

# CIENA CORP

## FORM 10-Q (Quarterly Report)

Filed 09/08/10 for the Period Ending 07/31/10

Address	1201 WINTERSON ROAD LINTHICUM, MD 21090
Telephone	4108658500
CIK	0000936395
Symbol	CIEN
SIC Code	3661 - Telephone and Telegraph Apparatus
Industry	Communications Equipment
Sector	Technology
Fiscal Year	10/31

## Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended July 31, 2010

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if smaller reporting company)

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

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

**Class**

common stock, \$.01 par value

**Outstanding at August 28, 2010**

93,571,893

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

	<u>PAGE NUMBER</u>
<b>PART I — FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	3
Condensed Consolidated Statements of Operations for the Quarters and Nine Months Ended July 31, 2009 and July 31, 2010	3
Condensed Consolidated Balance Sheets at October 31, 2009 and July 31, 2010	4
Condensed Consolidated Statements of Cash Flows for the Nine Months Ended July 31, 2009 and July 31, 2010	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	30
Item 3. Quantitative and Qualitative Disclosures About Market Risk	52
Item 4. Controls and Procedures	53
<b>PART II – OTHER INFORMATION</b>	
Item 1. Legal Proceedings	54
Item 1A. Risk Factors	54
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	66
Item 3. Defaults Upon Senior Securities	66
Item 4. Removed and Reserved	66
Item 5. Other Information	66
Item 6. Exhibits	67
Signatures	68
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 LABELS LINKBASE DOCUMENT	
EX-101 PRESENTATION LINKBASE DOCUMENT	
EX-101 DEFINITION LINKBASE DOCUMENT	

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Revenue:				
Products	\$139,903	\$ 312,378	\$ 398,469	\$ 667,852
Services	24,855	77,297	77,890	151,170
Total revenue	<u>164,758</u>	<u>389,675</u>	<u>476,359</u>	<u>819,022</u>
Cost of goods sold:				
Products	72,842	201,559	214,628	396,449
Services	17,251	44,107	54,503	93,462
Total cost of goods sold	<u>90,093</u>	<u>245,666</u>	<u>269,131</u>	<u>489,911</u>
Gross profit	<u>74,665</u>	<u>144,009</u>	<u>207,228</u>	<u>329,111</u>
Operating expenses:				
Research and development	44,442	100,869	140,624	222,044
Selling and marketing	31,468	52,127	98,582	131,692
General and administrative	11,524	32,649	35,724	66,915
Acquisition and integration costs	—	17,033	—	83,285
Amortization of intangible assets	6,224	38,727	18,852	61,829
Restructuring costs	3,941	2,157	10,416	3,985
Goodwill impairment	—	—	455,673	—
Total operating expenses	<u>97,599</u>	<u>243,562</u>	<u>759,871</u>	<u>569,750</u>
Loss from operations	<u>(22,934)</u>	<u>(99,553)</u>	<u>(552,643)</u>	<u>(240,639)</u>
Interest and other income (loss), net	999	(2,668)	9,167	307
Interest expense	(1,856)	(5,990)	(5,552)	(11,931)
Loss on cost method investments	<u>(2,193)</u>	<u>—</u>	<u>(5,328)</u>	<u>—</u>
Loss before income taxes	<u>(25,984)</u>	<u>(108,211)</u>	<u>(554,356)</u>	<u>(252,263)</u>
Provision for income taxes	470	1,644	139	934
Net loss	<u>\$ (26,454)</u>	<u>\$ (109,855)</u>	<u>\$ (554,495)</u>	<u>\$ (253,197)</u>
Basic net loss per common share	<u>\$ (0.29)</u>	<u>\$ (1.18)</u>	<u>\$ (6.10)</u>	<u>\$ (2.73)</u>
Diluted net loss per potential common share	<u>\$ (0.29)</u>	<u>\$ (1.18)</u>	<u>\$ (6.10)</u>	<u>\$ (2.73)</u>
Weighted average basic common shares outstanding	<u>91,364</u>	<u>92,906</u>	<u>90,970</u>	<u>92,851</u>
Weighted average dilutive potential common shares outstanding	<u>91,364</u>	<u>92,906</u>	<u>90,970</u>	<u>92,851</u>

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

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

	October 31, 2009	July 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 485,705	\$ 470,237
Short-term investments	563,183	184
Accounts receivable, net	118,251	260,277
Inventories	88,086	222,164
Prepaid expenses and other	50,537	118,571
Total current assets	<u>1,305,762</u>	<u>1,071,433</u>
Long-term investments	8,031	—
Equipment, furniture and fixtures, net	61,868	118,755
Goodwill	—	38,086
Other intangible assets, net	60,820	470,610
Other long-term assets	67,902	112,587
Total assets	<u>\$ 1,504,383</u>	<u>\$ 1,811,471</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 53,104	\$ 118,972
Accrued liabilities	103,349	178,427
Restructuring liabilities	1,811	3,021
Income tax payable	—	1,306
Deferred revenue	40,565	58,655
Total current liabilities	<u>198,829</u>	<u>360,381</u>
Long-term deferred revenue	35,368	32,122
Long-term restructuring liabilities	7,794	5,995
Other long-term obligations	8,554	10,098
Convertible notes payable	798,000	1,174,580
Total liabilities	<u>1,048,545</u>	<u>1,583,176</u>
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; 92,038,360 and 93,567,775 shares issued and outstanding	920	936
Additional paid-in capital	5,665,028	5,692,387
Accumulated other comprehensive income (loss)	1,223	(498)
Accumulated deficit	(5,211,333)	(5,464,530)
Total stockholders' equity	<u>455,838</u>	<u>228,295</u>
Total liabilities and stockholders' equity	<u>\$ 1,504,383</u>	<u>\$ 1,811,471</u>

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

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

	Nine Months Ended July 31,	
	2009	2010
<b>Cash flows from operating activities:</b>		
Net loss	\$(554,495)	\$(253,197)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of (discount) premium on marketable securities	(858)	574
Loss on cost method investments	5,328	—
Gain on embedded redemption feature	—	(2,570)
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	16,270	28,146
Impairment of goodwill	455,673	—
Share-based compensation costs	26,075	26,451
Amortization of intangible assets	23,804	82,476
Provision for inventory excess and obsolescence	11,126	10,749
Provision for warranty	13,620	16,388
Other	1,529	1,955
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	18,128	(134,844)
Inventories	(7,274)	(30,765)
Prepaid expenses and other	(1,696)	(29,528)
Accounts payable, accruals and other obligations	(5,799)	83,580
Income taxes payable	—	1,306
Deferred revenue	4,073	(3,957)
Net cash provided by (used in) operating activities	<u>5,504</u>	<u>(203,236)</u>
<b>Cash flows from investing activities:</b>		
Payments for equipment, furniture, fixtures and intellectual property	(17,630)	(34,646)
Restricted cash	(1,914)	(18,845)
Purchase of available for sale securities	(926,621)	(63,591)
Proceeds from maturities of available for sale securities	321,554	454,141
Proceeds from sales of available for sale securities	523,137	179,380
Acquisition of business	—	(693,247)
Net cash used in investing activities	<u>(101,474)</u>	<u>(176,808)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of 4.0% convertible notes payable, net	—	364,316
Proceeds from issuance of common stock and warrants	533	924
Net cash provided by financing activities	<u>533</u>	<u>365,240</u>
Effect of exchange rate changes on cash and cash equivalents	500	(664)
Net decrease in cash and cash equivalents	(95,437)	(14,804)
Cash and cash equivalents at beginning of period	<u>550,669</u>	<u>485,705</u>
Cash and cash equivalents at end of period	<u>\$ 455,732</u>	<u>\$ 470,237</u>

**Supplemental disclosure of cash flow information**

Cash paid during the period for:		
Interest	\$ 4,748	\$ 4,748
Income taxes, net	\$ 250	\$ 2,037
<b>Non-cash investing and financing activities</b>		
Purchase of equipment in accounts payable	\$ 1,205	\$ 4,421

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

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

**(1) INTERIM FINANCIAL STATEMENTS**

The interim financial statements included herein for Ciena Corporation (“Ciena”) have been prepared by Ciena, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, financial statements included in this report reflect all normal recurring adjustments that Ciena considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial position of Ciena at the date of the interim balance sheets. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The October 31, 2009 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, 2009.

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 third quarter include the results of the MEN Business for the entire period and the results of operations for the nine month period ended July 31, 2010 reflect the operations of the MEN Business beginning on the March 19, 2010 acquisition date. See Note 3 below.

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

**(2) SIGNIFICANT ACCOUNTING POLICIES**

*Use of Estimates*

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

*Cash and Cash Equivalents*

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

*Investments*

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

Ciena has certain minority equity investments in privately held technology companies that are classified as other assets. These investments are carried at cost because Ciena 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*

Effective upon the March 19, 2010 completion of the acquisition of the MEN Business, Ciena reorganized its internal organizational structure and the management of its business. 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 Notes 3 and 20.

### *Goodwill*

Goodwill is the excess of the purchase price over the fair values assigned to the net assets acquired in a business combination. Goodwill is assigned to the reporting units that are expected to benefit from the synergies of the combination. Ciena has determined that its operating segments and reporting units for goodwill assignment are the same. This determination is based on the fact that components below Ciena's operating segment level, such as individual product or service offerings, do not constitute a reporting unit because they do not constitute a business for which discrete financial information is available.

Ciena tests each reporting unit's goodwill for impairment on an annual basis, which Ciena has determined to be the last business day of its fiscal September each year. Testing is required between annual tests if events occur or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. Prior to the reorganization of Ciena's operations described above, Ciena tested its goodwill for impairment as a single reporting unit.

### *Long-lived Assets*

Ciena's 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 reporting units 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 life.

#### *Intangible Assets*

Ciena has recorded finite-lived and indefinite 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.

## Table of Contents

Indefinite-lived intangible assets are carried at cost and reflect in-process research and development assets acquired from the MEN Business. In-process research and development assets will be impaired, if abandoned, or amortized in future periods, depending upon the ability of Ciena to use the research and development in future periods. Future expenditures to complete the in-process research and development projects will be expensed as incurred.

### *Maintenance Spares*

Maintenance spares are recorded at cost. Spares usage cost is computed using the straight-line method over useful lives of four years.

### *Concentrations*

Substantially all of Ciena's cash and cash equivalents and short-term and long-term investments in marketable debt securities 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 9 and 20 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. 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.

Some of Ciena's communications networking equipment is integrated with software that is essential to the functionality of the equipment. 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 of the product is specified by the customer, revenue is deferred until there are no uncertainties regarding customer acceptance.

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 to be allocated to those separate units of accounting. Multiple element arrangements that include software are separated into more than one unit of accounting if the functionality of the delivered element(s) is not dependent on the undelivered element(s), there is vendor-specific objective evidence of the fair value of the undelivered element(s), and general revenue recognition criteria related to the delivered element(s) have been met. The amount of product and services revenue recognized is affected by Ciena's judgments as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence of fair value exists. Changes to the elements in an arrangement and Ciena's ability to establish vendor-specific objective evidence for those elements could affect the timing of revenue

## Table of Contents

recognition. For all other deliverables, 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.

### *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.

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, the first nine months of fiscal 2010 or the expected annual results for fiscal 2010.

### *Accounts Receivable, Net*

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

### *Research and Development*

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

### *Advertising Costs*

Ciena expenses all advertising costs as incurred.

### *Legal Costs*

Ciena expenses legal costs associated with litigation defense as incurred.

### *Share-Based Compensation Expense*

Ciena 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 18 below.

## Table of Contents

### *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.

Ciena adopted the accounting guidance on uncertainty related to income tax positions at the beginning of fiscal 2008. 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.

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's major tax jurisdictions and the related open tax years are as follows: United States (2007), United Kingdom (2004), 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 has not provided U.S. deferred income taxes on the cumulative unremitted earnings of its non-U.S. affiliates as it plans to permanently reinvest cumulative unremitted foreign earnings outside the U.S. and it is not practicable to determine the unrecognized deferred income taxes. These cumulative unremitted foreign earnings relate to ongoing operations in foreign jurisdictions and are required to fund foreign operations, capital expenditures, and any expansion requirements.

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

### *Loss Contingencies*

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

### *Fair Value of Financial Instruments*

The carrying value of Ciena's cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximates fair market value due to the relatively short period of time to maturity. The fair value of investments in marketable debt securities is determined using quoted market prices for those securities or similar financial instruments. For information related to the fair value of Ciena's convertible notes, see Note 8 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;

## Table of Contents

- 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 6 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 U.S. dollar is the functional currency of foreign branch offices or subsidiaries, re-measurement adjustments are recorded in other income. The net gain (loss) on foreign currency re-measurement and exchange rate changes is immaterial for separate financial statement presentation.

### *Derivatives*

Ciena'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 (expense), net on the Condensed Consolidated Statement of Operations.

Occasionally, Ciena uses foreign currency forward contracts to hedge certain forecasted foreign currency transactions relating to operating expenses. Historically these derivatives, designated as cash flow hedges, had maturities of less than one year and permitted net settlement.

At the inception of the cash flow hedge and on an ongoing basis, Ciena assesses the hedging relationship to determine its effectiveness in offsetting changes in cash flows attributable to the hedged risk during the hedge period. The effective portion of the hedging instrument's net gain or loss is initially reported as a component of accumulated other comprehensive income (loss), and upon occurrence of the forecasted transaction, is subsequently reclassified into the operating expense line item to which the hedged transaction relates. Any net gain or loss associated with the ineffectiveness of the hedging instrument is reported in interest and other income, net. See Note 15 below.

### *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 17.

## Table of Contents

### *Software Development Costs*

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

### *Newly Issued Accounting Standards*

In October 2009, the Financial Accounting Standards Board, (FASB) amended the accounting standards for revenue recognition with multiple deliverables. The amended guidance allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor-specific objective evidence or third-party evidence is unavailable. Additionally, it eliminates the residual method of revenue recognition in accounting for multiple deliverable arrangements. The guidance is effective for fiscal years beginning on or after June 15, 2010 and early adoption is permitted. Ciena is currently evaluating the impact this new guidance could have on its financial condition, results of operations and cash flows.

In October 2009, the FASB amended the accounting standards for revenue arrangements with software elements. The amended guidance modifies the scope of the software revenue recognition guidance to exclude tangible products that contain both software and non-software components that function together to deliver the product's essential functionality. The pronouncement is effective for fiscal years beginning on or after June 15, 2010 and early adoption is permitted. This guidance must be adopted in the same period an entity adopts the amended revenue arrangements with multiple deliverables guidance described above. Ciena is currently evaluating the impact this new guidance could have on its financial condition, results of operations and cash flows.

## **(3) BUSINESS COMBINATIONS**

### *Acquisition of MEN Business*

On March 19, 2010, Ciena completed its acquisition of the MEN Business. Ciena believes that this transaction strengthens its position as a leader in next-generation, converged optical Ethernet networking and will accelerate the execution of its corporate and research and development strategies. Ciena believes that the additional geographic reach, expanded customer relationships, and broader portfolio of complementary network solutions derived from the acquisition will enable Ciena to better compete with larger equipment vendors.

In accordance with the agreements for the acquisition, the initial \$773.8 million aggregate purchase price, which was payable in cash and convertible notes, was subsequently adjusted downward by \$80.6 million based upon the amount of net working capital transferred to Ciena at closing. Prior to closing, Ciena elected to replace the \$239.0 million in aggregate principal of convertible notes that were to be issued to Nortel as part of the aggregate purchase price with cash equivalent to 102% of the face amount of the notes replaced, or \$243.8 million. Ciena completed a private placement of 4.0% Convertible Senior Notes due March 15, 2015 in aggregate principal amount of \$375.0 million which funded this election and reduced the amount of cash on hand required to fund the aggregate purchase price. See Note 16 below. As a result, the aggregate purchase price was \$693.2 million consisting entirely of cash.

Given the structure of the transaction as an asset carve-out from Nortel, Ciena expects that the transaction will result in a costly and complex integration with a number of operational risks. Ciena expects to incur approximately \$180 million in costs associated with equipment and information technology, transaction expense, severance expense and consulting and third party service fees associated with the integration, with the majority of these costs to be incurred in fiscal 2010. In addition to these costs, Ciena has incurred inventory obsolescence charges and may incur additional expenses related to, among other things, facilities restructuring. As a result, the expense that Ciena incurs and recognizes for financial statement purposes will be significantly higher than the estimated costs above. As of July 31, 2010, Ciena has incurred \$83.3 million in transaction, consulting and third party service fees, \$4.0 million in severance expense, and an additional \$10.8 million, primarily related to purchases of capitalized information technology equipment. In addition to the estimated costs above, Ciena also expects to incur significant transition services expense. Ciena is currently relying upon an affiliate of Nortel to perform certain critical operational and business support functions during an interim integration period. Ciena can utilize certain of these support services for a period of up to 24 months following the acquisition of the MEN Business, 12 months in Europe, Middle East and Africa, (EMEA). The cost of these transition services is estimated to be approximately \$94 million annually. The actual expense will depend upon the scope of the services that Ciena utilizes and the time within which Ciena is able to complete the planned transfer of these services to internal resources or other third party providers.

## Table of Contents

During fiscal 2010, Ciena adopted the new FASB guidance on business combinations. The acquisition of the MEN Business has been accounted for under the acquisition method of accounting which requires the total purchase price to be allocated to the assets acquired and liabilities assumed based on their estimated fair values. The fair values assigned to the assets acquired and liabilities assumed are based on valuations using management's best estimates and assumptions. The allocation of the purchase price as reflected in these consolidated financial statements is based on the best information available to management at the time these consolidated financial statements were issued and is preliminary pending the completion of the valuation analysis of selected assets and liabilities. During the measurement period (which is not to exceed one-year from the acquisition date), Ciena is required to retrospectively adjust the provisional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets or liabilities as of that date. The following table summarizes the initial measurement allocation of the purchase price, measurement period adjustments and the current measurement allocation related to the MEN Business based on the estimated fair value of the acquired assets and assumed liabilities (in thousands):

	Initial Measurement Allocation	Measurement Period Adjustment	Current Measurement Allocation
Unbilled receivables	\$ 7,454	\$ (271)	\$ 7,183
Inventories	114,169	(107)	114,062
Prepaid expenses and other	32,517	—	32,517
Other long-term assets	21,821	—	21,821
Equipment, furniture and fixtures	45,351	—	45,351
Developed technology	218,774	—	218,774
In-process research and development	11,000	—	11,000
Customer relationships, outstanding purchase orders and contracts	257,964	2,283	260,247
Trade name	2,000	—	2,000
Goodwill	39,991	(1,905)	38,086
Deferred revenue	(18,801)	—	(18,801)
Accrued liabilities	(36,349)	—	(36,349)
Other long-term obligations	(2,644)	—	(2,644)
Total purchase price allocation	<u>\$ 693,247</u>	<u>\$ —</u>	<u>\$ 693,247</u>

Any additional changes in the estimated fair value of the net assets during the remaining measurement period will change the amount of the purchase price allocable to goodwill and, if material, Ciena's consolidated financial results will be adjusted retroactively. Ciena is currently not aware of any significant potential changes to the current purchase price allocation.

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. This revaluation resulted in an increase in inventory carrying value of approximately \$39.7 million for marketable inventory offset by a decrease of \$2.5 million for unmarketable inventory.

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

Developed technology represents purchased technology which has 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. In-process research and development assets will be impaired, if abandoned, or amortized in future periods, depending upon the ability of Ciena to use the research and development in future periods. Future expenditures to complete the in-process research and development projects will be expensed as incurred.

## Table of Contents

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 \$14.2 million related to a contract asset for acquired in-process projects which will be billed in full by Ciena and recognized as a reduction in revenue within the next year. Trade name represents acquired product trade names which are expected to have a useful life of nine months.

Goodwill represents the purchase price in excess of the amounts assigned to acquired tangible or intangible assets and assumed liabilities. Amounts allocated to goodwill are tax deductible in all relevant jurisdictions. The goodwill is attributable to the assigned workforce of the MEN Business and the synergies expected to arise as a result of the acquisition.

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 periods indicated as if Ciena's acquisition of the MEN Business had been completed as of the beginning of each of the periods presented. Revenue specific to the MEN Business since the March 19, 2010 acquisition date was \$275.3 million. As Ciena has begun to integrate the combined operations, eliminating overlapping processes and expenses and integrating its products and sales efforts with those of the acquired MEN Business, it is impractical to determine the earnings specific to the MEN Business since the acquisition date.

These pro forma amounts (in thousands) do not purport to be indicative of the results that would have actually been obtained if the acquisition occurred as of the beginning of the periods presented or that may be obtained in the future.

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Pro forma revenue	<u>\$ 406,758</u>	<u>\$393,843</u>	<u>\$1,260,112</u>	<u>\$1,174,719</u>
Pro forma net loss	<u>\$(127,845)</u>	<u>\$(77,080)</u>	<u>\$( 859,305)</u>	<u>\$( 463,150)</u>

#### (4) GOODWILL

##### *Goodwill*

As a result of its acquisition of the MEN Business, Ciena recorded goodwill of \$38.1 million. This goodwill was assigned to the Packet-Optical Transport reporting unit as that unit is expected to benefit from synergies of the combination.

The table below sets forth changes in the carrying amount of goodwill in each of our reporting units for the period indicated (in thousands):

	Packet-Optical Transport	Packet-Optical Switching	Carrier Ethernet Service Delivery	Software and Services	Total
Balance as of October 31, 2009	\$ —	\$—	\$—	\$—	\$ —
Acquired	38,086	—	—	—	38,086
Balance as of July 31, 2010	<u>\$38,086</u>	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>	<u>\$38,086</u>

The table below sets forth changes in the carrying amount of goodwill for the period indicated (in thousands):

	Total
Balance as of October 31, 2008	\$ 455,673
Impairment loss	(455,673)
Balance as of July 31, 2009	<u>\$ —</u>

*Goodwill Impairment*

Prior to the acquisition of the MEN Business, Ciena assessed its goodwill based upon a single reporting unit and tested its single reporting unit's goodwill for impairment annually on the last business day of fiscal September each year. Testing is required between annual tests if events occur or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. Based on a combination of factors, including macroeconomic conditions and a sustained decline in Ciena's common stock price and market capitalization below net book value, Ciena conducted an interim impairment assessment of goodwill during the second quarter of fiscal 2009. Ciena performed the step one fair value comparison, and its market capitalization was \$721.8 million and its carrying value, including goodwill, was \$949.0 million. Ciena applied a 25% control premium to its market capitalization to determine a fair value of \$902.2 million. Because step one indicated that Ciena's fair value was less than its carrying value, Ciena performed the step two analysis. Under the step two analysis, the implied fair value of goodwill requires valuation of a reporting unit's tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. The implied fair value of the reporting unit's goodwill was determined to be \$0, and, as a result, Ciena recorded a goodwill impairment of \$455.7 million, representing the full carrying value of the goodwill.

**(5) LONG-LIVED ASSET IMPAIRMENTS**

Due to the reorganization described in Note 2 above, Ciena performed an impairment analysis of its long-lived assets during the second quarter of fiscal 2010. Based on Ciena's estimate of future, undiscounted cash flows by asset group, no impairment was required.

**(6) RESTRUCTURING COSTS**

In April 2010, Ciena committed to certain restructuring actions and subsequently effected a headcount reduction of approximately 70 employees, principally affecting Ciena's Global Product Group and Global Field Organization outside of the EMEA region. This action resulted in a restructuring charge of \$1.8 million in the second quarter of fiscal 2010 and \$0.3 million in the third quarter of fiscal 2010.

In May 2010, following the end of its fiscal second quarter, Ciena informed employees of its proposal to reorganize and restructure portions of Ciena's business and operations in the EMEA region, which is expected to involve the elimination of 120 to 140 roles with reductions expected to principally affect employees in Ciena's Global Field Organization and Global Supply Chain organization. Execution of any specific reorganization is subject to local legal requirements, including notification and consultation processes with employees and employee representatives. Ciena estimates completing the reorganization by the first half of calendar year 2011. Ciena expects total restructuring costs related to this action to range from \$8.0 million to \$10.0 million. During the third quarter of fiscal 2010, Ciena recorded expenses of \$1.9 million related to the reduction in head count of approximately 26 employees in the Global Field Organization.

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

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2009	\$ 170	\$ 9,435	\$ 9,605
Additional liability recorded	3,985	—	3,985
Cash payments	(2,476)	(2,098)	(4,574)
Balance at July 31, 2010	<u>\$ 1,679</u>	<u>\$ 7,337</u>	<u>\$ 9,016</u>
Current restructuring liabilities	<u>\$ 1,679</u>	<u>\$ 1,342</u>	<u>\$ 3,021</u>
Non-current restructuring liabilities	<u>\$ —</u>	<u>\$ 5,995</u>	<u>\$ 5,995</u>

## Table of Contents

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

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

## (7) MARKETABLE SECURITIES

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

	July 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Publicly traded equity securities	\$ 184	\$ —	\$ —	\$ 184
	<u>\$ 184</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 184</u>
Included in short-term investments	\$ 184	—	—	\$ 184
Included in long-term investments	—	—	—	—
	<u>\$ 184</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 184</u>

	October 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations	\$ 570,505	\$ 460	\$ 2	\$ 570,963
Publicly traded equity securities	251	—	—	251
	<u>\$ 570,756</u>	<u>\$ 460</u>	<u>\$ 2</u>	<u>\$ 571,214</u>
Included in short-term investments	562,781	404	\$ 2	563,183
Included in long-term investments	7,975	56	—	8,031
	<u>\$ 570,756</u>	<u>\$ 460</u>	<u>\$ 2</u>	<u>\$ 571,214</u>

Gross unrealized losses related to marketable debt investments, included in short-term and long-term investments, were primarily due to changes in interest rates. Ciena's management determined that the gross unrealized losses at October 31, 2009 were temporary in nature because Ciena had the ability and intent to hold these investments until a recovery of fair value, which may be maturity. There were no gross unrealized losses at July 31, 2010. As of October 31, 2009, gross unrealized losses were as follows (in thousands):

	October 31, 2009					
	Unrealized Losses Less Than 12 Months		Unrealized Losses 12 Months or Greater		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government obligations	\$ 2	\$ 37,744	\$ —	\$ —	\$ 2	\$ 37,744
	<u>\$ 2</u>	<u>\$ 37,744</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2</u>	<u>\$ 37,744</u>

## (8) 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):

## Table of Contents

	July 31, 2010			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Embedded redemption feature	\$ —	\$ —	\$ 4,280	\$ 4,280
Publicly traded equity securities	184	—	—	184
Total assets measured at fair value	<u>\$ 184</u>	<u>\$ —</u>	<u>\$ 4,280</u>	<u>\$ 4,464</u>

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

	July 31, 2010			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Short-term investments	\$ 184	\$ —	\$ —	\$ 184
Other long-term assets	—	—	4,280	4,280
Total assets measured at fair value	<u>\$ 184</u>	<u>\$ —</u>	<u>\$ 4,280</u>	<u>\$ 4,464</u>

Ciena's Level 1 asset is a corporate equity security publicly traded on a major exchange that is valued using quoted prices in active markets.

Ciena's Level 3 asset reflects the embedded redemption feature contained within Ciena's 4.0% convertible senior notes. See Note 16 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 Level 3 fair value measurements:

	Level 3
Balance at October 31, 2009	\$ —
Issuances	1,710
Changes in unrealized gain (loss)	2,570
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at July 31, 2010	<u>\$ 4,280</u>

### *Fair value of outstanding convertible notes*

At July 31, 2010, the fair value of the outstanding \$500.0 million of 0.875% convertible senior notes, \$375.0 million of 4.0% convertible senior notes and \$298.0 million of 0.25% convertible senior notes was \$337.5 million, \$357.4 million and \$264.9 million, respectively. Fair value for the 0.875% and the 0.25% convertible senior notes is based on the quoted market price for the notes on the date above. Due to the lack of trading activity, fair value of the 4.0% convertible senior notes is based on a modified binomial model as described above.

## **(9) ACCOUNTS RECEIVABLE**

As of October 31, 2009, one customer accounted for 10.7% of net accounts receivable, and as of July 31, 2010, no customers accounted for greater than 10.0% of net accounts receivable.

Ciena's allowance for doubtful accounts receivable is based on management's assessment, on a specific identification basis, of the collectibility of customer accounts. As of October 31, 2009 and July 31, 2010, allowance for doubtful accounts was \$0.1 million.

## Table of Contents

### (10) INVENTORIES

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

	October 31, 2009	July 31, 2010
Raw materials	\$ 19,694	\$ 26,606
Work-in-process	1,480	6,021
Finished goods	90,914	220,044
	<u>112,088</u>	<u>252,671</u>
Provision for excess and obsolescence	<u>(24,002)</u>	<u>(30,507)</u>
	<u>\$ 88,086</u>	<u>\$222,164</u>

Ciena writes down its inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value, based on assumptions about future demand and market conditions. During the first nine months of fiscal 2010, Ciena recorded a provision for excess and obsolescence of \$10.7 million, primarily due to product rationalization decisions in connection with the acquisition of the MEN Business. 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 period indicated (in thousands):

	Inventory Reserve
Reserve balance as of October 31, 2009	\$ 24,002
Provision for excess for obsolescence	10,749
Actual inventory disposed	(4,244)
Reserve balance as of July 31, 2010	<u>\$ 30,507</u>

During the first nine months of fiscal 2009, Ciena recorded a provision for excess and obsolete inventory of \$11.1 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory relate to disposal activities. The following table summarizes the activity in Ciena's reserve for excess and obsolete inventory for the period indicated (in thousands):

	Inventory Reserve
Reserve balance as of October 31, 2008	\$ 23,257
Provision for excess and obsolescence	11,126
Actual inventory disposed	(12,837)
Reserve balance as of July 31, 2009	<u>\$ 21,546</u>

### (11) PREPAID EXPENSES AND OTHER

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

	October 31, 2009	July 31, 2010
Interest receivable	\$ 993	\$ —
Prepaid VAT and other taxes	14,527	43,845
Deferred deployment expense	4,242	6,797
Product demonstration equipment, net	—	28,573
Prepaid expenses	8,869	16,480
Capitalized acquisition costs	12,473	—
Restricted cash	7,477	14,943
Other non-trade receivables	1,956	7,933
	<u>\$ 50,537</u>	<u>\$118,571</u>

Prepaid expenses and other as of July 31, 2010 include \$28.6 million related to product demonstration equipment, net acquired as part of the MEN Business. Depreciation of product demonstration equipment was \$2.3 million for the first nine months of fiscal 2010. Capitalized acquisition costs at October 31, 2009 include direct costs related to Ciena's then pending acquisition of the MEN Business. In the first quarter of fiscal 2010, Ciena adopted newly issued accounting guidance related to business combinations, which required the full amount of these capitalized acquisition costs to be expensed in the Condensed Consolidated Statement of Operations.

## Table of Contents

### (12) EQUIPMENT, FURNITURE AND FIXTURES

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

	October 31, 2009	July 31, 2010
Equipment, furniture and fixtures	\$ 293,093	\$ 353,752
Leasehold improvements	45,761	48,907
	<u>338,854</u>	<u>402,659</u>
Accumulated depreciation and amortization	(276,986)	(283,904)
	<u>\$ 61,868</u>	<u>\$ 118,755</u>

Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements was \$16.3 million and \$25.8 million for the first nine months of fiscal 2009 and 2010, respectively.

### (13) OTHER INTANGIBLE ASSETS

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

	October 31, 2009			July 31, 2010		
	<u>Gross Intangible</u>	<u>Accumulated Amortization</u>	<u>Net Intangible</u>	<u>Gross Intangible</u>	<u>Accumulated Amortization</u>	<u>Net Intangible</u>
<b>Finite-lived intangibles:</b>						
Developed technology	\$185,833	\$ (147,504)	\$38,329	\$406,833	\$ (173,694)	\$233,139
Patents and licenses	47,370	(42,811)	4,559	45,388	(44,868)	520
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	<u>60,981</u>	<u>(43,049)</u>	<u>17,932</u>	<u>323,228</u>	<u>(97,277)</u>	<u>225,951</u>
Total finite-lived intangibles	<u>294,184</u>	<u>(233,364)</u>	<u>60,820</u>	<u>775,449</u>	<u>(315,839)</u>	<u>459,610</u>
<b>Indefinite-lived intangibles:</b>						
In-process research and development	—	—	—	11,000	—	11,000
Total indefinite-lived intangibles	—	—	—	11,000	—	11,000
Total other intangible assets	<u>\$294,184</u>	<u>\$ (233,364)</u>	<u>\$60,820</u>	<u>\$786,449</u>	<u>\$ (315,839)</u>	<u>\$470,610</u>

The amortization expense of finite-lived other intangible assets was \$23.8 million and \$72.6 million for the first nine months of fiscal 2009 and 2010, respectively. In addition, during the first nine months of fiscal 2010, revenue was reduced by \$9.9 million related to the amortization of contract assets from the acquisition of the MEN Business. In-process research and development assets are impaired, if abandoned, or amortized in future periods, depending upon the ability of Ciena to use the research and development in future periods. See Note 3 above for information pertaining to newly acquired intangible assets related to the MEN Business. Expected future amortization of finite-lived other intangible assets for the fiscal years indicated is as follows (in thousands):

	Period ended October 31,
2010 (remaining three months)	\$ 47,661
2011	91,373
2012	71,993
2013	69,573
2014	55,415
Thereafter	<u>123,595</u>
	<u>\$459,610</u>

## Table of Contents

### (14) OTHER BALANCE SHEET DETAILS

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

	October 31, 2009	July 31, 2010
Maintenance spares inventory, net	\$ 31,994	\$ 53,237
Restricted cash	18,792	30,172
Deferred debt issuance costs, net	12,832	20,904
Embedded redemption feature	—	4,280
Investments in privately held companies	907	907
Other	3,377	3,087
	<u>\$ 67,902</u>	<u>\$112,587</u>

Deferred debt issuance costs are amortized using the straight line method which approximates the effect of the effective interest rate method on the maturity of the related debt. Amortization of debt issuance costs, which is included in interest expense, was \$1.7 million and \$2.6 million during the first nine months of fiscal 2009 and fiscal 2010, respectively.

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

	October 31, 2009	July 31, 2010
Warranty	\$ 40,196	\$ 64,510
Compensation, payroll related tax and benefits	20,025	29,906
Vacation	11,508	17,706
Interest payable	2,045	6,370
Other	29,575	59,935
	<u>\$ 103,349</u>	<u>\$178,427</u>

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

	Nine months ended July 31,	Beginning Balance	Acquired	Provisions	Settlements	Balance at end of period
2009		\$ 37,258	—	13,620	(11,498)	\$ 39,380
2010		\$ 40,196	26,000	16,388	(18,074)	\$ 64,510

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

	October 31, 2009	July 31, 2010
Products	\$ 11,998	\$ 15,132
Services	63,935	75,645
	75,933	90,777
Less current portion	(40,565)	(58,655)
Long-term deferred revenue	<u>\$ 35,368</u>	<u>\$ 32,122</u>

### (15) 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 operating expenses. Ciena uses these derivatives to partially offset its market exposure to fluctuations in certain foreign currencies. These derivatives are designated as cash flow hedges. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and, upon occurrence of the forecasted transaction, is subsequently reclassified into the operating expense line item to which the hedged transaction relates. Ciena records the ineffective portion of the hedging instruments in interest and other income, net. As of October 31, 2009 and July 31, 2010, there were no foreign currency forward contracts outstanding and Ciena did not enter into any foreign currency forward contracts during the first nine months of fiscal 2010.

## Table of Contents

Ciena's foreign currency forward contracts are classified as follows (in thousands):

Line Item in Condensed Consolidated Statement of Operations	Reclassified to Condensed Consolidated Statement of Operations (Effective Portion)			
	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Research and development	\$ (283)	\$ —	\$ 21	\$ —
Selling and marketing	(692)	—	46	—
	<u>\$ (975)</u>	<u>\$ —</u>	<u>\$ 67</u>	<u>\$ —</u>

  

Line Item in Condensed Consolidated Balance Sheet	Recognized in Other Comprehensive Income (Loss)		Recognized in Other Comprehensive Income (Loss)	
	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Accumulated other comprehensive income (loss)	\$ 2,904	\$ —	\$ 1,420	\$ —
	<u>\$ 2,904</u>	<u>\$ —</u>	<u>\$ 1,420</u>	<u>\$ —</u>

  

Line Item in Condensed Consolidated Statement of Operations	Ineffective Portion		Ineffective Portion	
	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Interest and other income, net	\$ —	\$ —	\$ —	\$ —
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

## (16) CONVERTIBLE NOTES PAYABLE

### *Ciena 4.0% Convertible Senior Notes, due March 15, 2015*

On March 15, 2010, Ciena completed a private placement of 4.0% convertible senior notes due March 15, 2015, in aggregate principal amount of \$375.0 million (the "Notes"). Interest is payable on the Notes on March 15 and September 15 of each year, beginning on September 15, 2010. The Notes are senior unsecured obligations of Ciena and rank equally with all of Ciena's other existing and future senior unsecured debt.

At the election of the holder, the Notes may be converted prior to maturity into shares of Ciena common stock at the initial conversion rate of 49.0557 shares per \$1,000 in principal amount, which is equivalent to an initial conversion price of approximately \$20.38 per share. The Notes may be redeemed by Ciena on or after March 15, 2013 if the closing sale price of Ciena's common stock for at least 20 trading days in any 30 consecutive trading day period ending on the date one day prior to the date of the notice of redemption exceeds 150% of the conversion price. Ciena may redeem the Notes in whole or in part, at a redemption price in cash equal to the principal amount to be redeemed, plus accrued and unpaid interest, including any additional interest to, but excluding, the redemption date, plus a "make-whole premium" payment. The make whole premium payment will be made in cash and equal the present value of the remaining interest payments, to maturity, computed using a discount rate equal to 2.75%. The make-whole premium is paid to holders whether or not they convert the Notes following Ciena's issuance of a redemption notice. For accounting purposes, this redemption feature is an embedded derivative that is not clearly and closely related to the Notes. Consequently, it was initially bifurcated from the indenture and separately recorded at its fair value as an asset with subsequent changes in fair value recorded through earnings. As of July 31, 2010, the fair value of the embedded redemption feature was \$4.3 million and is included in other long-term assets on the Condensed Consolidated Balance Sheet. Since inception on March 15, 2010, the changes in fair value of the embedded redemption feature in the amount of \$2.6 million were reflected as interest and other income (loss), net on the Condensed Consolidated Statement of Operations.

The shares of common stock issuable upon conversion of the Notes have not been registered for resale on a shelf registration statement. In some instances, Ciena's failure to timely file periodic reports with the SEC or remove restrictive legends on the Notes may require it to pay additional interest on the Notes; which will accrue at the rate of 0.50% per annum of the principal amount of Notes outstanding for each day such failure to file or to remove the restrictive legend has occurred and is continuing.

If Ciena undergoes a "fundamental change" (as that term is defined in the indenture governing the Notes to include certain change in control transactions), holders of Notes will have the right, subject to certain exemptions, to require Ciena to purchase for cash any or all of their Notes at a price equal to the principal amount, plus accrued and unpaid interest. If the holder elects to convert his or her Notes in connection with a specified fundamental change, in certain circumstances, Ciena will be required to increase the applicable conversion rate, depending on the price paid per share for Ciena common stock and the effective date of the fundamental change transaction.

## Table of Contents

The indenture governing the Notes provides for customary events of default which include (subject in certain cases to customary grace and cure periods), among others, the following: nonpayment of principal or interest; breach of covenants or other agreements in the Indenture; defaults in failure to pay certain other indebtedness; and certain events of bankruptcy or insolvency. Generally, if an event of default occurs and is continuing, the trustee or the holders of at least 25% in aggregate principal amount of the Notes may declare the principal of, accrued interest on, and premium, if any, on all the Notes immediately due and payable.

The net proceeds from the offering of the Notes were \$364.3 million after deducting the placement agents' fees and other fees and expenses. Ciena used \$243.8 million of this amount to fund its payment election to replace its contractual obligation to issue convertible notes to Nortel as part of the aggregate purchase price for the acquisition of the MEN Business. The remaining proceeds were used to reduce the cash on hand required to fund the aggregate purchase price of the MEN Business. See Note 3 above.

### (17) 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 July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Net loss	\$(26,454)	\$(109,855)	\$(554,495)	\$(253,197)
Add: Interest expense for 0.250% convertible senior notes	—	—	—	—
Add: Interest expense for 4.000% convertible senior notes	—	—	—	—
Add: Interest expense for 0.875% convertible senior notes	—	—	—	—
Net loss used to calculate diluted EPS	<u>\$(26,454)</u>	<u>\$(109,855)</u>	<u>\$(554,495)</u>	<u>\$(253,197)</u>
Denominator	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Basic weighted average shares outstanding	91,364	92,906	90,970	92,851
Add: Shares underlying outstanding stock options, employees stock purchase plan options, warrants and restricted stock units	—	—	—	—
Add: Shares underlying 0.250% convertible senior notes	—	—	—	—
Add: Shares underlying 4.000% convertible senior notes	—	—	—	—
Add: Shares underlying 0.875% convertible senior notes	—	—	—	—
Dilutive weighted average shares outstanding	<u>91,364</u>	<u>92,906</u>	<u>90,970</u>	<u>92,851</u>
EPS	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Basic EPS	<u>\$ (0.29)</u>	<u>\$ (1.18)</u>	<u>\$ (6.10)</u>	<u>\$ (2.73)</u>
Diluted EPS	<u>\$ (0.29)</u>	<u>\$ (1.18)</u>	<u>\$ (6.10)</u>	<u>\$ (2.73)</u>

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

For the quarters and nine months ended July 31, 2009 and July 31, 2010, the weighted average number of shares underlying outstanding stock options, employee stock purchase plan options, restricted stock units, and warrants set forth in the table below are considered anti-dilutive because Ciena incurred a net loss. In addition, the shares, representing the weighted average number of shares issuable upon conversion of Ciena's outstanding convertible senior notes, are considered anti-dilutive because the related interest expense on a per common share "if converted" basis exceeds Basic EPS for the period.

## Table of Contents

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

Shares excluded from EPS Denominator due to anti-dilutive effect	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Shares underlying stock options, restricted stock units and warrants	8,249	7,171	8,161	8,171
0.25% convertible senior notes	7,539	7,539	7,539	7,539
4.0% convertible senior notes	—	18,396	—	9,333
0.875% convertible senior notes	13,108	13,108	13,108	13,108
Total excluded due to anti-dilutive effect	<u>28,896</u>	<u>46,214</u>	<u>28,808</u>	<u>38,151</u>

### (18) 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, 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 July 31, 2010, there were approximately 5.8 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 Inducement Equity Award Plan (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 July 31, 2010, there were approximately 0.7 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 Outstanding	Weighted Average Exercise Price
Balance as of October 31, 2009	5,538	\$ 45.80
Granted	84	12.40
Exercised	(90)	5.09
Canceled	(427)	85.01
Balance as of July 31, 2010	<u>5,105</u>	\$ 42.68

The total intrinsic value of options exercised during the first nine months of fiscal 2009 and fiscal 2010, was \$0.5 million and \$0.8 million, respectively. The weighted average fair values of each stock option granted by Ciena during the first nine months of fiscal 2009 and fiscal 2010 were \$4.66 and \$6.95, respectively.

## Table of Contents

The following table summarizes information with respect to stock options outstanding at July 31, 2010, based on Ciena's closing stock price of \$13.09 per share on the last trading day of Ciena's third fiscal quarter of 2010 (shares and intrinsic value in thousands):

Range of Exercise Price	Options Outstanding at July 31, 2010				Vested Options at July 31, 2010			
	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	876	6.44	\$ 11.10	\$ 2,910	633	5.53	\$ 11.48	\$ 2,177
\$16.53 – \$ 17.43	518	5.23	17.21	—	483	5.02	17.21	—
\$17.44 – \$ 22.96	435	4.66	21.75	—	401	4.41	21.85	—
\$22.97 – \$ 31.71	1,438	4.45	29.43	—	1,313	4.18	29.54	—
\$31.72 – \$ 46.90	878	5.74	39.42	—	697	5.32	39.87	—
\$46.91 – \$ 73.78	439	2.33	59.62	—	439	2.33	59.62	—
\$73.79 – \$1,046.50	521	1.13	166.31	—	521	1.13	166.31	—
\$ 0.01 – \$1,046.50	<u>5,105</u>	4.59	\$ 42.68	<u>\$ 2,910</u>	<u>4,487</u>	4.12	\$ 45.41	<u>\$ 2,177</u>

### Assumptions for Option-Based Awards

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Expected volatility	65.0%	61.9%	65.0%	61.9%
Risk-free interest rate	2.8 – 3.1%	2.4%	1.7 – 3.1%	2.4 – 3.0%
Expected life (years)	5.2 – 5.3	5.3 – 5.5	5.2 – 5.3	5.3 – 5.5
Expected dividend yield	0.0%	0.0%	0.0%	0.0%

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

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

The expected life of employee stock options represents the weighted-average period during which the stock options are expected to remain outstanding. Ciena gathered detailed historical information about specific exercise behavior of its grantees, which it used to determine the expected term.

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

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

### Restricted Stock Units

A restricted stock unit is a stock award that entitles the holder to receive shares of Ciena common stock as the unit vests. Ciena's outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. Awards subject to service-based conditions typically vest in increments over a three to four year period.

## Table of Contents

Awards with performance-based vesting conditions require the achievement of certain operational, financial or other performance criteria or targets as a condition of vesting, or acceleration of vesting, of such awards.

Ciena's outstanding restricted stock units include "performance-accelerated" restricted stock units (PARS), which vest in full four years after the date of grant (assuming that the grantee is still employed by Ciena at that time). Under the PARS, the Compensation Committee may establish performance targets which, if satisfied, provide for the acceleration of vesting of that portion of the award designated by the Compensation Committee. As a result, the grantee may have the opportunity, subject to satisfaction of performance conditions, to vest as to the entire award prior to the expiration of the four-year period above. 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, 2009	3,716	\$ 14.67	\$43,591
Granted	3,489		
Vested	(1,407)		
Canceled or forfeited	(172)		
Balance as of July 31, 2010	<u>5,626</u>	\$ 13.76	\$73,648

The total fair value of restricted stock units that vested and were converted into common stock during the first nine months of fiscal 2009 and fiscal 2010 was \$7.7 million and \$19.0 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first nine months of fiscal 2009 and fiscal 2010 was \$6.97 and \$13.43, respectively.

### *Assumptions for Restricted Stock Unit Awards*

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

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

### *2003 Employee Stock Purchase Plan*

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

## Table of Contents

	ESPP shares available for issuance	Intrinsic value at exercise date
Balance as of October 31, 2009	3,469	
Evergreen provision	102	
Issued March 15, 2010	(33)	\$ 26
Balance as of July 31, 2010	<u>3,538</u>	

### Share-Based Compensation Expense for Periods Reported

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Product costs	\$ 460	\$ 548	\$ 1,618	\$ 1,475
Service costs	419	432	1,241	1,315
Share-based compensation expense included in cost of sales	<u>879</u>	<u>980</u>	<u>2,859</u>	<u>2,790</u>
Research and development	2,431	2,302	7,814	6,948
Sales and marketing	2,640	2,902	8,028	8,025
General and administrative	2,621	2,473	7,813	7,349
Acquisition and integration costs	—	883	—	1,229
Share-based compensation expense included in operating expense	<u>7,692</u>	<u>8,560</u>	<u>23,655</u>	<u>23,551</u>
Share-based compensation expense capitalized in inventory, net	<u>(87)</u>	<u>111</u>	<u>(439)</u>	<u>110</u>
Total share-based compensation	<u>\$ 8,484</u>	<u>\$ 9,651</u>	<u>\$ 26,075</u>	<u>\$ 26,451</u>

As of July 31, 2010, total unrecognized compensation expense was \$72.4 million: (i) \$7.0 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 0.9 years; and (ii) \$65.4 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.6 years.

### (19) COMPREHENSIVE LOSS

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
Net loss	\$(26,454)	\$(109,855)	\$(554,495)	\$(253,197)
Change in unrealized gain (loss) on available-for-sale securities	(270)	—	1,407	(458)
Change in unrealized gain on foreign forward contracts	1,334	—	892	—
Change in accumulated translation adjustments	756	(728)	763	(1,263)
Total comprehensive loss	<u>\$(24,634)</u>	<u>\$(110,583)</u>	<u>\$(551,433)</u>	<u>\$(254,918)</u>

### (20) SEGMENT AND ENTITY WIDE DISCLOSURES

#### Segment Reporting

Effective upon the March 19, 2010 completion of Ciena's acquisition of the MEN Business, Ciena reorganized its internal organizational structure and the management of its business. 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:

- Packet-Optical Transport** — includes optical transport solutions that increase network capacity and enable delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the cost effective and efficient transport of voice, video and data traffic in core networks, as well as regional, metro and access networks. Ciena's principal products in this segment include its Optical Multiservice Edge 6500 (OME 6500); Optical Multiservice Edge 6110 (OME 6110); Optical Metro 5200 (OM5200); Common Photonic Layer (CPL); Optical Multiservice Edge 1000 series; and Optical Metro 3500 (OM 3500). It includes sales of our CN 4200™ FlexSelect™ Advanced Services Platform and our Corestream® Agility Optical Transport System. 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.

## Table of Contents

- Packet-Optical Switching** — includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Ciena's principal products in this segment include its CoreDirector<sup>®</sup> Multiservice Optical Switch; CoreDirector FS; and the 5430 Reconfigurable Switching System. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed service services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced software features embedded in each of these products.
- Carrier Ethernet Service Delivery** - includes the CN 3900 family of service delivery switches and service aggregation switches, including the CN 5100 family. 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 and Ciena's legacy broadband products that transition 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.
- Software and Services** - includes Ciena's integrated network and service management software designed to automate and simplify network management and operation, while increasing network performance and functionality. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network troubles. This segment also includes a broad range of consulting and support services offered within the Ciena Specialist Services practice, which include installation and deployment, maintenance support, consulting, network design and training activities.

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, including the presentation of prior periods to reflect the change in reportable segments, for the respective periods:

	Quarter Ended July 31,				Nine Months Ended July 31,			
	2009	%*	2010	%*	2009	%*	2010	%*
<b>Revenue:</b>								
Packet-Optical Transport	\$ 78,048	47.3	\$242,057	62.1	\$221,684	46.5	\$423,216	51.6
Packet-Optical Switching	37,503	22.8	34,806	8.9	124,841	26.2	90,638	11.1
Carrier Ethernet Service Delivery	22,677	13.8	33,802	8.7	45,561	9.6	149,047	18.2
Software and Services	26,530	16.1	79,010	20.3	84,273	17.7	156,121	19.1
Consolidated revenue	<u>\$164,758</u>	<u>100.0</u>	<u>\$389,675</u>	<u>100.0</u>	<u>\$476,359</u>	<u>100.0</u>	<u>\$819,022</u>	<u>100.0</u>

\* 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; goodwill impairment; interest and other income (net), interest expense, equity investment gains or losses, gains or losses on extinguishment of debt, and provisions (benefit) for income taxes.

## Table of Contents

The table below (in thousands) sets forth Ciena's segment profit (loss) and the reconciliation to consolidated net income (loss) including the presentation of prior periods to reflect the change in reportable operating segments during the respective periods:

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2009	2010	2009	2010
<b>Segment profit (loss):</b>				
Packet-Optical Transport	\$ 12,807	\$ 12,874	\$ 20,282	\$ 26,402
Packet-Optical Switching	10,443	10,320	43,325	13,749
Carrier Ethernet Service Delivery	2,575	(3,212)	(12,323)	31,642
Software and Services	4,398	23,158	15,320	35,274
<b>Total segment profit (loss)</b>	<b>30,223</b>	<b>43,140</b>	<b>66,604</b>	<b>107,067</b>
<b>Reconciling items:</b>				
Selling and marketing	(31,468)	(52,127)	(98,582)	(131,692)
General and administrative	(11,524)	(32,649)	(35,724)	(66,915)
Acquisition and integration costs	—	(17,033)	—	(83,285)
Amortization of intangible assets	(6,224)	(38,727)	(18,852)	(61,829)
Restructuring costs	(3,941)	(2,157)	(10,416)	(3,985)
Goodwill impairment	—	—	(455,673)	—
Interest and other financial charges, net	(857)	(8,658)	3,615	(11,624)
Loss on cost method investments	(2,193)	—	(5,328)	—
(Provision) benefit for income taxes	(470)	(1,644)	(139)	(934)
<b>Consolidated net loss</b>	<b><u>\$(26,454)</u></b>	<b><u>\$(109,855)</u></b>	<b><u>\$(554,495)</u></b>	<b><u>\$(253,197)</u></b>

### 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):

	Quarter Ended July 31,				Nine Months Ended July 31,			
	2009	%*	2010	%*	2009	%*	2010	%*
United States	\$104,041	63.1	\$229,739	59.0	\$294,688	61.9	\$534,174	65.2
United Kingdom	23,439	14.2	n/a	—	68,737	14.4	n/a	—
Other International	37,278	22.7	159,936	41.0	112,934	23.7	284,848	34.8
<b>Total</b>	<b><u>\$164,758</u></b>	<b><u>100.0</u></b>	<b><u>\$389,675</u></b>	<b><u>100.0</u></b>	<b><u>\$476,359</u></b>	<b><u>100.0</u></b>	<b><u>\$819,022</u></b>	<b><u>100.0</u></b>

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):

## Table of Contents

	October 31,		July 31,	
	2009	%*	2010	%*
United States	\$ 47,875	77.4	\$ 61,747	52.0
Canada	n/a	—	44,778	37.7
Other International	13,993	22.6	12,230	10.3
Total	<u>\$ 61,868</u>	<u>100.0</u>	<u>\$118,755</u>	<u>100.0</u>

n/a Denotes equipment, furniture and fixtures representing less than 10% of total equipment, furniture and fixtures

\* 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):

	Quarter Ended July 31,				Nine Months Ended July 31,			
	2009	%*	2010	%*	2009	%*	2010	%*
Company A	\$ 20,005	12.1	n/a	—	\$ 53,244	11.2	n/a	—
Company B	18,041	10.9	n/a	—	n/a	—	n/a	—
Company C	22,268	13.6	90,769	23.3	94,928	19.9	204,092	24.9
Company D	n/a	—	40,556	10.4	n/a	—	n/a	—
Total	<u>\$ 60,314</u>	<u>36.6</u>	<u>\$131,325</u>	<u>33.7</u>	<u>\$148,172</u>	<u>31.1</u>	<u>\$204,092</u>	<u>24.9</u>

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

## (21) 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, 2009 and July 31, 2010, Ciena had accrued liabilities of \$1.1 million and \$1.3 million, respectively, related to these contingencies, which are reported as a component of other current accrued liabilities. As of July 31, 2010, 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.

### Litigation

On May 29, 2008, Graywire, LLC filed a complaint in the United States District Court for the Northern District of Georgia against Ciena and four other defendants, alleging, among other things, that certain of the parties' products infringe U.S. Patent 6,542,673 (the "'673 Patent'"), relating to an identifier system and components for optical assemblies. The complaint, 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.

## Table of Contents

As a result of our 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, 2009. 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, 2009, 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.

We are a network specialist targeting the transition of disparate, legacy communications networks to converged, next-generation architectures, better able to handle increased traffic volumes and deliver more efficiently a broader mix of high-bandwidth communications services at a lower cost. Our products, through their embedded network element software and our network service and transport management software suites, enable network operators to efficiently and cost-effectively deliver critical enterprise and consumer-oriented communication services. Together with our professional support and consulting services, our product offerings seek to enable software-defined, automated networks that address the business challenges, communications infrastructure requirements and service needs of our customers. Our customers face a challenging and rapidly changing environment. This environment requires that our customers' networks be able to address growing capacity needs from wireless and broadband adoption and quickly adapt to execute new business strategies and support the delivery of innovative revenue-creating services. By improving network productivity and automation, reducing operating costs and providing flexibility to enable new and integrated service offerings, our equipment, software and services solutions create business and operational value for our customers.

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

## Table of Contents

### *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”). In accordance with the agreements for the acquisition, the initial \$773.8 million aggregate purchase price for the acquisition, which was payable in cash and convertible notes, was subsequently adjusted downward by \$80.6 million based upon the amount of net working capital transferred to Ciena at closing. Prior to closing, we elected to replace the \$239.0 million in aggregate principal of convertible notes that were to be issued to Nortel as part of the aggregate purchase price with cash equivalent to 102% of the face amount of the notes replaced, or \$243.8 million. We completed a private placement of 4.0% Convertible Senior Notes due March 15, 2015 in aggregate principal amount of \$375.0 million which funded this election and reduced the amount of cash on hand required to fund the aggregate purchase price. See “Private Placement of \$375 Million in Convertible Notes to Fund Purchase Price” below for more information on the source of funds for this payment election and the purchase price. As a result, the aggregate purchase price was \$693.2 million consisting entirely of cash.

#### *Rationale for MEN Acquisition*

The MEN Business that we acquired is a leading provider of next-generation, communications network equipment, with a significant global installed base and a strong technology heritage. The MEN Business is a leader in high-capacity 40G and 100G coherent optical transport technology that enables network operators to seamlessly upgrade their existing 2.5G and 10G networks, thereby enabling a significant increase in network capacity without the need for new fiber deployments or complex re-engineering. The product and technology assets that we acquired include:

- long-haul optical transport portfolio;
- metro optical Ethernet switching and transport solutions;
- Ethernet transport, aggregation and switching technology;
- multiservice SONET/SDH product families; and
- network management software products.

In addition to these hardware and software solutions, we also acquired the network implementation and support service resources related to the MEN Business.

We believe that the MEN Acquisition represents a transformative opportunity for Ciena. We believe that this transaction strengthens our position as a leader in next-generation, converged optical Ethernet networking and will accelerate the execution of our corporate and research and development strategies. We believe that the additional geographic reach, expanded customer relationships, and broader portfolio of complementary network solutions derived from the MEN Acquisition will help us better compete with traditional, larger network equipment vendors. We also expect that the transaction will add desired scale to our business, enabling increased operating leverage and providing an opportunity to optimize our research and development investment toward next-generation technologies and product platforms.

#### *Integration Activities and Costs*

We continue to make progress on integration-related activities in connection with the MEN Acquisition including the substantial completion of our organizational structure, sales coverage plans, decisions regarding the rationalization of our combined product portfolio and, as described in “Restructuring Activities” below, the realization of initial operating synergies from the MEN Acquisition. Significant and complex additional integration efforts remain, including the rationalization of our supply chain, third party manufacturers and facilities, the execution of our combined product and software development plan, and our reduced reliance upon and winding down of transition services provided by an affiliate of Nortel.

Given the magnitude of the MEN Acquisition and its structure as an asset carve-out from Nortel, we expect that the integration of the MEN Business will be costly and complex, with a number of operational risks. We expect to incur costs of approximately \$180 million associated with equipment and information technology, transaction expense, severance expense and consulting and third party service fees associated with the integration, with the majority of these costs to be incurred in fiscal 2010. In addition to these costs, we have incurred inventory obsolescence charges and may incur additional expenses related to, among other things, facilities restructuring. As a result, the expense we incur and recognize for financial statement purposes as a result of the MEN Acquisition may be significantly higher than the estimate above. As of July 31, 2010, we have incurred \$83.3 million in transaction, consulting and third party service fees, \$4.0 million in severance expense, and an additional \$10.8 million, primarily related to purchases of capitalized information technology equipment. Any material delays or difficulties in integrating the MEN Business or additional, unanticipated expense may harm our business and results of operations.

## Table of Contents

In addition to the costs above, we are incurring significant transition services expense as a component of operating expense, principally general and administrative expense, and cost of goods sold. We are currently relying upon an affiliate of Nortel to perform certain critical operational and business support functions during an interim integration period that will continue until we can perform these services ourselves or locate another provider. These support services include key 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 can utilize certain of these support services for a period of up to 24 months following the MEN Acquisition (12 months in EMEA). These services are estimated to cost approximately \$94.0 million per year, were Ciena to utilize all of the transition services for a full year. The actual expense we incur will depend upon the scope of the services that Ciena utilizes and the time within which we are able to complete the planned transfer of these services to internal resources or other providers. We expect to incur additional costs as we simultaneously build up internal resources, including headcount, facilities and information systems, or engage alternate third party providers, while we simultaneously rely upon and transition away from these transition support services. The wind down and transfer of critical transition services is a complex undertaking and may be costly and disruptive to our business and operations.

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

Due to the relative scale of the operations of the MEN Business, 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 acquisition. These and other effects on our financial statements described below and elsewhere in this report may make period to period comparisons difficult.

As a result of the MEN Acquisition, we recorded \$38.1 million in goodwill and \$492.0 million in other intangible assets that will be amortized over their useful lives and increase our operating expense. See “Critical Accounting Policies and Estimates- Goodwill” and “-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 approximately \$39.7 million all of which was recognized in cost of goods sold during the first nine months of fiscal 2010. See Note 3 of the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report.

As expected, our liquidity and cash and investment balance was significantly affected by our use of cash to fund the purchase price of the MEN Acquisition and resulting acquisition and integration expense, transition service expense and investments to support working capital related to the increased scale of our business. In addition, our private placement of a new issue of convertible debt in March 2010, in part to fund the purchase price of the MEN Business, resulted in additional indebtedness. See “Liquidity and Capital Resources” below and Note 16 of the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report for more information regarding the convertible notes.

### *Private Placement of \$375 Million in Convertible Notes to Fund Purchase Price*

On March 15, 2010, we completed a private offering of \$375.0 million in aggregate principal amount of 4.0% Convertible Senior Notes due March 15, 2015. The net proceeds from the offering were \$364.3 million after deducting the placement agents’ fees and other fees and expenses. We used \$243.8 million of the net proceeds to replace the contractual obligation to issue convertible notes to Nortel as part of the purchase price for the MEN Acquisition. The remaining proceeds were used to reduce the cash on hand required to fund the aggregate purchase price of the MEN Acquisition. See Note 16 of the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report for more information regarding the convertible notes.

### *Restructuring Activities*

In April 2010, we took action to effect a headcount reduction of approximately 70 employees, with reductions principally affecting our Global Product Group and Global Field Organization outside of the EMEA region. This action resulted in a restructuring charge of \$1.8 in the second quarter of fiscal 2010 and \$0.3 million in the third quarter of fiscal 2010. In May 2010, we informed employees of our proposal to reorganize and restructure portions of our business and operations in the EMEA region. This action is expected to involve the elimination of 120 to 140 roles, with reductions expected to principally affect employees in our Global Field Organization and Global Supply Chain organization. Execution of any specific reorganization is subject to local legal requirements, including notification and consultation processes with

## Table of Contents

employees and employee representatives. We estimate completing the reorganization by the first half of calendar year 2011. We expect total restructuring costs related to this action to range from \$8.0 million to \$10.0 million. During the third quarter of fiscal 2010, we recorded expenses of \$1.9 million related to the reduction in head count of approximately 26 employees in the Global Field Organization. These actions are intended to reduce operating expense and better align our workforce and operating costs with market and business opportunities following the completion of our MEN Acquisition. 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.

### *Effect of Global Market Conditions and Competitive Landscape*

We continue to experience cautious customer spending as a result of the sustained period of economic weakness. Broad macroeconomic weakness has previously resulted in periods of decreased demand for our products and services that have adversely affected our results of operations. We remain uncertain as to how long current macroeconomic and industry conditions will persist, the pace of recovery, and the magnitude of the effect of recent market conditions on our business and results of operations.

At the same time we are experiencing challenging macroeconomic conditions, we have encountered an increasingly competitive marketplace. Competition has intensified, 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. 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 to continue and, as larger Chinese equipment vendors seek to gain entry into the U.S. market, potentially increase.

The combination of market conditions, constraints on customer capital expenditures and 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 margins. Pricing pressure has been most severe in metro and core applications for our Packet-Optical Transport platforms, which we expect to 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 and 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.

### *Financial Results*

Financial results for the third quarter of fiscal 2010 reflect the first full quarter of operations from the MEN Business. Our results for the second quarter of fiscal 2010 include activity from the MEN Business since the March 19, 2010 acquisition date. We reorganized our internal organizational structure and the management of our business upon the MEN Acquisition, and as described in Note 20 of the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report, present our results of operations based upon the following operating segments: (i) Packet-Optical Transport; (ii) Packet-Optical Switching; (iii) Carrier Ethernet Service Delivery; and (iv) Software and Services.

Revenue for the third quarter of fiscal 2010 was \$389.7 million, representing a 53.7% sequential increase from \$253.5 million in the second quarter of fiscal 2010. Third quarter revenue reflects \$221.8 million in revenue from the MEN Business and \$167.9 million related to Ciena's pre-acquisition portfolio. Additional sequential revenue-related details reflecting changes from the second quarter of fiscal 2010 include:

- Product revenue for the third quarter of fiscal 2010 increased by \$106.0 million, reflecting a \$138.6 million increase in sales of products from the MEN Business and a \$32.6 million decrease in sales of Ciena's pre-acquisition products. Carrier Ethernet Service Delivery revenue decreased by \$41.0 million reflecting decreased spending by two significant customers of these products for use in wireless backhaul applications. We believe that these declines reflect the effect of cyclical purchasing activity for these customers and typical fluctuations in purchasing and deployment activity for longer-term infrastructure build outs for relatively nascent technology adoption. Packet-Optical Transport revenue increased by \$144.4 million, reflecting a \$136.1 million increase in sales of products from the MEN Business and \$8.3 million increase in Ciena's pre-acquisition Packet-Optical Transport products. Sales of Packet-Optical Switching products increased by \$2.4 million.
- Service revenue for the third quarter of fiscal 2010 increased by \$30.2 million, reflecting a \$29.8 million increase in service revenue from the MEN Business and a \$0.4 million increase in sales of Ciena's pre-acquisition service offerings.
- Revenue from the U.S. for the third quarter of fiscal 2010 was \$229.7 million, an increase from \$180.5 million in the second quarter of fiscal 2010. This increase reflects a \$74.9 million increase in sales of products and services from the MEN Business and a decrease of \$25.7 million in sales of Ciena's pre-acquisition portfolio.

## Table of Contents

- International revenue for the third quarter of fiscal 2010 was \$159.9 million, an increase from \$73.0 million in the second quarter of fiscal 2010. This increase reflects \$93.4 million in sales of products and services from the MEN Business and partially offset by a decrease of \$6.5 million in sales of Ciena's pre-acquisition portfolio.
- As a percentage of revenue, international revenue was 41.0% during the third quarter of fiscal 2010, an increase from 28.8% in the second quarter of fiscal 2010. As a percentage of Ciena's pre-acquisition portfolio revenue, the portion attributable to international revenue comprised 39.6%.
- For the third quarter of fiscal 2010, two customers each accounted for greater than 10% of revenue and 33.7% in the aggregate. This compares to two customers that accounted for 42.3% of revenue in the second quarter of fiscal 2010.

Gross margin for the third quarter of fiscal 2010 was 37.0% , down from 41.4% in the second quarter of fiscal 2010. Gross margin for the third quarter was adversely affected by certain items relating to the MEN Acquisition, including the revaluation of inventory described above and increased amortization of intangible assets. The gross margin decline during the third quarter of fiscal 2010 also reflects product mix, including increased concentration of Packet-Optical Transport revenue from 38.5% in the second quarter of fiscal 2010, to 62.1% in the third quarter of fiscal 2010.

Operating expense was \$243.6 million for the third quarter of fiscal 2010, an increase from \$196.2 million in the second quarter of fiscal 2010 reflecting a full quarter of operations following the MEN Acquisition. Operating expense for our second and third quarters of fiscal 2010 include \$39.2 million and \$17.0 million, respectively, in acquisition and integration-related costs associated with the MEN Acquisition. Operating expense for the third quarter was also adversely affected by an increase of \$22.9 million in amortization of intangible assets from the second quarter.

Our loss from operations for the third quarter of fiscal 2010 was \$99.6 million. This compares to a \$91.2 million loss from operations during the second quarter of fiscal 2010. Our net loss for the third quarter of fiscal 2010 was \$109.9 million, or \$1.18 per share. This compares to a net loss of \$90.0 million, or \$0.97 per share, for the second quarter of fiscal 2010.

We used \$130.0 million in cash from operations during the third quarter of fiscal 2010, consisting of \$108.9 million for changes in working capital and \$21.1 million from net losses (adjusted for non-cash charges). Cash used from operations includes \$25.0 million of acquisition and integration-related expense, of which \$17.0 million was reflected in net losses (adjusted for non-cash charges) and \$8.0 million was reflected in changes in working capital. This compares with the use of \$77.7 million in cash from operations during the second quarter of fiscal 2010, consisting of a use of cash of \$41.8 million from net losses (adjusted for non-cash charges) and a use of cash of \$35.9 million from changes in working capital. Use of cash for the second quarter reflects cash payments of \$38.0 million associated with acquisition and integration-related expense and was reflected in the net losses (adjusted for non-cash charges).

At July 31, 2010, we had \$470.2 million in cash and cash equivalents and \$0.2 million of short-term investments. This compares to \$584.2 million in cash and cash equivalents and \$29.5 million of short-term investments securities at April 30, 2010.

As of July 31, 2010, headcount was 4,214, an increase from 4,157 at April 30, 2010 and 2,110 at July 31, 2009.

## Consolidated Results of Operations

Our results of operations for the periods in fiscal 2010, including the nine-month period ended July 31, 2010, reflect the operations of the MEN Business beginning on the March 19, 2010 acquisition date.

### Revenue

Revenue is discussed in the following product and service groupings:

1. *Packet-Optical Transport* . This product grouping, aligned with our Packet-Optical Transport operating segment, reflects sales of our optical transport products including the following products acquired from the MEN Business: Optical Multiservice Edge 6500 (OME 6500); Optical Multiservice Edge 6110 (OME 6110); Optical Metro 5200 (OM5200); Common Photonic Layer (CPL); Optical Multiservice Edge 1000 series; and Optical Metro 3500 (OM 3500). It includes sales of our CN 4200™ FlexSelect™ Advanced Services Platform and our Corestream® Agility Optical Transport System. This group 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. Revenue for this grouping also includes the operating system software and enhanced software features embedded in each of the products above.

## Table of Contents

2. *Packet-Optical Switching*. This product grouping, aligned with our Packet-Optical Switching operating segment, reflects sales of our CoreDirector<sup>®</sup> Multiservice Optical Switch; CoreDirector-FS, an expansion of our CoreDirector platform that delivers substantial new hardware and software features; and our 5430 Reconfigurable Switching System. Revenue for this grouping also includes the operating system software and enhanced software features embedded in each of the products above.
3. *Carrier Ethernet Service Delivery*. This product grouping, aligned with our Carrier Ethernet Service Delivery operating segment, reflects sales of our CN 3900 family of service delivery switches and our service aggregation switches, including the CN 5100 family. This product grouping also includes our metro Ethernet routing switch (MERS) product line, broadband access products, and the operating system software and enhanced software features embedded in these products.
4. *Unified Service and Network Management Software*. This product grouping, aligned with our Software and Services operating segment, reflects sales of ON-Center<sup>®</sup> Network & Service Management Suite, our integrated network and service management software designed to simplify network management and operation across our portfolio. It also includes revenue from the Preside and OMEA software platforms acquired from the MEN Business.
5. *Services*. This service grouping, aligned with our Software and Services operating segment, includes sales of installation and deployment services, maintenance support, consulting services and training activities.

A sizable portion of our revenue comes from sales to a small number of communications service providers. While the MEN Acquisition may reduce our concentration of revenue somewhat, our revenue remains closely tied to the prospects, performance, and financial condition of our largest service provider customers. As a result, our results are significantly affected by the business challenges encountered by our largest customers as well as market-wide conditions or shifts in competitive landscape that adversely affect enterprise and consumer spending levels, the adoption and growth of broadband services and the level of network infrastructure-related spending by communications service providers. Our contracts do not have terms that obligate these customers to purchase any minimum or specific amounts of equipment or services. Because customer spending may be unpredictable and sporadic, and their purchases may result in the recognition or deferral of significant amounts of revenue in a given quarter, our revenue can fluctuate on a quarterly basis.

Our concentration of revenue increases the risk of quarterly fluctuations in revenue and operating results and can exacerbate our exposure to reductions in spending or changes in network strategy involving one or more of our significant customers. Our concentration of revenue and exposure to quarterly fluctuations can be adversely affected by consolidation activity among our large customers. In April 2010, CenturyLink announced that it had agreed to acquire Qwest, which has been a significant customer of Ciena in recent years. This transaction may further increase our concentration of revenue. 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. In April 2010, we were selected as a domain network equipment supplier by AT&T for its optical transport network and metro and core transport domains. AT&T represented approximately 19.6% of our revenue in fiscal 2009 and was a major customer of the MEN Business. Being named as a vendor in multiple technology domains under this program affords us an opportunity to forge a more collaborative technology relationship across these product platforms. Should sales to AT&T increase as a result of sales under this program, our concentration of revenue may be adversely affected.

### *Cost of Goods Sold*

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

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

## Table of Contents

### Gross Margin

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 products, customers and services in a given fiscal quarter. Gross margin can also be affected by geographic mix, competitive environment and level of pricing pressure we encounter, our introduction of new products, charges for excess and obsolete inventory, changes in warranty costs and sales volume. Our gross margins have also been adversely affected in the past due to estimated losses on committed customer contracts when entering a new market or securing a new customer and may be affected by future efforts to capture market share. Gross margins will also be affected by our level of success in driving cost reductions and rationalizing our supply chain and third party contract manufacturers as part of the integration following the MEN Acquisition.

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

### Operating Expense

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

### Quarter ended July 31, 2009 compared to the quarter ended July 31, 2010

#### Revenue, cost of goods sold and gross profit

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

	Quarter Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
<b>Revenue:</b>						
Products	\$139,903	84.9	\$312,378	80.2	\$172,475	123.3
Services	24,855	15.1	77,297	19.8	52,442	211.0
Total revenue	<u>164,758</u>	<u>100.0</u>	<u>389,675</u>	<u>100.0</u>	<u>224,917</u>	<u>136.5</u>
<b>Costs:</b>						
Products	72,842	44.2	201,559	51.7	128,717	176.7
Services	17,251	10.5	44,107	11.3	26,856	155.7
Total cost of goods sold	<u>90,093</u>	<u>54.7</u>	<u>245,666</u>	<u>63.0</u>	<u>155,573</u>	<u>172.7</u>
Gross profit	<u>\$ 74,665</u>	<u>45.3</u>	<u>\$144,009</u>	<u>37.0</u>	<u>\$ 69,344</u>	<u>92.9</u>

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

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

## Table of Contents

	Quarter Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Product revenue	\$139,903	100.0	\$312,378	100.0	\$172,475	123.3
Product cost of goods sold	72,842	52.1	201,559	64.5	128,717	176.7
Product gross profit	\$ 67,061	47.9	\$110,819	35.5	\$ 43,758	65.3

\* Denotes % of product revenue

\*\* Denotes % change from 2009 to 2010

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

	Quarter Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Services revenue	\$ 24,855	100.0	\$ 77,297	100.0	\$ 52,442	211.0
Services cost of goods sold	17,251	69.4	44,107	57.1	26,856	155.7
Services gross profit	\$ 7,604	30.6	\$ 33,190	42.9	\$ 25,586	336.5

\* Denotes % of services revenue

\*\* Denotes % change from 2009 to 2010

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

	Quarter Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
United States	\$104,041	63.1	\$229,739	59.0	\$125,698	120.8
International	60,717	36.9	159,936	41.0	99,219	163.4
Total	\$164,758	100.0	\$389,675	100.0	\$224,917	136.5

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

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

	Quarter Ended July 31,			
	2009	%*	2010	%*
Company A	\$ 20,005	12.1	n/a	—
Company B	18,041	10.9	n/a	—
Company C	22,268	13.6	90,769	23.3
Company D	n/a	—	40,556	10.4
Total	\$ 60,314	36.6	\$131,325	33.7

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

\* Denotes % of total revenue

### Revenue

- **Product revenue** increased due to a \$164.0 million increase in sales of our Packet-Optical Transport products, principally as a result of the MEN Acquisition, and an \$11.1 million increase of revenue from our Carrier Ethernet Service Delivery products, partially offset by a \$2.7 million decrease in Packet-Optical Switching revenue.

## Table of Contents

- **Services revenue** increased primarily due to the addition of \$34.2 million in maintenance support revenue and \$10.7 million in installation and deployment services from the MEN Business. Services revenue also benefited from a \$6.1 million increase in maintenance support revenue from Ciena's pre-acquisition portfolio.
- **United States revenue** increased due to a \$77.7 million increase in sales of Packet-Optical Transport products, principally as a result of the MEN Acquisition, a \$31.6 million increase in services revenue, an \$8.9 million increase in Packet-Optical Switching revenue, and a \$7.2 million increase in Carrier Ethernet Service Delivery revenue.
- **International revenue** increased primarily due to an \$86.4 million increase in Packet-Optical Transport revenue, principally as a result of the MEN Acquisition, a \$20.9 increase in services revenue and a \$4.0 million increase in Carrier Ethernet Service Delivery revenue. These increases were partially offset by an \$11.6 million decrease in revenue from Packet-Optical Switching products.

### Gross profit

- **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** decreased due to a number of items relating to the MEN Acquisition that increased costs of goods sold. These items include the revaluation of inventory described in "Overview" above and increased amortization of intangible assets. The gross margin decline during the third quarter of fiscal 2010 also reflects product mix, including an increased concentration of Packet-Optical Transport revenue.
- **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

Increased operating expense for the third quarter of fiscal 2010 principally reflects the increased scale of our business resulting from the MEN Acquisition on March 19, 2010. The table below (in thousands, except percentage data) sets forth the changes in operating expense for the periods indicated:

	Quarter Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Research and development	\$ 44,442	27.0	\$ 100,869	25.8	\$ 56,427	127.0
Selling and marketing	31,468	19.1	52,127	13.4	20,659	65.7
General and administrative	11,524	7.0	32,649	8.4	21,125	183.3
Acquisition and integration costs	—	0.0	17,033	4.4	17,033	100.0
Amortization of intangible assets	6,224	3.7	38,727	9.9	32,503	522.2
Restructuring costs	3,941	2.4	2,157	0.6	(1,784)	(45.3)
<b>Total operating expense</b>	<b>\$ 97,599</b>	<b>59.2</b>	<b>\$ 243,562</b>	<b>62.5</b>	<b>\$ 145,963</b>	<b>149.6</b>

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

- **Research and development** expense was adversely affected by \$4.8 million in foreign exchange rates, primarily due to the weakening of the U.S. dollar in relation to the Canadian dollar. The resulting \$56.4 million change primarily reflects increases of \$26.7 million in employee compensation and related costs, \$12.4 million in professional services and fees, \$5.5 million in depreciation expense, \$5.3 million in facilities and information systems expense and \$4.2 million in prototype expense related to product development initiatives.
- **Selling and marketing** expense benefited by \$0.9 million in foreign exchange rates primarily due to the strengthening of the U.S. dollar in relation to the Euro. The resulting \$20.7 million change primarily reflects increases of \$15.3 million in employee compensation and related costs, \$2.1 million in travel-related expenditures, and \$1.0 million in facilities and information systems expenses.
- **General and administrative** expense increased by \$21.1 million, reflecting increases of \$8.8 million in consulting service expense, \$5.3 million in facilities and information systems expenses, and \$5.2 million in employee compensation and related costs.
- **Acquisition and integration costs** associated with the MEN Acquisition reflect consulting and third party service fees, which were expensed in the Condensed Consolidated Statement of 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.

## Table of Contents

- **Restructuring costs** for fiscal 2010 reflect the headcount reductions during the second and third quarters of fiscal 2010 described in the “Overview – Restructuring Activities” above.

### Other items

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

	Quarter Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Interest and other income (loss), net	\$ 999	0.6	\$(2,668)	(0.7)	\$(3,667)	(367.1)
Interest expense	\$1,856	1.1	\$ 5,990	1.5	\$ 4,134	222.7
Loss on cost method investments	\$2,193	1.3	\$ —	—	\$(2,193)	(100.0)
Provision for income taxes	\$ 470	0.3	\$ 1,644	0.4	\$ 1,174	249.8

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

- **Interest and other income (loss), net** decreased as a result of a \$4.1 million non-cash loss related to the fair value of the redemption feature associated with our 4.0% Convertible Senior Notes due March 15, 2015. See Notes 8 and 16 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 and other income (loss), net also decreased by \$0.7 million due to lower interest rates and invested balances, partially offset by a \$1.2 million increase related to foreign currency re-measurement gains.
- **Interest expense** increased due to our private placement of \$375.0 million in aggregate principal amount of 4.0% Convertible Senior Notes due March 15, 2015. See Note 16 to the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report.
- **Loss on cost method investments** for fiscal 2009 was primarily due to a decline in value of our investment in a privately held technology company that was determined to be other-than-temporary.
- **Provision for income taxes** increased primarily due to a decrease in refundable federal tax credits.

### Nine months ended July 31, 2009 compared to the nine months ended July 31, 2010

#### Revenue, cost of goods sold and gross profit

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

	Nine Months Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
<b>Revenue:</b>						
Products	\$398,469	83.6	\$667,852	81.5	\$269,383	67.6
Services	77,890	16.4	151,170	18.5	73,280	94.1
Total revenue	<u>476,359</u>	<u>100.0</u>	<u>819,022</u>	<u>100.0</u>	<u>342,663</u>	<u>71.9</u>
<b>Costs:</b>						
Products	214,628	45.1	396,449	48.4	181,821	84.7
Services	54,503	11.4	93,462	11.4	38,959	71.5
Total cost of goods sold	<u>269,131</u>	<u>56.5</u>	<u>489,911</u>	<u>59.8</u>	<u>220,780</u>	<u>82.0</u>
Gross profit	<u>\$207,228</u>	<u>43.5</u>	<u>\$329,111</u>	<u>40.2</u>	<u>\$121,883</u>	<u>58.8</u>

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

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

## Table of Contents

	Nine Months Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Product revenue	\$398,469	100.0	\$667,852	100.0	\$269,383	67.6
Product cost of goods sold	214,628	53.9	396,449	59.4	181,821	84.7
Product gross profit	<u>\$183,841</u>	<u>46.1</u>	<u>\$271,403</u>	<u>40.6</u>	<u>\$ 87,562</u>	47.6

\* Denotes % of product revenue

\*\* Denotes % change from 2009 to 2010

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

	Nine Months Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Services revenue	\$ 77,890	100.0	\$151,170	100.0	\$ 73,280	94.1
Services cost of goods sold	54,503	70.0	93,462	61.8	38,959	71.5
Services gross profit	<u>\$ 23,387</u>	<u>30.0</u>	<u>\$ 57,708</u>	<u>38.2</u>	<u>\$ 34,321</u>	146.8

\* Denotes % of services revenue

\*\* Denotes % change from 2009 to 2010

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

	Nine Months Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
United States	\$294,688	61.9	\$534,174	65.2	\$239,486	81.3
International	181,671	38.1	284,848	34.8	103,177	56.8
Total	<u>\$476,359</u>	<u>100.0</u>	<u>\$819,022</u>	<u>100.0</u>	<u>\$342,663</u>	71.9

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

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

	Nine Months Ended July 31,			
	2009	%*	2010	%*
Company A	\$ 53,244	11.2	n/a	—
Company C	94,928	19.9	204,092	24.9
Total	<u>\$148,172</u>	<u>31.1</u>	<u>\$204,092</u>	<u>24.9</u>

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

\* Denotes % of total revenue

### Revenue

- **Product revenue** increased due to a \$201.6 million increase in sales of our Packet-Optical Transport products, principally as a result of the MEN Acquisition, and a \$103.5 million increase in revenue from our Carrier Ethernet Service Delivery products, partially offset by a \$34.2 million decrease in Packet-Optical Switching revenue.

## Table of Contents

- **Services revenue** increased primarily due to the addition of \$47.8 million in maintenance support revenue and \$12.2 million in installation and deployment services from the MEN Business. Services revenue also benefited from a \$12.2 million increase in revenue from Ciena’s pre-acquisition services portfolio.
- **United States revenue** increased primarily due to a \$108.5 million increase in sales of Packet-Optical Transport products, principally as a result of the MEN Acquisition, a \$97.6 million increase in sales of Carrier Ethernet Service Delivery products, and a \$48.6 million increase in services revenue. These increases offset a \$15.3 million decrease in Packet-Optical Switching revenue.
- **International revenue** increased primarily due to a \$93.1 million increase in Packet-Optical Transport revenue, principally as a result of the MEN Acquisition, a \$24.7 million increase in services revenue and a \$5.9 million increase in sales of Carrier Ethernet Service Delivery products. These increases offset an \$18.9 million decrease in Packet-Optical Switching revenue.

### Gross profit

- **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** decreased due to a number of items relating to the MEN Acquisition that increased costs of goods sold. These items include the revaluation of inventory described in “Overview” above, excess purchase commitment losses on Ciena’s pre-acquisition inventory relating to product rationalization decisions, and increased amortization of intangible assets. Fiscal 2010 gross profit was also adversely affected by a lower concentration of Packet-Optical Switching sales. These additional costs were offset by lower warranty and excess and obsolete inventory charges as compared to fiscal 2009. Gross margin for the first nine months of fiscal 2009 was negatively affected by a \$5.8 million charge related to two committed customer sales contracts that resulted in a negative gross margin on the initial phases of the customers’ deployment.
- **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

Increased operating expense for the first nine months of fiscal 2010 principally reflects the increased scale of our business resulting from the acquisition of the MEN Business on March 19, 2010. The table below (in thousands, except percentage data) sets forth the changes in operating expense for the periods indicated:

	Nine Months Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Research and development	\$140,624	29.5	\$222,044	27.1	\$ 81,420	57.9
Selling and marketing	98,582	20.7	131,692	16.1	33,110	33.6
General and administrative	35,724	7.5	66,915	8.2	31,191	87.3
Acquisition and integration costs	—	0.0	83,285	10.2	83,285	100.0
Amortization of intangible assets	18,852	4.0	61,829	7.5	42,977	228.0
Goodwill impairment	455,673	95.6	—	0.0	(455,673)	(100.0)
Restructuring costs	10,416	2.2	3,985	0.5	(6,431)	(61.7)
Total operating expense	<u>\$759,871</u>	<u>159.5</u>	<u>\$569,750</u>	<u>69.6</u>	<u>\$(190,121)</u>	<u>(25.0)</u>

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

- **Research and development** expense was adversely affected by \$11.3 million in foreign exchange rates, primarily due to the weakening of the U.S. dollar in relation to the Canadian dollar. The resulting \$81.4 million change primarily reflects increases of \$38.8 million in employee compensation and related costs, \$17.7 million in professional services and fees, \$8.5 million in facilities and information systems, \$6.6 million in prototype expense related to the development initiatives described above, and \$6.9 million in depreciation expense.
- **Selling and marketing** expense benefited by \$1.5 million in foreign exchange rates primarily due to the strengthening of the U.S. dollar in relation to the Euro. The resulting \$33.1 million change primarily reflects increases of \$25.8 million in employee compensation and related costs, \$3.6 million in travel-related expenditures and \$1.3 million in facilities and information systems.
- **General and administrative** increased by \$13.6 million in consulting service expense, \$7.6 million in employee compensation and related costs, and \$7.1 million in facilities and information systems expense.

## Table of Contents

- **Acquisition and integration costs** are related to the MEN Acquisition. As of July 31, 2010, we have incurred \$83.3 million in transaction, consulting and third party service fees.
- **Amortization of intangible assets** increased due to the acquisition of additional intangible assets as a result of the MEN Acquisition.
- **Goodwill impairment costs** reflect the impairment of goodwill and resulting charge incurred in fiscal 2009 as described in Note 4 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report
- **Restructuring costs** for fiscal 2010 primarily reflect the headcount reductions taken during the second and third quarters of fiscal 2010 described in the “Overview – Restructuring Activities” above.

### Other items

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

	Nine Months Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Interest and other income (loss), net	\$9,167	1.9	\$ 307	—	\$(8,860)	(96.7)
Interest expense	\$5,552	1.2	\$11,931	1.5	\$ 6,379	114.9
Loss on cost method investments	\$5,328	1.1	\$ —	—	\$(5,328)	(100.0)
Provision for income taxes	\$ 139	—	\$ 934	0.1	\$ 795	571.9

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

- **Interest and other income (loss), net** decreased as a result of an \$8.9 million decrease in interest income due to lower interest rates and lower invested balances. Decreased interest and other income, net also reflects a \$2.0 million charge relating to the termination of an indemnification asset upon the expiration of the statute of limitations applicable to one of the uncertain tax contingencies acquired as part of the MEN Acquisition. These items were partially offset by a \$2.6 million non-cash gain related to the fair value of the redemption feature associated with our 4.0% Convertible Senior Notes due March 15, 2015. See Notes 8 and 16 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 our private placement of \$375.0 million in aggregate principal amount of 4.0% Convertible Senior Notes due March 15, 2015. See Note 16 to the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report.
- **Loss on cost method investments** for fiscal 2009 was primarily due to a decline in value of our investment in two privately held technology companies that was determined to be other-than-temporary.
- **Provision for income taxes** increased primarily due to a decrease in refundable federal tax credits.

### Results of Operating Segments

Upon the completion of the MEN Acquisition, we reorganized our internal organizational structure and the management of our business into the following operating segments: Packet-Optical Transport; Packet-Optical Switching; Carrier Ethernet Service Delivery; and Software and Services. See Note 20 to the Condensed Consolidated Financial Statements found under Item 1 of Part I of this report. The table below (in thousands, except percentage data) sets forth the changes in our operating segment revenue, including the presentation of prior periods to reflect the change in reportable segments, for the periods indicated:

## Table of Contents

	Quarter Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Revenue:						
Packet Optical Transport	\$ 78,048	47.3	\$242,057	62.1	\$164,009	210.1
Packet Optical Switching	37,503	22.8	34,806	8.9	(2,697)	(7.2)
Carrier Ethernet Service Delivery	22,677	13.8	33,802	8.7	11,125	49.1
Software and Services	26,530	16.1	79,010	20.3	52,480	197.8
Consolidated revenue	<u>\$164,758</u>	<u>100.0</u>	<u>\$389,675</u>	<u>100.0</u>	<u>\$224,917</u>	136.5

\* Denotes % of total revenue

\*\* Denotes % change from 2009 to 2010

- **Packet-Optical Transport revenue** for fiscal 2010 reflects the addition of \$171.5 million in revenue from the MEN Business and a decrease of \$7.5 million related to Ciena's pre-acquisition portfolio. The addition of MEN Business revenue reflects \$72.6 million of OME 6500, \$68.3 million of OM 5200, \$11.1 million of CPL, \$8.0 million of OME 3500, \$4.4 million of OME 6110 and \$7.1 million of legacy transport products. These increases offset a \$4.0 million decrease in CoreStream revenue and a \$3.5 million decrease in Ciena's pre-acquisition legacy transport products.
- **Packet-Optical Switching revenue** decreased reflecting a decline in CoreDirector revenue. Sales of Packet-Optical Switching products reflect principally our CoreDirector platform, which has a concentrated customer base. As a result, revenue can fluctuate considerably depending upon individual customer purchasing decisions.
- **Carrier Ethernet Service Delivery revenue** increased reflecting sales of switching and aggregation products in support of wireless backhaul deployments.
- **Software and Services revenue** increased primarily due to the addition of \$34.2 million in maintenance support revenue and \$10.7 million in installation and deployment services from the MEN Business. Services revenue also benefited from a \$6.1 million increase in maintenance support revenue from Ciena's pre-acquisition portfolio.

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

	Nine Months Ended July 31,				Increase (decrease)	%**
	2009	%*	2010	%*		
Revenue:						
Packet Optical Transport	\$221,684	46.5	\$423,216	51.6	\$201,532	90.9
Packet Optical Switching	124,841	26.2	90,638	11.1	(34,203)	(27.4)
Carrier Ethernet Service Delivery	45,561	9.6	149,047	18.2	103,486	227.1
Software and Services	84,273	17.7	156,121	19.1	71,848	85.3
Consolidated revenue	<u>\$476,359</u>	<u>100.0</u>	<u>\$819,022</u>	<u>100.0</u>	<u>\$342,663</u>	71.9

\* Denotes % of total revenue

\*\* Denotes % change from fiscal 2009 to fiscal 2010

- **Packet-Optical Transport revenue** for fiscal 2010 reflects the addition of Packet-Optical Transport revenue from the MEN Business of \$88.8 million related to our OME 6500, \$82.4 million related to OM 5200, \$12.2 million related to CPL and \$10.2 million related to OME 3500. In addition, revenue related to our CN4200 increased by \$15.4 million. These increases were offset by a \$16.4 million decrease in revenue related to Corestream reflecting, in part, the long life cycle of this platform and the ongoing platform transition resulting from the MEN Acquisition.
- **Packet-Optical Switching revenue** decreased reflecting a decline in CoreDirector revenue. Sales of Packet-Optical Switching products reflect principally our CoreDirector platform, which has a concentrated customer base. As a result, revenue can fluctuate considerably depending upon individual customer purchasing decisions. In addition, we anticipate sales of CoreDirector will fluctuate, in part reflecting the technology transition from this product toward our 5430 Family of Reconfigurable Switching Solutions.
- **Carrier Ethernet Service Delivery revenue** increased significantly, reflecting sales of switching and aggregation products in support of wireless backhaul deployments.

## Table of Contents

- **Software and Services revenue** increased primarily due to the addition of \$47.8 million in maintenance support revenue and \$12.2 million in installation and deployment services from the MEN Business. Services revenue also benefited from a \$12.2 million increase in Ciena's pre-acquisition services portfolio.

### Segment Profit (Loss)

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

	Quarter Ended July 31,			%*
	2009	2010	Increase (decrease)	
Segment profit (loss):				
Packet-Optical Transport	\$12,807	\$12,874	\$ 67	0.5
Packet-Optical Switching	10,443	10,320	(123)	(1.2)
Carrier Ethernet Service Delivery	2,575	(3,212)	(5,787)	(224.7)
Software and Services	4,398	23,158	18,760	426.6

\* Denotes % change from 2009 to 2010

- **Packet-Optical Transport segment profit** was relatively flat on higher sales volume as a result of lower product gross margin and higher research and development costs due to the MEN Acquisition.
- **Packet-Optical Switching segment profit** was relatively flat due to lower sales volume and increased research and development costs.
- **Carrier Ethernet Service Delivery segment profit** decreased due to increased research and development costs partially offset by higher sales volume and improved gross margin.
- **Software and Services segment profit** increased due to increased sales volume and improved gross margin, partially offset by increased research and development costs.

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:

	Nine Months Ended July 31,			%*
	2009	2010	Increase (decrease)	
Segment profit (loss):				
Packet-Optical Transport	\$ 20,282	\$26,402	\$ 6,120	30.2
Packet-Optical Switching	43,325	13,749	(29,576)	(68.3)
Carrier Ethernet Service Delivery	(12,323)	31,642	43,965	356.8
Software and Services	15,320	35,274	19,954	130.2

\* Denotes % change from 2009 to 2010

- **Packet-Optical Transport segment profit** increased due to higher sales volume, partially offset by higher research and development costs, in part due to the MEN Acquisition.
- **Packet-Optical Switching segment profit** decreased due to lower sales volume and increased research and development costs.
- **Carrier Ethernet Service Delivery segment loss** decreased due to significantly higher sales volume and improved gross margin, partially offset by increased research and development costs.
- **Software and Services segment profit** increased due to higher sales volume and improved gross margin, partially offset by increased research and development costs.

### Liquidity and Capital Resources

At July 31, 2010, our principal source of liquidity was cash and cash equivalents. The following table summarizes our cash and cash equivalents and investments (in thousands):

## Table of Contents

	October 31, 2009	July 31, 2010	Increase (decrease)
Cash and cash equivalents	\$ 485,705	\$470,237	\$ (15,468)
Short-term investments	563,183	184	(562,999)
Long-term investments	8,031	—	(8,031)
Total cash and cash equivalents and investments	<u>\$1,056,919</u>	<u>\$470,421</u>	<u>\$(586,498)</u>

The decrease in total cash and cash equivalents and investments during the first nine months of fiscal 2010 was primarily related to our payment of \$693.2 million related to the purchase price for the MEN Acquisition, partially offset by our receipt of \$364.3 million in net proceeds from the private placement of \$375.0 million in aggregate principal amount of 4.0% Convertible Senior Notes due March 15, 2015. We used \$203.2 million in cash from operations during first nine months of fiscal 2010, consisting of \$114.2 million for changes in working capital and \$89.0 million from net losses (adjusted for non-cash charges). Cash used from operations includes \$83.3 million of acquisition and integration-related expense, of which \$74.4 million was reflected in net losses (adjusted for non-cash charges) and \$8.9 million was reflected in changes in working capital. See Notes 3 and 16 to the Condensed Consolidated Financial Statements under Item 1 of Part I of this report for more information regarding the MEN Acquisition and our convertible notes offering.

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 nine months of fiscal 2010 reflects the increased scale of business as the result of the MEN Acquisition and the lower net working capital transferred to Ciena at closing, which resulted in a purchase price adjustment following the closing. 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 review the significant activities that had an impact on our cash during the first nine months of fiscal 2010.

### Operating Activities

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

#### Net loss

	Nine Months Ended July 31, 2010
Net loss	<u>\$ 253,197</u>

Our net loss during the first nine months of fiscal 2010 included the significant non-cash items summarized in the following table (in thousands):

	Nine Months Ended July 31, 2010
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	\$ 28,146
Share-based compensation costs	26,451
Amortization of intangible assets	82,476
Provision for inventory excess and obsolescence	10,749
Provision for warranty	16,388
Total significant non-cash charges	<u>\$ 164,210</u>

## Table of Contents

### *Accounts Receivable, Net*

Excluding the addition of \$7.2 million of accounts receivable recorded upon completion of the MEN Acquisition, cash used by accounts receivable, net of allowance for doubtful accounts, during the first nine months of fiscal 2010 was \$134.8 million primarily due to higher sales volume. Our days sales outstanding (DSOs) increased from 68 days for the first nine months of fiscal 2009 to 86 days for the first nine months of fiscal 2010. Our DSOs increased due to a larger proportion of sales occurring later in our third quarter of fiscal 2010.

The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2009 through the end of the third quarter of fiscal 2010:

	October 31, 2009	July 31, 2010	Increase (decrease)
Accounts receivable, net	<u>\$ 118,251</u>	<u>\$260,277</u>	<u>\$142,026</u>

### *Inventory*

Excluding the addition of \$114.1 million of inventory recorded upon completion of the MEN Acquisition, cash consumed by inventory during the first nine months of fiscal 2010 was \$30.8 million due to increased inventory levels to support a higher sales volume. Our inventory turns decreased from 3.2 turns during the first nine months of fiscal 2009 to 2.4 turns for the first nine months of fiscal 2010.

During the first nine months of fiscal 2010, changes in inventory reflect a \$10.7 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 2009 through the end of the third quarter of fiscal 2010:

	October 31, 2009	July 31, 2010	Increase (decrease)
Raw materials	\$ 19,694	\$ 26,606	\$ 6,912
Work-in-process	1,480	6,021	4,541
Finished goods	<u>90,914</u>	<u>220,044</u>	<u>129,130</u>
Gross inventory	112,088	252,671	140,583
Provision for inventory excess and obsolescence	<u>(24,002)</u>	<u>(30,507)</u>	<u>(6,505)</u>
Inventory	<u>\$ 88,086</u>	<u>\$222,164</u>	<u>\$134,078</u>

### *Accounts payable, accruals and other obligations*

Excluding the addition of \$39.0 million of accounts payable, accruals and other obligations upon completion of the MEN Acquisition, cash generated in operations related to accounts payable, accruals and other obligations during the first nine months of fiscal 2010 was \$83.6 million.

During the first nine months of fiscal 2010, we had non-operating cash accounts payable increases of \$2.9 million related to equipment purchases. Changes in accrued liabilities reflect non-cash provisions of \$16.4 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 2009 through the end of the third quarter of fiscal 2010:

	October 31, 2009	July 31, 2010	Increase (decrease)
Accounts payable	\$ 53,104	\$118,972	\$ 65,868
Accrued liabilities	103,349	178,427	75,078
Restructuring liabilities	9,605	9,016	(589)
Other long-term obligations	<u>8,554</u>	<u>10,098</u>	<u>1,544</u>
Accounts payable, accruals and other obligations	<u>\$ 174,612</u>	<u>\$316,513</u>	<u>\$141,901</u>

### *Interest Payable on Convertible Notes*

Interest on our outstanding 0.25% convertible senior notes, due May 1, 2013, is payable on May 1 and November 1 of each year. We paid \$0.4 million in interest on these convertible notes during the first nine months of fiscal 2010.

Interest on our outstanding 4.0% convertible senior notes, due March 15, 2015, is payable on March 15 and September 15 of each year. Our initial interest payment on these notes will be due on September 15, 2010.

## Table of Contents

Interest on our outstanding 0.875% convertible senior notes, due June 15, 2017, is payable on June 15 and December 15 of each year. We paid \$4.3 million in interest on these convertible notes during the first nine months of fiscal 2010.

The indentures governing our outstanding convertible notes do not contain any financial covenants. The indentures provide for customary events of default, including payment defaults, breaches of covenants, failure to pay certain judgments and certain events of bankruptcy, insolvency and reorganization. If an event of default occurs and is continuing, the principal amount of the notes, plus accrued and unpaid interest, if any, may be declared immediately due and payable. These amounts automatically become due and payable if an event of default relating to certain events of bankruptcy, insolvency or reorganization occurs. See Note 16 to the Condensed Consolidated Financial Statements under Item 1 of Part I of this report for more information regarding our outstanding convertible notes.

The following table reflects (in thousands) the balance of interest payable and the change in this balance from the end of fiscal 2009 through the end of the third quarter of fiscal 2010:

	October 31, 2009	July 31, 2010	Increase (decrease)
Accrued interest payable	<u>\$ 2,045</u>	<u>\$ 6,370</u>	<u>\$ 4,325</u>

### *Deferred revenue*

Excluding the addition of \$18.8 million of deferred revenue recorded upon completion of the MEN Acquisition, deferred revenue decreased by \$4.0 million during the first nine months of fiscal 2010. 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 2009 through the end of the third quarter of fiscal 2010:

	October 31, 2009	July 31, 2010	Increase (decrease)
Products	<u>\$ 11,998</u>	<u>\$ 15,132</u>	<u>\$ 3,134</u>
Services	<u>63,935</u>	<u>75,645</u>	<u>11,710</u>
Total deferred revenue	<u>\$ 75,933</u>	<u>\$ 90,777</u>	<u>\$ 14,844</u>

### *Investing Activities*

During the first nine months of fiscal 2010, we had net sales and maturities of approximately \$633.5 million of available for sale securities. Investing activities also include our payment of the \$693.2 million purchase price related to the MEN Acquisition. Investing activities also included the purchase of \$63.6 million in marketable debt securities and the payment of approximately \$34.6 million in equipment purchases. We also purchased an additional \$4.4 million of equipment that was included in accounts payable. Purchases of equipment in accounts payable increased by \$2.9 million from the end of fiscal 2009.

### *Financing Activities*

On March 15, 2010, we completed a private placement of 4.0% Convertible Senior Notes due March 15, 2015 in aggregate principal amount of \$375.0 million. The net proceeds from this offering were \$364.3 million. See Note 16.

### **Contractual Obligations**

Significant changes to contractual obligations during the first nine months of fiscal 2010 relate to purchase obligations and operating leases, principally for additional facilities, associated with the MEN Acquisition. Changes to interest and principal due on convertible notes relate to our private placement, during the second quarter of fiscal 2010, of 4.0% Convertible Senior Notes due March 15, 2015 in aggregate principal amount of \$375.0 million. The following is a summary of our future minimum payments under contractual obligations as of July 31, 2010 (in thousands):

## Table of Contents

	Total	Less than one year	One to three years	Three to five years	Thereafter
Interest due on convertible notes	\$ 107,860	\$ 20,120	\$ 40,240	\$ 38,750	\$ 8,750
Principal due at maturity on convertible notes	1,173,000	—	298,000	375,000	500,000
Operating leases (1)	102,128	23,497	33,691	19,797	25,143
Purchase obligations (2)	244,142	244,142	—	—	—
Transition service obligations (3)	23,492	23,492	—	—	—
Total (4)	<u>\$1,650,622</u>	<u>\$ 311,251</u>	<u>\$ 371,931</u>	<u>\$ 433,547</u>	<u>\$533,893</u>

- (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) Transition service obligations represent the non-cancelable portion of fees under the transition service agreement. See “Overview — Integration Activities and Costs”.
- (4) As of July 31, 2010, we also had approximately \$7.1 million of other long-term obligations in our condensed consolidated balance sheet for unrecognized tax positions that are not included in this table because the periods of cash settlement with the respective tax authority cannot be reasonably estimated.

Some of our commercial commitments, including some of the future minimum payments set forth above, are secured by standby letters of credit. The following is a summary of our commercial commitments secured by standby letters of credit by commitment expiration date as of July 31, 2010 (in thousands):

	Total	Less than one year	One to three years	Three to five years
Standby letters of credit	<u>\$39,860</u>	<u>\$ 35,261</u>	<u>\$ 3,895</u>	<u>\$ 704</u>

### Off-Balance Sheet Arrangements

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

### Critical Accounting Policies and Estimates

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

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

### Revenue Recognition

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

## Table of Contents

We apply the percentage of completion method to long term arrangements where we are required to undertake significant production customizations or modification engineering, and reasonable and reliable estimates of revenue and cost are available. Utilizing the percentage of completion method, we recognize revenue based on the ratio of actual costs incurred to date to total estimated costs expected to be incurred. In instances that do not meet the percentage of completion method criteria, and recognition of revenue is deferred until there are no uncertainties regarding customer acceptance. If circumstances arise that change the original estimates of revenue, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenue or costs, and such revisions are reflected in income in the period in which the circumstances that gave rise to the revision become known by management.

Some of our communications networking equipment is integrated with software that is essential to the functionality of the equipment. 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 of the product is specified by the customer, revenue is deferred until there are no uncertainties regarding customer acceptance.

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 to those separate units of accounting. Multiple element arrangements that include software are separated into more than one unit of accounting if the functionality of the delivered element(s) is not dependent on the undelivered element(s), there is vendor-specific objective evidence of the fair value of the undelivered element(s), and general revenue recognition criteria related to the delivered element(s) have been met. The amount of product and services revenue recognized is affected by our judgments as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence of fair value exists. Changes to the elements in an arrangement and our ability to establish vendor-specific objective evidence for those elements could affect the timing of revenue recognition. For all other deliverables, we 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 within our control. Revenue is allocated to each unit of accounting based on the relative fair value of each accounting unit or using the residual method if objective evidence of fair value does not exist for the delivered element(s). The revenue recognition criteria described above are applied to each separate unit of accounting. If these criteria are not met, revenue is deferred until the criteria are met or the last element has been delivered.

Our total deferred revenue for products was \$12.0 million and \$15.1 million as of October 31, 2009 and July 31, 2010, 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 \$63.9 million and \$75.7 million as of October 31, 2009 and July 31, 2010, respectively.

### ***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. Because we considered our options to be "plain vanilla," we calculated the expected term using the simplified method for fiscal 2007. Options are considered to be "plain vanilla" if they have the following basic characteristics: they are granted "at-the-money;" exercisability is conditioned upon service through the vesting date; termination of service prior to vesting results in forfeiture; there is a limited exercise period following termination of service; and the options are non-transferable and non-hedgeable. Beginning in fiscal 2008 we gathered more detailed historical information about specific exercise behavior of our grantees, which we used to determine expected term. We considered the implied volatility and historical volatility of our stock price in determining our expected volatility, and, finding both to be equally reliable, determined that a combination of both measures would result in the best estimate of expected volatility. We recognize the estimated fair value of option-based awards, net of estimated forfeitures, as share-based compensation expense on a straight-line basis over the requisite service period.

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

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

Because share-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures. 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 18 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to share-based compensation and the amount of share-based compensation expense we incurred for the periods covered in this report. As of July 31, 2010, total unrecognized compensation expense was: (i) \$7.0 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 0.9 years; and (ii) \$65.4 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.6 years.

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

### ***Reserve for Inventory Obsolescence***

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. Upon recognition of the write down, a new lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. We recorded charges for excess and obsolete inventory of \$11.1 million and \$10.7 million in the first nine months of fiscal 2009 and 2010, respectively. During fiscal 2009, these charges were primarily related to excess inventory due to a change in forecasted product sales. For the first nine months of fiscal 2010, these charges were primarily related to excess and obsolete inventory charges relating to product rationalization decisions in connection with the MEN Acquisition. 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 \$88.1 million and \$222.2 million as of October 31, 2009 and July 31, 2010, respectively.

### ***Restructuring***

As part of our restructuring costs, we provide for the estimated cost of the net lease expense for facilities that are no longer being used. The provision is equal to the fair value of the minimum future lease payments under our contracted lease obligations, offset by the fair value of the estimated sublease payments that we may receive. As of July 31, 2010, our accrued restructuring liability related to net lease expense and other related charges was \$7.3 million. The total minimum remaining lease payments for these restructured facilities are \$11.9 million. These lease payments will be made over the remaining lives of our leases, which range from nine months to nine 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 \$118.3 million and \$260.3 million as of October 31, 2009 and July 31, 2010, respectively. Our allowance for doubtful accounts as of October 31, 2009 and July 31, 2010 was \$0.1 million.

***Goodwill***

Goodwill represents the excess purchase price over amounts assigned to tangible or identifiable intangible assets acquired and liabilities assumed from our acquisitions. We test goodwill for impairment on an annual basis, which we have determined to be the last business day of fiscal September each year. We also test goodwill for impairment between annual tests if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value. The first step is to compare the fair value of the reporting unit with the unit's carrying amount, including goodwill. If this test indicates that the fair value is less than the carrying value, then step two is required to compare the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. A non-cash goodwill impairment charge would have the effect of decreasing our earnings or increasing our losses in such period. If we are required to take a substantial impairment charge, our operating results would be materially adversely affected in such period. At July 31, 2010, we had \$38.1 million in goodwill, assigned to our Packet-Optical Transport reporting unit. All of the goodwill on our Condensed Consolidated Balance Sheet as of July 31, 2010 is a result of the acquisition of the MEN Business. See Note 4 to the Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information relating to our interim impairment assessment during fiscal 2009.

***Long-lived Assets***

Our long-lived assets include: equipment, furniture and fixtures; finite-lived intangible assets; indefinite-lived intangible assets; and maintenance spares. As of October 31, 2009 and July 31, 2010 these assets totaled \$154.7 million and \$642.6 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 our reporting units which represents the lowest level for which we identify cash flows.

***Derivatives***

Our 4.0% convertible senior notes include a redemption feature that is accounted for as a separate embedded derivative. The embedded redemption feature is bifurcated from these notes using the "with-and-without" approach. As such, the total value of the embedded redemption feature is calculated as the difference between the value of these notes (the "Hybrid Instrument") and the value of an identical instrument without the embedded redemption feature (the "Host Instrument"). Both the Host Instrument and the Hybrid Instrument are valued using a modified binomial model. The modified binomial model utilizes a risk free interest rate, an implied volatility of Ciena's stock, the recovery rates of bonds, and the implied default intensity of the 4.0% convertible senior notes. The embedded redemption feature is recorded at fair value on a recurring basis and these changes are included in interest and other income (expense), net on the Condensed Consolidated Statement of Operations.

***Deferred Tax Valuation Allowance***

As of July 31, 2010, we have recorded a valuation allowance offsetting essentially all our net deferred tax assets of \$1.3 billion. When measuring the need for a valuation allowance, we assess both positive and negative evidence regarding the realizability of these deferred tax assets. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. In determining net deferred tax assets and valuation allowances, management is required to make judgments and estimates related to projections of profitability, the timing and extent of the utilization of net operating loss carryforwards, applicable tax rates, transfer pricing methodologies

## Table of Contents

and tax planning strategies. The valuation allowance is reviewed quarterly and is maintained until sufficient positive evidence exists to support a reversal. Because evidence such as our operating results during the most recent three-year period is afforded more weight than forecasted results for future periods, our cumulative loss during this three-year period represents sufficient negative evidence regarding the need for nearly a full valuation allowance. We will release this valuation allowance when management determines that it is more likely than not that our deferred tax assets will be realized. Any future release of valuation allowance may be recorded as a tax benefit increasing net income or as an adjustment to paid-in capital, based on tax ordering requirements.

### *Warranty*

Our liability for product warranties, included in other accrued liabilities, was \$40.2 million and \$64.5 million as of October 31, 2009 and July 31, 2010, respectively. Our products are generally covered by a warranty for periods ranging from one to five years. We accrue for warranty costs as part of our cost of goods sold based on associated material costs, technical support labor costs, and associated overhead. Material cost is estimated based primarily upon historical trends in the volume of product returns within the warranty period and the cost to repair or replace the equipment. Technical support labor cost is estimated based primarily upon historical trends and the cost to support the customer cases within the warranty period. The provision for product warranties was \$13.6 million and \$16.4 million for the first nine months of fiscal 2009 and 2010, respectively. The provision for warranty claims may fluctuate on a quarterly basis depending upon the mix of products and customers in that period. If actual product failure rates, material replacement costs, service or labor costs differ from our estimates, revisions to the estimated warranty provision would be required. An increase in warranty claims or the related costs associated with satisfying these warranty obligations could increase our cost of sales and negatively affect our gross margin.

### *Uncertain Tax Positions*

We account for uncertainty in income tax positions using a two-step approach. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made. As of July 31, 2010, we had \$1.3 million and \$7.1 million recorded as current and long-term obligations, respectively, related to uncertain tax positions. The provision for income taxes includes the effect of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

The total amount of unrecognized tax benefits increased by \$1.0 million during the first nine months of fiscal 2010 to \$8.4 million, which includes \$1.4 million of interest and some minor penalties. On March 19, 2010, as a result of the acquisition of the MEN Business, Ciena recorded a liability and an indemnification asset of \$2.6 million related to the uncertain income tax positions of the MEN Business. During the second quarter of fiscal 2010, subsequent to the acquisition, this acquired liability and associated indemnification asset were reduced by \$2.0 million due to a lapse in applicable statute of limitations.

### *Loss Contingencies*

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

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

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

## Table of Contents

*Interest Rate Sensitivity.* As of July 31, 2010 we no longer hold any marketable debt securities which would be subject to interest rate sensitivity. See Notes 7 and 8 to the Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information relating to these investments and their fair value. Accordingly, if market interest rates were to increase immediately and uniformly by 10 percentage points from current levels, the fair value of the portfolio would not be affected.

*Foreign Currency Exchange Risk.* As a global concern, we face exposure to adverse movements in foreign currency exchange rates. Historically, our sales have primarily been denominated in U.S. dollars and the impact of foreign currency fluctuations on revenue has not been material. As a result of our increased global presence from the MEN Acquisition, we expect that a larger percentage of our revenue will be non-U.S. dollar denominated, with increased sales denominated in Canadian Dollars and Euros. As a result, if the U.S. dollar strengthens against these currencies, our revenues could be adversely affected in our non-U.S. dollar denominated sales. For our U.S. dollar denominated sales, an increase in the value of the U.S. dollar would increase the real cost to our customers of our products in markets outside the United States.

With regard to operating expense, our primary exposures to foreign currency exchange risk are related to non-U.S. dollar denominated operating expense in Canadian Dollars, British Pounds, Euros and Indian Rupees. During the first nine months of fiscal 2010, approximately 69.2% of our operating expense was U.S. dollar denominated.

To reduce variability in non-U.S. dollar denominated operating expense, we have previously entered into foreign currency forward contracts and may do so in the future. We utilize these derivatives to partially offset our market exposure to fluctuations in certain foreign currencies. In the past, these derivatives have been designated as cash flow hedges and were fully matured as of October 31, 2009. We do not enter into foreign exchange forward or option contracts for trading purposes.

For the nine months of fiscal 2010, research and development, and general and administrative expenses, were negatively affected by approximately \$11.3 million, \$0.2 million respectively, due to unfavorable foreign exchange rates related to the weakening of the U.S. dollar in relation to the Canadian Dollar, partially offset by favorable foreign exchange rates related to the strengthening of the U.S. dollar in relation to the Euro. Sales and marketing benefited by \$1.5 million due to favorable foreign exchange rates related to the strengthening of the U.S. dollar in relation to the Euro.

As of July 31, 2010, our assets and liabilities related to non-dollar denominated currencies were primarily related to intercompany payables and receivables.

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

#### **Disclosure Controls and Procedures**

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

#### **Changes in Internal Control over Financial Reporting**

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

As described elsewhere in this report, we acquired the MEN Business on March 19, 2010. We are in the process of integrating the MEN Business and we currently rely on services provided through an affiliate of Nortel under a transition services agreement to support, among other purposes, the control activities of the MEN Business. Such services commenced during our second fiscal quarter and initially impacted our internal controls over financial reporting during that period. We have not fully evaluated the internal control over financial reporting of the MEN Business and, as permitted by SEC rules and regulations, will exclude the MEN Business from our evaluation of the effectiveness of the internal control over financial reporting from our Annual Report on Form 10-K for fiscal 2010. The process of integrating the MEN Business into our evaluation of internal control over financial reporting may result in future changes to our internal control over financial reporting. The MEN Business will be part of our evaluation of the effectiveness of internal control over financial reporting in our Annual Report on Form 10-K for our fiscal year ending October 31, 2011, in which report we will be initially required to include the MEN Business in our annual assessment.

## PART II — OTHER INFORMATION

### *Item 1. Legal Proceedings*

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

As a result of our June 2002 merger with ONI Systems Corp., 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, 2009. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation and because the settlement remains subject to appeal, the ultimate outcome of the matter is uncertain.

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

### *Item 1A. Risk Factors*

#### ***Risks relating to our Acquisition of the Nortel Metro Ethernet Networks (MEN) Business***

During the second quarter of fiscal 2010, we completed our acquisition of the MEN Business. Business combinations of the scale and complexity of this transaction involve a high degree of risk. You should consider the following risk factors before investing in our securities.

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

The success of the MEN Acquisition will depend, in significant part, on our ability to successfully integrate the acquired business, grow the combined business's revenue and realize the anticipated strategic benefits and operating synergies from the combination. We believe that the addition of the MEN Business will accelerate the execution of our corporate and product development strategy, enable us to compete with larger equipment providers and provide opportunities to optimize our product development investment. Achieving these goals requires growth of the revenue of the MEN Business and realization of the targeted sales synergies from our combined customer bases and solutions offerings. This growth and the anticipated benefits of the transaction may not be realized fully or at all, or may take longer to realize than we expect. Actual operating, technological, strategic and sales synergies, if achieved at all, may be less significant than we expect or may take longer to achieve than anticipated. If we are not able to achieve these objectives and realize the anticipated benefits and operating synergies of the MEN Acquisition within a reasonable time following the closing, our results of operations and the value of Ciena's common stock may be adversely affected.

### **The MEN Acquisition will result in significant integration costs and any material delays or unanticipated additional expense may harm our business and results of operations.**

The complexity and magnitude of the integration effort associated with the MEN Acquisition will be significant and will require that Ciena fund significant capital and operating expense to support the integration of the combined operations. We currently expect that integration expense associated with equipment and information technology, transaction expense, and consulting and third party service fees associated with integration, will be approximately \$180.0 million over a two-year period, with a significant portion of such costs anticipated to be incurred during fiscal 2010. We have incurred and expect to continue to incur additional costs as we build up internal resources, including headcount, facilities and information systems, or engage third party providers, while we simultaneously continue to rely upon and transition away from critical transition support services provided by an affiliate of Nortel during a transition period. In addition to these transition costs, we have incurred and expect to continue to incur increased expense relating to, among other things, restructuring and increased amortization of intangibles and inventory obsolescence charges. Any material delays, difficulties or unanticipated additional expense associated with integration activities may harm our business and results of operations.

### **The integration of the MEN Business is a complex undertaking, involving a number of operational risks, and disruptions or delays could significantly harm our business and results of operations.**

Because of the structure of the MEN Acquisition as an asset carve out from Nortel, in a number of areas we did not acquire back-office systems and processes that support the operation of the business. The MEN Acquisition will therefore require that we build new organizations, grow Ciena's existing infrastructure, or retain third party services to ensure business continuity and to support and scale our business. As noted below, we are currently relying upon an affiliate of Nortel to provide critical business support services for a transition period and will ultimately have to transfer these activities to internal or other third party resources. As a result, integrating the operations of the MEN Business will be extremely complex and we could encounter material disruptions, delays or unanticipated costs. Successful integration involves numerous risks, including:

- assimilating product offerings and sales and marketing operations;
- coordinating and implementing a combined research and development strategy;
- retaining and attracting customers following a period of significant uncertainty associated with the acquired business;
- diversion of management attention from business and operational matters;
- identifying and retaining key personnel;
- maintaining and transitioning relationships with key vendors, including component providers, manufacturers and service providers;
- integrating accounting, information technology, enterprise management and administrative systems which may be difficult or costly;
- making significant cash expenditures that may be required to retain personnel or eliminate unnecessary resources;
- managing tax costs or liabilities for acquired or acquiring corporate entities;
- coordinating a broader and more geographically dispersed organization;
- maintaining uniform standards, procedures and policies to ensure efficient and compliant administration of the organization; and
- making any necessary modifications to internal control to comply with the Sarbanes-Oxley Act of 2002 and related rules and regulations.

Disruptions or delays associated with these and other risks encountered in the integration process could have a material adverse effect on our business and results of operations.

### **We are relying on an affiliate of Nortel for the performance of certain critical business support services during a transition period following the closing of the MEN Acquisition and there can be no assurance that such services will be performed timely and effectively.**

We currently rely upon an affiliate of Nortel for certain key business support services related to the operation and continuity of the MEN Business. These services will be transferred to and taken over by our organization over time as we build up the capability and capability to do so. These services include key finance and accounting functions, supply chain and logistics management, maintenance and product support services, order management and fulfillment, trade compliance, and information technology services. These transition services are costly and we could incur approximately \$94.0 million per year, if all of the transition services are used for a full year. Relying upon the transition services provider to perform critical operations and services raises a number of significant business and operational risks. The transition service provider also performs services on behalf of other purchasers of the businesses that Nortel has recently divested. There is no assurance the provider will serve as an effective support partner for all of the Nortel purchasers and we face risks associated with the provider's ability to retain experienced and knowledgeable personnel as Ciena and other purchasers wind down support services. Ciena's administration and oversight of

these transition services is complex, requires significant resources and presents issues related to the segregation of duties and information among the purchasers. In particular, the wind down and transfer to Ciena or other third parties of these critical services is a complex undertaking and may be disruptive to our business and operations. Significant disruption in business support services, the transfer of these activities to Ciena or unanticipated costs related to such services could adversely affect our business and results of operations.

**The MEN Acquisition may expose us to significant unanticipated liabilities that could adversely affect our business and results of operations.**

Our purchase of the MEN Business may expose us to significant unanticipated liabilities relating to the operation of the Nortel business. These liabilities could include employment, retirement or severance-related obligations under applicable law or other benefits arrangements, legal claims, warranty or similar liabilities to customers, and claims by or amounts owed to vendors, including as a result of any contracts assigned to Ciena. We may also incur liabilities or claims associated with our acquisition or licensing of Nortel's technology and intellectual property including claims of infringement. Particularly in international jurisdictions, our acquisition of the MEN Business, or our decision to independently enter new international markets where Nortel previously conducted business, could also expose us to tax liabilities and other amounts owed by Nortel. The incurrence of such unforeseen or unanticipated liabilities, should they be significant, could have a material adverse affect on our business, results of operations and financial condition.

**The MEN Acquisition may cause dilution to our earnings per share, which may harm the market price of our common stock.**

A number of factors, including lower than anticipated revenue and gross margin of the MEN Business, or fewer operating synergies of the combined operations, could cause dilution to our earnings per share or decrease or delay any accretive effect of the MEN Acquisition. We could also encounter unanticipated or additional integration-related costs or fail to realize all of the benefits of the MEN Acquisition that underlie our financial model and expectations for future growth and profitability. These and other factors could cause dilution to our earnings per share or decrease or delay the expected financial benefits of the MEN Acquisition and cause a decrease in the price of our common stock.

**The complexity of the integration and transition associated with the MEN Acquisition, together with Ciena's increased scale and global presence, may affect our internal control over financial reporting and our ability to effectively and timely report our financial results.**

We currently rely upon a combination of Ciena information systems and critical transition services provided by an affiliate of Nortel to accurately and effectively compile and report our financial results. The additional scale of our operations, together with the complexity of the integration effort, including changes to or implementation of critical information technology systems and reliance upon third party transition services, may adversely affect our ability to report our financial results on a timely basis. In addition, we have had to train new employees and third party providers, and assume operations in jurisdictions where we have not previously had operations. We expect that the MEN Acquisition may necessitate significant modifications to our internal control systems, processes and information systems, both on a transition basis, and over the longer-term as we fully integrate the combined company. We cannot be certain that changes to our design for internal control over financial reporting, or the controls utilized by other third parties, will be sufficient to enable management or our independent registered public accounting firm to determine that our internal controls are effective for any period, or on an ongoing basis. If we are unable to accurately and timely report our financial results, or are unable to assert that our internal controls over financial reporting are effective, our business and market perception of our financial condition may be harmed and the trading price of our stock may be adversely affected.

***Risks related to our current business and operations***

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

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

## Table of Contents

Broad macroeconomic weakness has previously resulted in sustained periods of decreased demand for our products and services that have adversely affected our operating results. In response to these conditions, many of our customers significantly reduced their network infrastructure expenditures as they sought to conserve capital, reduce debt or address uncertainties or changes in their own business models brought on by broader market challenges. We continue to experience cautious spending among our customers as a result of the recent period of economic weakness and remain uncertain as to how long these macroeconomic and industry conditions will continue, the pace of recovery, and the magnitude of the effect of recent market conditions on our business and results of operations. Continued or increased challenging economic and market conditions could result in:

- difficulty forecasting, budgeting and planning due to limited visibility into the spending plans of current or prospective customers;
- increased competition for fewer network projects and sales opportunities;
- increased pricing pressure that may adversely affect revenue and gross margin;
- higher overhead costs as a percentage of revenue;
- increased risk of charges relating to excess and obsolete inventories and the write off of other intangible assets; and
- customer financial difficulty and increased difficulty in collecting accounts receivable.

Our business and operating results could be materially affected by periods of unfavorable macroeconomic and market conditions, globally or specific to a particular region where we operate, and any resulting reductions in the level of capital expenditure by our customers.

**A small number of communications service providers account for a significant portion of our revenue. The loss of any of these customers, or a significant reduction in their spending, would have a material adverse effect on our business and results of operations.**

A significant portion of our revenue is concentrated among a relatively small number of communications service providers. Eight customers accounted for greater than 60% of our revenue in fiscal 2009, including AT&T, which represented approximately 19.6% of fiscal 2009 revenue. Consequently, our financial results are closely correlated with the spending of a relatively small number of service providers and are significantly affected by market or industry changes that affect their businesses. The terms of our frame contracts generally do not obligate these customers to purchase any minimum or specific amounts of equipment or services. Because their spending may be unpredictable and sporadic, our revenue and operating results can fluctuate on a quarterly basis. Reliance upon a relatively small number of customers increases our exposure to changes in their network and purchasing strategies. Some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce or rationalize the number of vendors from which they purchase equipment. These strategies may present challenges to our business and could benefit our larger competitors. Our concentration in revenue has increased in recent years, in part, as a result of consolidations among a number of our largest customers. Consolidations may increase the likelihood of temporary or indefinite reductions in customer spending or changes in network strategy that could harm our business and operating results. The loss of one or more large service provider customers, or a significant reduction in their spending, as a result of the factors above or otherwise, would have a material adverse effect on our business, financial condition and results of operations.

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

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

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

- broader economic and market conditions affecting us and our customers;
- changes in capital spending by large communications service providers;
- the timing and size of orders, including our ability to recognize revenue under customer contracts;
- the transition from selling legacy to next-generation technology platforms;
- variations in the mix between higher and lower margin products and services; and
- the level of pricing pressure we encounter, particularly for our Packet-Optical Transport.

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

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

The markets in which we compete for sales of networking equipment, software and services are extremely competitive. Competition is particularly intense in attracting large carrier customers and securing new market opportunities with existing carrier customers. In an effort to secure new or long-term customers and capture market share, in the past we have and in the future we may agree to pricing or other terms that result in negative gross margins on a particular order or group of orders. The level of competition and pricing pressure that we face increases substantially during periods of macroeconomic weakness, constrained spending or fewer network projects. As a result of recent market conditions, we have experienced significant competition and increased pricing pressure, particularly for our Packet-Optical Transport products, as we and other vendors have sought to retain or grow market share.

Competition in our markets, generally, is based on any one or a combination of the following factors: price, product features, functionality and performance, introduction of innovative network solutions, manufacturing capability and lead-times, incumbency and existing business relationships, scalability and the flexibility of products to meet the immediate and future network requirements of customers. A small number of very large companies have historically dominated our industry. These competitors have substantially greater financial and marketing resources, greater manufacturing capacity, broader product offerings and more established relationships with service providers and other potential customers than we do. Because of their scale and resources, they may be perceived to be better positioned to offer network operating or management service for large carrier customers. We expect that the acquired products and technologies, increased market share and global presence resulting from the MEN Acquisition will only intensify the level of competition that we face, particularly from larger vendors. We also compete with a number of smaller companies that provide significant competition for a specific product, application, customer segment or geographic market. Due to the narrower focus of their efforts, these competitors may achieve commercial availability of their products more quickly or may be more attractive to customers.

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

- significant price competition, particularly for our Packet-Optical Transport platforms;
- customer financing assistance;
- early announcements of competing products and extensive marketing efforts;
- competitors offering equity ownership positions to customers;
- competitors offering to repurchase our equipment from existing customers;
- marketing and advertising assistance; and
- intellectual property assertions and disputes.

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

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

We rely upon third party contract manufacturers to perform the majority of the manufacturing of our products and components. We do not have contracts in place with some of our manufacturers, do not have guaranteed supply of components or manufacturing capacity and in some cases are utilizing temporary or transitional commercial arrangements intended to facilitate the integration of the MEN Business. Our reliance upon third party manufacturers could expose us to increased risks related to lead times, continued supply, on-time delivery, quality assurance and compliance with environmental standards and other regulations. Reliance upon third parties manufacturers exposes us to risks related to their operations, financial position, business continuity and continued viability, which may be adversely affected by broader macroeconomic conditions and difficulties in the credit markets. In an effort to drive cost reductions, we anticipate rationalizing our supply chain and third party contract manufacturers as part of the integration of the MEN Business into Ciena's operations. There can be no assurance that these efforts, including any consolidation or reallocation the third party sourcing and manufacturing, will not ultimately result in additional costs or disruptions in our operations and business.

We may also experience difficulties as a result of geopolitical events, military actions or health pandemics in the countries where our products or critical components are manufactured. Our product manufacturing principally takes place in Mexico, Canada, Thailand and China. Thailand is undergoing a period of instability and we have in the past experienced product shipment delays associated with political turmoil in Thailand, including a blockade of its main international airport. Significant disruptions in these countries affecting supply and manufacturing capacity, or other difficulties with our contract manufacturers would negatively affect our business and results of operations.

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

The market for communications networking equipment is characterized by rapidly evolving technologies and changes in market demand. We continually invest in research and development to sustain or enhance our existing products and develop or acquire new products technologies. Our current development efforts are focused upon the evolution of our CoreDirector Multiservice Optical Switch family, the expansion of our Carrier Ethernet Service Delivery and aggregation products, and 40G and 100G coherent technologies and capabilities for our Packet-Optical Transport platforms. There is often a lengthy period between commencing these development initiatives and bringing a new or improved product to market. During this time, technology preferences, customer demand and the market for our products may move in directions we had not anticipated. There is no guarantee that new products or enhancements will achieve market acceptance or that the timing of market adoption will be as predicted. There is a significant possibility, therefore, that some of our development decisions, including significant expenditures on acquisitions, research and development costs, or investments in technologies, will not turn out as anticipated, and that our investment in some projects will be unprofitable. There is also a possibility that we may miss a market opportunity because we failed to invest, or invested too late, in a technology, product or enhancement. Changes in market demand or investment priorities may also cause us to discontinue existing or planned development for new products or features, which can have a disruptive effect on our relationships with customers. These product development risks can be compounded in the context of a significant acquisition such as the MEN Business and decision making regarding our product portfolio and the significant development work required to integrate the combined product and software offerings. If we fail to make the right investments or fail to make them at the right time, our competitive position may suffer and our revenue and profitability could be harmed.

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

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

- increased costs to remediate software or hardware defects or replace products;
- payment of liquidated damages or similar claims for performance failures or delays;
- increased inventory obsolescence;
- increased warranty expense or estimates resulting from higher failure rates, additional field service obligations or other rework costs related to defects;
- delays in recognizing revenue or collecting accounts receivable; and
- declining sales to existing customers and order cancellations.

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

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

Our future success will depend in large part on our ability to maintain and expand our sales to large communications service providers. These sales typically involve lengthy sales cycles, protracted and sometimes difficult contract negotiations, and sales to service providers often involve extensive product testing and network certification, including network-specific or region-specific processes. We are sometimes required to agree to contract terms or conditions that negatively affect pricing, payment terms and the timing of revenue recognition in order to consummate a sale. During periods of macroeconomic or market weakness, these customers may request extended payment terms, vendor or third-party financing and other alternative purchase structures. These terms may, in turn, negatively affect our revenue and results of operations and increase our risk and susceptibility to quarterly fluctuations in our results. Service providers may ultimately insist upon terms and conditions that we deem too onerous or not in our best interest. Moreover, our purchase agreements generally do not require that a customer guarantee any minimum purchase level and customers often have the right to modify, delay, reduce or cancel previous orders. As a result, we may incur substantial expense and devote time and resources to potential relationships that never materialize or result in lower than anticipated sales.

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

We depend on third party suppliers for our product components and subsystems, as well as for equipment used to manufacture and test our products. Our products include key optical and electronic components for which reliable, high-volume supply is often available only from sole or limited sources. Increases in market demand or periods of economic weakness have previously resulted in shortages in availability for important components. Unfavorable economic conditions can affect our suppliers' liquidity level and ability to continue to invest in their business and to stock components in sufficient quantity. We have experienced increased lead times and a higher incidence of component discontinuation. These difficulties with suppliers could result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships. We do not have any guarantee of supply from these third parties, and in many cases relating to the MEN Business, are relying upon temporary or transitional commercial arrangements intended to facilitate the integration. As a result, there is no assurance that we will be able to secure the components or subsystems that we require in sufficient quantity and quality on reasonable terms. The loss of a source of supply, or lack of sufficient availability of key components, could require that we locate an alternate source or redesign our products, each of which could increase our costs and negatively affect our product gross margin and results of operations. Our business and results of operations would be negatively affected if we were to experience any significant disruption of difficulties with key suppliers affecting the price, quality, availability or timely delivery of required components.

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

We expanded our geographic presence significantly as a result of the MEN Acquisition, and we continue to take steps to sell our products into new geographic markets outside of our traditional markets and to a broader customer base, including other large communications service providers, enterprises, cable operators, wireless operators and federal, state and local governments. In many cases, we have less experience in these markets and customers have less familiarity with our company. To succeed in some of these markets we believe we must develop and manage new sales channels and distribution arrangements. We expect these relationships to be an important part of our business internationally as well as for sales to federal, state and local governments. Failure to manage additional sales channels effectively would limit our ability to succeed in these new markets and could adversely affect our ability to expand our customer base and grow our business.

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

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

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

## Table of Contents

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

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

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

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

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

- we may suffer delays in recognizing revenue;
- our services revenue and gross margin may be adversely affected; and
- our relationship with customers could suffer.

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

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

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

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

### **We may incur significant costs in response to claims by others that we infringe their intellectual property rights.**

From time to time third parties may assert claims or initiate litigation or other proceedings related to patent, copyright, trademark and other intellectual property rights to technologies and related standards that are relevant to our business. These assertions have increased over time due to our growth, the increased number of products and competitors in the communications network equipment industry and the corresponding overlaps, and the general increase in the rate of patent claims assertions, particularly in the United States. Asserted claims, litigation or other proceedings can include claims against us or our manufacturers, suppliers or customers, alleging infringement of third party proprietary rights with respect our existing or future products and technology or components of those products. Regardless of the merit of these claims, they can be time-consuming, divert the time and attention of our technical and management personnel, and result in costly litigation. These claims, if successful, can require us to:

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

Any of these events could adversely affect our business, results of operations and financial condition.

Our exposure to risks associated with the use of intellectual property may be increased as a result of acquisitions, as we have a lower level of visibility into the development process with respect to such technology or the steps taken to safeguard against the risks of infringing the rights of third parties.

### **Our international scale could expose our business to additional risks and expense and adversely affect our results of operations.**

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

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

We expect that we may enter new markets and withdraw from or reduce operations in others. In some countries, our success will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements could adversely affect our business and operations. Our global operations may result in increased risk and expense to our business and could give rise to unanticipated liabilities or difficulties that could adversely affect our operations and financial results.

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

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

- difficulty hiring and retaining appropriate engineering resources due to intense competition for such resources and resulting wage inflation;
- the knowledge transfer related to our technology and resulting exposure to misappropriation of intellectual property or information that is proprietary to us, our customers and other third parties;
- heightened exposure to changes in the economic, security and political conditions of India; and

- fluctuations in currency exchange rates and tax compliance in India.

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

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

We have entered into agreements with strategic partners that permit us to distribute their products or technology. We may rely upon these relationships to add complementary products or technologies, diversify our product portfolio, or address a particular customer or geographic market. We may enter into additional original equipment manufacturer (OEM), resale or similar arrangements in the future, including in support of our selection as a domain supply partner with AT&T. We may incur unanticipated costs or difficulties relating to our resale of third party products. Our third party relationships could expose us to risks associated with the business and viability of such partners, as well as delays in their development, manufacturing or delivery of products or technology. We may also be required by customers to assume warranty, indemnity, service and other commercial obligations greater than the commitments, if any, made to us by our technology partners. Some of our strategic partners are relatively small companies with limited financial resources. If they are unable to satisfy their obligations to us or our customers, we may have to expend our own resources to satisfy these obligations. Exposure to the risks above could harm our reputation with key customers and negatively affect our business and our results of operations.

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

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

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

Competition to attract and retain highly skilled technical, engineering and other personnel with experience in our industry is intense and our employees have been the subject of targeted hiring by our competitors. We may experience difficulty retaining and motivating existing employees and attracting qualified personnel to fill key positions. As a result of the MEN Acquisition, employees may experience uncertainty, real or perceived, about their role with Ciena as strategies and initiatives relating to combined operations are announced or executed. Because we rely upon equity awards as a significant component of compensation, particularly for our executive team, a lack of positive performance in our stock price, reduced grant levels, or changes to our compensation program may adversely affect our ability to attract and retain key employees. It may be difficult to replace members of our management team or other key personnel, and the loss of such individuals could be disruptive to our business. In addition, none of our executive officers is bound by an employment agreement for any specific term. If we are unable to attract and retain qualified personnel, we may be unable to manage our business effectively and our operations and results of operations could suffer.

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

As a global concern, we face exposure to adverse movements in foreign currency exchange rates. Historically, our sales have primarily been denominated in U.S. dollars. As a result of our increased global presence from the MEN Acquisition, we expect that a larger percentage of our revenue will be non-U.S. dollar denominated and therefore subject to foreign currency fluctuation. In addition, we face exposure to currency exchange rates as a result of our non-U.S. dollar denominated operating expense in Europe, Asia, Latin America and Canada. We have previously hedged against currency exposure associated with anticipated foreign currency cash flows and may do so in the future. There can be no assurance that these hedging instruments will be effective and losses associated with these instruments or fluctuations and the adverse effect of foreign currency exchange rate fluctuation may negatively affect our results of operations.

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

## Table of Contents

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

### **Our business is dependent upon the proper functioning of our internal business processes and information systems and modifications to integrate the MEN Business or support future growth may disrupt our business, operating processes and internal controls.**

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

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

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

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

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

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

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

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

The United States and various foreign governments have imposed controls, license requirements and other restrictions on the usage, import or export of some of the technologies that we sell. Governmental regulation of usage, import or export of our products, or our failure to obtain required approvals for our products, could harm our international and domestic sales and adversely affect our revenue and costs of sales. Failure to comply with such regulations could result in enforcement actions, fines or penalties and restrictions on export privileges. In addition, costly tariffs on our equipment, restrictions on importation, trade protection measures and domestic preference requirements of certain countries could limit our access to these markets and harm our sales. For example, India's government has recently implemented certain rules applicable to non-Indian network equipment vendors and is considering further restrictions that may inhibit sales of certain communications equipment, including equipment manufactured in China, where certain of our products are assembled. These and other regulations could adversely affect the sale or use of our products and could adversely affect our business and revenue.

### **Governmental regulations related to the environment and potential climate change, could adversely affect our business and operating results.**

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

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

As of July 31, 2010, our balance sheet includes \$38.1 million of goodwill and \$642.6 million in long-lived assets, which includes \$470.6 million of intangible assets. Goodwill relates to the excess of the total purchase price of the MEN Acquisition over the fair value of the net acquired assets. We have incurred significant charges in the past relating to impairment of goodwill that we have acquired from business combinations. Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products. These assumptions are used to forecast future, undiscounted cash flows. Given the significant uncertainty and instability of macroeconomic conditions in recent periods, forecasting future business is difficult and subject to modification. If actual market conditions differ or our forecasts change, we may be required to reassess long-lived assets and could record an impairment charge. Any impairment charge relating to goodwill or long-lived assets would have the effect of decreasing our earnings or increasing our losses in such period. If we are required to take a substantial impairment charge, our operating results could be materially adversely affected in such period.

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

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

**Our outstanding indebtedness on our convertible notes and lower cash balance may adversely affect our business.**

At July 31, 2010, indebtedness on our outstanding convertible notes totaled \$1.2 billion in aggregate principal. Our use of cash to acquire the MEN Business, together with our private placement of \$375.0 million in aggregate principal amount of additional convertible notes in March 2010 to fund in part the purchase price, resulted in significant additional indebtedness and materially reduced our existing cash balance.

Our indebtedness and lower cash balance could have important negative consequences, including:

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

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

**Our stock price is volatile.**

Our common stock price has experienced substantial volatility in the past and may remain volatile in the future. Volatility in our stock price can arise as a result of a number of the factors discussed in this “Risk Factors” section. During fiscal 2009, our stock price ranged from a high of \$16.64 per share to a low of \$4.98 per share. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, with such volatility often unrelated to the operating performance of these companies. Divergence between our actual or anticipated financial results and published expectations of analysts can cause significant swings in our stock price. Our stock price can also be affected by announcements that we, our competitors, or our customers may make, particularly announcements related to acquisitions or other significant transactions. Our common stock is included in a number of market indices and any change in the composition of these indices to exclude our company would adversely affect our stock price. On December 18, 2009, we were removed from the S&P 500, a widely-followed index. These factors, as well as conditions affecting the general economy or financial markets, may materially adversely affect the market price of our common stock in the future.

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

Not applicable.

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

Not applicable.

***Item 4. Removed and Reserved***

***Item 5. Other Information***

**Item 5.02 – Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.**

***Amendment to Change in Control Severance Agreements***

On September 8, 2010, the Compensation Committee of Ciena’s Board of Directors approved an amendment to the standard form of change in control severance agreements Ciena has previously entered into with our executive officers, including the named executive officers from our most recent proxy statement (Gary B. Smith, James E. Moylan, Jr., Stephen B. Alexander and Michael G. Aquino) and our principal operating officer (Philippe Morin). These agreements provide for the provision of certain severance benefits in the event that such officer’s employment is terminated by Ciena or any successor entity without “cause,” or by the officer for “good reason,” within one year following a change in control of Ciena (a “covered termination”).

The amended form of severance agreements, among other things, modifies the amount of cash severance payable, the period of benefits coverage continuity and treatment of equity awards upon a covered termination. Mr. Smith’s severance agreement was amended to provide a lump sum payment of two and one-half times his base salary and annual target incentive bonus upon a covered termination. His agreement previously provided for a lump sum payment of the greater of \$2 million or the sum of his base salary and annual target incentive bonus. Mr. Smith’s severance agreement was also amended to increase the length of his post-termination non-competition and non-solicitation obligations, upon which receipt of the severance benefits are conditioned, from 12 to 18 months. The severance agreements of the other Named Executive Officers were amended to provide a lump sum payment of one and one-half times base salary and annual target incentive bonus upon a covered termination. These agreements previously provided for one year of salary continuation and target incentive bonus payments, payable quarterly. The amended form of severance agreements increases from 12 to 18 months the period of continuity of benefits coverage for each officer, while at the same time eliminating any continuity of life and disability insurance coverage and removing the gross up for additional taxes incurred by the officer by reason of any income realized as a result of the continuation of benefits coverage. With regard to the treatment of equity awards upon a covered termination, the amended form of severance agreement increases from 50% to 100% the acceleration of vesting of outstanding awards, thereby aligning the Named Executive Officers with the treatment of equity in Mr. Smith’s existing agreement.



## Table of Contents

The amended form of severance agreements also modifies the definition of “cause,” as it is used in the agreement, such that the revised definition includes the following conditions:

- the officer’s willful or continued failure substantially to perform the duties of his position, as determined by the Governance and Nominations Committee of the Board;
- any willful act or omission in connection with such officer’s responsibilities as an employee constituting dishonesty, fraud or other malfeasance, immoral conduct or gross misconduct;
- any willful material violation of Ciena’s Code of Business Conduct and Ethics or the contractual proprietary information, inventions and non-solicitation arrangements between Ciena and such officer; or
- the officer’s conviction of, or plea of nolo contendere to, a felony or a crime of moral turpitude.

The amended form of severance agreements also modifies the definition of “change in control,” as it is used in the agreement, such that the revised definition includes a change in the composition of the Board of Directors occurring within a two year period, as a result of which less than a majority of the directors are “incumbent directors,” which includes either existing directors or directors who are elected or nominated for election with the affirmative votes of at least a majority of the directors of Ciena at the time of such election or nomination (but not including individuals who are elected or nominated in connection with an actual or threatened proxy contest relating to the election of directors).

Lastly, the amended form of severance agreements eliminates the perpetual term in favor of a fixed, three-year term, provided that the term is subject to an automatic extension in the event that Ciena is in active negotiations regarding, or has entered into a definitive agreement with respect to, a change of control transaction.

### **Item 6. Exhibits**

31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

---

\* In accordance with Regulation S-T, XBRL (Extensible Business Reporting Language) related information in Exhibit No. (101) to this Quarterly Report on Form 10-Q shall be deemed “furnished” and not “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section, and shall not be incorporated by reference into any registration statement pursuant to the Securities Act of 1933, as amended.

**SIGNATURES**

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

Ciena Corporation

Date: September 8, 2010

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

Date: September 8, 2010

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

**CIENA CORPORATION**  
**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Gary B. Smith, certify that:

1. I have reviewed this quarterly report of Ciena Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 8, 2010

/s/ Gary B. Smith

Gary B. Smith  
President and Chief Executive Officer

**CIENA CORPORATION**  
**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, James E. Moylan, Jr., certify that:

1. I have reviewed this quarterly report of Ciena Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 8, 2010

/s/ James E. Moylan, Jr.

\_\_\_\_\_  
James E. Moylan, Jr.  
Senior Vice President and Chief Financial Officer

**CIENA CORPORATION**

**Written Statement of Chief Executive Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

The undersigned, the Chief Executive Officer of Ciena Corporation (the "Company"), hereby certifies that, to his knowledge, on the date hereof:

(a) the Report on Form 10-Q of the Company for the quarter ended July 31, 2010 filed on the date hereof with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(b) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gary B. Smith

Gary B. Smith

President and Chief Executive Officer

September 8, 2010

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Ciena Corporation and will be retained by Ciena Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

**CIENA CORPORATION**

**Written Statement of Chief Financial Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

The undersigned, the Chief Financial Officer of Ciena Corporation (the "Company"), hereby certifies that, to his knowledge, on the date hereof:

(a) the Report on Form 10-Q of the Company for the quarter ended July 31, 2010 filed on the date hereof with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(b) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James E. Moylan, Jr.

James E. Moylan, Jr.

Senior Vice President and Chief Financial Officer

September 8, 2010

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Ciena Corporation and will be retained by Ciena Corporation and furnished to the Securities and Exchange Commission or its staff upon request.