapid change in technology, we may be required to take additional inventory write-downs, and our gross margin could be adversely affected. Our inventory net of allowance for excess and obsolescence was \$261.6 million and \$267.3 million as of October 31, 2010 and January 31, 2011, respectively.

Restructuring

As part of our restructuring costs, we provide for the estimated cost of the net lease expense for facilities that are no longer being used. The provision is equal to the fair value of the minimum future lease payments under our contracted lease obligations, offset by the fair value of the estimated sublease payments that we may receive. As of January 31, 2011, our accrued restructuring liability related to net lease expense and other related charges was \$5.9 million. The total minimum remaining lease payments for these restructured facilities are \$8.5 million. These lease payments will be made over the remaining lives of our leases, which range from two months to eight years. If actual market conditions are different than those we have projected, we will be required to recognize additional restructuring costs or benefits associated with these facilities.

Allowance for Doubtful Accounts Receivable

Our allowance for doubtful accounts receivable is based on management's assessment, on a specific identification basis, of the collectibility of customer accounts. We perform ongoing credit evaluations of our customers and generally have not required collateral or other forms of security from customers. In determining the appropriate balance for our allowance for doubtful accounts receivable, management considers each individual customer account receivable in order to determine collectibility. In doing so, we consider creditworthiness, payment history, account activity and communication with such customer. If a customer's financial condition changes, or if actual defaults are higher than our historical experience, we may be required to take a charge for an allowance for doubtful accounts receivable which could have an adverse impact on our results of operations. Our accounts receivable net of allowance

for doubtful accounts was \$343.6 million and \$369.7 million as of October 31, 2010 and January 31, 2011, respectively. Our allowance for doubtful accounts was \$0.1 million and \$0.4 million as of October 31, 2010 and January 31, 2011, respectively.

Long-lived Assets

Our long-lived assets include: equipment, furniture and fixtures; finite-lived intangible assets; and maintenance spares. As of October 31, 2010 and January 31, 2011 these assets totaled \$600.4 million and \$566.5 million, net, respectively. We test long-lived assets for impairment whenever events or changes in circumstances indicate that the assets' carrying amount is not recoverable from its undiscounted cash flows. Our long-lived assets are assigned to a