

EXTREME NETWORKS INC

Form 10-Q

October 29, 2014

Table of Contents

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 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 September 30, 2014

OR

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

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

Commission file number 000-25711

---

EXTREME NETWORKS, INC.  
(Exact name of registrant as specified in its charter)

---

DELAWARE  
[State or other jurisdiction  
of incorporation or organization]

77-0430270  
[I.R.S Employer  
Identification No.]

145 Rio Robles,  
San Jose, California  
[Address of principal executive office]

95134  
[Zip Code]

Registrant's telephone number, including area code: (408) 579-2800

---

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 (§ 229.405 of this chapter) 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.

Edgar Filing: EXTREME NETWORKS INC - Form 10-Q

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares of the Registrant's Common Stock, \$.001 par value, outstanding at October 21, 2014 was 97,538,572.

---

Table of Contents

EXTREME NETWORKS, INC.  
 FORM 10-Q  
 QUARTERLY PERIOD ENDED September 30, 2014  
 INDEX

	PAGE
<u>PART I. CONDENSED CONSOLIDATED FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited):</u>	
<u>Condensed Consolidated Balance Sheets as of September 30, 2014 and June 30, 2014</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three Months ended September 30, 2014 and September 30, 2013</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive (Loss) Income for the Three Months ended September 30, 2014 and September 30, 2013</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Three Months ended September 30, 2014 and September 30, 2013</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>26</u>
Item 4. <u>Controls and Procedures</u>	<u>28</u>
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>29</u>
Item 1A <u>Risk Factors</u>	<u>29</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>41</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>41</u>
Item 4. <u>Mine Safety Disclosure</u>	<u>41</u>
Item 5. <u>Other Information</u>	<u>41</u>
Item 6. <u>Exhibits</u>	<u>42</u>
<u>Signatures</u>	<u>43</u>



Table of Contents

EXTREME NETWORKS, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands, except share and per share amounts)  
 (Unaudited)

	September 30, 2014	June 30, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 74,067	\$ 73,190
Short-term investments	30,395	32,692
Accounts receivable, net of allowances of \$4,569 at September 30, 2014 and \$3,618 at June 30, 2014	99,980	124,664
Inventories	55,341	57,109
Deferred income taxes	1,069	1,058
Prepaid expenses and other current assets	13,486	14,143
Total current assets	274,338	302,856
Property and equipment, net	46,258	46,554
Intangible assets, net	78,710	87,459
Goodwill	70,877	70,877
Other assets	18,867	18,686
Total assets	\$ 489,050	\$ 526,432
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 30,500	\$ 29,688
Accounts payable	29,994	37,308
Accrued compensation and benefits	21,712	26,677
Restructuring liabilities	186	322
Accrued warranty	7,889	7,551
Deferred revenue, net	72,599	74,735
Deferred distributors revenue, net of cost of sales to distributors	26,060	31,992
Other accrued liabilities	35,768	38,035
Total current liabilities	224,708	246,308
Deferred revenue, less current portion	21,968	22,942
Long-term debt, less current portion	90,250	91,875
Other long-term liabilities	9,014	8,595
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Convertible preferred stock, \$.001 par value, issuable in series, 2,000,000 shares authorized; none issued	—	—
Common stock, \$.001 par value, 750,000,000 shares authorized; 97,528,819 shares issued and outstanding at September 30, 2014 and 96,980,214 shares issued and outstanding at June 30, 2014	98	97
Additional paid-in-capital	851,817	845,267
Accumulated other comprehensive loss	(1,262	) (439 )
Accumulated deficit	(707,543	) (688,213 )
Total stockholders' equity	143,110	156,712
Total liabilities and stockholders' equity	\$ 489,050	\$ 526,432
See accompanying notes to condensed consolidated financial statements.		



Table of Contents

EXTREME NETWORKS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (In thousands, except per share amounts)  
 (Unaudited)

	Three Months Ended		
	September 30, 2014	September 30, 2013	
Net revenues:			
Product	\$102,672	\$61,045	
Service	33,602	14,871	
Total net revenues	136,274	75,916	
Cost of revenues:			
Product	54,025	27,516	
Service	11,722	4,693	
Total cost of revenues	65,747	32,209	
Gross profit:			
Product	48,647	33,529	
Service	21,880	10,178	
Total gross profit	70,527	43,707	
Operating expenses:			
Research and development	23,347	9,937	
Sales and marketing	44,779	22,694	
General and administrative	11,074	6,934	
Acquisition and integration costs	4,058	3,695	
Restructuring charge, net of reversals	—	75	
Amortization of intangibles	4,467	—	
Total operating expenses	87,725	43,335	
Operating (loss) income	(17,198	) 372	
Interest income	146	275	
Interest expense	(836	) —	
Other expense, net	(434	) (255	)
(Loss) income before income taxes	(18,322	) 392	
Provision for income taxes	1,008	427	
Net loss	\$(19,330	) \$(35	)
Basic and diluted net loss per share:			
Net loss per share – basic	\$(0.20	) \$0.00	
Net loss per share – diluted	\$(0.20	) \$0.00	
Shares used in per share calculation – basic	97,314	94,062	
Shares used in per share calculation – diluted	97,314	94,062	
See accompanying notes to condensed consolidated financial statements.			

Table of Contents

## EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

(Unaudited)

	Three Months Ended	
	September 30, 2014	September 30, 2013
Net loss:	\$(19,330	) \$(35
Other comprehensive income, net of tax:		
Available for sale securities:		
Change in unrealized (losses) gains on available for sale securities, net of taxes	(57	) 433
Reclassification of adjustment for realized net gains on available for sale securities included in net (loss) income	—	(148
Net change in unrealized (losses) gains on available for sale securities, net of taxes	(57	) 285
Net change in foreign currency translation adjustments	(766	) 101
Other comprehensive (loss) income	(823	) 386
Total comprehensive (loss) income	\$(20,153	) \$351

See accompanying notes to condensed consolidated financial statements.



Table of Contents

EXTREME NETWORKS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)  
 (Unaudited)

	Three Months Ended	
	September 30, 2014	September 30, 2013
Cash flows from operating activities:		
Net loss	\$(19,330 )	\$ (35 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	3,037	1,437
Amortization of intangible assets	9,001	286
Provision for (recovery of) doubtful accounts and allowance for sales returns	951	(164 )
Stock-based compensation	4,813	1,575
Other non-cash charges	544	278
Changes in operating assets and liabilities, net		
Accounts receivable	23,733	8,510
Inventories	1,769	(14,222 )
Prepaid expenses and other assets	682	(2,073 )
Accounts payable	(7,313 )	1,288
Accrued compensation and benefits	(4,966 )	(545 )
Restructuring liabilities	(136 )	(894 )
Deferred revenue	(3,111 )	(1,219 )
Deferred distributor revenue, net of cost of sales to distributors	(5,932 )	1,211
Other current and long term liabilities	(2,110 )	6,492
Net cash provided by operating activities	1,632	1,925
Cash flows from investing activities:		
Capital expenditures	(2,784 )	(9,808 )
Proceeds from maturities of investments and marketable securities	2,000	13,062
Purchases of intangible assets	(252 )	—
Net cash (used in) provided by investing activities	(1,036 )	3,254
Cash flows from financing activities:		
Borrowings under Revolving Facility	24,000	—
Repayment of debt	(24,813 )	—
Proceeds from issuance of common stock	1,738	1,799
Net cash provided by financing activities	925	1,799
Foreign currency effect on cash	(644 )	227
Net increase in cash and cash equivalents	877	7,205
Cash and cash equivalents at beginning of period	73,190	95,803
Cash and cash equivalents at end of period	\$74,067	\$ 103,008
See accompanying notes to the condensed consolidated financial statements.		

Table of Contents

EXTREME NETWORKS, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The unaudited condensed consolidated financial statements of Extreme Networks, Inc. (referred to as the “Company” or “Extreme Networks”) included herein have been prepared under the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted under such rules and regulations. The condensed consolidated balance sheet at June 30, 2014 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme Networks at September 30, 2014. The results of operations for the three months ended September 30, 2014 are not necessarily indicative of the results that may be expected for fiscal 2015 or any future periods.

2. Summary of Significant Accounting Policies

For a description of significant accounting policies, see Note 3, Summary of Significant Accounting Policies, to the consolidated financial statements included in the Company's Annual report on Form 10-K for the fiscal year ended June 30, 2014. There have been no material changes to the Company's significant accounting policies since the filing of the Annual report on Form 10-K.

3. Recently Issued Accounting Pronouncements

In May 2014, the FASB, jointly with the International Accounting Standards Board, issued Accounting Standard Update No. 2014-09 (Topic 606) - Revenue from Contracts with Customers ("ASU 2014-09"). This ASU's core principle is that a reporting entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying this new guidance to contracts within its scope, an entity will: (1) identify the contract(s) with a customer, (2) identify the performance obligation in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. Additionally, this new guidance will require significantly expanded disclosures about revenue recognition. ASU 2014-09 is effective for annual reporting periods (including interim reporting periods within those annual periods) beginning after December 15, 2016. Early application is not permitted. Entities have the option of using either a full retrospective or a modified retrospective approach to adopt this ASU. The Company is currently evaluating the potential effect on its consolidated financial position, results of operations and cash flows from adoption of this standard.

4. Business combinations

On October 31, 2013 (the “Acquisition Date”), the Company completed the acquisition of Enterasys Networks, Inc. ("Enterasys"), a privately held provider of wired and wireless network infrastructure and security solutions, for \$180.0 million, net of cash acquired. The Company also assumed outstanding options and restricted stock units of Enterasys at the Acquisition Date, all of which were unvested.

The acquisition was accounted for using the acquisition method of accounting. The preliminary and final purchase price allocation as of the date of the acquisition is set forth in the table below and reflects various fair value estimates.



Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the final allocation as of September 30, 2014 of the tangible and identifiable intangible assets acquired and liabilities assumed as compared to the allocation as of December 31, 2013, the quarter in which the transaction was completed:

	Preliminary Allocation as of December 31, 2013 (Initial allocation)	Change during the measurement period		Final Allocation as of September 30, 2014	
Cash	\$4,969	\$2,428	a	\$7,397	
Receivables	25,699	(2,428)	) a	23,271	
Inventory	33,662	—		33,662	
Other current assets	8,888	(1,514)	) b	7,374	
Property and equipment	23,122	(1,829)	) c	21,293	
Identifiable intangible assets	108,900	—	d	108,900	
In-process research and development	3,000	—		3,000	
Deferred tax assets	9	—		9	
Other assets	7,343	—		7,343	
Goodwill	57,922	12,955		70,877	
Current liabilities	(75,394)	) (6,141)	) c,e,f	(81,535)	)
Other long-term liabilities	(13,151)	) (1,043)	) c	(14,194)	)
Total purchase price allocation	\$184,969	\$2,428		\$187,397	
Less: Cash acquired from acquisition	(4,969)	) (2,428)	) a	(7,397)	)
Total purchase price consideration, net of cash acquired	\$180,000	\$—		\$180,000	

a. The Company finalized the working capital adjustment during the nine months ended September 30, 2014, which led to a decrease of \$2.4 million in receivables and a corresponding increase in cash. As a result of this adjustment, the total cash acquired from the acquisition also increased by the same amount. The net effect of this adjustment is an increase in goodwill of \$2.4 million.

b. The Company obtained new information regarding the existence of prepaids as of the acquisition date which led to a decrease in the fair value of current assets of \$1.5 million, and a corresponding increase in goodwill. The change in the amortization of prepaids due to the change in fair value of current assets was immaterial.

c. The Company updated its preliminary estimate of the fair value of property and equipment which led to a decrease of \$3.0 million in property and equipment with a corresponding increase in goodwill. The Company also updated the fair values of the asset retirement obligations and the related asset retirement assets which led to an increase in the fair value of property and equipment of \$1.2 million and a corresponding increase in current liabilities and other long-term liabilities of \$0.2 million and \$1.0 million, respectively. The decrease in depreciation expense due to the change in fair value of property and equipment was immaterial.

d. During the nine months ended September 30, 2014, there were no changes to the fair value of the identifiable intangible assets acquired. However, the Company revised the estimated useful life of Order backlog from 1.5 years to 1 year.

e. The Company obtained new information regarding accruals for litigation and statutory tax assessment as of the acquisition date which led to an increase in the fair value of current liabilities of \$5.4 million and a corresponding increase in goodwill.

f. The Company obtained new information regarding the existence of accrued liabilities as of the acquisition date which led to a net increase in the fair value of accrued liabilities by \$0.5 million with a corresponding increase in goodwill.

8

---

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## 5. Balance Sheet Accounts

Cash, Cash Equivalents, Short-Term Investments and Marketable Securities

Summary of Cash and Available-for-Sale Securities (in thousands)

	September 30, 2014	June 30, 2014
Cash	\$71,190	\$72,623
Cash equivalents	\$2,877	\$567
Short-term investments	30,395	32,692
Total available-for-sale	\$33,272	\$33,259
Total cash, cash equivalents and available for sale securities	\$104,462	\$105,882

Available-for-Sale Securities

The following is a summary of available-for-sale securities (in thousands):

	Amortized Cost	Fair Value	Unrealized Holding Gains	Unrealized Holding Losses
September 30, 2014				
Money market funds	\$2,877	\$2,877	\$—	\$—
U.S. corporate debt securities	30,338	30,395	57	—
	\$33,215	\$33,272	\$57	\$—
Classified as:				
Cash equivalents	\$2,877	\$2,877	\$—	\$—
Short-term investments	30,338	30,395	57	—
	\$33,215	\$33,272	\$57	\$—
June 30, 2014				
Money market funds	\$567	\$567	\$—	\$—
U.S. corporate debt securities	32,578	32,692	114	—
	\$33,145	\$33,259	\$114	\$—
Classified as:				
Cash equivalents	\$567	\$567	\$—	\$—
Short-term investments	32,578	32,692	114	—
Marketable securities	—	—	—	—
	\$33,145	\$33,259	\$114	\$—

The amortized cost and estimated fair value of available-for-sale investments in debt securities at September 30, 2014, by contractual maturity, were as follows (in thousands):

	Amortized Cost	Fair Value
Due in 1 year or less	\$23,312	\$23,363
Due in 1-2 years	6,024	6,027
Due in 2-5 years	1,002	1,005
Total investments in available for sale debt securities	\$30,338	\$30,395

The Company considers highly liquid investments with maturities of three months or less at the date of purchase to be cash equivalents. Investments with original maturities of greater than three months, but less than one year at the balance sheet date are

9

---

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

classified as Short Term Investments. Investments with maturities of greater than one year at balance sheet date which the Company intends to hold for longer than one year are classified as Marketable Securities.

The Company accumulates unrealized gains and losses on the Company's available-for-sale debt securities, net of tax, in accumulated other comprehensive income (loss) in the stockholders' equity section of its balance sheets. If the fair value of an available-for-sale debt instrument is less than its amortized cost basis, an other-than-temporary impairment is triggered in circumstances where (1) the Company intends to sell the instrument, (2) it is more likely than not that the Company will be required to sell the instrument before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the instrument (that is, a credit loss exists).

The Company determines the basis of the cost of a security sold or the amount reclassified out of accumulated other comprehensive income (loss) into earnings using the specific identification method. As of September 30, 2014, four out of eighteen investment securities had unrealized losses. For investments that were in an unrealized loss position as of September 30, 2014, the other-than-temporary impairment loss was immaterial during the three months ended September 30, 2014. The Company did not have any other-than temporary impairment loss for the three months ended September 30, 2013.

## Deferred Revenue, Net

Deferred revenue, net represents amounts for (i) deferred services revenue (support arrangements, professional services and training), and (ii) deferred product revenue net of the related cost of revenue when the revenue recognition criteria have not been met. The following table summarizes deferred revenue, net at September 30, 2014 and June 30, 2014, respectively (in thousands):

	September 30, 2014	June 30, 2014
Deferred services	\$87,012	\$89,657
Deferred product and other revenue	7,555	8,020
Total deferred revenue	94,567	97,677
Less: current portion	72,599	74,735
Non-current deferred revenue, net	\$21,968	\$22,942

The Company offers for sale to its customers, renewable support arrangements that range from one to five years. Deferred support revenue is included within deferred revenue, net within the services category above. The change in the Company's deferred support revenue balance in relation to these arrangements was as follows (in thousands):

	Three Months Ended	
	September 30, 2014	September 30, 2013
Balance beginning of period	\$89,657	\$38,003
New support arrangements	28,539	13,343
Recognition of support revenue	(31,184)	(14,255)
Balance end of period	87,012	37,091
Less: current portion	65,044	28,935
Non-current deferred revenue	\$21,968	\$8,156

Deferred Distributors Revenue, Net of Cost of Sales to Distributors



The Company records revenue from its distributors on a sell-through basis, recording deferred revenue and deferred cost of sales associated with all sales transactions to its distributors in “Deferred distributors revenue, net of cost of sales to distributors” in the liability section of its condensed consolidated balance sheet. The amount shown as “Deferred distributors revenue, net of cost of sales to distributors” represents the deferred gross margin on sales to distributors based on contractual pricing.

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes deferred distributors revenue, net of cost of sales to distributors at September 30, 2014 and June 30, 2014, respectively (in thousands):

	September 30, 2014	June 30, 2014
Deferred distributors revenue	\$34,206	\$40,715
Deferred cost of sales to distributors	(8,146	) (8,723
Deferred distributors revenue, net of cost of sales to distributors	\$26,060	\$31,992

## Debt

The Company's debt is comprised of the following:

	September 30, 2014
Current portion of long-term debt:	
Term Loan	6,500
Revolving Facility	24,000
Current portion of long-term debt	30,500
Long-term debt, less current portion:	
Term Loan	55,250
Revolving Facility	35,000
Total long-term debt, less current portion	90,250
Total debt	120,750

On October 31, 2013, the Company entered into a Credit Agreement (the "Credit Agreement") which provides for a \$60 million five-year revolving credit facility (the "Revolving Facility") and a \$65 million five-year term loan (the "Term Loan") and together with the Revolving Facility (the "Senior Secured Credit Facilities"). The proceeds from the Term Loan were used to pay a portion of the purchase price in the acquisition of all of the issued and outstanding capital stock of Enterasys. The company also drew \$35 million of the Revolving Facility to pay a portion of the purchase price and subsequently drew \$24 million in the first quarter of fiscal 2015 to fund working capital requirements. Such additional draw of \$24 million was repaid as of the filing date of this Form 10-Q.

## Guarantees and Product Warranties

Upon issuance of a standard product warranty, the Company discloses and recognizes a liability for the obligation it assumes under the warranty. The Company's standard hardware warranty period is typically 12 months from the date of shipment to end-users and 90 days for software. For certain products, the Company offers a limited lifetime hardware warranty commencing on the date of shipment from the Company and ending five (5) years following the Company's announcement of the end of sale of such product. The following table summarizes the activity related to the Company's product warranty liability during the three months ended September 30, 2014 and 2013:

	Three Months Ended	
	September 30, 2014	September 30, 2013
Balance beginning of period	\$7,551	\$3,296
New warranties issued	2,265	1,304
Warranty expenditures	(1,927	) (1,160
Balance end of period	\$7,889	\$3,440

In the normal course of business to facilitate sales of its products, the Company indemnifies its resellers and end-user customers with respect to certain matters. The Company has agreed to hold the customer harmless against losses arising from a breach of intellectual property infringement or other claims made against certain parties. These agreements may limit the time

11

---

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

within which an indemnification claim can be made and the amount of the claim. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material impact on its operating results or financial position.

**Concentrations**

The Company may be subject to concentration of credit risk as a result of certain financial instruments consisting principally of marketable investments and accounts receivable. The Company has placed its investments with high-credit quality issuers. The Company does not invest an amount exceeding 10% of its combined cash, cash equivalents, short-term investments and marketable securities in the securities of any one obligor or maker, except for obligations of the United States government, obligations of United States government agencies and money market accounts.

The following table sets forth major customers accounting for 10% or more of our net revenue:

	Three Months Ended	
	September 30, 2014	September 30, 2013
Tech Data	14%	*
Westcon Group Inc.	13%	18%
Scansource, Inc.	*	14%

\* Less than 10% of revenue

**6. Fair Value Measurements**

The following table presents the Company's fair value hierarchy for its financial assets measured at fair value on a recurring basis:

September 30, 2014	Level 1 (In thousands)	Level 2	Level 3	Total
Assets				
Investments:				
Money market funds	\$2,877	\$—	\$—	\$2,877
Corporate notes/bonds	—	30,395	—	30,395
Foreign currency forward contracts	—	(11	) —	(11
Total	\$2,877	\$30,384	\$—	\$33,261
June 30, 2014	Level 1 (In thousands)	Level 2	Level 3	Total
Assets				
Investments:				
Money market funds	\$567	\$—	\$—	\$567
Corporate notes/bonds	—	32,692	—	32,692
Foreign currency forward contracts	—	21	—	21
Total	\$567	\$32,713	\$—	\$33,280

Level 2 investment valuations are based on inputs such as quoted market prices of similar instruments, dealer quotations or valuations provided by alternative pricing sources supported by observable inputs. These generally

include U.S. government and sovereign obligations, most government agency securities, investment-grade corporate bonds, and state, municipal and provincial obligations. There were no transfers of assets or liabilities between Level 1 and Level 2 during the three months ended September 30, 2014. There were no liabilities as of September 30, 2014 that were being measured using fair value on a recurring basis.

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## 7. Share-based Compensation

Share-based compensation expense recognized in the condensed consolidated financial statements by line item caption is as follows (in thousands):

	Three Months Ended	
	September 30, 2014	September 30, 2013
Cost of product revenue	\$283	\$ 102
Cost of service revenue	291	40
Research and development	1,644	243
Sales and marketing	1,557	570
General and administrative	1,038	620
Total share-based compensation expense	\$4,813	\$ 1,575

During the three months ended September 30, 2014 and 2013, the Company did not capitalize any stock-based compensation expense in inventory, as the amounts were immaterial. The income tax benefit for share-based compensation expense was immaterial in the three months ended September 30, 2014 and 2013.

The weighted-average grant-date per share fair value of options granted during the three months ended September 30, 2014 and 2013 was \$2.39 and \$2.24, respectively. The weighted-average estimated per share fair value of shares purchased under the Company's 1999 Employee Stock Purchase Plan ("ESPP") during the three months ended September 30, 2014 and 2013 was \$1.50 and \$1.07, respectively.

The following table summarizes stock option activity under all plans for the three months ended September 30, 2014:

	Number of Shares (000's)	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000's)
Options outstanding at June 30, 2014	11,732	\$4.26		
Granted	432	\$5.21		
Exercised	(149)	) \$3.36		\$ 245
Cancelled	(785)	) \$4.95		
Options outstanding at September 30, 2014	11,230	\$4.25	5.00	\$ 8,795
Exercisable at September 30, 2014	5,135	\$3.85	3.87	\$ 5,487
Vested and expected to vest at September 30, 2014	10,232	\$4.21	4.89	\$ 8,329

## Stock Awards

Stock awards may be granted under the 2013 Plan on terms approved by the Board of Directors. Stock awards generally provide for the issuance of restricted stock which vests over a fixed period.

The following table summarizes stock award activity for the three months ended September 30, 2014:

	Number of Shares (000's)	Weighted-Average Grant-Date Fair Value	Aggregate Fair Market Value (\$000's)
Non-vested stock outstanding at June 30, 2014	6,000	\$ 4.98	
Granted	124	\$ 5.21	
Vested	(88)	) \$ 3.71	\$422

Edgar Filing: EXTREME NETWORKS INC - Form 10-Q

Cancelled	(279	)	\$4.28
Non-vested stock outstanding at September 30, 2014	5,757		\$5.04

.

13

---

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Excluding the options assumed as part of the Enterasys acquisition, the fair value of each option award and share purchase option under the Company's ESPP is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the following table.

The Company uses the Monte-Carlo simulation model to determine the fair value and the derived service period of performance-based option awards, with market conditions, on the date of the grant.

	Stock Option Plan		Employee Stock Purchase Plan			
	Three Months Ended		Three Months Ended			
	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
	2014	2013	2014	2013	2014	2013
Expected life	5 years	5 years	0.25 years	0.25 years		
Risk-free interest rate	1.52	% 1.53	% 0.02	% 0.09	%	%
Volatility	54	% 64	% 53	% 32	%	%
Dividend yield	—	% —	% —	% —	%	%

## 8. Commitments and Contingencies

## Purchase Commitments

The Company currently has arrangements with contract manufacturers and suppliers for the manufacture of its products. The arrangements allow them to procure long lead-time component inventory based upon a rolling production forecast provided by the Company. The Company is obligated to the purchase of long lead-time component inventory that its contract manufacturer procures in accordance with the forecast, unless the Company gives notice of order cancellation outside of applicable component lead-times. As of September 30, 2014, the Company had non-cancelable commitments to purchase approximately \$90.7 million of such inventory.

## Legal Proceedings

The Company may from time to time be party to litigation arising in the course of its business, including, without limitation, allegations relating to commercial transactions, business relationships or intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Litigation in general and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict.

In accordance with applicable accounting guidance, the Company records accruals for certain of its outstanding legal proceedings, investigations or claims when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. The Company evaluates, at least on a quarterly basis, developments in legal proceedings, investigations or claims that could affect the amount of any accrual, as well as any developments that would result in a loss contingency to become both probable and reasonably estimable. When a loss contingency is not both probable and reasonably estimable, the Company does not record a loss accrual. However, if the loss (or an additional loss in excess of any prior accrual) is at least a reasonable possibility and material, then the Company would disclose an estimate of the possible loss or range of loss, if such estimate can be made, or disclose that an estimate cannot be made. The assessment whether a loss is probable or a reasonable possibility, and whether the loss or a range of loss is estimable, involves a series of complex judgments about future events. Even if a loss is reasonably possible, the Company may not be able to estimate a range of possible loss, particularly where (i) the damages sought are substantial or indeterminate, (ii) the proceedings are in the early stages, or (iii) the matters involve novel or unsettled legal theories or a large number of parties. In such cases, there is considerable uncertainty regarding the ultimate resolution of such matters, including the amount of any possible loss, fine or penalty. Accordingly, for current proceedings, except as noted below, the Company is currently unable to estimate any reasonably possible loss or range of possible loss. However, an adverse resolution of one or more of such matters could have a material adverse effect



on the Company's results of operations in a particular quarter or fiscal year.

14

---

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Intellectual Property Litigation

Net Navigation Systems, LLC.

On April 23, 2014, Net Navigation Systems, LLC (“Net Navigation”) filed a complaint against Extreme Networks, Inc. in the Eastern District of Texas. In the Complaint, the plaintiff asserts infringement of U.S. Patent No. 6,625,122 (“the ‘122 Patent”), entitled “Selection of Data for Network Transmission,” which issued on September 23, 2003. Although somewhat vague, the Complaint identifies the following products as accused of infringing the ‘122 Patent: “Networking products capable of providing priority to different data flows based on bandwidth.” The Complaint also states that Extreme has infringed by “making, selling, and causing its customers to use networking products capable of providing priority to different data flows based on bandwidth, such as, without limitation, the Black Diamond X8 and the Black Diamond 8000 Series of switches and routers.” The Complaint also asserts infringement of U.S. Patent No. 6,434,145 (“the ‘145 Patent”), entitled “Processing of Network Data by Parallel Processing Channels,” which issued on August 13, 2002. Again, although somewhat vague, the Complaint states that Extreme has infringed by “making, using, importing, selling, and/or offering for sale in the United States, including within this judicial district, networking products that use parallel processing channels, such as, without limitation, the Black Diamond X8 and the Black Diamond 8000 Series of switches and routers.” Net Navigation, a non-practicing entity, seeks injunctive relief as well as monetary damages, cost, expenses and attorney fees, although the complaint seeks no quantified amount. The Company denies the claims and is preparing to vigorously defend our technology. Given the preliminary nature of the claims, it is premature to assess the likelihood of a particular outcome.

Selene Communication Technologies, LLC.

On April 7, 2014, Selene Communication Technologies, LLC (“Selene”), filed a complaint in the US District Court for the District of Delaware against Extreme and Enterasys asserting a cause of action for infringement of United States Patent No. 7,143,444 (the “444 Patent”). Selene has also recently sued a number of other technology companies including Cisco for infringement of the 444 Patent. Selene, a non-practicing entity, seeks injunctive relief as well as monetary damages, costs, expenses and attorney fees, although the complaint seeks no quantified amount.

The Company is a member of RPX Corporation’s (“RPX”) network of clients, who procure patent risk management services from RPX. On September 30, 2014, RPX signed an agreement on behalf of its members (including Extreme) with Selene to resolve the litigation cases against its members by Selene and to obtain a license for all RPX members to the 444 Patent and its foreign counterparts. As a result, the Company expects this case to be dismissed shortly without any further liability to Company.

Commonwealth of Kentucky

On or about February 3, 2014, a class action lawsuit was filed in the Commonwealth of Kentucky against Enterasys Networks, Inc. and two other defendants. The complaint alleges that Enterasys and its subcontractor, TJL Information Technologies, Inc., d.b.a. Unbridled Information Technologies (“Subcontractor”), violated Kentucky’s wage and hour laws and failed to pay the prevailing wage in violation of the Kentucky State Prevailing Wage Act (the “Act”) on various public works projects for a number of Kentucky government agencies since January 2010. Plaintiffs also allege common law actions for quantum merit and unjust enrichment and they seek monetary damages, costs, expenses and attorney fees, although there was no quantified amount identified. One of the defendants, Integrated Facility Systems, LLC (“IFS”), has also filed a cross-claim against Enterasys. The Company denies the claims and filed answers to both the complaint and cross-claim on April 16, 2014. In addition, the Company filed a cross-claim for indemnity against IFS.

Plaintiffs filed a first amended complaint on September 26, 2014, in which they named Commonwealth of Kentucky’s Office of Technology under the State’s Finance and Administration Cabinet (“COT”) as a defendant. The Company filed an answer to the Plaintiffs’ first amended complaint on October 10, 2014 and is considering filing a cross-claim against COT. This litigation is in the early stages of discovery.



Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## ICMS Tax Assessment Matters

The State of Sao Paulo (Brazil) denied Enterasys Networks do Brazil Ltda. the use of certain credits derived from the State of Espirito Santo under the terms of the FUNDAP scheme for the tax years of 2002 through 2009. Enterasys' application to resolve the ICMS Tax Assessments at the administrative level of the Sao Paulo Tax Department under the amnesty relief program (Reference No 3.056.963-1) was denied in March, 2014 by the Sao Paulo Tax Administration. The value of the ICMS tax credits that were disallowed by the Sao Paulo Tax Administration is approximately BR 3,443,914 (or approximately US\$1.5 million), plus interest and penalties (that are currently estimated to be approximately US\$9 million). On January 10, 2014, Enterasys filed a lawsuit to overturn or reduce the assessment, which lawsuit remains on-going. As part of this lawsuit, Enterasys made a request for a stay of execution, so that no tax foreclosure can be filed until a final ruling is made and no guarantee needs to be presented. In the first week of October, the preliminary injunction was granted with regard to the stay of execution; however, the court ruled that a cash deposit of the full amount at issue is to be made by Enterasys. Enterasys then prepared a motion aimed at the partial reconsideration of such decision concerning the need for a deposit, which was denied on October 10, 2014. The Company is currently considering an appeal to the Court of Appeals against such denial.

Given the preliminary nature of the lawsuit and the uncertainty of the legal environment in Brazil, it is premature to assess the likelihood of a particular final outcome. Based on the currently available information, the Company believes the ultimate outcome of this audit will not have material adverse effect on the Company's financial position, cash flows or overall trends in results of operations. The range of the potential total tax liability related to these matters is estimated to be from \$0 million to \$9 million, of which the Company believes \$4.3 million is the best estimate within the range and has recorded an accrual as of the acquisition date of Enterasys as such matter relates to the period before the acquisition.

## Indemnification Obligations

Subject to certain limitations, the Company may be obligated to indemnify its current and former directors, officers and employees. These obligations arise under the terms of its certificate of incorporation, its bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify, where applicable, generally means that the Company is required to pay or reimburse, and in certain circumstances the Company has paid or reimbursed, the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of these claims. The cost to defend the Company and the named individuals could have a material adverse effect on its consolidated financial position, results of operations and cash flows in the future. Recovery of such costs under its directors and officers insurance coverage is uncertain. As of September 30, 2014, the Company had no outstanding indemnification claims.

## 9. Income Taxes

For the three months ended September 30, 2014 and 2013, the Company recorded an income tax provision of \$1.0 million and \$0.4 million, respectively.

The income tax provisions for the three months ended September 30, 2014 and 2013 consisted primarily of taxes on the income of our foreign subsidiaries as well as tax expense associated with the establishment of a U.S. deferred tax liability for amortizable goodwill resulting from the acquisition of Enterasys Networks, Inc. The income tax provisions for both fiscal years were calculated based on the actual results of operations for the three months ended September 30, 2014 and 2013, and therefore may not reflect the annual effective tax rate.

The Company has provided a full valuation allowance against all of its U.S. federal and state deferred tax assets as well as substantially all of the acquired Enterasys foreign entities' deferred tax assets. No valuation allowance has been established against the non-U.S. deferred tax assets of the legacy Extreme Networks, Inc. foreign subsidiaries. A valuation allowance is determined by assessing both negative and positive evidence to determine whether it is "more likely than not" that the deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction

basis. The Company's inconsistent earnings in recent periods, coupled with the Company's inability to forecast greater than one quarter in advance and the cyclical nature of its business represent sufficient negative evidence to require a full valuation allowance against its U.S. federal and state net deferred tax assets as well as the above mentioned foreign jurisdictions. This valuation allowance will be evaluated periodically and can be reversed partially or in whole if business results and the economic environment have sufficiently improved to support realization of some or all of the Company's deferred tax assets.

The acquisition of Enterasys included a U.S. parent company as well as its wholly-owned domestic and foreign subsidiaries. The Company has elected to treat this stock acquisition as an asset purchase by filing the required election forms under IRC Sec 338(h)(10). The Company has estimated the value of the intangible assets from this transaction and is amortizing the amount over 15 years for tax purposes. During the current period, the Company deducted \$1.1 million of tax amortization

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

expense related to capitalized goodwill. As of September 30, 2014, the Company recorded a deferred tax liability of \$1.5 million related to this amortization which is not considered a future source of taxable income in evaluating the need for a valuation allowance against our deferred tax assets.

The Company had \$11.3 million of unrecognized tax benefits as of September 30, 2014. The future impact of the unrecognized tax benefit of \$11.3 million, if recognized, is as follows: approximately \$0.2 million would impact the effective tax rate, and approximately \$11.1 million would result in adjustments to deferred tax assets and corresponding adjustments to the valuation allowance. It is reasonably possible that the amount of unrealized tax benefit could decrease by approximately \$0.2 million during the next twelve months due to the expiration of the statute of limitations in certain foreign jurisdictions.

Estimated interest and penalties related to the underpayment of income taxes are classified as a component of tax expense in the Condensed Consolidated Statements of Operations and were immaterial for the three month ended September 30, 2014 and 2013. Accrued interest and penalties were \$23,000 and \$42,000 as of September 30, 2014 and 2013, respectively.

In general, the Company's U.S. federal income tax returns are subject to examination by tax authorities for fiscal years 2001 forward due to net operating losses and the Company's state income tax returns are subject to examination for fiscal years 2003 forward due to net operating losses.

**10. Net (Loss) Income Per Share**

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period, less shares subject to repurchase, and excludes any dilutive effects of options, warrants and unvested restricted stock. Dilutive earnings per share is calculated by dividing net income by the weighted average number of common shares used in the basic earnings per share calculation plus the dilutive effect of shares subject to repurchase, options, warrants and unvested restricted stock.

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

	Three Months Ended	
	September 30, 2014	September 30, 2013
Net (loss) income	\$(19,330 )	\$ (35 )
Weighted-average shares used in per share calculation – basic	97,314	94,062
Incremental shares using the treasury stock method:		
Stock options	—	—
Restricted stock units	—	—
Employee Stock Purchase Plan	—	—
Weighted -average share used in per share calculation – diluted	97,314	94,062
Net (loss) income per share – basic	\$(0.20 )	\$ 0.00
Net (loss) income per share – diluted	\$(0.20 )	\$ 0.00

Potentially dilutive common shares from employee incentive plans are determined by applying the treasury stock method to the assumed exercise of outstanding stock options, the assumed vesting of outstanding restricted stock units, and the assumed issuance of common stock under the stock purchase plan. Weighted stock options outstanding with an exercise price higher than the Company's average stock price for the periods presented are excluded from the calculation of diluted net income per share since the effect of including them would have been anti-dilutive due to the net income position of the Company during the periods presented. For the three months ended September 30, 2014 and 2013, the Company excluded 8.6 million and 6.8 million outstanding weighted average stock options and awards,

respectively, from the calculation of diluted earnings per common share because they would have been anti-dilutive.

#### 11. Restructuring Charges

As part of the Company's on-going restructuring efforts, during the second quarter of fiscal year 2013, the Company initiated a plan to reduce its worldwide headcount by 13%, consolidate specific global administrative functions, and shift certain operating costs to lower cost regions, among other actions. Restructuring expense was \$0.1 million in the three months ended September 30, 2013.

Table of Contents

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes restructuring activities for the three months ended September 30, 2014:

	Contract Termination	Total
Balance at June 30, 2014	\$322	\$322
Period payments	(136)	(136)
Restructuring liabilities at September 30, 2014	\$186	\$186

## 12. Foreign Exchange Forward Contracts

The Company uses derivative financial instruments to manage exposures to foreign currency. The Company's objective for holding derivatives is to use the most effective methods to minimize the impact of these exposures. The Company does not enter into derivatives for speculative or trading purposes. The Company records all derivatives on the balance sheet as Other Assets, Net at fair value. Changes in the fair value of derivatives are recognized in earnings as Other Income (Expense). The Company enters into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the foreign currency forecasted transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges. At September 30, 2014, these forward foreign currency contracts had a notional principal amount of \$11.4 million and an immaterial unrealized loss on foreign exchange contracts. These contracts have maturities of less than 60 days. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities.

Foreign currency transaction gains and losses from operations were a \$0.4 million loss and a \$0.1 million loss for the three months ended September 30, 2014 and September 30, 2013, respectively.

## 13. Disclosure about Segments of an Enterprise and Geographic Areas

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision makers with respect to the allocation of resources and performance.

The Company operates in one segment, the development and marketing of network infrastructure equipment. The Company conducts business globally and is managed geographically. Revenue is attributed to a geographical area based on the location of the customers. The Company operates in three geographical areas: Americas, which includes the United States, Canada, Mexico, Central America and South America; EMEA, which includes Europe, Russia, Middle East and Africa; and APAC which includes Asia Pacific, South Asia, India, Australia and Japan.

The Company attributes revenues to geographic regions primarily based on the customer's ship-to location.

Information regarding geographic areas is as follows (in thousands):

	Three Months Ended	
	September 30, 2014	September 30, 2013
Net Revenues:		
Americas:		
United States	\$58,488	\$ 25,389
Other	7,341	6,301
Total Americas	65,829	31,690
EMEA	53,934	30,842
APAC	16,511	13,384
Total net revenues	\$136,274	\$ 75,916



Of the Company's total long-lived assets as of September 30, 2014, \$98.5 million were attributable to Americas; \$41.9 million were attributable to the EMEA region and the remaining to APAC. Of the total assets as of June 30, 2014, \$104.4 million were attributable to Americas, \$45.2 million were attributable to the EMEA region and the remaining to APAC.

Table of Contents

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

This quarterly report on Form 10-Q, including the following sections, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including in particular, our expectations regarding market demands, customer requirements and the general economic environment, future results of operations, and other statements that include words such as “may” “expect” or “believe” . These forward-looking statements involve risks and uncertainties. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in the section entitled “Risk Factors” in this Report, our Quarterly Report on Form 10-Q for the first quarter of fiscal 2015, our Annual Report on Form 10-K for the fiscal year ended June 30, 2014, and other filings we have made with the Securities and Exchange Commission. These risk factors, include, but are not limited to: fluctuations in demand for our products and services; a highly competitive business environment for network switching equipment; our effectiveness in controlling expenses; the possibility that we might experience delays in the development or introduction of new technology and products; customer response to our new technology and products; the timing of any recovery in the global economy; risks related to pending or future litigation; a dependency on third parties for certain components and for the manufacturing of our products; and our ability to receive the anticipated benefits of the acquisition of Enterasys.

Business Overview

We are a leading provider of network infrastructure equipment and services for enterprises, data centers, and service providers. We were incorporated in California in May 1996 and reincorporated in Delaware in March 1999. The shares of Extreme Networks, Inc. (EXTR) began trading on NASDAQ in April 1999. Our corporate headquarters are located in San Jose, California. We develop and sell network infrastructure equipment to our enterprise, data center and telecommunications service provider customers.

On October 31, 2013 (the “Acquisition Date”), we completed the acquisition of Enterasys Networks, Inc. (“Enterasys”), a privately held provider of wired and wireless network infrastructure and security solutions, for \$180.0 million, net of cash acquired, whereby Enterasys became our wholly-owned subsidiary. The combined entity immediately became a networking industry leader with more than 12,000 customers. As a combined Company, we believe we will set the standard for the networking industry with a strategic focus on three principles:

**Highly scaled and differentiated products and solutions:** Our combined product portfolio spans data center networking, switching and routing, Software-Defined Networking (SDN), wired and wireless LAN access, network management with analytics and integrated security features. This broader solutions portfolio can be leveraged to better serve existing and new customers. We will continue to enhance and support the product roadmaps of both companies going forward to protect the investments of customers and avoid any disruption to their businesses. We intend to increase research and development to accelerate our vision for high-performance, modular, open networking.

**Leading customer service and support:** We are working to augment our current outsourced support model by integrating Enterasys' in-sourced expertise, building on Enterasys' award-winning heritage and strong commitment to exceptional customer experience. The Company's expanded global network of channel partners and distributors will benefit from expanded services and support capabilities.

**Strong Channels and Strategic Partners:** Our focus is to leverage the capabilities of the combined Company and expand existing partnerships with Ericsson and the developing partnership with Lenovo as well as continue to add new strategic partnerships in the future. Additionally, we will increase our focus on partnering with distributors and channel partners globally. The goal is to develop and enhance relationships that grow revenue and profits for the Company and our alliance and channel partners. At the same time, we are investing in infrastructure to make doing business with the Company easier and more efficient.

We conduct our sales and marketing activities on a worldwide basis through a distribution channel utilizing distributors, resellers and our field sales organization. We primarily sell our products through an ecosystem of channel

partners who combine our Ethernet, wireless and software analytics products with their offerings to create compelling information technology solutions for end-user customers. We utilize our field sales organization to support our channel partners and to sell direct to end-user customers, including some large global accounts. Our customers include businesses, hospitals, hotels, universities, sports venues, telecommunications companies and government agencies around the world.

Table of Contents

We outsource the majority of our manufacturing and supply chain management operations as part of our strategy to maintain global manufacturing capabilities and to reduce our costs. We conduct quality assurance, manufacturing engineering, document control and test development at engineering facilities in San Jose, California, RTP, North Carolina, Salem, New Hampshire, Toronto, Canada and Chennai, India. This approach enables us to reduce fixed costs and to flexibly respond to changes in market demand.

The market for network infrastructure equipment is highly competitive and dominated by a few large companies. The current economic climate has further driven consolidation of vendors within the Ethernet networking market and with vendors from adjacent markets, including storage, security, wireless and voice applications. We believe that the underpinning technology for all of these adjacent markets is Ethernet. As a result, we believe that, as an independent Ethernet switch vendor, we must provide products that, when combined with the products of our large strategic partners, create compelling solutions for end user customers. Our approach is to focus on the intelligence and automation layer that spans our hardware and software products that facilitates end-to-end solutions, as opposed to positioning Extreme Networks as a low-cost-vendor with point products.

We believe that continued success in our marketplace is dependent upon a variety of factors that includes, but is not limited to, our ability to design, develop and distribute new and enhanced products employing leading-edge technology.

## Results of Operations

During the first quarter of fiscal 2015, we achieved the following results:

Net revenues of \$136.3 million compared to net revenues of \$75.9 million in the first quarter of fiscal 2014.

Product revenues of \$102.7 million compared to product revenues of \$61.0 million in the first quarter of fiscal 2014.

Service revenues of \$33.6 million compared to service revenues of \$14.9 million in the first quarter of fiscal 2014.

Total gross margin of 52% of net revenues compared to total gross margin of 58% of net revenues in the first quarter of fiscal 2014.

Operating loss of \$17.2 million compared to operating income of \$0.4 million in the first quarter of fiscal 2014.

Net loss of \$19.3 million compared to net loss of \$35.0 thousand in the first quarter of fiscal 2014.

Cash flow provided by operating activities of \$1.6 million in the three months ended September 30, 2014 compared to cash flow provided by operating activities of \$1.9 million in the three months ended September 30, 2013.

Cash and cash equivalents, short-term investments and marketable securities decreased by \$1.4 million to \$104.5 million as of September 30, 2014 from \$105.9 million as of June 30, 2014, primarily due to less proceeds from cash used in operations.

We operate in three regions: Americas, which includes the United States, Canada, Mexico, Central America and South America; EMEA, which includes Europe, Russia, Middle East, and Africa; and APAC which includes Asia Pacific, South Asia, India, and Australia.

The following table presents the total net revenue geographically for the three months ended September 30, 2014 and September 30, 2013, respectively (dollars in thousands):

Net Revenues	Three Months Ended		\$ Change	% Change	
	September 30, 2014	September 30, 2013			
Americas:					
United States	\$58,488	\$25,389	\$33,099	130.4	%
Other	7,341	6,301	1,040	16.5	%
Total Americas	65,829	31,690	34,139	107.7	%
Percentage of net revenue	48.0	% 41.7	%		
EMEA	53,934	30,842	23,092	74.9	%
Percentage of net revenue	39.6	% 40.6	%		
APAC	16,511	13,384	3,127	23.4	%
Percentage of net revenue	12.1	% 17.6	%		

Total net revenues	\$136,274	\$75,916	\$60,358	79.5	%
--------------------	-----------	----------	----------	------	---

20

---

Table of Contents

## Net Revenues

The following table presents net product and service revenue for the three months ended September 30, 2014 and September 30, 2013, respectively (dollars in thousands):

	Three Months Ended			
	September 30, 2014	September 30, 2013	\$ Change	% Change
Net Revenues:				
Product	\$102,672	\$61,045	\$41,627	68.2 %
Percentage of net revenue	75.3	% 80.4	%	
Service	33,602	14,871	18,731	126.0 %
Percentage of net revenue	24.7	% 19.6	%	
Total net revenues	\$136,274	\$75,916	\$60,358	79.5 %

Product revenue increased \$41.6 million or 68.2% in the first quarter of fiscal 2015 compared to the corresponding period of fiscal 2014. In the three months ending September 30, 2014, there was a significant increase in the number of customers and products sold during the period due to our acquisition of Enterasys in the second quarter of fiscal 2014. This resulted in a significant increase in our product revenue in all regions. Such increase from the acquisition was offset by lower revenue in EMEA region during the quarter due to political and economic conditions and the weakening of the Euro and British Pound Sterling against the United States Dollar which dampened the demand for product sales in EMEA.

Service revenue increased \$18.7 million or 126.0% in the first quarter of fiscal 2015 and \$18.7 million compared to the corresponding period of fiscal 2014. The increase in service revenue for the three months ended September 30, 2014 was due to an increase in service maintenance contracts and professional service and training revenues due to our acquisition of Enterasys in the second quarter of fiscal 2014 partially offset by purchase price accounting adjustments of \$0.8 million.

## Cost of Revenue and Gross Profit

The following table presents the gross profit on product and service revenue and the gross profit percentage of product and service revenue for the three months ended September 30, 2014 and 2013 (in thousands):

	Three Months Ended			
	September 30, 2014	September 30, 2013	\$ Change	% Change
Gross profit:				
Product	\$48,647	\$33,529	\$15,118	45.1 %
Percentage of product revenue	47.4	% 54.9	%	
Service	21,880	10,178	11,702	115.0 %
Percentage of service revenue	65.1	% 68.4	%	
Total gross profit	\$70,527	\$43,707	\$26,820	61.4 %
Percentage of net revenue	51.8	% 57.6	%	

Cost of product revenue includes costs of materials, amounts paid to third-party contract manufacturers, costs related to warranty obligations, charges for excess and obsolete inventory, amortization expense for developed technology, royalties under technology license agreements, and internal costs associated with manufacturing overhead, including management, manufacturing engineering, quality assurance, development of test plans, and document control. We outsource substantially all of our manufacturing and supply chain management operations, and we conduct quality assurance, manufacturing engineering, document control and distribution in San Jose, California; Salem, New Hampshire; China, and Taiwan.

Product gross margin percentage decreased to 47.4% in the first quarter of fiscal 2015 from 54.9% in the first quarter of fiscal 2014. The decrease in product gross margin percentage for the three months ended September 30, 2014 was primarily due to \$4.3 million increase in the amortization of the developed technology intangibles from the acquisition of Enterasys during the second quarter of fiscal 2014, increase in excess and obsolete inventory charges of \$1.4 million and higher warranty costs for the products from the acquisition of Enterasys for the quarter ended September 30, 2014 as compared to the corresponding periods of fiscal 2014.

Table of Contents

Our cost of service revenue consists primarily of personnel, overhead, repair and freight costs and the cost of spares used in providing support under customer service contracts. Service gross margin percentage decreased to 65.1% from 68.4% in the first quarter of fiscal 2015. The service gross margin percentage for the three ended September 30, 2014 decreased primarily due to higher personnel, overhead and travel cost as well as purchase accounting adjustments as a result of our acquisition of Enterasys during the second quarter of fiscal 2014.

## Operating Expenses

The following table presents operating expenses and operating income (in thousands, except percentages):

	Three Months Ended		\$	%	
	September 30, 2014	September 30, 2013			
Research and development	\$23,347	\$9,937	\$13,410	135.0	%
Sales and marketing	44,779	22,694	22,085	97.3	%
General and administrative	11,074	6,934	4,140	59.7	%
Acquisition and integration costs	4,058	3,695	363	9.8	%
Restructuring charge, net of reversals	—	75	(75	) (100.0	)%
Amortization of intangibles	4,467	—	4,467	100.0	%
Total operating expenses	\$87,725	\$43,335	\$44,390	102.4	%
Operating income (loss)	\$(17,198	) \$372	\$(17,570	) (4,723.1	)%

## Research and Development Expenses

Research and development expenses consist primarily of salaries and related personnel expenses, consultant fees and prototype expenses related to the design, development, and testing of our products.

Research and development expenses increased by \$13.4 million, or 135.0% in the first quarter of fiscal 2015 as compared to the corresponding period of fiscal 2014. The increase in research and development expenses for the three months ended September 30, 2014 was primarily due to increased personnel costs due to increase in headcount of approximately 300 employees and higher occupancy costs due to additional facilities primarily in Salem, New Hampshire and Toronto, Canada, as a result of our acquisition of Enterasys in the second quarter of fiscal 2014.

## Sales and Marketing Expenses

Sales and marketing expenses consist of salaries, commissions and related expenses for personnel engaged in marketing and sales functions, as well as trade shows and promotional expenses.

Sales and marketing expenses increased by \$22.1 million, or 97.3% in the first quarter of fiscal 2015 as compared to the corresponding period of fiscal 2014. The increase in sales and marketing expenses for the three months ended September 30, 2014 was primarily due to increased personnel costs as a result of an increase in headcount of approximately 330 employees as a result of our acquisition of Enterasys in the second quarter of fiscal 2014 as well as additional spending on sales and marketing programs as compared to first quarter of fiscal 2014.

## General and Administrative Expenses

General and administrative expenses increased by \$4.1 million, or 59.7% in the first quarter of fiscal 2015 compared to the corresponding period of fiscal 2014. The increase in general and administrative expenses during the three months ending September 30, 2014, compared to the corresponding period of fiscal 2014, was primarily due to higher personnel and travel costs due to an increase in headcount of approximately 100 employees, and higher occupancy costs due to additional facilities in Salem, New Hampshire and Shannon, Ireland as a result of our acquisition of Enterasys in the second quarter of fiscal 2014 and an increase in bad debt expense as compared to the corresponding period of fiscal 2014.

## Acquisition and Integration Costs

As a result of our acquisition of Enterasys, we incurred \$4.1 million of integration costs during the first quarter of fiscal 2015 primarily for IT integration and severance costs. The Company expects to incur integration costs through fiscal 2015. The Company incurred \$3.7 million of acquisition-related costs during the quarter ended September 30,



2013.

22

---

## Table of Contents

### Restructuring Charge, Net of Reversals

During the second quarter of fiscal 2013, we initiated a plan to reduce our worldwide headcount by 13%, consolidate specific global administrative functions, and shift certain operating costs to lower cost regions, among other actions. The Company has substantially expensed all of the costs associated with this initiative. As of September 30, 2014, we had restructuring liabilities of \$0.2 million, which we anticipate paying by the end of fiscal 2015.

### Amortization of intangibles

During the three months ended September 30, 2014, we recorded \$4.5 million of amortization, primarily for certain intangibles related to the acquisition of Enterasys.

### Interest Expense

During the three months ended September 30, 2014 we recorded \$0.8 million interest expense related to the Credit Facility that the Company entered into on October 31, 2013.

### Other Expense, Net

Other expense, net increased by \$0.2 million in the first quarter of fiscal 2015 compared to the corresponding period of fiscal 2014. The increase in other expense, net was primarily due to losses from the revaluation of certain assets and liabilities denominated in foreign currencies into U.S. dollars.

### Provision for Income Taxes

For the three months ended September 30, 2014 and September 30, 2013, we recorded an income tax provision of \$1.0 million and \$0.4 million, respectively.

The income tax provisions for the three months ended September 30, 2014 and 2013 consisted primarily of taxes on the income of our foreign subsidiaries as well as tax expense associated with the establishment of a U.S. deferred tax liability for amortizable goodwill resulting from the acquisition of Enterasys Networks, Inc.

### Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements and the related notes included elsewhere in this report are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. On an ongoing basis, we evaluate our estimates and assumptions. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

As discussed in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K for the year ended June 30, 2014, we consider the following accounting policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements:

Revenue Recognition

Business Combinations

Goodwill

Share-based Payments

Deferred Tax Valuation Allowance

Accounting for Uncertainty in Income Taxes

There have been no changes to our critical accounting policies since the filing of our last Annual Report on Form 10-K.

23

---

Table of Contents

## New Accounting Pronouncements

See Note 2 of the accompanying condensed consolidated financial statements for a full description of new accounting pronouncements, including the respective expected dates of adoption and effects on results of operations and financial condition.

## Liquidity and Capital Resources

The following summarizes information regarding our cash, investments, and working capital (in thousands):

	September 30, 2014	June 30, 2014
Cash and cash equivalent	\$74,067	\$73,190
Short-term investments	30,395	32,692
Total cash and investments	\$104,462	\$105,882
Working capital	\$49,630	\$96,279

As of September 30, 2014, our principal sources of liquidity consisted of cash, cash equivalents and investments of \$104.5 million, net accounts receivable of \$100.0 million and \$0.9 million of letters of credit and borrowings from the Revolving Facility under which the Company had \$0.1 million of availability at September 30, 2014. Our principal uses of cash will include purchase of finished goods inventory from our contract manufacturers, payroll, restructuring expenses and other operating expenses related to the development, marketing of our products, purchases of property and equipment, repayments of debt and related interest. We believe that our \$104.5 million of cash and cash equivalents and investments at September 30, 2014 along with the availability of borrowings from the Revolving Facility will be sufficient to fund our principal uses of cash for at least the next 12 months including the repayment of the additional borrowings of \$24 million from the Revolving Facility as of the filing date of this report.

Our Credit Agreement contains financial covenants that require us to maintain a minimum Consolidated Fixed Charge Coverage Ratio and Consolidated Quick Ratio and a maximum a Consolidated Leverage Ratio and several other covenants and restrictions that limit our ability to incur additional indebtedness, create liens upon any of our property, merge, consolidate or sell all or substantially all of our assets, etc.

The Credit Agreement also includes customary events of default, including failure to pay principal, interest or fees when due, failure to comply with covenants, if any representation or warranty made by us is false or misleading in any material respect, certain insolvency or receivership events affecting Extreme and its subsidiaries, the occurrence of certain material judgments, the occurrence of certain ERISA events, the invalidity of the loan documents or a change in control of our Company. The amounts outstanding under the Credit Agreement may be accelerated upon certain events of default. We believe we are in compliance and expect to remain in compliance with our Credit Agreement covenants and they are not expected to impact our liquidity or capital resources.

## Key Components of Cash Flows and Liquidity

A summary of the sources and uses of cash and cash equivalents is as follows (in thousands):

	Three Months Ended	
	September 30, 2014	September 30, 2013
Net cash provided by operating activities	\$1,632	\$1,925
Net cash (used in) provided by investing activities	\$(1,036)	\$3,254
Net cash provided by financing activities	\$925	\$1,799
Foreign currency effect on cash	\$(644)	\$227
Net increase in cash and cash equivalents	\$877	\$7,205
Net Cash Provided by Operating Activities		

Cash flows provided by operations was \$1.6 million in the three months ending September 30, 2014. Current year's net loss was primarily offset by non-cash expenses such as amortization of intangibles, stock-based compensation expense and

Table of Contents

depreciation. Accounts receivables decreased primarily due to lower revenue during the quarter and higher collections. Inventories decreased primarily due to the timing of inventory receipts to bring the inventory levels in line with the near term demand. Such increases in cash inflows were offset by decrease in accounts payable due to timing of payments.

Cash flows provided by operations was \$1.9 million for the three months ended September 30, 2013. Net loss for the quarter ended September 30, 2013 was primarily offset by non-cash expenses such as stock-based compensation expense and depreciation. Inventories increased primarily due to the timing of inventory receipts to bring the inventory levels in line with the near term demand and an increase in accounts payable balance due to the timing of payments.

**Net Cash (Used In) Provided by Investing Activities**

Cash flow used in investing activities in the three months ending September 30, 2014 was \$1.0 million, primarily comprised of \$2.8 million used to purchase property and equipment offset by proceeds of \$2.0 million from the maturities of investments.

Cash flow provided by investing activities in the three months ending September 30, 2013 was \$3.3 million, comprised of proceeds of \$13.1 million from the maturities of investments, offset by \$9.8 million used to purchase property and equipment.

**Net Cash Provided by Financing Activities**

Cash flow provided by financing activities in the three months ending September 30, 2014 was \$0.9 million, comprised of a draw on the Revolving Facility of \$24 million during the quarter ended September 30, 2014 for working capital requirements, \$1.7 million proceeds from the exercise of stock options and issuance of shares of our common stock under the ESPP, net of taxes paid on vested and released stock awards offset by \$24.8 million of cash used for repayment of debt.

Cash flow provided by financing activities in the three months ending September 30, 2013 was \$1.8 million, comprised of proceeds from the exercise of stock options and issuance of shares of our common stock under the ESPP, net of taxes paid on vested and released stock awards.

**Contractual Obligations**

The following summarizes our contractual obligations at September 30, 2014, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	Total	Less than 1 Year	1-3 years	3-5 years	More than 5 years
Contractual Obligations:					
Debt obligations	\$120,750	\$30,500	\$32,500	\$57,750	\$—
Interest on debt obligations	8,131	2,543	4,167	1,421	—
Non-cancellable inventory purchase commitments	90,737	90,737	—	—	—
Non-cancellable operating lease obligations	58,920	9,600	15,961	13,933	19,426
Other liabilities	7,032	4,468	2,433	131	—
Total contractual cash obligations	\$285,570	\$137,848	\$55,061	\$73,235	\$19,426

Non-cancelable inventory purchase commitments represent the purchase of long lead-time component inventory that our contract manufacturers procure in accordance with our forecast. Inventory purchase commitments were \$90.7 million as of September 30, 2014. We expect to honor the inventory purchase commitments within the next 12 months.

Non-cancelable operating lease obligations represent base rents and operating expense obligations to landlords for facilities we occupy at various locations.

Other liabilities include the Company's commitments towards debt related fees and specific arrangements other than inventory.

The amounts in the table above exclude immaterial income tax liabilities related to uncertain tax positions as we are unable to reasonably estimate the timing of settlement.

We did not have any material commitments for capital expenditures as of September 30, 2014.

Table of Contents

## Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of September 30, 2014.

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

## Interest Rate Sensitivity

## Investments

The primary objective of our investment activities is to preserve principal while at the same time maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, other non-government debt securities and money market funds. The valuation of our investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact its valuation include changes to credit ratings of the securities, discount rates and ongoing strength and quality of market credit and liquidity.

If the current market conditions deteriorate further, or the anticipated recovery in market values does not occur, we may be required to record impairment charges in future quarters.

The following table presents the amounts of our cash equivalents, short-term investments and marketable securities that are subject to market risk by range of expected maturity and weighted-average interest rates as of September 30, 2014.

	Maturing in Three months or less (In thousands)	Three months to one year	Greater than one year	Total	Fair Value
September 30, 2014					
Included in short-term investments	\$2,877	\$23,363	\$7,032	\$33,272	\$33,272
Weighted average interest rate	0.01	% 0.95	% 0.68	%	

The following tables present hypothetical changes in fair value of the financial instruments held at September 30, 2014 that are sensitive to changes in interest rates:

Unrealized gain given a decrease in interest rate of X bps (100 bps) (In thousands)	(50 bps)	Fair value as of September 30, 2014	Unrealized loss given an increase in interest rate of X bps 100 bps	50 bps
\$200	\$100	\$33,272	\$(198	) \$(180

## Debt

At certain points in time we are exposed to the impact of interest rate fluctuations, primarily in the form of variable rate borrowings from our credit facility.

The following table presents hypothetical changes in interest expense for the quarter ended September 30, 2014, on outstanding credit facility borrowings as of September 30, 2014, that are sensitive to changes in interest rates:



Table of Contents

Change in interest expense given a decrease in interest rate of X bps* (100 bps)	Average outstanding debt as of September 30, 2014	Change in interest expense given an increase in interest rate of X bps 100 bps
(In thousands)		
\$(39 )	\$(39 )	\$96,750
		\$242
		\$121

\* Underlying interest rate was 0.16% during the quarter. The table above assumed the underlying interest rate did not decrease below 0%.

Exchange Rate Sensitivity

Majority of our sales and expenses are denominated in United States dollars. While we conduct some sales transactions and incur certain operating expenses in foreign currencies and expect to continue to do so, we do not anticipate that foreign exchange gains or losses will be significant, in part because of our foreign exchange risk management process discussed below.

Foreign Exchange Forward Contracts

We record all derivatives on the balance sheet at fair value. Changes in the fair value of derivatives are recognized in earnings as Other Income (Expense), net. We enter into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the foreign currency forecasted transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges. At September 30, 2014, these forward foreign currency contracts had a notional principal amount of \$11.4 million and an immaterial unrealized gain on foreign exchange contracts. These contracts have maturities of less than 60 days. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities.

Foreign currency transaction gains and losses from operations were a \$0.4 million and \$0.1 million loss for the three months ended September 30, 2014 and September 30, 2013, respectively.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 as amended, such as this Report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our CEO and CFO, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Report. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Report.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurances with respect to financial statement preparation. Further because of changes in conditions, the effectiveness of internal control may vary over time.

We assessed the effectiveness of our internal control over financial reporting as of the end of the period covered by this Report. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (1992).

Based on our assessment using those criteria, we concluded that, as of the end of the period covered by this Report, our internal control over financial reporting is effective.

Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2014, the Company expanded the scope to include the former operations of Enterasys under the assessment of internal controls over financial reporting. There were no other changes in our internal control over financial reporting during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Our controls and procedures are designed to provide reasonable assurance that our control system's objective will be met and our CEO and CFO have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within Extreme Networks have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events. Projections of any evaluation of the effectiveness of controls in future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Notwithstanding these limitations, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. Our CEO and CFO have concluded that our disclosure controls and procedures are, in fact, effective at the

“reasonable assurance” level.

28

---

Table of Contents

PART II. Other Information

Item 1. Legal Proceedings

For information regarding litigation matters that we deem significant, refer to Part I, Item 3, Legal Proceedings of our Annual Report on Form 10-K for the fiscal year ended June 30, 2014 and Note 8 to our Notes to Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report which are incorporated herein by reference.

Item 1A. Risk Factors

The following is a list of risks and uncertainties which may have a material and adverse effect on our business, financial condition or results of operations. The risks and uncertainties set out below are not the only risks and uncertainties we face, and some are endemic to the networking industry.

We cannot assure you that we will be profitable in the future because a number of factors could negatively affect our financial results.

We have a limited history of profitability and have reported losses in some of our prior fiscal years. In addition, in years when we reported profits, we were not profitable in each quarter during those years. We anticipate continuing to incur significant sales and marketing, product development and general and administrative expenses. Any delay in generating or recognizing revenue could result in a loss for a quarter or full year. Even if we are profitable, our operating results may fall below our expectations and those of our investors, which could cause the price of our stock to fall.

We may experience challenges or delays in generating or recognizing revenue for a number of reasons and our revenue and operating results have varied significantly in the past and may vary significantly in the future due to a number of factors, including, but not limited to, the following:

- we are dependent upon obtaining orders during a quarter and shipping those orders in the same quarter to achieve our revenue objectives;
- decreases in the prices of the products that we sell;
- the mix of products sold and the mix of distribution channels through which products are sold;
- acceptance provisions in customer contracts;
- our ability to deliver installation or inspection services by the end of the quarter;
- changes in general and/or specific economic conditions in the networking industry;
- seasonal fluctuations in demand for our products and services;
- a disproportionate percentage of our sales occurring in the last month of the quarter;
- our ability to ship products by the end of a quarter;
- reduced visibility into the implementation cycles for our products and our customers' spending plans;
- our ability to forecast demand for our products, which in the case of lower-than-expected sales, may result in excess or obsolete inventory in addition to non-cancelable purchase commitments for component parts;
- sales to the telecommunications service provider market, which represent a significant source of large product orders, are especially volatile and difficult to forecast;
- product returns or the cancellation or rescheduling of orders;
- announcements and new product introductions by our competitors;
- our ability to develop and support relationships with enterprise customers, service providers and other potential large customers;
- our ability to achieve targeted cost reductions;
- fluctuations in warranty or other service expenses actually incurred;
- our ability to obtain sufficient supplies of sole- or limited-source components for our products on a timely basis;
- increases in the price of the components that we purchase.

Due to the foregoing factors, period-to-period comparisons of our operating results should not be relied upon as an indicator of our future performance.

We may fail to realize the anticipated benefits of the acquisition of Enterasys.

The success of the acquisition of Enterasys Networks Inc., which we acquired on October 31, 2013, will depend on, among other things, our ability to combine the businesses of Extreme and Enterasys in a manner that does not materially disrupt existing relationships and that allows us to achieve anticipated operational synergies. We have faced and will continue to face significant challenges in combining the two operations into one in a timely and efficient manner. The failure to integrate successfully and to manage successfully the challenges presented by the integration process may result in us not achieving the anticipated benefits of the acquisition.

Table of Contents

We have made certain assumptions relating to the acquisition in our forecasts but the actual results could differ materially.

We have made certain assumptions relating to the forecast level of cost savings, synergies and associated costs of the acquisition of Enterasys. Our assumptions relating to the forecast level of cost savings, synergies and associated costs of the acquisition may be inaccurate based on the information available to us, including as the result of the failure to realize the expected benefits of the acquisition, higher than expected transaction and integration costs, including our ability to service new debt, as well as general economic and business conditions that may adversely affect the combined company following the completion of the acquisition.

The global economic environment has and may continue to negatively impact our business and operating results. The challenges and uncertainty currently affecting global economic conditions may negatively impact our business and operating results in the following ways:

- customers may delay or cancel plans to purchase our products and services;
- customers may not be able to pay, or may delay payment of, the amounts that they owe us which may adversely affect our cash flow, the timing of our revenue recognition and the amount of revenue;
- increased pricing pressure may result from our competitors aggressively discounting their products;
- accurate budgeting and planning will be difficult due to low visibility into future sales;
- forecasting customer demand will be more difficult, increasing the risk of either excess and obsolete inventory if our forecast is too high or insufficient inventory to meet customer demand if our forecast is too low; and
- our component suppliers and contract manufacturers have been negatively affected by the economy which may result in product delays and changes in pricing and service levels.

If global economic conditions do not show continued improvement, we believe that we could experience material adverse impacts to our business and operating results.

The combination of our business with the Enterasys' business will continue to require significant management attention, and we expect to incur significant additional integration costs.

The combined company requires us to devote significant management attention and other resources to integrating the two businesses. We may not successfully complete the integration of our operations in a timely manner and may experience disruptions in relationships with customers, suppliers and employees as a result.

Through September 30, 2014, we have incurred transaction and integration costs in connection with the Enterasys acquisition of approximately \$29.4 million. We expect to incur additional costs integrating the companies' operations, product offerings, and personnel, which cannot be estimated accurately at this time. Although we expect that the realization of efficiencies related to the integration of the business will offset incremental transaction, integration and restructuring costs over time, we cannot give any assurance that this net benefit will be achieved. If the total costs of the integration exceed the anticipated benefits of the acquisition, our results of operations could be adversely affected. We expect the average selling prices of our products to decrease, which may reduce gross margin and/or revenue. The network equipment industry has traditionally experienced an erosion of average selling prices due to a number of factors, including competitive pricing pressures, promotional pricing and technological progress. We anticipate that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, excess inventories, increased sales discounts and new product introductions by us or our competitors. We may experience decreases in future operating results due to the erosion of our average selling prices. To maintain our gross margin, we must develop and introduce on a timely basis new products and product enhancements and continually reduce our product costs. Our failure to do so would likely cause our revenue and gross margin to decline. We may engage in future acquisitions that dilute the ownership interests of our stockholders, cause us to incur debt or assume contingent liabilities.

As part of our business strategy, we review acquisition and strategic investment prospects that we believe would complement our current product offerings, augment our market coverage or enhance our technical capabilities, or

otherwise offer growth opportunities. In the event of any future acquisitions, we could:

- issue equity securities which would dilute current stockholders' percentage ownership;
- incur substantial debt;

30

---

Table of Contents

assume contingent liabilities; or  
expend significant cash.

These actions could have a material adverse effect on our operating results or the price of our common stock.

Moreover, even if we do obtain benefits in the form of increased sales and earnings, these benefits may be recognized much later than the time when the expenses associated with an acquisition are incurred. This is particularly relevant in cases where it would be necessary to integrate new types of technology into our existing portfolio and new types of products may be targeted for potential customers with which we do not have pre-existing relationships. Acquisitions and investment activities also entail numerous risks, including:

- difficulties in the assimilation of acquired operations, technologies and/or products;
- unanticipated costs associated with the acquisition or investment transaction;
- the diversion of management's attention from other business concerns;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience;
- the potential loss of key employees of acquired organizations; and
- substantial charges for the amortization of certain purchased intangible assets, deferred stock compensation or similar items.

We may not be able to successfully integrate any businesses, products, technologies, or personnel that we might acquire in the future, and our failure to do so could have a material adverse effect on our business, operating results and financial condition.

Our credit facilities impose financial and operating restrictions on us.

Our debt instruments impose, and the terms of any future debt may impose, operating and other restrictions on us.

These restrictions could affect, and in many respects limit or prohibit, among other items, our ability to:

- incur additional indebtedness;
- create liens;
- make investments;
- enter into transactions with affiliates;
- sell assets;
- guarantee indebtedness;
- declare or pay dividends or other distributions to stockholders;
- repurchase equity interests;
- change the nature of our business;
- enter into swap agreements;
- issue or sell capital stock of certain of our subsidiaries; and
- consolidate, merge, or transfer all or substantially all of our assets and the assets of our subsidiaries on a consolidated basis.

The agreements governing our credit facilities also require us to achieve and maintain compliance with specified financial ratios.

A breach of any of these restrictive covenants or the inability to comply with the required financial ratios could result in a default under our debt instruments. If any such default occurs, the lenders under our credit agreement may elect to declare all outstanding borrowings, together with accrued interest and other fees, to be immediately due and payable. The lenders under our credit agreement also have the right in these circumstances to terminate any commitments they have to provide further borrowings. If we are unable to repay outstanding borrowings when due, the lenders under our credit agreement will have the right to proceed against the collateral granted to them to secure the debt. If the debt under our credit agreement were to be accelerated, we cannot give assurance that this collateral would be sufficient to repay our debt.



If we fail to meet our payment or other obligations under our credit agreement, the lenders under such credit agreement could foreclose on, and acquire control of, substantially all of our assets.

Our credit agreement is jointly and severally guaranteed by us and certain of our subsidiaries. Borrowings under our credit facilities are secured by liens on substantially all our assets, including the capital stock of certain of our subsidiaries, and the assets of our subsidiaries that are loan party guarantors. If we are unable to repay outstanding borrowings when due, the lenders under our credit agreement will have the right to proceed against this pledged capital stock and take control of substantially all of our assets.

## Table of Contents

We purchase several key components for products from single or limited sources and could lose sales if these suppliers fail to meet our needs.

We currently purchase several key components used in the manufacture of our products from single or limited sources and are dependent upon supply from these sources to meet our needs. Certain components such as tantalum capacitors, SRAM, DRAM, and printed circuit boards, have been in the past, and may in the future be, in short supply. We have encountered, and are likely in the future to encounter, shortages and delays in obtaining these or other components, and this could have a material adverse effect on our ability to meet customer orders. Our principal sole-source components include:

- ASICs;
- Merchant silicon;
- microprocessors;
- programmable integrated circuits;
- selected other integrated circuits;
- custom power supplies; and
- custom-tooled sheet metal.

Our principal limited-source components include:

- flash memory;
- DRAMs and SRAMs;
- printed circuit boards; and
- CAMs
- Connectors
- Timing circuits (crystals & clocks).

We use our forecast of expected demand to determine our material requirements. Lead times for materials and components we order vary significantly, and depend on factors such as the specific supplier, contract terms and demand for a component at a given time. If forecasts exceed orders, we may have excess and/or obsolete inventory, which could have a material adverse effect on our operating results and financial condition. If orders exceed forecasts, we may have inadequate supplies of certain materials and components, which could have a material adverse effect on our ability to meet customer delivery requirements and to recognize revenue.

Generally, we do not have agreements fixing long-term prices or minimum volume requirements from suppliers. From time to time we have experienced shortages and allocations of certain components, resulting in delays in filling orders. Qualifying new suppliers to compensate for such shortages may be time-consuming and costly, and may increase the likelihood of errors in design or production. In addition, during the development of our products, we have experienced delays in the prototyping of our chipsets, which in turn has led to delays in product introductions. Similar delays may occur in the future. Furthermore, the performance of the components as incorporated in our products may not meet the quality requirements of our customers.

Intense competition in the market for networking equipment could prevent us from increasing revenue and maintaining profitability.

The market for network switching solutions is intensely competitive and dominated primarily by Brocade Communications Systems, Inc., Cisco Systems Inc., Dell, Hewlett-Packard Company, Huawei Technologies Co. Ltd., and Juniper Networks, Inc. Most of our competitors have longer operating histories, greater name recognition, larger customer bases, broader product lines and substantially greater financial, technical, sales, marketing and other resources. As a result, these competitors are able to devote greater resources to the development, promotion, sale and support of their products. In addition, they have larger distribution channels, stronger brand names, access to more customers, a larger installed customer base and a greater ability to make attractive offers to channel partners and customers than we do. For example, we have encountered, and expect to continue to encounter, many potential customers who are confident in and committed to the product offerings of our principal competitors. Accordingly, these potential customers may not consider or evaluate our products. When such potential customers have considered

or evaluated our products, we have in the past lost, and expect in the future to lose, sales to some of these customers as large competitors have offered significant price discounts to secure these sales.

The pricing policies of our competitors impact the overall demand for our products and services. Some of our competitors are capable of operating at significant losses for extended periods of time, increasing pricing pressure on our products and services. If we do not maintain competitive pricing, the demand for our products and services, as well as our market share, may decline. From time to time, we may lower the prices of our products and services in response to competitive pressure. When this happens, if we are unable to reduce our component costs or improve operating efficiencies, our revenue and margins will be adversely affected.

Table of Contents

Industry consolidation may lead to stronger competition and may harm our operating results.

There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. For example, some of our current and potential competitors for enterprise data center business have made acquisitions, or announced new strategic alliances, designed to position them with the ability to provide end-to-end technology solutions for the enterprise data center. Companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, operating results, and financial condition.

Furthermore, particularly in the service provider market, rapid consolidation will lead to fewer customers, with the effect that loss of a major customer could have a material impact on results not anticipated in a customer marketplace composed of more numerous participants.

We intend to invest in engineering, sales, service, marketing and manufacturing on a long term basis, and delays or inability to attain the expected benefits may result in unfavorable operating results.

While we intend to focus on managing our costs and expenses, over the long term, we also intend to invest in personnel and other resources related to our engineering, sales, service, marketing and manufacturing functions as we focus on our foundational priorities, such as leadership in our core products and solutions and architectures for business transformation. We are likely to recognize the costs associated with these investments earlier than some of the anticipated benefits and the return on these investments may be lower, or may develop more slowly, than we expect. If we do not achieve the benefits anticipated from these investments, or if the achievement of these benefits is delayed, our operating results may be adversely affected.

Our success is dependent on our ability to continually introduce new products and features that achieve broad market acceptance.

The network equipment market is characterized by rapid technological progress, frequent new product introductions, changes in customer requirements and evolving industry standards. If we do not regularly introduce new products in this dynamic environment, our product lines will become obsolete. These new products must be compatible and inter-operate with products and architectures offered by other vendors. We have and may in the future experience delays in product development and releases, and such delays have and could in the future adversely affect our ability to compete and our operating results.

When we announce new products or product enhancements or end of sale existing products that have the potential to replace or shorten the life cycle of our existing products, customers may defer or cancel orders for our existing products. These actions could have a material adverse effect on our operating results by unexpectedly decreasing sales, increasing inventory levels of older products and exposing us to greater risk of product obsolescence.

Even if we introduce new switching products, alternative technologies could achieve widespread market acceptance and displace the Ethernet technology on which we have based our product architecture. For example, developments in routers and routing software could significantly reduce demand for our products. As a result, we may not be able to achieve widespread market acceptance of our current or future products.

If we do not successfully anticipate technological shifts, market needs and opportunities, and develop products and product enhancements that meet those technological shifts, needs and opportunities, or if those products are not made available in a timely manner or do not gain market acceptance, we may not be able to compete effectively and our ability to generate revenues will suffer.

We cannot guarantee that we will be able to anticipate future technological shifts, market needs and opportunities or be able to develop new products or product enhancements to meet such technological shifts, needs or opportunities in a timely manner or at all. For example, the move from traditional network infrastructures towards SDN has been receiving considerable attention. In our view, it will take several years to see the full impact of SDN, and we believe the successful products and solutions in this market will combine hardware and software elements together. If we fail

to anticipate market requirements or fail to develop and introduce new products or product enhancements to meet those needs in a timely manner, it could cause us to lose customers, and such failure could substantially decrease or delay market acceptance and sales of our present and future products, which would significantly harm our business, financial condition, and results of operations. Even if we are able to anticipate, develop, and commercially introduce new products and enhancements, there can be no assurance that new products or enhancements will achieve widespread market acceptance.

Table of Contents

Claims of infringement by others may increase and the resolution of such claims may adversely affect our operating results.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patents, copyrights (including rights to “open source” software), and other intellectual property rights. Because of the existence of a large number of patents in the networking field, the secrecy of some pending patents and the issuance of new patents at a rapid pace, it is not possible to determine in advance if a product or component might infringe the patent rights of others. Because of the potential for courts awarding substantial damages, the lack of predictability of such awards, and the high legal costs associated with the defense of such patent infringement matters that would be expended to prove lack of infringement, it is not uncommon for companies in our industry to settle even potentially unmeritorious claims for very substantial amounts. Further, the entities with whom we have or could have disputes or discussions include entities with extensive patent portfolios and substantial financial assets. These entities are actively engaged in programs to generate substantial revenue from their patent portfolios and are seeking or may seek significant payments or royalties from us and others in our industry.

Litigation resulting from claims that we are infringing the proprietary rights of others has resulted and could in the future result in substantial costs and a diversion of resources, and could have a material adverse effect on our business, financial condition and results of operations. We have received notices from entities alleging that we may be infringing their patents, and we are currently parties to patent litigation as described under Part I, Item 3, Legal Proceedings. Without regard to the merits of these or any other claims, an adverse court order or a settlement could require us, among other actions, to:

- stop selling our products that incorporate the challenged intellectual property;
- obtain a royalty bearing license to sell or use the relevant technology, and that license may not be available on reasonable terms or available at all;
- pay damages; or
- redesign those products that use the disputed technology.

In addition, our products include so-called “open source” software. Open source software is typically licensed for use at no initial charge, but imposes on the user of the open source software certain requirements to license to others both the open source software as well as modifications to the open source software under certain circumstances. Our use of open source software subjects us to certain additional risks for the following reasons:

- open source license terms may be ambiguous and may result in unanticipated obligations regarding the licensing of our products and intellectual property;
- open source software cannot be protected under trade secret law;
- suppliers of open-source software do not provide the warranty, support and liability protections typically provided by vendors who offer proprietary software; and
- it may be difficult for us to accurately determine the developers of the open source code and whether the acquired software infringes third-party intellectual property rights.

We believe that even if we do not infringe the rights of others, we will incur significant expenses in the future due to defense of legal claims, disputes or licensing negotiations, though the amounts cannot be determined. These expenses may be material or otherwise adversely affect our operating results.

Our operating results may be negatively affected by defending or pursuing claims or lawsuits.

We have and may in the future pursue or be subject to claims or lawsuits in the normal course of our business. In addition to the intellectual property lawsuits described above, we are currently parties to other litigation as described in Part I, Item 3. Legal Proceedings. Regardless of the result, litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a lawsuit in which we are a defendant could result in a court order against us or payments to other parties that would have an adverse effect on our business, results of operations, or financial condition. Even if we are successful in prosecuting claims and lawsuits, we may not recover damages sufficient to cover our expenses incurred to manage, investigate and pursue the litigation. In addition, subject to certain limitations, we may be obligated to indemnify our current and former directors, officers and employees in certain lawsuits. We do not maintain adequate insurance coverage to cover all of our litigation costs and liabilities.

If we fail to protect our intellectual property, our business could suffer.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. However, we cannot ensure that the actions we have taken will adequately protect our intellectual property rights or that other parties will not independently develop similar or competing products that do not infringe on our patents. We generally enter into confidentiality, invention assignment or license agreements with our employees, consultants and other third parties with whom we do business, and control access to and distribution of our intellectual property and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise misappropriate or use our products or technology, which would adversely affect our business.

Table of Contents

When our products contain undetected errors, we may incur significant unexpected expenses and could lose sales. Network products frequently contain undetected errors when new products or new versions or updates of existing products are released to the marketplace. In the past, we have experienced such errors in connection with new products and product updates. We have experienced component problems in prior years that caused us to incur higher than expected warranty, service costs and expenses, and other related operating expenses. In the future, we expect that, from time to time, such errors or component failures will be found in new or existing products after the commencement of commercial shipments. These problems may have a material adverse effect on our business by causing us to incur significant warranty, repair and replacement costs, diverting the attention of our engineering personnel from new product development efforts, delaying the recognition of revenue and causing significant customer relations problems. Further, if products are not accepted by customers due to such defects, and such returns exceed the amount we accrued for defective returns based on our historical experience, our operating results would be adversely affected.

Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. The occurrence of system errors, whether or not caused by our products, could result in the delay or loss of market acceptance of our products and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems would likely have a material adverse effect on our business, operating results and financial condition.

Our dependence on an OEM for a portion of our wireless products could harm our operating results.

We historically relied exclusively on Motorola for our wireless product offering. With the integration of Extreme Networks with Enterasys Networks, we have two lines of wireless products. We have issued our last purchase order for manufacturing for the line of wireless products manufactured by Motorola. However, we will continue to rely on Motorola for several years for hardware and software support for projected new sales and our existing customer base. Should Motorola cease to timely or effectively honor these supply and support obligations, it may create financial liabilities for us that could have a material adverse effect on our business and operating results.

Our dependence on few manufacturers for our manufacturing requirements could harm our operating results.

We primarily rely on our manufacturing partners; Alpha Networks, Inc. headquartered in Hsinchu, Taiwan, Flextronics, Inc. headquartered in Singapore, and select other partners to manufacture our products. We have experienced delays in product shipments from our manufacturing partners in the past, which in turn delayed product shipments to our customers. These or similar problems may arise in the future, such as delivery of products of inferior quality, delivery of insufficient quantity of products, or the interruption or discontinuance of operations of a manufacturer, any of which could have a material adverse effect on our business and operating results. In addition, any natural disaster or business interruption to our manufacturing partners could significantly disrupt our business. While we maintain strong relationships with our manufacturing partners, our agreements with these manufacturers are generally of limited duration and pricing, quality and volume commitments are negotiated on a recurring basis. The failure to maintain continuing agreements with our manufacturing partners could adversely affect our business. We intend to introduce new products and product enhancements, which will require that we rapidly achieve volume production by coordinating our efforts with those of our suppliers and contract manufacturers.

As part of our cost-reduction efforts, we will need to realize lower per unit product costs from our manufacturing partner by means of volume efficiencies and the utilization of manufacturing sites in lower-cost geographies. However, we cannot be certain when or if such price reductions will occur. The failure to obtain such price reductions would adversely affect our operating results.

Regulations related to disclosure requirements regarding conflict minerals may force us to incur additional compliance expenses and make our supply chain more complex.

On August 22, 2012, as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC adopted new disclosure regulations for public companies that manufacture products that contain certain minerals and their derivatives, namely tin, tantalum, tungsten or gold, known as conflict minerals, if these minerals are necessary to the functionality or production of the company's products. These regulations require issuers to report annually whether or not such minerals originate from the Democratic Republic of Congo ("DRC") and adjoining



countries and in some cases to perform extensive due diligence on their supply chains for such minerals. The implementation of these new requirements could adversely affect the sourcing, availability and pricing of conflict minerals used in the manufacture of networking equipment, including our products. In addition, we may incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals used in our products. Since our supply chain is complex, the due diligence procedures that we implement may not enable us to ascertain the origins for these minerals or determine that these minerals are DRC conflict free, which may harm our reputation. We may also face difficulties in satisfying customers who may require that our products be certified as DRC conflict free, which could harm our relationships with these customers and lead to a loss of revenue. These new requirements also

Table of Contents

could have the effect of limiting the pool of suppliers from which we source these minerals, and we may be unable to obtain conflict-free minerals at competitive prices, which could increase our costs and adversely affect our manufacturing operations and our profitability.

We depend upon international sales for a significant portion of our revenue which imposes a number of risks on our business.

International sales constitute a significant portion of our net revenue. Our ability to grow will depend in part on the expansion of international sales. Our international sales primarily depend on the success of our resellers and distributors. The failure of these resellers and distributors to sell our products internationally would limit our ability to sustain and grow our revenue. There are a number of risks arising from our international business, including:

- longer accounts receivable collection cycles;
- difficulties in managing operations across disparate geographic areas;
- difficulties associated with enforcing agreements through foreign legal systems;
- higher credit risks requiring cash in advance or letters of credit;
- difficulties in safeguarding intellectual property;
- political and economic turbulence;
- terrorism, war or other armed conflict;
- natural disasters and epidemics;
- potential adverse tax consequences;
- compliance with regulatory requirements of foreign countries, including compliance with rapidly evolving environmental regulations;
- compliance with U.S. laws and regulations pertaining to the sale and distribution of products to customers in foreign countries, including export controls and the Foreign Corrupt Practices Act; and
- the payment of operating expenses in local currencies, which exposes us to risks of currency fluctuations.

Our international sales are primarily U.S. dollar-denominated. Future increases in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. We invoice some of our international customers in local currency, which would expose us to fluctuations in exchange rates between the U.S. dollar and the particular local currency. If we do so, we may decide to engage in hedging transactions to minimize the risk of such fluctuations.

We have entered into foreign exchange forward contracts to offset the impact of payment of operating expenses in local currencies to some of our operating foreign subsidiaries. However, if we are not successful in managing these foreign currency transactions, we could incur losses from these activities.

We must continue to develop and increase the productivity of our indirect distribution channels to increase net revenue and improve our operating results.

Our distribution strategy focuses primarily on developing and increasing the productivity of our indirect distribution channels. If we fail to develop and cultivate relationships with significant channel partners, or if these channel partners are not successful in their sales efforts, sales of our products may decrease and our operating results could suffer.

Many of our channel partners also sell products from other vendors that compete with our products. Our channel partners may not continue to market or sell our products effectively or to devote the resources necessary to provide us with effective sales, marketing and technical support. We may not be able to successfully manage our sales channels or enter into additional reseller and/or distribution agreements. Our failure to do any of these could limit our ability to grow or sustain revenue.

Our operating results for any given period have and will continue to depend to a significant extent on large orders from a relatively small number of channel partners and other customers. However, we do not have binding purchase commitments from any of them. A substantial reduction or delay in sales of our products to a significant reseller, distributor or other customer could harm our business, operating results and financial condition because our expense levels are based on our expectations as to future revenue and to a large extent are fixed in the short term. Under specified conditions, some third-party distributors are allowed to return products to us and unexpected returns could adversely affect our results.

The sales cycle for our products is long and we may incur substantial non-recoverable expenses or devote significant resources to sales that do not occur when anticipated.

Our products represent a significant strategic decision by a customer regarding its communications infrastructure. The decision by customers to purchase our products is often based on the results of a variety of internal procedures associated with the evaluation, testing, implementation and acceptance of new technologies. Accordingly, the product evaluation process frequently results in a lengthy sales cycle, typically ranging from three months to longer than a year, and as a result, our ability to sell products is subject to a number of significant risks, including risks that:

Table of Contents

budgetary constraints and internal acceptance reviews by customers will result in the loss of potential sales; there may be substantial variation in the length of the sales cycle from customer to customer, making decisions on the expenditure of resources difficult to assess; we may incur substantial sales and marketing expenses and expend significant management time in an attempt to initiate or increase the sale of products to customers, but not succeed; if a sales forecast from a specific customer for a particular quarter is not achieved in that quarter, we may be unable to compensate for the shortfall, which could harm our operating results; and downward pricing pressures could occur during the lengthy sales cycle for our products.

Accordingly, our financial performance in a specific quarter is both difficult to forecast and subject to volatility. Any failure to achieve expected revenues, gross margin or net earnings per share could materially and adversely impact the value of our stock, our future financial prospects and employee retention which is based in part on the perceived value of equity compensation.

Our revenues may decline as a result of changes in public funding of educational institutions.

A portion of our revenues comes from sales to both public and private K-12 educational institutions. Public schools receive funding from local tax revenue, and from state and federal governments through a variety of programs, many of which seek to assist schools located in underprivileged or rural areas. The funding for a portion of our sales to educational institutions comes from a federal funding program known as the E-Rate program. E-Rate is a program of the Federal Communications Commission that subsidizes the purchase of approved telecommunications, Internet access, and internal connection costs for eligible public educational institutions. The E-Rate program, its eligibility criteria, the timing and specific amount of federal funding actually available and which Wi-Fi infrastructure and product sectors will benefit, are uncertain and subject to final federal program approval and funding appropriation continues to be under review by the Federal Communications Commission and there can be no assurance that this program or its equivalent will continue, and as a result, our business may be harmed. Furthermore, if state or local funding of public education is significantly reduced because of legislative or policy changes or by reductions in tax revenues due to changing economic conditions, our sales to educational institutions may be negatively impacted by these changed conditions. Any reduction in spending on information technology systems by educational institutions would likely materially and adversely affect our business and results of operations. This is a specific example of the many factors which add additional uncertainty to our future revenue from our education end-customers.

To successfully manage our business or achieve our goals, we must attract, retain, train, motivate, develop and promote key employees, and failure to do so can harm us.

Our success depends to a significant degree upon the continued contributions of our key management, engineering, sales and marketing, service and operations personnel, many of whom would be difficult to replace. We do not have employment contracts with these individuals that mandate that they render services for any specific term, nor do we carry life insurance on any of our key personnel. We have experienced and may in the future experience significant turnover in our executive personnel. In addition, retention has generally become more difficult for us, in part because the exercise price of most of the stock options granted to many of our employees is above the market price. As a result, we experienced high levels of attrition. We believe our future success will also depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing, service, finance and operations personnel. The market for these personnel is competitive, and we have had difficulty in hiring employees, particularly engineers, in the time-frame we desire.

Companies in the networking industry whose employees accept positions with competitors frequently claim that competitors have engaged in unfair hiring practices. We have from time to time been involved in claims like this with other companies and, although to date they have not resulted in material litigation, we do not know whether we will be involved in additional claims in the future. We could incur substantial costs in litigating any such claims, regardless of

the merits.

Failure to successfully expand our sales and support teams or educate them in regard to technologies and our product families may harm our operating results.

The sale of our products and services requires a concerted effort that is frequently targeted at several levels within a prospective customer's organization. We may not be able to increase net revenue unless we expand our sales and support teams in order to address all of the customer requirements necessary to sell our products.

We cannot assure you that we will be able to successfully integrate employees into our company or to educate and train current and future employees in regard to rapidly evolving technologies and our product families. A failure to do so may hurt our revenue growth and operating results.

37

---

Table of Contents

Failure of our products to comply with evolving industry standards and complex government regulations may adversely impact our business.

If we do not comply with existing or evolving industry standards and government regulations, we may not be able to sell our products where these standards or regulations apply. The network equipment industry in which we compete is characterized by rapid changes in technology and customers' requirements and evolving industry standards. As a result, our success depends on:

- the timely adoption and market acceptance of industry standards, and timely resolution of conflicting U.S. and international industry standards; and

- our ability to influence the development of emerging industry standards and to introduce new and enhanced products that are compatible with such standards.

In the past, we have introduced new products that were not compatible with certain technological standards, and in the future, we may not be able to effectively address the compatibility and interoperability issues that arise as a result of technological changes and evolving industry standards.

Our products must also comply with various U.S. federal government regulations and standards defined by agencies such as the Federal Communications Commission, standards established by governmental authorities in various foreign countries and recommendations of the International Telecommunication Union. In some circumstances, we must obtain regulatory approvals or certificates of compliance before we can offer or distribute our products in certain jurisdictions or to certain customers. Complying with new regulations or obtaining certifications can be costly and disruptive to our business.

If we do not comply with existing or evolving industry standards or government regulations, we will not be able to sell our products where these standards or regulations apply, which may prevent us from sustaining our net revenue or achieving profitability.

If we do not adequately manage and evolve our financial reporting and managerial systems and processes, our ability to manage and grow our business may be harmed.

Our ability to successfully implement our business plan and comply with regulations requires an effective planning and management process. We need to continue improving our existing, and implement new, operational and financial systems, procedures and controls. We need to ensure that the businesses acquired are appropriately integrated in our financial systems. We integrated the financial and other key managerial systems of Enterasys with Extreme effective July 1, 2014, the first day of our fiscal 2015. Any delay in the implementation of, or disruption in the integration of acquired businesses, or delay and disruption in the transition to, new or enhanced systems, procedures or controls, could harm our ability to record and report financial and management information on a timely and accurate basis, or to forecast future results.

Changes in the effective tax rate including from the release of the valuation allowance recorded against our net U.S. deferred tax assets, or adverse outcomes resulting from examination of our income or other tax returns or change in ownership, could adversely affect our results.

Our future effective tax rates may be volatile or adversely affected by changes in our business or U.S. or foreign tax laws, including: the partial or full release of the valuation allowance recorded against our net U.S. deferred tax assets; expiration of or lapses in the research and development tax credit laws; transfer pricing adjustments; tax effects of stock-based compensation; or costs related to restructurings. In addition, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. Although we regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes, there is no assurance that such determinations by us are in fact adequate. Changes in our effective tax rates or amounts assessed upon examination of our tax returns may have a material, adverse impact on our cash flows and our financial condition.

Our future effective tax rate in particular could be adversely affected by a change in ownership pursuant to U.S. Internal Revenue Code Section 382. If a change in ownership occurs, it may limit our ability to utilize our net operating losses to offset our U.S. taxable income. If U.S. taxable income is greater than the change in ownership limitation, we will pay a higher rate of tax with respect to the amount of taxable income that exceeds the limitation. This could have a material adverse impact on our results of operations. On April 26, 2012, we adopted an

Amended and Restated Rights Agreement to help protect our assets (the “Rights Agreement”). In general, this does not allow a stockholder to acquire more than 4.95% of our outstanding common stock without a waiver from our board of directors, who must take into account the relevant tax analysis relating to potential limitation of our net operating losses. The Rights Agreement is effective through May 31, 2015, subject to ratification by a majority of stockholders at our next annual stockholder meeting on November 12, 2014.

Table of Contents

Compliance with laws, rules and regulations relating to corporate governance and public disclosure may result in additional expenses.

Federal securities laws, rules and regulations, as well as NASDAQ Stock Market rules and regulations, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their Chief Executive Officers, Chief Financial Officers and directors for securities law violations. These laws, rules and regulations and the interpretation of these requirements are evolving, and we are making investments to evaluate current practices and to continue to achieve compliance, which investments may have a material impact on the Company's financial condition.

Our headquarters and some significant supporting businesses are located in northern California and other areas subject to natural disasters that could disrupt our operations and harm our business.

Our corporate headquarters are located in Silicon Valley in Northern California. Historically, this region as well as our R&D centers in North Carolina and New Hampshire have been vulnerable to natural disasters and other risks, such as earthquakes, fires, floods and tropical storms, which at times have disrupted the local economy and posed physical risks to our property. We have contract manufacturers located in Taiwan where similar natural disasters and other risks may disrupt the local economy and pose physical risks to our property and the property of our contract manufacturer.

In addition, the continued threat of terrorism and heightened security and military action in response to this threat, or any future acts of terrorism, may cause further disruptions to the economies of the U.S. and other countries. If such disruptions result in delays or cancellations of customer orders for our products, our business and operating results will suffer.

We currently do not have redundant, multiple site capacity in the event of a natural disaster, terrorist act or other catastrophic event. In the event of such an occurrence, our business would suffer.

Our stock price has been volatile in the past and our stock price may significantly fluctuate in the future.

In the past, our common stock price has fluctuated significantly. This could continue as we or our competitors announce new products, our results or those of our customers or competition fluctuate, conditions in the networking or semiconductor industry change, or when investors, change their sentiment toward stocks in the networking technology sector.

In addition, fluctuations in our stock price and our price-to-earnings multiple may make our stock attractive to momentum, hedge or day-trading investors who often shift funds into and out of stock rapidly, exacerbating price fluctuations in either direction, particularly when viewed on a quarterly basis.

Provisions in our charter documents and Delaware law and our adoption of a stockholder rights plan may delay or prevent an acquisition of Extreme, which could decrease the value of our Common Stock.

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our Board of Directors. Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, our Board of Directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Although we believe these provisions of our certificate of incorporation and bylaws and Delaware law will provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our Board of Directors, these provisions apply even if the offer may be considered beneficial by some of our stockholders.

Our Rights Agreement provides that if a single stockholder (or group) acquires more than 4.95% of our outstanding common stock without a waiver from our Board of Directors, each holder of one share of our common stock (other than the stockholder or group who acquired in excess of 4.95% of our common stock) may purchase a fractional share of our preferred stock that would result in substantial dilution to the triggering stockholder or group. Accordingly, although this plan is designed to prevent any limitation on the utilization of our net operating losses by avoiding issues raised under Section 382 of the U.S. Internal Revenue Code, the Rights Agreement could also serve as a deterrent to stockholders wishing to effect a change of control.



We rely on the availability of third-party licenses

Some of our products are designed to include software or other intellectual property, including open source software, licensed from third parties. It may be necessary in the future to seek or renew licenses relating to various aspects of these products. There can be no assurance that the necessary licenses would be available on acceptable terms, if at all. The inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could have a material adverse effect on our business, operating results, and financial condition. Moreover, the inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability

Table of Contents

to protect our proprietary rights in our products. Further, the failure to comply with the terms of any license, including free open source software, may result in our inability to continue to use such license. Our inability to maintain or re-license any third-party licenses required in our products or our inability to obtain third-party licenses necessary to develop new products and product enhancements, could require us, if possible, to develop substitute technology or obtain substitute technology of lower quality or performance standards or at a greater cost, any of which could delay or prevent product shipment and harm our business, financial condition, and results of operations.

System security risks, data protection breaches, and cyber-attacks could compromise our proprietary information, disrupt our internal operations and harm public perception of our products, which could adversely affect our business. In the ordinary course of business, we store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners on our networks. The secure maintenance of this information is critical to our operations and business strategy. Increasingly, companies, including Extreme Networks, are subject to a wide variety of attacks on their networks on an ongoing basis. Despite our security measures, Extreme Networks' information technology and infrastructure may be vulnerable to penetration or attacks by computer programmers and hackers, or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks, creating system disruptions or slowdowns and exploiting security vulnerabilities of our products, and the information stored on our networks could be accessed, publicly disclosed, lost or stolen, which could subject us to liability to our customers, suppliers, business partners and others, and cause us reputational and financial harm. In addition, sophisticated hardware and operating system software and applications that we produce or procure from third parties may contain defects in design or manufacture, including "bugs" and other problems that could unexpectedly interfere with the operation of our networks.

If an actual or perceived breach of network security occurs in our network or in the network of a customer of our networking products, regardless of whether the breach is attributable to our products, the market perception of the effectiveness of our products could be harmed. In addition, the economic costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software systems and security vulnerabilities could be significant and may be difficult to anticipate or measure. Because the techniques used by computer programmers and hackers, many of whom are highly sophisticated and well-funded, to access or sabotage networks change frequently and generally are not recognized until after they are used, we may be unable to anticipate or immediately detect these techniques. This could impede our sales, manufacturing, distribution or other critical functions, which could adversely affect our business.

Market conditions and changes in the industry could lead to discontinuation of our products or businesses resulting in asset impairments

In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as inventory and technology-related write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Although in certain instances, our supply agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed, our loss contingencies may include liabilities for contracts that we cannot cancel with contract manufacturers and suppliers. Further, our estimates relating to the liabilities for excess facilities are affected by changes in real estate market conditions.

If our products do not effectively inter-operate with our customers' networks and result in cancellations and delays of installations our business could be harmed.

Our products are designed to interface with our customers' existing networks, each of which have different specifications and utilize multiple protocol standards and products from other vendors. Many of our customers' networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products must inter-operate with many or all of the products within these networks as well as future

products in order to meet our customers' requirements. If we find errors in the existing software or defects in the hardware used in our customers' networks, we may need to modify our software or hardware to fix or overcome these errors so that our products will inter-operate and scale with the existing software and hardware, which could be costly and could negatively affect our business, financial condition, and results of operations. In addition, if our products do not inter-operate with those of our customers' networks, demand for our products could be adversely affected or orders for our products could be cancelled. This could hurt our operating results, damage our reputation, and seriously harm our business and prospects.

Table of Contents

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

We currently have authority granted by our Board of Directors to repurchase up to \$75 million in common stock over a three year period starting October 1, 2012. Since the inception of the program, 4.1 million shares have been repurchased for a total purchase price of \$14.5 million and \$60.5 million of the authorized amount is remaining. For the three month periods ended September 30, 2014, the Company did not repurchase any shares of its common stock.

Item 3. Defaults Upon Senior Securities - Not applicable

Item 4. Mine Safety Disclosure - Not Applicable

Item 5. Other Information

41

---

Table of Contents

## Item 6. Exhibits

## (a) Exhibits:

Exhibit Number	Description of Document	Incorporated by Reference			Filed Herewith
		Form	Filing Date	Number	
10.1	Offer Letter executed September 29, 2014, between Extreme Networks, Inc. and Jeffrey White.	8-K	10/2/2014	10.1	
31.1	Section 302 Certification of Chief Executive Officer				X
31.2	Section 302 Certification of Chief Financial Officer				X
32.1	Section 906 Certification of Chief Executive Officer				X
32.2	Section 906 Certification of Chief Financial Officer				X
101.INS	XBRL Instance Document.				X
101.SCH	XBRL Taxonomy Extension Schema Document.				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				X

Table of Contents

SIGNATURES

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

EXTREME NETWORKS, INC.

(Registrant)

/S/ KENNETH AROLA

KENNETH AROLA

Senior Vice President, Chief Financial Officer, and Chief  
Accounting Officer

October 29, 2014