CIENA CORP
Form 10-Q
March 08, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
(Mark one)

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

For the quarterly period ended January 31, 2012
OR

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

For the transition period from to
Commission file number: 0-21969
Ciena Corporation
(Exact name of registrant as specified in its charter)

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

(410) 865-8500
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (do not check if smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as determined in Rule 12b-2 of the Exchange Act). YES o NO þ
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding at February 25, 2012
common stock, $.01 par value	98,659,716

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Quarter Ended January 31,	
	2011	2012
Revenue:		
Products	$352,427	$333,673
Services	80,881	83,012
Total revenue	433,308	416,685
Cost of goods sold:		
Products	214,401	197,752
Services	50,401	51,177
Total cost of goods sold	264,802	248,929
Gross profit	168,506	167,756
Operating expenses:		
Research and development	95,790	89,664
Selling and marketing	57,092	64,411
General and administrative	38,314	29,400
Acquisition and integration costs	24,185	264
Amortization of intangible assets	28,784	13,471
Restructuring costs	1,522	1,722
Change in fair value of contingent consideration	(3,289)	—
Total operating expenses	242,398	198,932
Loss from operations	(73,892)	(31,176)
Interest and other income (loss), net	6,265	(4,887)
Interest expense	(9,550)	(9,570)
Loss before income taxes	(77,177)	(45,633)
Provision for income taxes	1,879	2,020
Net loss	$(79,056)	$(47,653)
Basic net loss per common share	$(0.84)	$(0.49)
Diluted net loss per potential common share	$(0.84)	$(0.49)
Weighted average basic common shares outstanding	94,496	98,066
Weighted average dilutive potential common shares outstanding	94,496	98,066

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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

	October 31, 2011	January 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$541,896	$550,461
Short-term investments	—	50,239
Accounts receivable, net	417,509	399,457
Inventories	230,076	248,651
Prepaid expenses and other	143,357	126,556
Total current assets	1,332,838	1,375,364
Long-term investments	50,264	—
Equipment, furniture and fixtures, net	122,558	118,105
Other intangible assets, net	331,635	312,220
Other long-term assets	114,123	112,567
Total assets	$1,951,418	$1,918,256
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$157,116	$176,747
Accrued liabilities	197,004	200,114
Deferred revenue	99,373	79,880
Total current liabilities	453,493	456,741
Long-term deferred revenue	24,425	21,284
Other long-term obligations	17,263	19,056
Convertible notes payable	1,442,364	1,442,279
Total liabilities	1,937,545	1,939,360
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred stock – par value $0.01; 20,000,000 shares authorized; zero shares issued and outstanding	—	—
Common stock – par value $0.01; 290,000,000 shares authorized; 97,440,436 and 98,650,874 shares issued and outstanding	974	987
Additional paid-in capital	5,753,236	5,767,781
Accumulated other comprehensive income (loss)	31	(1,851)
Accumulated deficit	(5,740,368)	(5,788,021)
Total stockholders' equity (deficit)	13,873	(21,104)
Total liabilities and stockholders' equity (deficit)	$1,951,418	$1,918,256

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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

	Three Months Ended January 31,	
	2011	2012
Cash flows from operating activities:		
Net loss	$(79,056)	$(47,653)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of premium (discount) on marketable securities	—	(13)
Change in fair value of embedded redemption feature	(7,130)	980
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	14,543	14,721
Share-based compensation costs	9,864	8,888
Amortization of intangible assets	37,137	19,415
Deferred tax provision (benefit)	183	(49)
Provision for inventory excess and obsolescence	2,645	8,224
Provision for warranty	1,093	7,706
Other	851	2,667
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	(26,451)	17,078
Inventories	(8,372)	(26,799)
Prepaid expenses and other	(5,095)	14,500
Accounts payable, accruals and other obligations	(4,300)	15,850
Deferred revenue	427	(22,634)
Net cash provided by (used in) operating activities	(63,661)	12,881
Cash flows used in investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(17,265)	(7,898)
Restricted cash	(3,505)	(866)
Proceeds from sale of cost method investment	—	524
Receipt of contingent consideration related to business acquisition	16,394	—
Net cash used in investing activities	(4,376)	(8,240)
Cash flows from financing activities:		
Proceeds from issuance of common stock	5,275	5,669
Net cash provided by financing activities	5,275	5,669
Effect of exchange rate changes on cash and cash equivalents	(105)	(1,745)
Net increase (decrease) in cash and cash equivalents	(62,762)	10,310
Cash and cash equivalents at beginning of period	688,687	541,896
Cash and cash equivalents at end of period	$625,820	$550,461
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$2,458	$2,458
Cash paid during the period for income taxes, net	$1,698	$2,823
Non-cash investing and financing activities		
Purchase of equipment in accounts payable	$3,815	$7,409
Fixed assets acquired under capital leases	$1,456	$3,078

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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CIENA CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) INTERIM FINANCIAL STATEMENTS

The interim financial statements included herein for Ciena Corporation ("Ciena") have been prepared by Ciena, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, financial statements included in this report reflect all normal recurring adjustments that Ciena considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial position of Ciena at the date of the interim balance sheets. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The October 31, 2011 Condensed Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. However, Ciena believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with Ciena's audited consolidated financial statements and notes thereto included in Ciena's annual report on Form 10-K for the fiscal year ended October 31, 2011.

Ciena has a 52 or 53 week fiscal year, which ends on the Saturday nearest to the last day of October of each year. Fiscal 2012 is a 53-week fiscal year with the additional week occurring in the fourth quarter. For purposes of financial statement presentation, each fiscal year is described as having ended on October 31, and each fiscal quarter is described as having ended on January 31, April 30 and July 31 of each fiscal year.

(2) SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

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

Cash and Cash Equivalents

Ciena considers all highly liquid investments purchased with original maturities of 3 months or less to be cash equivalents. Restricted cash collateralizing letters of credit is included in other current assets and other long-term assets depending upon the duration of the restriction.

Investments

Ciena's investments are classified as available-for-sale and are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income. Ciena recognizes losses when it determines that declines in the fair value of its investments, below their cost basis, are other-than-temporary. In determining whether a decline in fair value is other-than-temporary, Ciena considers various factors including market price (when available), investment ratings, the financial condition and near-term prospects of the investee, the length of time and the extent to which the fair value has been less than Ciena's cost basis, and its intent and ability to hold the investment until maturity or for a

period of time sufficient to allow for any anticipated recovery in market value. Ciena considers all marketable debt securities that it expects to convert to cash within one year or less to be short-term investments. All others are considered long-term investments.

Inventories

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

Segment Reporting

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Ciena's chief operating decision maker, its chief executive officer, evaluates performance and allocates resources based on multiple factors, including segment profit (loss) information for the following product categories: (i) Packet-Optical Transport; (ii) Packet-Optical Switching; (iii) Carrier-Ethernet Solutions; and (iv) Software and Services. Operating segments are defined as components of an enterprise: that engage in business activities which may earn revenue and incur expense; for which discrete financial information is available; and for which such information is evaluated regularly by the chief operating decision maker for purposes of allocating resources and assessing performance. Ciena considers the four product categories above to be its operating segments for reporting purposes. See Note 17.

Long-lived Assets

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

Equipment, Furniture and Fixtures

Equipment, furniture and fixtures are recorded at cost. Depreciation and amortization are computed using the straight-line method over useful lives of 2 years to 5 years for equipment, furniture and fixtures and the shorter of useful life or lease term for leasehold improvements.

Qualifying internal use software and website development costs incurred during the application development stage that consist primarily of outside services and purchased software license costs, are capitalized and amortized straight-line over the estimated useful lives of 2 years to 5 years.

Intangible Assets

Ciena has recorded finite-lived intangible assets as a result of several acquisitions. Finite-lived intangible assets are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the expected economic lives of the respective assets, up to 7 years, which approximates the use of intangible assets.

Maintenance Spares

Maintenance spares are recorded at cost. Spares usage cost is expensed ratably over 4 years.

Concentrations

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

Historically, a significant percentage of Ciena's revenue has been concentrated among sales to a small number of large communications service providers. Consolidation among Ciena's customers has increased this concentration. Consequently, Ciena's accounts receivable are concentrated among these customers. See Note 17 below.

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

Revenue Recognition

Ciena recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and evidence of customer acceptance, when applicable, are used to verify delivery or

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services rendered. Ciena assesses whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. Ciena assesses collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are to be performed.

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

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

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each delivered element, with revenue recognized when the revenue recognition criteria are met for each delivered element. Ciena determines the selling price for each deliverable based upon the selling price hierarchy for multiple-deliverable arrangements. Under this hierarchy, Ciena uses vendor-specific objective evidence (“VSOE”) of selling price, if it exists, or third party evidence (“TPE”) of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, Ciena uses its best estimate of selling price (“BESP”) for that deliverable. Ciena limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or refund privileges.

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

Warranty Accruals

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

Accounts Receivable, Net

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

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

Research and Development

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

Government Grants

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Ciena accounts for proceeds from government grants as a reduction of operating expense when there is reasonable assurance that Ciena has complied with the conditions attached to the grant and that the grant proceeds will be received. Grant benefits are recorded to the line item in the Consolidated Statement of Operations to which the grant activity relates. See Note 18 below.

Advertising Costs

Ciena expenses all advertising costs as incurred.

Legal Costs

Ciena expenses legal costs associated with litigation defense as incurred.

Share-Based Compensation Expense

Ciena measures and recognizes compensation expense for share-based awards based on estimated fair values on the date of grant. Ciena estimates the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This model is affected by Ciena's stock price as well as estimates regarding a number of variables including expected stock price volatility over the expected term of the award and projected employee stock option exercise behaviors. Ciena estimates the fair value of each restricted stock unit is based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense to its consolidated statement of operations for those options or shares that are expected ultimately to vest. Ciena recognizes the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon its determination of whether it is probable that the performance targets will be achieved. At each reporting period, Ciena reassesses the probability of achieving the performance targets and the performance period required to meet those targets. Ciena uses the straight-line method to record expense for grants with only service-based vesting. See Note 15 below.

Income Taxes

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

In the ordinary course of business, transactions occur for which the ultimate outcome may be uncertain. In addition, tax authorities periodically audit Ciena's income tax returns. These audits examine significant tax filing positions, including the timing and amounts of deductions and the allocation of income tax expenses among tax jurisdictions. Ciena is currently under audit in India for 2007 and 2008, Mexico for 2007 and the United Kingdom for 2009. Management does not expect the outcome of these audits to have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows. Ciena's major tax jurisdictions and the earliest open tax years are as follows: United States (2008), United Kingdom (2006), Canada (2005) and India (2007). However, limited adjustments can be made to Federal tax returns in earlier years in order to reduce net operating loss carryforwards. Ciena classifies interest and penalties related to uncertain tax positions as a component of income tax expense. All of the uncertain tax positions, if recognized, would decrease the effective income tax rate.

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

Ciena recognizes windfall tax benefits associated with the exercise of stock options or release of restricted stock units directly to stockholders' equity only when realized. A windfall tax benefit occurs when the actual tax benefit realized by Ciena upon an employee's disposition of a share-based award exceeds the deferred tax asset, if any, associated with the award that Ciena had recorded. When assessing whether a tax benefit relating to share-based compensation has been realized, Ciena follows the tax law “with-and-without” method. Under the with-and-without method, the windfall is considered realized and recognized for financial statement purposes only when an incremental benefit is provided after considering all other tax

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benefits including Ciena's net operating losses. The with-and-without method results in the windfall from share-based compensation awards always being effectively the last tax benefit to be considered. Consequently, the windfall attributable to share-based compensation will not be considered realized in instances where Ciena's net operating loss carryover (that is unrelated to windfalls) is sufficient to offset the current year's taxable income before considering the effects of current-year windfalls.

Loss Contingencies

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

Fair Value of Financial Instruments

The carrying value of Ciena's cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximates fair market value due to the relatively short period of time to maturity. For information related to the fair value of Ciena's convertible notes, see Note 13 below.

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

- Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 inputs are quoted prices for identical or similar assets or liabilities in less active markets or model-derived valuations in which significant inputs are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;
- Level 3 inputs are unobservable inputs based on Ciena's assumptions used to measure assets and liabilities at fair value.

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

Restructuring

From time to time, Ciena takes actions to better align its workforce, facilities and operating costs with perceived market opportunities, business strategies and changes in market and business conditions. Ciena implements these restructuring plans and incurs the associated liability concurrently. Generally accepted accounting principles require that a liability for the cost associated with an exit or disposal activity be recognized in the period in which the liability is incurred, except for one-time employee termination benefits related to a service period of more than 60 days, which are accrued over the service period. See Note 3 below.

Foreign Currency

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

Derivatives

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

From time to time, Ciena uses foreign currency forward contracts to reduce variability in certain forecasted non U.S.-dollar denominated cash flows. Generally, these derivatives have maturities of twelve months or less and are designated as cash flow hedges. At the inception of the cash flow hedge, and on an ongoing basis, Ciena assesses whether the forward contract has been effective in offsetting changes in cash flows attributable to the hedged risk during the hedging period. The effective portion of the derivative's net gain or loss is initially reported as a component of accumulated other comprehensive income (loss), and, upon the occurrence of the forecasted transaction, is subsequently reclassified to the line item in the Consolidated Statement of Operations to which the hedged transaction relates. Any net gain or loss associated with the ineffectiveness of the hedging instrument is reported in interest and other income, net. See Note 12 below.

Computation of Net Income (Loss) per Share

Ciena calculates basic earnings per share (EPS) by dividing earnings attributable to common stock by the weighted-average number of common shares outstanding for the period. Diluted EPS includes other potential dilutive shares that would be outstanding if securities or other contracts to issue common stock were exercised or converted into common stock. Ciena uses a dual presentation of basic and diluted EPS on the face of its income statement. A reconciliation of the numerator and denominator used for the basic and diluted EPS computations is set forth in Note 14.

Software Development Costs

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

Newly Issued Accounting Standards

In June 2011, the FASB issued an accounting standards update that requires an entity to present total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. In December 2011, the portion of this guidance related to the presentation of the reclassifications of items out of accumulated other comprehensive income was deferred. The remainder of this guidance is effective for fiscal years and interim periods beginning after December 15, 2011. Early adoption is permitted. Ciena does not expect this new guidance to have any impact on its financial condition, results of operations and cash flows.

In May 2011, the FASB issued an accounting standards update that amends current fair value measurement and disclosure guidance to converge with International Financial Reporting Standards (IFRS). This update provides improved comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. This guidance is effective for fiscal years and interim periods, beginning after

December 15, 2011. Early application by public companies is not permitted. Ciena does not expect this new guidance to have any impact on its financial condition, results of operations and cash flows.

(3) RESTRUCTURING COSTS

Ciena has undertaken a number of restructuring activities intended to reduce expense and better align its workforce and costs with market opportunities, product development and business strategies. The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the three months ended January 31, 2012 (in thousands):

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	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2011	$160	$3,293	$3,453
Additional liability recorded	1,722	—	1,722
Cash payments	(242)	(463)	(705)
Balance at January 31, 2012	$1,640	$2,830	$4,470
Current restructuring liabilities	$1,640	$439	$2,079
Non-current restructuring liabilities	$—	$2,391	$2,391

The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the three months ended January 31, 2011 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2010	$1,576	$6,392	$7,968
Additional liability recorded	1,522	—	1,522
Cash payments	(2,112)	(501)	(2,613)
Balance at January 31, 2011	$986	$5,891	$6,877
Current restructuring liabilities	$986	$1,182	$2,168
Non-current restructuring liabilities	$—	$4,709	$4,709

(4) MARKETABLE SECURITIES

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

	January 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations	$49,946	$293	$—	$50,239
Included in short-term investments	$49,946	$293	$—	$50,239

	October 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations	$49,933	$331	$—	$50,264
Included in long-term investments	$49,933	$331	$—	$50,264

The following table summarizes final legal maturities of debt investments at January 31, 2012 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than one year	$49,946	$50,239
Due in 1-2 years	—	—

	$49,946	$50,239

(5) FAIR VALUE MEASUREMENTS

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

	January 31, 2012			
	Level 1	Level 2	Level 3	Total
Assets:				
U.S. government obligations	$50,239	$—	$—	$50,239
Foreign currency forward contracts	—	575	—	575
Embedded redemption feature	—	—	6,040	6,040
Total assets measured at fair value	$50,239	$575	$6,040	$56,854

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

	January 31, 2012			
	Level 1	Level 2	Level 3	Total
Assets:				
Short-term investments	$50,239	$—	$—	$50,239
Prepaid expenses and other	—	575	—	575
Other long-term assets	—	—	6,040	6,040
Total assets measured at fair value	$50,239	$575	$6,040	$56,854

Ciena's Level 3 assets included in other long-term assets reflect an embedded redemption feature contained within Ciena's 4.0% convertible senior notes. See Note 13 below. The embedded redemption feature is bifurcated from Ciena's 4.0% convertible senior notes using the "with-and-without" approach. As such, the total value of the embedded redemption feature is calculated as the difference between the value of the 4.0% convertible senior notes (the "Hybrid Instrument") and the value of an identical instrument without the embedded redemption feature (the "Host Instrument"). Both the Host Instrument and the Hybrid Instrument are valued using a modified binomial model. The modified binomial model utilizes a risk free interest rate, an implied volatility of Ciena's stock, the recovery rates of bonds and the implied default intensity of the 4.0% convertible senior notes.

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

	Level 3
Balance at October 31, 2011	$7,020
Issuances	—
Settlements	—
Changes in unrealized gain (loss)	(980)
Transfers into Level 3	—
Transfers out of Level 3	—
Balance at January 31, 2012	$6,040

(6) ACCOUNTS RECEIVABLE

Allowance for doubtful accounts was $0.7 million and $1.6 million as of October 31, 2011 and January 31, 2012, respectively. Ciena has not historically experienced a significant amount of bad debt expense.

(7) INVENTORIES

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

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	October 31, 2011	January 31, 2012
Raw materials	$45,333	$43,486
Work-in-process	13,851	17,659
Finished goods	134,998	146,857
Deferred cost of goods sold	67,665	76,243
	261,847	284,245
Provision for excess and obsolescence	(31,771)	(35,594)
	$230,076	$248,651

Ciena writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated net realizable value based on assumptions about future demand and market conditions. During the first three months of fiscal 2012, Ciena recorded a provision for excess and obsolescence of $8.2 million, primarily related to engineering design changes and the discontinuance of certain parts and components used in the manufacture of our Packet-Optical Transport and Packet-Optical Switching products. Deductions from the provision for excess and obsolete inventory relate to disposal activities.

(8) PREPAID EXPENSES AND OTHER

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

	October 31, 2011	January 31, 2012
Prepaid VAT and other taxes	$44,969	$29,154
Deferred deployment expense	17,839	22,022
Product demonstration equipment, net	46,996	36,739
Prepaid expenses	14,769	12,250
Restricted cash	12,533	13,986
Other non-trade receivables	6,251	12,405
	$143,357	$126,556

Depreciation of product demonstration equipment was $2.1 million and $2.4 million for the first three months of fiscal 2011 and 2012, respectively.

(9) EQUIPMENT, FURNITURE AND FIXTURES

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

	October 31, 2011	January 31, 2012
Equipment, furniture and fixtures	$396,310	$401,352
Leasehold improvements	50,380	50,252
	446,690	451,604
Accumulated depreciation and amortization	(324,132)	(333,499)
	$122,558	$118,105

Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements was $12.4 million and $12.3 million for the first three months of fiscal 2011 and 2012, respectively.

(10) OTHER INTANGIBLE ASSETS

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

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	October 31, 2011			January 31, 2012		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Developed technology	$417,833	$(234,393)	$183,440	$417,833	$(246,412)	$171,421
Patents and licenses	46,538	(45,320)	1,218	46,538	(45,382)	1,156
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	323,573	(176,596)	146,977	323,573	(183,930)	139,643
Total other intangible assets	$787,944	$(456,309)	$331,635	$787,944	$(475,724)	$312,220

The amortization of finite-lived other intangible assets was $37.1 million and $19.4 million for the first three months of fiscal 2011 and 2012, respectively. Expected future amortization of finite-lived other intangible assets for the fiscal years" indicated is as follows (in thousands):

Period ended October 31,	
2012 (remaining nine months)	$55,082
2013	71,309
2014	57,151
2015	52,879
2016	52,879
Thereafter	22,920
	$312,220

(11)OTHER BALANCE SHEET DETAILS

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

	October 31, 2011	January 31, 2012
Maintenance spares inventory, net	$50,442	$51,674
Deferred debt issuance costs, net	23,481	22,148
Embedded redemption feature	7,020	6,040
Restricted cash	27,507	26,920
Other	5,673	5,785
	$114,123	$112,567

Deferred debt issuance costs are amortized using the straight line method, which approximates the effect of the effective interest rate method, through the maturity of the related debt. Amortization of debt issuance costs, which is included in interest expense, was $1.3 million and $1.3 million during the first three months of fiscal 2011 and fiscal 2012, respectively.

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

	October 31, 2011	January 31, 2012
Warranty	$47,282	$49,044
Compensation, payroll related tax and benefits	51,808	45,897
Vacation	27,808	27,575
Current restructuring liabilities	664	2,079
Interest payable	4,248	10,026
Other	65,194	65,493

	$197,004	$200,114

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

Three months ended January 31,	Beginning Balance	Provisions	Settlements	Balance at end of period
2011	$54,372	1,093	(6,900)	$48,565
2012	$47,282	7,706	(5,944)	$49,044

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

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

	October 31, 2011	January 31, 2012
Products	$ 42,915	$35,046
Services	80,883	66,118
	123,798	101,164
Less current portion	(99,373)	(79,880)
Long-term deferred revenue	$ 24,425	$21,284

(12) FOREIGN CURRENCY FORWARD CONTRACTS

During the first quarter of fiscal 2012, Ciena entered into forward contracts to reduce the variability in its Canadian Dollar denominated expense, which principally relate to research and development activities. These derivative contracts have been designated as cash flow hedges and are immaterial for separate financial statement presentation.

(13) CONVERTIBLE NOTES PAYABLE

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

	January 31, 2012	
Description	Carrying Value	Fair Value
0.25% Convertible Senior Notes due May 1, 2013	$216,210	$214,318
4.0% Convertible Senior Notes due March 15, 2015 [(1)]	376,069	406,406
0.875% Convertible Senior Notes due June 15, 2017	500,000	411,250
3.75% Convertible Senior Notes due October 15, 2018	350,000	375,375
	$1,442,279	$1,407,349

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

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

(14) EARNINGS (LOSS) PER SHARE CALCULATION

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

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	Quarter Ended January 31,	
Numerator	2011	2012
Net loss	$(79,056)	$(47,653)

	Quarter Ended January 31,	
Denominator	2011	2012
Basic weighted average shares outstanding	94,496	98,066
Dilutive weighted average shares outstanding	94,496	98,066

	Quarter Ended January 31,	
EPS	2011	2012
Basic EPS	$(0.84)	$(0.49)
Diluted EPS	$(0.84)	$(0.49)

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

	Quarter Ended January 31,	
	2011	2012
Shares underlying stock options, restricted stock units and warrants	6,447	7,098
0.25% Convertible Senior Notes due May 1, 2013	5,470	5,470
4.00% Convertible Senior Notes due March 15, 2015	18,396	18,396
0.875% Convertible Senior Notes due June 15, 2017	13,108	13,108
3.75% Convertible Senior Notes due October 15, 2018	17,355	17,355
Total excluded due to anti-dilutive effect	60,776	61,427

(15) SHARE-BASED COMPENSATION EXPENSE

Ciena maintains two active equity compensation plans, the 2008 Omnibus Incentive Plan (“2008 Plan”) and 2003 Employee Stock Purchase Plan (“ESPP”). These plans were approved by shareholders and are described in Ciena’s annual report on Form 10-K. Ciena has previously made stock option and restricted stock unit awards under the 2008 Plan and certain legacy plans. As of January 31, 2012, there were approximately 1.5 million shares authorized and remaining available for issuance under the 2008 Plan. Ciena has also previously granted restricted stock unit awards under its 2010 Inducement Equity Award Plan (“2010 Plan”). This plan, described in Ciena’s annual report on Form 10-K, expired on March 19, 2011.

Stock Options

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

	Shares Underlying Options Outstanding	Weighted Average Exercise Price
Balance at October 31, 2011	3,690	$30.01
Granted	—	—
Exercised	(14)	4.44
Canceled	(22)	57.81
Balance at January 31, 2012	3,654	$29.95

The total intrinsic value of options exercised during the first three months of fiscal 2011 and fiscal 2012 was $1.4 million and $0.1 million, respectively. There were no stock options granted by Ciena during the first three months of fiscal 2011 and

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fiscal 2012.

The following table summarizes information with respect to stock options outstanding at January 31, 2012, based on Ciena's closing stock price on the last trading day of Ciena's first fiscal quarter of 2012 (shares and intrinsic value in thousands):

	Options Outstanding at January 31, 2012				Vested Options at January 31, 2012			
Range of Exercise Price	Number of Underlying Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number of Underlying Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
$0.94 — $16.31	363	5.87	$8.34	$2,431	278	5.40	$7.75	$2,027
$16.52 — $17.29	401	3.43	16.69	—	394	3.38	16.68	—
$17.43 — $24.50	554	3.32	20.49	—	548	3.28	20.49	—
$24.69 — $28.28	419	4.72	26.97	—	418	4.72	26.98	—
$28.61 — $31.43	284	3.58	29.78	—	279	3.54	29.77	—
$31.71 — $32.55	523	1.08	31.72	—	521	1.06	31.72	—
$33.00 — $37.10	349	5.27	35.17	—	347	5.26	35.18	—
$37.31 — $47.32	508	2.68	44.72	—	508	2.68	44.72	—
$47.53 — $167.09	251	0.33	65.60	—	251	0.33	65.60	—
$267.52 — $267.52	2	0.65	267.52	—	2	0.65	267.52	—
$0.94 — $267.52	3,654	3.34	$29.95	$2,431	3,546	3.22	$30.46	$2,027

Assumptions for Option-Based Awards

Ciena recognizes the fair value of service-based options as share-based compensation expense on a straight-line basis over the requisite service period. Ciena did not grant any option-based awards during the first three months of fiscal 2011 and fiscal 2012.

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

Restricted Stock Units

A restricted stock unit is a stock award that entitles the holder to receive shares of Ciena common stock as the unit vests. Ciena's outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. Awards subject to service-based conditions typically vest in increments over a three or four-year period. Awards with performance-based vesting conditions require the achievement of certain operational, financial or other performance criteria or targets as a condition of vesting, or the acceleration of vesting, of such awards. Ciena recognizes the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based compensation expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon Ciena's determination of whether it is probable that the performance targets will be achieved. At each reporting period, Ciena reassesses the probability of achieving the performance targets and the performance period required to meet those targets.

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

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	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value Per Share	Aggregate Fair Value
Balance at October 31, 2011	4,298	$16.28	$59,399
Granted	2,090		
Vested	(629)		
Canceled or forfeited	(178)		
Balance at January 31, 2012	5,581	19.30	$83,879

The total fair value of restricted stock units that vested and were converted into common stock during the first three months of fiscal 2011 and fiscal 2012 was $10.8 million and $7.3 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first three months of fiscal 2011 and fiscal 2012 was $19.25 and $10.69, respectively.

Assumptions for Restricted Stock Unit Awards

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

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

2003 Employee Stock Purchase Plan

In March 2003, Ciena stockholders approved the ESPP, which has a ten-year term expiring on January 24, 2013. The ESPP provides for up to 3.6 million shares to be issued thereunder, subject to an “evergreen” provision. On December 31 of each year, the number of shares available under the ESPP increases by up to 0.6 million shares, provided that the total number of shares available at that time shall not exceed 3.6 million. Under the ESPP, eligible employees may enroll in a six-month offer period that begins on December 21 and June 21 of each year. The purchase price under the ESPP reflects a 15% discount off of the lower of the fair market value of Ciena common stock on the day preceding the offer period or the last day of the offer period. The ESPP is considered compensatory for purposes of share-based compensation expense. During the first three months of fiscal 2012, Ciena issued 0.6 million shares under the ESPP. At January 31, 2012, 3.2 million shares remained available for issuance under the ESPP.

Share-Based Compensation Expense for Periods Reported

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

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	Quarter Ended January 31,	
	2011	2012
Product costs	$574	$485
Service costs	503	437
Share-based compensation expense included in cost of sales	1,077	922
Research and development	2,571	2,134
Sales and marketing	2,991	3,101
General and administrative	3,001	2,797
Acquisition and integration costs	160	6
Share-based compensation expense included in operating expense	8,723	8,038
Share-based compensation expense capitalized in inventory, net	64	(72)
Total share-based compensation	$9,864	$8,888

As of January 31, 2012, total unrecognized share-based compensation expense was $71.3 million: (i) $0.6 million related to unvested stock options and expected to be recognized over a weighted-average period of 0.7 year and (ii) $70.7 million related to unvested restricted stock units and expected to be recognized over a weighted-average period of 1.7 years.

(16) COMPREHENSIVE LOSS

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

	Quarter Ended January 31,	
	2011	2012
Net loss	$(79,056)	$(47,653)
Change in unrealized gain (loss) on available-for-sale securities, net of tax	183	(24)
Change in unrealized gain on foreign currency forward contracts, net of tax	—	364
Change in accumulated translation adjustments	(432)	(2,222)
Total comprehensive loss	$(79,305)	$(49,535)

(17) SEGMENT AND ENTITY WIDE DISCLOSURES

Segment Reporting

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

- Packet-Optical Transport — includes optical transport solutions that increase network capacity and enable more rapid delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the cost effective and efficient transport of voice, video and data traffic in core, regional, metro and access networks. Ciena's Packet-Optical Transport products support the efficient delivery of a wide variety of consumer-oriented network services, as well as key managed service and enterprise applications. Ciena's principal products in this segment include the 6500 Packet-Optical Platform, 4200 Advanced Services Platform; Corestream® Agility Optical Transport System, 5100/5200 Advanced Services Platform, Common Photonic Layer (CPL), and 6100 Multiservice Optical Platform. This segment also includes sales from legacy SONET/SDH, transport and data networking products, as well as certain enterprise-oriented transport solutions that support storage and LAN extension, interconnection of data centers, and virtual private networks. This segment also includes operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Consolidated Statement of Operations.
- Packet-Optical Switching — includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Ciena's principal products in this segment include its family of CoreDirector® Multiservice Optical Switches, its 5430 Reconfigurable Switching System and its OTN configuration for the 5410 Reconfigurable Switching System. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital

cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed service services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced

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

- Carrier-Ethernet Solutions — principally includes Ciena's 3000 family of service delivery switches and service aggregation switches, the 5000 series of service aggregation switches, and its Carrier Ethernet packet configuration for the 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have principally been deployed to support wireless backhaul infrastructures and business data services. Employing sophisticated Carrier Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment also includes legacy broadband products, including the CNX-5 Broadband DSL System (CNX-5), that transitions legacy voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Consolidated Statement of Operations.
- Software and Services — includes the Ciena One software suite, including OneControl, the integrated network and service management software designed to automate and simplify network management, operation and service delivery. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network troubles. In addition to Ciena One, this segment includes the ON-Center® Network & Service Management Suite, and the OMEA and Preside platforms from the MEN Business. This segment also includes a broad range of consulting and support services, including installation and deployment, maintenance support, consulting, network design and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Consolidated Statement of Operations.

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

Segment Revenue

The table below (in thousands) sets forth Ciena’s segment revenue for the respective periods:

	Quarter Ended January 31,	
	2011	2012
Revenue:		
Packet-Optical Transport	$286,481	$266,284
Packet-Optical Switching	35,274	43,416
Carrier-Ethernet Solutions	27,628	21,913
Software and Services	83,925	85,072
Consolidated revenue	$433,308	$416,685

Segment Profit (Loss)

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

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

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	Quarter Ended January 31,	
	2011	2012
Segment profit:		
Packet-Optical Transport	$39,026	$47,138
Packet-Optical Switching	12,877	17,181
Carrier-Ethernet Solutions	2,393	(6,107)
Software and Services	18,420	19,880
Total segment profit	72,716	78,092
Less: non-performance operating expenses		
Selling and marketing	57,092	64,411
General and administrative	38,314	29,400
Acquisition and integration costs	24,185	264
Amortization of intangible assets	28,784	13,471
Restructuring costs	1,522	1,722
Change in fair value of contingent consideration	(3,289)	—
Add: other non-performance financial items		
Interest expense and other income (loss), net	(3,285)	(14,457)
Less: Provision for income taxes	1,879	2,020
Consolidated net loss	$(79,056)	$(47,653)

Entity Wide Reporting

The following table reflects Ciena’s geographic distribution of revenue based on the location of the purchaser, with any country accounting for a significant percentage of total revenue in the period specifically identified. Revenue attributable to geographic regions outside of the United States and Canada is reflected as “Other International” revenue. For the periods below, Ciena’s geographic distribution of revenue was as follows (in thousands):

	Quarter Ended January 31,	
	2011	2012
United States	$220,349	$233,078
Canada	44,485	42,652
Other International	168,474	140,955
Total	$433,308	$416,685

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

	October 31,	January 31,
	2011	2012
United States	$60,848	$56,628
Canada	47,424	49,403
Other International	14,286	12,074
Total	$122,558	$118,105

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

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	Quarter Ended January 31,	
	2011	2012
Company A	$60,837	$80,586
Company B	47,822	n/a
Total	$108,659	$80,586

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

(18) COMMITMENTS AND CONTINGENCIES

Ontario Grant

Ciena was awarded a conditional grant from the Province of Ontario in June 2011. Under this strategic jobs investment fund grant, Ciena can receive up to an aggregate of C$25.0 million in funding for eligible costs relating to certain next-generation, coherent optical transport development initiatives over the period from November 1, 2010 to October 31, 2015. Ciena anticipates receiving disbursements, approximating C$5.0 million per fiscal year over the period above. Amounts received under the grant are subject to recoupment in the event that Ciena fails to achieve certain minimum investment, employment and project milestones. As of January 31, 2012, Ciena has recorded a C$7.0 million benefit to date as a reduction in research and development expenses because it believes it has complied with the conditions entitling it to this disbursement, of which C$5.0 million has been received.

Foreign Tax Contingencies

Ciena has received assessment notices from the Mexican tax authorities asserting deficiencies in payments between 2001 and 2005 related primarily to income taxes and import taxes and duties. Ciena has filed judicial petitions appealing these assessments. As of October 31, 2011 and January 31, 2012, Ciena had accrued liabilities of $1.4 million and $1.6 million related to these contingencies, which are reported as a component of other current accrued liabilities. As of January 31, 2012, Ciena estimates that it could be exposed to possible losses of up to $5.8 million, for which it has not accrued liabilities. Ciena has not accrued the additional income tax liabilities because it does not believe that such losses are probable. Ciena has not accrued the additional import taxes and duties because it does not believe the incurrence of such losses are probable. Ciena continues to evaluate the likelihood of probable and reasonably possible losses, if any, related to these assessments. As a result, future increases or decreases to accrued liabilities may be necessary and will be recorded in the period when such amounts are estimable and more likely than not (for income taxes) or probable (for non-income taxes).

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

Litigation

On July 29, 2011, Cheetah Omni LLC filed a complaint in the United States District Court for the Eastern District of Texas against Ciena and several other defendants, alleging, among other things, that certain of the parties' products infringe upon multiple U.S. Patents relating to certain reconfigurable optical add-drop multiplexer (ROADM) technologies. The complaint seeks injunctive relief and damages. On November 8, 2011, Ciena filed an answer and counterclaims to Cheetah Omni's amended complaint. Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously.

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

assemblies. The complaint seeks injunctive relief and damages. Ciena filed an answer to the complaint and counterclaims against Graywire on April 17, 2009. On April 27, 2009, Ciena and certain other defendants filed an application for inter partes reexamination of the '673 Patent with the U.S. Patent and Trademark Office (the “PTO”). On the same date, Ciena and the other defendants filed a motion to stay the case pending reexamination of all of the patents-in-suit. On July 17, 2009, the district court granted the defendants' motion to stay the case. On July 23, 2009, the PTO granted the defendants' application for reexamination with respect to certain claims of the '673 Patent and, on December 17, 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims. On February 28, 2011, Ciena and the other defendants filed an appeal with respect to certain aspects of the PTO's determination. Separately, on March 17, 2011, the PTO granted a third party application for ex parte reexamination with respect to certain claims of the '673 Patent and, on September 2, 2011, the PTO issued a non-final rejection of the validity of those

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claims. On December 14, 2011, the PTO issued a Notice of Intent to Issue a Reexamination Certificate in the ex parte reexamination. Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously in the event the stay of the case is lifted.

As a result of its June 2002 acquisition of ONI Systems Corp., Ciena became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The cause of action and history of the proceedings are more fully described in Ciena's Annual Report on Form 10-K for fiscal 2011 filed with the SEC on December 22, 2011. On January 9, 2012, the final appellant in this securities class action lawsuit withdrew and dismissed his appeal with prejudice in accordance with the terms of the settlement agreement. Ciena was not required to pay any amount toward the settlement or to make any other payments to plaintiffs in connection with the resolution of this matter.

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

Operating Lease Commitments

Ciena entered into a lease agreement dated November 3, 2011, with W2007 RDG Realty, L.L.C. relating to office space for its new corporate headquarters in Hanover, Maryland, consisting of an agreed-upon rentable area of approximately 154,100 square feet. The future minimal rental commitments to be paid over the 15-year lease term are approximately $64.9 million.

(19) SUBSEQUENT EVENT

On February 13, 2012, Ciena Canada, Inc., a subsidiary of Ciena Corporation, and Public Works and Government Services Canada (PWGSC), entered into an amendment (the “Amendment”) to the agreement dated March 19, 2010 relating to Ciena's lease of the “Lab 10” building on the former Nortel Carling Campus (the “Lab 10 Lease”) in Ottawa, Canada. The Amendment extends the term of the Lab 10 Lease from March 19, 2015 to March 18, 2016, with the resulting aggregate annual payment by Ciena for this additional year to be approximately C$8.8 million, consisting of both base rent and additional operating expense obligations under the Lab 10 Lease. In connection with the Amendment, by separate agreement, Ciena and PWGSC agreed to shorten the term of the lease of Ciena's “Lab 2” facility on the Carling Campus from March 18, 2015 to December 31, 2012.

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

Some of the statements contained, or incorporated by reference, in this quarterly report discuss future events or expectations, contain projections of results of operations or financial condition, changes in the markets for our products and services, or state other “forward-looking” information. Ciena’s “forward-looking” information is based on various factors and was derived using numerous assumptions. In some cases, you can identify these “forward-looking statements” by words like “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “pote “continue” or the negative of those words and other comparable words. You should be aware that these statements only reflect our current predictions and beliefs. These statements are subject to known and unknown risks, uncertainties and other factors, and actual events or results may differ materially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly in Item 1A “Risk Factors” of Part II of this report below. You should review these risk factors and the rest of this quarterly report in combination with the more detailed description of our business and management’s discussion and analysis of financial condition in our annual report on Form 10-K, which we filed with the Securities and Exchange Commission on December 22, 2011, for a more complete understanding of the risks associated with an investment in Ciena’s securities. Ciena undertakes no obligation to revise or update any forward-looking statements.

Overview

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

We are a network specialist focused on the modernization and transition of disparate, legacy network infrastructures to

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converged, next-generation architectures, optimized to handle a broader mix of high-bandwidth communications services. Our product portfolio consists of our Packet-Optical Transport, Packet-Optical Switching and Carrier-Ethernet Solutions products that enable network operators to scale capacity and increase transmission speeds, transport and efficiently allocate network traffic, and deliver services to business and consumer end users. Our network solutions also include our Ciena One software suite for unified network management and network planning and design, as well as a broad offering of advanced network consulting, design, implementation and support services.

Our customers face a challenging and rapidly changing environment that requires their networks to be robust enough to address increasing capacity needs and flexible enough to quickly adapt to emerging applications and evolving consumer and business use of communications services. Our comprehensive, solutions-oriented approach, comprised of hardware, software and advanced service offerings, seek to enable software-defined, automated, next-generation networks that better address the business challenges, infrastructure requirements and service delivery needs of our customers. By improving network productivity and automation, reducing network costs and enabling rapid deployment of differentiated service offerings, our communications networking solutions create business and operational value for our customers.

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

Global Market Conditions and Competitive Landscape

The sustained period of macroeconomic weakness and volatility in the global economy and in capital markets has resulted in heightened uncertainty and cautious customer behavior in our industry and markets. These dynamics have caused increased customer scrutiny with respect to network investment, which has resulted in protracted sales cycles, lengthier network deployments, revenue recognition delays and extended collection cycles, particularly for international and solutions-oriented network projects. Broad macroeconomic weakness has previously resulted in periods of decreased demand for our products and services that have adversely affected our results of operations. We remain uncertain as to how long current macroeconomic and industry conditions will persist, the pace of any recovery, and the magnitude of the effect of these conditions on the growth of our markets and business, as well as our results of operations.

We continue to encounter a highly competitive marketplace for sales of our networking solutions offering, particularly within our Packet-Optical Transport segment. Competition has intensified as we and our competitors have introduced new, high-capacity, high-speed network solutions and have more aggressively sought to capture market share and displace incumbent vendors at larger customers. We have also encountered increased competition as we have expanded our business in new geographies, markets, customer segments and applications for our communications networking products. In this competitive environment, securing new opportunities, particularly in international markets, often requires that we agree to less favorable commercial terms or pricing, commercial or deployment arrangements that can elongate the revenue recognition cycle, financial commitments requiring collateralized performance bonds or similar instruments that place cash resources at risk, and other contractual commitments that place a disproportionate allocation of risk upon the vendor. These terms can adversely affect our result of operations and contribute to fluctuations in our results. We expect the level of competition, particularly in North America, to continue and potentially increase, as Chinese equipment vendors seek to gain entry into the U.S. market, and other multinational competitors seek to retain incumbent positions with large customers in the region.

Potential Supply Chain Disruption

In the fall of 2011, several regions of Thailand experienced severe flooding, causing significant damage to infrastructure and factories. This flooding affected the operations of certain component providers in our supply chain, or, in turn, their suppliers of components based in Thailand. In recent months, we have seen meaningful recovery, with the resumption of operations of certain suppliers and restoration of key transportation infrastructure. While we continue to work with our suppliers to monitor their operating and supply capabilities, we may encounter shortages, extended lead times, or additional costs over the next several fiscal quarters as the recovery continues.

Market Opportunity and Strategy

Despite recent macroeconomic and competitive dynamics, we believe that a number of important underlying drivers represent significant long-term opportunities and growing demand for converged optical Ethernet networking solutions in our target markets. We believe that market trends, including the proliferation of smartphones, tablets and similar devices running mobile web applications, the prevalence of video applications, and the shift of enterprise and consumer applications to cloud-

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based or virtualized network environments are emblematic of increased use and dependence by consumers and enterprises upon a growing variety of broadband applications and services. We expect that these services will continue to add significant multiservice network traffic, requiring our customers to invest in next-generation, high-capacity network infrastructures that are more efficient, robust and dynamic.

Our corporate strategy to capitalize on these market dynamics, promote operational efficiency and drive profitable growth of our business includes the following initiatives:

Evolve Go-to-Market Model. We seek to evolve our go-to-market model, both from a coverage and an engagement perspective.

Coverage. Our coverage model is focused on penetrating high-growth geographic markets, selling into emerging customer segments and addressing additional network applications with our solutions. We seek to enhance our brand internationally, expand our geographic reach and capture market share in international markets, including Brazil, the Middle East, Russia, Japan and India. We intend to pursue opportunities to diversify our customer base and seek to grow our sales to wireless providers, cable and multiservice operators, enterprises, government agencies, and research and educational institutions. We are also targeting network operators emerging as a result of network modernization drivers and the introduction and adoption of new communication services and applications. In particular, we seek to sell our solutions to support additional network applications, including in submarine networks, Internet content providers, cloud-based services, business Ethernet services and mobile backhaul. We intend to pursue sales initiatives and strategic channel opportunities, including relationships with resellers, service providers, other vendors and integrators, to complement our direct sales force and more deeply penetrate these geographic markets, customers and applications.

Engagement. Our strategy is to leverage our close relationship with customers in the design, development, implementation and support of their networks and to promote a close alignment of our solutions with customer network priorities. This engagement model is a key differentiator for our business and provides us with unique insight into the business and network needs of our customers. We seek to offer an expanded portfolio of advanced professional services that address the network modernization demands and business needs of our customers. We believe this services-oriented, solutions offering shifts our value proposition beyond the sale of our next-generation communications networking products and allows us to better participate in the evolution of our customers' networks. By understanding and addressing their network infrastructure needs, the competitive landscape, and the evolving markets in which our customers compete, we believe this customized solutions offering creates additional business and operational value for our customers, enabling them to better compete in a challenging environment.

Alignment of Research and Development Investment with Growth Opportunities. We seek to ensure that our product development initiatives and investments are closely aligned with current and future market growth opportunities. As end-user needs evolve, opportunities are emerging that allow us to expand our role in our customers' networks. We intend to apply our “intelligent infrastructure” approach -- a cost-optimized network platform that enables virtualization, mobility, and greater scale, bandwidth management and automation -- to high-growth markets, applications and customer segments. These include enterprise-oriented applications, optimized submarine cable solutions, Internet content delivery, cloud service infrastructure and packet-based infrastructure solutions for next-generation, high-capacity networks. Through a combination of technology innovation, as well as cross-selling and other sales initiatives, we seek to drive additional business from these growth applications and customer segments.

Promote our network approach and vision. The services and applications running on communications networks require that more of the traffic on these networks be packet-oriented. The traditional approach to this problem has been to add IP routing capability at various points in the network. As capacity needs grow, this approach becomes unnecessarily complex and costly. We reduce the cost and complexity of growing these networks by bringing together

the reliability and capacity of optical networking with the flexibility and economics of Ethernet, unified by our integrated network management software -- something we call “converged optical Ethernet.” Converged optical Ethernet creates a network that is resilient, reconfigurable and automated. We believe that these attributes are essential to supporting next-generation services and applications at the performance level required by end users. We intend to promote the scalability, flexibility and cost effectiveness advantages of our implementation of next-generation network architectures and see opportunities in providing a portfolio of carrier-class solutions that facilitate the transition to converged optical Ethernet networks.

Business optimization to yield operating leverage. We seek to improve the operational efficiencies in our business, and thereby gain additional operating leverage. We are focused on the transformation and redesign of certain business processes, systems, and resources. These initiatives include additional investments, re-engineering and automation of certain key business processes, including the engagement of strategic partners or resources to assist with select business functions. In addition, we

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are focused on optimizing our supply chain structure in order to reduce our costs and overhead. These initiatives include the rationalization and consolidation of third party manufacturers, distribution facilities and logistics providers, direct order fulfillment of additional products, and the consideration of select vertical integration within our supply chain. We seek to leverage these opportunities to promote the profitable growth of our business.

Financial Results

Revenue for the first quarter of fiscal 2012 was $416.7 million, representing a sequential decrease of 8.5% from $455.5 million in the fourth quarter of fiscal 2011. Revenue was adversely affected by longer customer deployment and revenue recognition cycles, particularly for solutions-oriented sales to new customers in international markets, as well as the impact of annual seasonality of our business due to the timing of our first fiscal quarter. Revenue-related details reflecting sequential changes from the fourth quarter of fiscal 2011 include:

- Product revenue for the first quarter of fiscal 2012 decreased by $34.4 million, primarily reflecting decreases of $29.8 million in Packet-Optical Transport and $6.9 million in Carrier-Ethernet Solutions.
- Service revenue for the first quarter of fiscal 2012 decreased by $4.4 million.
- Revenue from the United States for the first quarter of fiscal 2012 was $233.1 million, a decrease from $252.2 million in the fourth quarter of fiscal 2011.
- International revenue for the first quarter of fiscal 2012 was $183.6 million, a decrease from $203.3 million in the fourth quarter of fiscal 2011.
- As a percentage of revenue, international revenue was 44.1% during the first quarter of fiscal 2012, a decrease from 44.6% during the fourth quarter of fiscal 2011.
- For the first quarter of fiscal 2012, one customer accounted for greater than 10% of revenue and represented 19.3% of total revenue. This compares to one customer that accounted for greater than 10% of revenue and represented 14.9% of total revenue in the fourth quarter of fiscal 2011.

Gross margin for the first quarter of fiscal 2012 was 40.3%, a decrease from 41.7% in the fourth quarter of fiscal 2011. Gross margin for the first quarter of fiscal 2012 was affected by continued competitive pressures associated with our strategy to gain new customers, enter new markets and capture additional market share, particularly for 40G and 100G coherent optical transport solutions within our 6500 Packet-Optical Platform.

Operating expense was $198.9 million for the first quarter of fiscal 2012, a decrease from $206.2 million in the fourth quarter of fiscal 2011. First quarter 2012 operating expense primarily reflects a $6.8 million decrease in selling and marketing expense due to decreased variable compensation and decreases of $2.1 million in acquisition and integration costs.

Our loss from operations for the first quarter of fiscal 2012 was $31.2 million, compared to a $16.3 million loss from operations during the fourth quarter of fiscal 2011. Our net loss for the first quarter of fiscal 2012 was $47.7 million, or $0.49 per share. This compares to a net loss of $22.3 million or $0.23 per share, for the fourth quarter of fiscal 2011.

We generated $12.9 million in cash from operations during the first quarter of fiscal 2012, consisting of $14.9 million in cash provided by net losses adjusted for non-cash charges and $2.0 million used in working capital. This compares with cash generated of $42.0 million in cash from operations during the fourth quarter of fiscal 2011, consisting of $32.9 million in cash provided by net losses adjusted for non-cash charges and $9.1 million provided by working capital.

As of January 31, 2012, we had $550.5 million in cash and cash equivalents and $50.2 million of short-term investments in U.S. treasury securities. This compares to $625.8 million in cash and cash equivalents at January 31,

2011 and $541.9 million in cash and cash equivalents and $50.3 million of long-term investments in U.S. treasury securities at October 31, 2011.

As of January 31, 2012 headcount was 4,386, an increase from 4,339 and 4,254 at October 31, 2011 and January 31, 2011, respectively.

Consolidated Results of Operations

Our internal organizational structure and the management of our business and results of operations are presented based upon the following operating segments:

- Packet-Optical Transport — includes optical transport solutions that increase network capacity and enable more rapid delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the

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cost effective and efficient transport of voice, video and data traffic in core, regional, metro and access networks. Ciena's Packet-Optical Transport products support the efficient delivery of a wide variety of consumer-oriented network services, as well as key managed service and enterprise applications. Ciena's principal products in this segment include the 6500 Packet-Optical Platform, 4200 Advanced Services Platform; Corestream® Agility Optical Transport System, 5100/5200 Advanced Services Platform, Common Photonic Layer (CPL), and 6100 Multiservice Optical Platform. This segment also includes sales from legacy SONET/SDH, transport and data networking products, as well as certain enterprise-oriented transport solutions that support storage and LAN extension, interconnection of data centers, and virtual private networks. This segment also includes operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Consolidated Statement of Operations.

- Packet-Optical Switching — includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Ciena's principal products in this segment include its family of CoreDirector® Multiservice Optical Switches, its 5430 Reconfigurable Switching System and its OTN configuration for the 5410 Reconfigurable Switching System. These products include multiservice, multi-protocol switching systems that consolidate the functionality of an add/drop multiplexer, digital cross-connect and packet switch into a single, high-capacity intelligent switching system. These products address both the core and metro segments of communications networks and support key managed service services, Ethernet/TDM Private Line, Triple Play and IP services. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Consolidated Statement of Operations.
- Carrier-Ethernet Solutions — principally includes Ciena's 3000 family of service delivery switches and service aggregation switches, the 5000 series of service aggregation switches, and its Carrier Ethernet packet configuration for the 5410 Service Aggregation Switch. These products support the access and aggregation tiers of communications networks and have principally been deployed to support wireless backhaul infrastructures and business data services. Employing sophisticated Carrier Ethernet switching technology, these products deliver quality of service capabilities, virtual local area networking and switching functions, and carrier-grade operations, administration, and maintenance features. This segment also includes legacy broadband products, including the CNX-5 Broadband DSL System (CNX-5), that transitions legacy voice networks to support Internet-based (IP) telephony, video services and DSL. This segment also includes sales of operating system software and enhanced software features embedded in each of these products. Revenue from this segment is included in product revenue on the Consolidated Statement of Operations.
- Software and Services — includes the Ciena One software suite, including OneControl, the integrated network and service management software designed to automate and simplify network management, operation and service delivery. These software solutions can track individual services across multiple product suites, facilitating planned network maintenance, outage detection and identification of customers or services affected by network troubles. In addition to Ciena One, this segment includes the ON-Center® Network & Service Management Suite, and the OMEA and Preside platforms from the MEN Business. This segment also includes a broad range of consulting and support services, including installation and deployment, maintenance support, consulting, network design and training activities. Except for revenue from the software portion of this segment, which is included in product revenue, revenue from this segment is included in services revenue on the Consolidated Statement of Operations.

Quarter ended January 31, 2011 compared to the quarter ended January 31, 2012

Revenue

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

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	Quarter Ended January 31,				Increase	
	2011	%*	2012	%*	(decrease)	%**
Revenue:						
Packet-Optical Transport	$286,481	66.1	$266,284	63.9	$(20,197)	(7.1)
Packet-Optical Switching	35,274	8.1	43,416	10.4	8,142	23.1
Carrier-Ethernet Solutions	27,628	6.4	21,913	5.3	(5,715)	(20.7)
Software and Services	83,925	19.4	85,072	20.4	1,147	1.4
Consolidated revenue	$433,308	100.0	$416,685	100.0	$(16,623)	(3.8)

* Denotes % of total revenue

** Denotes % change from 2011 to 2012

- Packet-Optical Transport revenue decreased reflecting sales decreases of $11.2 million of our 5100/5200 Advanced Services Platform, $10.5 million in legacy transport products, $5.9 million in 4200 Advanced Services Platform, and $5.2 million in 6100 Multiservice Optical Platform. These decreases were partially offset by increases of $9.6 million in 6500 Packet-Optical Platform, largely driven by service provider demand for high-capacity, optical transport, including coherent 40G and 100G network infrastructures, and $3.3 million in Corestream® Agility Optical Transport System.
- Packet-Optical Switching revenue increased reflecting a $3.9 million increase in sales of our 5430 Reconfigurable Switching System and a $3.2 million increase in sales of our CoreDirector® Multiservice Optical Switches. Packet-Optical Switching revenue has historically reflected sales of our CoreDirector platform, which has a concentrated customer base. Our Packet-Optical Switching segment is in the midst of a platform transition to our next-generation 5430 Reconfigurable Switching System. As a result of these factors, revenue for this segment can fluctuate considerably depending upon individual customer purchasing decisions and the level of initial deployments with customers.
- Carrier-Ethernet Solutions revenue decreased reflecting a $5.5 million decrease in sales of our 5410 Service Aggregation Switch to support wireless backhaul, Ethernet business services and residential broadband applications. Revenue for this segment remains subject to fluctuation due to customer concentration and the timing of customer purchasing and deployment cycles. We expect segment results to be dependent upon further adoption of these products to support business Ethernet service applications and the level of customer adoption of our high-capacity, Carrier Ethernet configuration for our 5410 Service Aggregation Switch to support wireless backhaul, Ethernet business services and residential broadband applications.
- Software and Services revenue increased primarily due to increases of $3.3 million in maintenance support revenue, partially offset by decreases of $1.2 million in installation, deployment and consulting services.

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

	Quarter Ended January 31,				Increase	
	2011	%*	2012	%*	(decrease)	%**
United States	$220,349	50.9	$233,078	55.9	$12,729	5.8
International	212,959	49.1	183,607	44.1	(29,352)	(13.8)
Total	$433,308	100.0	$416,685	100.0	$(16,623)	(3.8)

* Denotes % of total revenue

** Denotes % change from 2011 to 2012

- United States revenue increased primarily due to an $8.9 million increase in Packet-Optical Switching products, a $6.6 million increase in sales of Packet-Optical Transport products and a $3.1 million increase in Software and Services revenue. These increases were partially offset by a $5.9 million decrease in Carrier Ethernet Solutions sales.

• International revenue decreased primarily due to a $26.8 million decrease in Packet-Optical Transport revenue and a

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$1.9 million decrease in Software and Services revenue.

A sizable portion of our revenue continues to come from sales to a small number of service providers, particularly within our Packet-Optical Switching and Carrier-Ethernet Solutions businesses. As a result, our financial results are significantly affected by spending levels and the business opportunities and challenges encountered by our largest service provider customers. Moreover, our contracts do not have terms that obligate these customers to purchase any minimum or specific amounts of equipment or services. Our concentration of revenue has been adversely affected in prior periods by consolidation activity among our customers. In addition, some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce the number of vendors from which they purchase equipment, which could further affect our concentration of revenue where we participate in these efforts. For the first quarter of fiscal 2012, one customer accounted for greater than 10% of revenue and represented 19.3% of total revenue. This compares to two customers that accounted for 25.1% of total revenue in the first quarter of fiscal 2011.

Cost of Goods Sold and Gross Profit

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

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

Our gross profit as a percentage of revenue, or “gross margin,” continues to be susceptible to quarterly fluctuation due to a number of factors. Gross margin can vary significantly depending upon the mix and concentration of revenue by segment or product line, the concentration of lower margin common equipment sales within a segment or product line, geographic mix and the mix of customers and services in a given fiscal quarter. Gross margin can also be affected by our introduction of new products, charges for excess and obsolete inventory, changes in warranty costs and sales volume. We expect that gross margins will be subject to fluctuation based on our level of success in driving cost reductions, rationalizing our supply chain and consolidating third party contract manufacturers and distribution sites as part of our effort to optimize our operations. Gross margin can also be adversely affected by the competitive environment and level of pricing pressure we encounter. The combination of the recent period of uncertain market conditions, constraints on customer capital expenditures and increased competition has resulted in a heightened customer focus on pricing and return on network investment, as customers address network traffic growth and strive to increase revenue and profit. While competition is intense across our segments, our exposure to pricing pressure has been most severe in metro and core applications for our Packet-Optical Transport platforms, particularly in international markets. As a result, in an effort to retain or secure customers, enter new markets or capture market share, in the past we have and in the future we may agree to pricing or other unfavorable commercial terms that result in lower or negative gross margins on a particular order or group of orders. Because Packet-Optical Transport and international revenue comprise a greater percentage of our overall revenue than in prior periods, these market dynamics may adversely affect our gross margins and results of operations in certain periods.

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

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

	Quarter Ended January 31,				Increase	
	2011	%*	2012	%*	(decrease)	%**
Total revenue	$433,308	100.0	$416,685	100.0	$(16,623)	(3.8)
Total cost of goods sold	264,802	61.1	248,929	59.7	(15,873)	(6.0)
Gross profit	$168,506	38.9	$167,756	40.3	$(750)	(0.4)

* Denotes % of total revenue

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** Denotes % change from 2011 to 2012

	Quarter Ended January 31,				Increase	
	2011	%*	2012	%*	(decrease)	%**
Product revenue	$352,427	100.0	$333,673	100.0	$(18,754)	(5.3)
Product cost of goods sold	214,401	60.8	197,752	59.3	(16,649)	(7.8)
Product gross profit	$138,026	39.2	$135,921	40.7	$(2,105)	(1.5)

* Denotes % of product revenue
** Denotes % change from 2011 to 2012

	Quarter Ended January 31,				Increase	
	2011	%*	2012	%*	(decrease)	%**
Service revenue	$80,881	100.0	$83,012	100.0	$2,131	2.6
Service cost of goods sold	50,401	62.3	51,177	61.7	776	1.5
Service gross profit	$30,480	37.7	$31,835	38.3	$1,355	4.4

* Denotes % of services revenue
** Denotes % change from 2011 to 2012

- Gross profit as a percentage of revenue increased as a result of the factors described below.
- Gross profit on products as a percentage of product revenue increased due to higher margin on Packet-Optical Transport products, partially offset by increased provisions for inventory excess and obsolescence. Gross profit for the first quarter of fiscal 2011 benefited from a $6.9 million reduction in warranty provision due to our consolidation of certain support operations and processes that resulted in lower costs to service future warranty obligations. The reduction was partially offset by a $5.7 million increase in costs of goods sold due to the required revaluation of acquired finished goods inventory of the MEN Business to fair value.
- Gross profit on services as a percentage of services revenue increased due to improved operational efficiencies.

Operating Expense

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

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

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

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

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

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	Quarter Ended January 31,				Increase	
	2011	%*	2012	%*	(decrease)	%**
Research and development	$95,790	22.1	$89,664	21.5	$(6,126)	(6.4)
Selling and marketing	57,092	13.2	64,411	15.5	7,319	12.8
General and administrative	38,314	8.8	29,400	7.1	(8,914)	(23.3)
Acquisition and integration costs	24,185	5.6	264	0.1	(23,921)	(98.9)
Amortization of intangible assets	28,784	6.6	13,471	3.2	(15,313)	(53.2)
Restructuring costs	1,522	0.4	1,722	0.4	200	13.1
Change in fair value of contingent consideration	(3,289)	(0.8)	—	0.0	3,289	(100.0)
Total operating expenses	$242,398	55.9	$198,932	47.8	$(43,466)	(17.9)

* Denotes % of total revenue

** Denotes % change from 2011 to 2012

- Research and development expense benefited from $1.3 million as a result of foreign exchange rates, primarily due to the strengthening of the U.S. dollar in relation to the Canadian dollar and the Indian Rupee. The $6.1 million decrease primarily reflects decreases of $2.6 million in prototype expense, and $1.3 million in employee compensation and related costs, as well as a benefit of $1.5 million related to a conditional grant from the Province of Ontario. Under this strategic jobs investment fund grant, we can receive up to an aggregate of C$25.0 million in funding for eligible costs relating to certain next-generation, coherent optical transport development initiatives over the period from fiscal 2011 to fiscal 2015. We anticipate receiving future disbursements, approximating C$5.0 million per fiscal year over the period above. Amounts received under the grant are subject to recoupment in the event that we fail to achieve certain minimum investment, employment and project milestones.
- Selling and marketing expense benefited from $0.4 million due to foreign exchange rates, primarily due to the strengthening of the U.S. dollar in relation to the Euro and the Canadian dollar. The $7.3 million increase primarily reflects increases in employee compensation and related costs due to increased headcount and variable compensation.
- General and administrative expense decreased by $5.8 million in facilities and information systems expense and $5.5 million in professional services. These decreases were partially offset by an increase of $1.9 million in employee compensation and related costs.
- Acquisition and integration costs principally consist of transaction, consulting and third party service fees related to the acquisition and integration of the MEN Business into the combined operations. This integration activity was substantially completed in the first half of fiscal 2011.
- Amortization of intangible assets decreased due to certain intangible assets from the MEN Acquisition reaching the end of their economic lives during fiscal 2011.
- Restructuring costs primarily reflect certain severance and related expense associated with headcount reductions and restructuring activities to align our workforce and resources with market opportunities.
- Change in fair value of contingent consideration relates to the contingent refund right we received as part of the MEN Acquisition associated with the early termination of the Carling lease. During the first quarter of fiscal 2011, Ciena received both notice of early termination from Nortel shortening the Carling lease to five years and the corresponding $33.5 million early termination payment.

Other items

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

	Quarter Ended January 31,				Increase	
	2011	%*	2012	%*	(decrease)	%**
Interest and other income (loss), net	$6,265	1.4	$(4,887)	(1.2)	$(11,152)	(178.0)
Interest expense	$9,550	2.2	$9,570	2.3	$20	0.2
Provision for income taxes	$1,879	0.4	$2,020	0.5	$141	7.5

* Denotes % of total revenue

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** Denotes % change from 2011 to 2012

- Interest and other income (loss), net decreased due to decreases of $8.1 million in non-cash gains related to the change in fair value of the embedded redemption feature associated with our 4.0% convertible senior notes due March 15, 2015 and $2.7 million related to the effect of foreign exchange rates on assets and liabilities denominated in a currency other than the relevant functional currency.
- Interest expense remained relatively unchanged.
- Provision for income taxes increased primarily due to increased foreign taxes.

Segment Profit (Loss)

The table below (in thousands, except percentage data) sets forth the changes in our segment profit (loss) for the respective periods:

	Quarter Ended January 31,			
	2011	2012	Increase (decrease)	%*
Segment profit (loss):				
Packet-Optical Transport	$39,026	$47,138	$8,112	20.8
Packet-Optical Switching	$12,877	$17,181	$4,304	33.4
Carrier-Ethernet Solutions	$2,393	$(6,107)	$(8,500)	(355.2)
Software and Services	$18,420	$19,880	$1,460	7.9

* Denotes % change from 2011 to 2012

- Packet-Optical Transport segment profit increased primarily due to lower research and development costs and higher gross margin, partially offset by lower sales volume.
- Packet-Optical Switching segment profit increased primarily due to higher sales volume and lower research and development costs, partially offset by lower gross margin.
- Carrier-Ethernet Solutions segment profit decreased primarily due to lower sales volume, lower gross margin and higher research and development costs.
- Software and Services segment profit increased primarily due to increased sales volume and lower research and development costs.

Liquidity and Capital Resources

At January 31, 2012, our principal sources of liquidity were cash and cash equivalents and short-term investments in marketable debt securities, representing U.S. treasuries. The following table summarizes our cash and cash equivalents and short-term and long-term investments (in thousands):

	October 31, 2011	January 31, 2012	Increase (decrease)
Cash and cash equivalents	$541,896	$550,461	$8,565
Short-term investments in marketable debt securities	—	50,239	50,239
Long-term investments in marketable debt securities	50,264	—	(50,264)
Total cash and cash equivalents and investments in marketable debt securities	$592,160	$600,700	$8,540

The increase in total cash and cash equivalents and investments in marketable debt securities during the first three months of fiscal 2012 was primarily related to the following:

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- $12.9 million cash generated from operations, consisting of $14.9 million provided by net losses (adjusted for non-cash charges) and $2.0 million used in working capital.
- $5.7 million from stock issuances under our employee stock purchase plan and the exercise of stock options;

These increases were partially offset by $7.9 million for purchases of equipment, furniture, fixtures and intellectual property.

We regularly evaluate our liquidity position, debt obligations, and anticipated cash needs to fund our operating plans and may consider capital raising and other market opportunities that may be available to us. Based on past performance and current expectations, we believe that our cash, cash equivalents and investments will satisfy our working capital needs, capital expenditures, and other liquidity requirements associated with our existing operations through at least the next 12 months.

The following sections set forth the components of our $12.9 million of cash generated by operating activities during the first three months of fiscal 2012:

Net loss (adjusted for non-cash charges)

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

	Three months ended January 31, 2012
Net loss	$(47,653)
Adjustments for non-cash charges:	
Amortization of premium on marketable securities	(13)
Change in fair value of embedded redemption feature	980
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	14,721
Share-based compensation costs	8,888
Amortization of intangible assets	19,415
Deferred tax benefit	(49)
Provision for inventory excess and obsolescence	8,224
Provision for warranty	7,706
Other	2,667
Net losses (adjusted for non-cash charges)	$14,886

Working Capital

Accounts Receivable, Net

Cash provided by accounts receivable during the first three months of fiscal 2012, net of $1.0 million in provision for doubtful accounts, was $17.1 million. Our days sales outstanding (DSOs) increased from 77 days for the first three months of fiscal 2011 to 86 days for the first three months of fiscal 2012.

The following table sets forth (in thousands) changes to our accounts receivable, net of allowance for doubtful accounts, from the end of fiscal 2011 through the end of the first quarter of fiscal 2012:

	October 31, 2011	January 31, 2012	Increase (decrease)
Accounts receivable, net	$ 417,509	$399,457	$(18,052)

Inventory

Cash used by inventory during the first three months of fiscal 2012 was $26.8 million. Our inventory turns remained the same at 3.2 turns during the first three months of fiscal 2011 and fiscal 2012. During the first three months of fiscal 2012, changes in inventory reflect an $8.2 million reduction related to a non-cash provision for excess and obsolescence. The following table sets forth (in thousands) changes to the components of our inventory from the end of fiscal 2011 through the end of the first quarter of fiscal 2012:

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	October 31, 2011	January 31, 2012	Increase (decrease)
Raw materials	$45,333	$43,486	$(1,847)
Work-in-process	13,851	17,659	3,808
Finished goods	134,998	146,857	11,859
Deferred cost of goods sold	67,665	76,243	8,578
Gross inventory	261,847	284,245	22,398
Provision for inventory excess and obsolescence	(31,771)	(35,594)	(3,823)
Inventory	$230,076	$248,651	$18,575

Prepaid expense and other

Cash generated by prepaid expense and other during the first three months of fiscal 2012 was $14.5 million, primarily related to decreases in prepaid taxes and product demonstration units, partially offset by increases in other non-trade receivables and deferred deployment expense.

Accounts payable, accruals and other obligations

Cash generated by accounts payable, accruals and other obligations during the first three months of fiscal 2012 was $15.9 million. Between the end of fiscal 2011 and the first three months of fiscal 2012, the change in unpaid equipment purchases was $1.0 million. Changes in accrued liabilities reflect non-cash provisions of $7.7 million related to warranties. The following table sets forth (in thousands) changes in our accounts payable, accruals and other obligations from the end of fiscal 2011 through the end of the first three months of fiscal 2012:

	October 31, 2011	January 31, 2012	Increase (decrease)
Accounts payable	$157,116	$176,747	$19,631
Accrued liabilities	197,004	200,114	3,110
Other long-term obligations	17,263	19,056	1,793
Accounts payable, accruals and other obligations	$371,383	$395,917	$24,534

Interest Paid on Convertible Notes

Interest on our outstanding 0.25% convertible senior notes, due May 1, 2013, is payable on May 1 and November 1 of each year. We paid $0.3 million in interest on these convertible notes during the first three months of fiscal 2012.

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

Interest on our outstanding 0.875% convertible senior notes, due June 15, 2017, is payable on June 15 and December 15 of each year. We paid $2.2 million in interest on these convertible notes during the first three months of fiscal 2012.

Interest on our outstanding 3.75% convertible senior notes, due October 15, 2018, is payable on April 15 and October 15 of each year.

For additional information about our convertible notes, see Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

Deferred revenue

Deferred revenue decreased by $22.6 million during the first three months of fiscal 2012. Product deferred revenue represents payments received in advance of shipment and payments received in advance of our ability to recognize revenue. Services deferred revenue is related to payment for service contracts that will be recognized over the contract term. The

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following table reflects (in thousands) the balance of deferred revenue and the change in this balance from the end of fiscal 2011 through the first three months of fiscal 2012:

	October 31, 2011	January 31, 2012	Increase (decrease)
Products	$ 42,915	$ 35,046	$ (7,869)
Services	80,883	66,118	(14,765)
Total deferred revenue	$ 123,798	$ 101,164	$ (22,634)

Contractual Obligations

During fiscal 2012, we entered into a lease for a new headquarters in Hanover, Maryland. This increased our operating lease commitments by approximately $64.9 million in the table below as compared to October 31, 2011. The following is a summary of our future minimum payments under contractual obligations as of January 31, 2012 (in thousands):

	Total	Less than one year	One to three years	Three to five years	Thereafter
Interest due on convertible notes	$169,249	$33,041	$65,270	$42,500	$28,438
Principal due at maturity on convertible notes	1,441,210	—	216,210	375,000	850,000
Operating leases (1)	158,202	30,938	51,425	20,351	55,488
Purchase obligations (2)	137,344	137,344	—	—	—
Total (3)	$1,906,005	$201,323	$332,905	$437,851	$933,926

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

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

(3) As of January 31, 2012, we also had approximately $8.9 million of other long-term obligations in our Condensed Consolidated Balance Sheet for unrecognized tax positions that are not included in this table because the timing or amount of any cash settlement with the respective tax authority cannot be reasonably estimated.

Some of our commercial commitments, including some of the future minimum payments in operating leases set forth above and certain commitments to customers, are secured by standby letters of credit collateralized by restricted cash. Restricted cash balances are included in other current assets or other long-term assets depending upon the duration of the underlying letter of credit obligation. The following is a summary, as of January 31, 2012, of our commitments secured by standby letters of credit by expiration date (in thousands):

	Total	Less than one year	One to three years	Three to five years
Standby letters of credit	$54,321	$47,816	$5,415	$1,090

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

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

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

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

Revenue Recognition

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

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

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

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each element, with revenue recognized when the revenue recognition criteria are met for each delivered element. We determine the selling price for each deliverable based upon the selling price hierarchy for multiple-deliverable arrangements. Under this hierarchy, we use VSOE of selling price, if it exists, or TPE of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, we use our BESP for that deliverable. We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or refund privileges.

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

Our total deferred revenue for products was $42.9 million and $35.0 million as of October 31, 2011 and January 31, 2012, respectively. Our services revenue is deferred and recognized ratably over the period during which the services are to be performed. Our total deferred revenue for services was $80.9 million and $66.1 million as of October 31, 2011 and January 31, 2012, respectively.

Share-Based Compensation

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

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

Because share-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures. We estimate forfeitures at the time of grant and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the measure of estimated fair value of our share-based compensation. See Note 15 to our Condensed Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to share-based compensation and the amount of share-based compensation expense we incurred for the periods covered in this report. As of January 31, 2012, total unrecognized compensation expense was $71.3 million: (i) $0.6 million, which relates to unvested stock options and is expected to be recognized over a weighted-average period of 0.7 year; and (ii) $70.7 million, which relates to unvested restricted stock units and is expected to be recognized over a weighted-average period of 1.7 years.

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

Incentive Compensation Expense

We provide incentive-based compensation opportunities to employees through cash incentive awards and, as described in “Share-Based Compensation” above, performance-based equity awards. The expense associated with these awards is reflected as a component of employee-related expense within our operating expense and costs of goods sold, as applicable.

For fiscal 2012, the Compensation Committee has approved an annual cash incentive arrangement, with the aggregate amount of any awards payable dependent upon the achievement of certain financial and operational goals for fiscal 2012. Given that the awards are generally contingent upon achieving annual objectives, the payment of cash incentive awards is not expected to be made until after fiscal year-end results are finalized. As a result, the expense that we accrue for incentive compensation in any interim period in fiscal 2012 is based upon estimates of expected financial results for the year and expected performance against relevant operating objectives. Because assessing actual performance against many of these objectives cannot generally occur until at or near fiscal year-end, determining the amount of expense that we incur in our interim financial statements for incentive compensation involves management judgment. Amounts accrued are subject to change in future interim periods if actual future financial results or operational performance are higher or lower than expected. We incurred an aggregate of $8.7 million of expense in the first three months of fiscal 2012 associated with cash incentive compensation for fiscal 2012.

Reserve for Inventory Obsolescence

We make estimates about future customer demand for our products when establishing the appropriate reserve for excess and obsolete inventory. We write down inventory that has become obsolete or unmarketable by an amount equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. Inventory write downs are a component of our product cost of goods sold. Upon recognition of the write down, a new lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. In an effort to limit our exposure to delivery delays and to satisfy customer needs we purchase inventory based on forecasted sales across our product lines. In addition, part of our research and development strategy is to promote the convergence of similar features and functionalities across our product lines. Each of these practices exposes us to the risk that our customers will not order products for which we have forecasted sales, or will purchase less than we have forecasted. Historically, we have experienced write downs due to changes in strategic direction,

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discontinuance of a product and declines in market conditions. If actual market conditions worsen or differ from those we have assumed, if there is a sudden and significant decrease in demand for our products, or if there is a higher incidence of inventory obsolescence due to a rapid change in technology, we may be required to take additional inventory write-downs, and our gross margin could be adversely affected. We recorded charges for excess and obsolete inventory of $2.6 million and $8.2 million in the first three months of fiscal 2011 and 2012, respectively. The charges in fiscal 2011 were primarily related to excess inventory due to a change in forecasted sales across our product line. The charges in fiscal 2012 were primarily related to engineering design changes and the discontinuance of certain parts and components used in the manufacture of our Packet-Optical Transport and Packet-Optical Switching products. Our inventory net of allowance for excess and obsolescence was $230.1 million and $248.7 million as of October 31, 2011 and January 31, 2012, respectively.

Allowance for Doubtful Accounts Receivable

Our allowance for doubtful accounts receivable is based on management's assessment, on a specific identification basis, of the collectibility of customer accounts. We perform ongoing credit evaluations of our customers and generally have not required collateral or other forms of security from customers. In determining the appropriate balance for our allowance for doubtful accounts receivable, management considers each individual customer account receivable in order to determine collectibility. In doing so, we consider creditworthiness, payment history, account activity and communication with such customer. If a customer's financial condition changes, or if actual defaults are higher than our historical experience, we may be required to take a charge for an allowance for doubtful accounts receivable which could have an adverse impact on our results of operations. Our accounts receivable, net of allowance for doubtful accounts, was $417.5 million and $399.5 million as of October 31, 2011 and January 31, 2012, respectively. Our allowance for doubtful accounts was $0.7 million and $1.6 million as of October 31, 2011 and January 31, 2012, respectively.

Long-lived Assets

Our long-lived assets include: equipment, furniture and fixtures; finite-lived intangible assets; and maintenance spares. As of October 31, 2011 and January 31, 2012 these assets totaled $504.6 million and $482.0 million, net, respectively. We test long-lived assets for impairment whenever events or changes in circumstances indicate that the assets' carrying amount is not recoverable from its undiscounted cash flows. Our long-lived assets are assigned to asset groups which represents the lowest level for which we identify cash flows.

Deferred Tax Valuation Allowance

As of January 31, 2012, we have recorded a valuation allowance offsetting nearly all our net deferred tax assets of $1.5 billion. When measuring the need for a valuation allowance, we assess both positive and negative evidence regarding the realizability of these deferred tax assets. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. In determining net deferred tax assets and valuation allowances, management is required to make judgments and estimates related to projections of profitability, the timing and extent of the utilization of net operating loss carryforwards, applicable tax rates, transfer pricing methodologies and tax planning strategies. The valuation allowance is reviewed quarterly and is maintained until sufficient positive evidence exists to support a reversal. Because evidence such as our operating results during the most recent three-year period is afforded more weight than forecasted results for future periods, our cumulative loss during this three-year period represents sufficient negative evidence regarding the need for nearly a full valuation allowance. We will release this valuation allowance when management determines that it is more likely than not that our deferred tax assets will be realized. Any future release of valuation allowance may be recorded as a tax benefit increasing net income or as an adjustment to paid-in capital, based on tax ordering requirements.

Warranty

Our liability for product warranties, included in other accrued liabilities, was $47.3 million and $49.0 million as of October 31, 2011 and January 31, 2012, respectively. Our products are generally covered by a warranty for periods ranging from one to five years. We accrue for warranty costs as part of our cost of goods sold based on associated material costs, technical support labor costs and associated overhead. Material cost is estimated based primarily upon historical trends in the volume of product returns within the warranty period and the cost to repair or replace the equipment. Technical support labor cost is estimated based primarily upon historical trends and the cost to support the customer cases within the warranty period. The provision for product warranties was $1.1 million and $7.7 million for the first three months of fiscal 2011 and 2012, respectively. As a result of the substantial completion of integration activities related to the MEN Acquisition, we consolidated certain support operations and processes during the first quarter of fiscal 2011, resulting in a reduction in costs to service future warranty obligations. Due to this consolidation and resulting efficiencies, we expect to realize lower failure rate costs and accordingly reversed a $6.9 million non-cash loss contingency included in our warranty liability. The provision for warranty

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claims may fluctuate on a quarterly basis depending upon the mix of products and customers in that period. If actual product failure rates, material replacement costs, service or labor costs differ from our estimates, revisions to the estimated warranty provision would be required. An increase in warranty claims or the related costs associated with satisfying these warranty obligations could increase our cost of sales and negatively affect our gross margin.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Sensitivity. We currently hold an investment in a U.S. Government obligation that matures in January 2013. See Notes 4 and 5 to our Condensed Consolidated Financial Statements for information relating to investments and fair value. This investment is sensitive to interest rate movements and its fair value will decline as interest rates rise and increase as interest rates decline. The estimated impact on this investment of a 100 basis point (1.0%) increase in interest rates across the yield curve from rates in effect as of the balance sheet date would be a $0.5 million decline in value.

Foreign Currency Exchange Risk. As a global concern, our business and results of operations are exposed to movements in foreign currency exchange rates. As a result of our increased global presence, in large part resulting from the MEN Acquisition, a larger percentage of our revenue is non-U.S. dollar denominated with Canadian Dollars and Euros being our most significant foreign currency revenue streams. If the U.S. dollar strengthens against these currencies, our revenues reported in U.S. dollars would decline. For our U.S. dollar denominated sales, an increase in the value of the U.S. dollar would increase the real cost to our customers of our products in markets outside the United States which could impact our competitive position.
With regard to operating expense, our primary exposure to foreign currency exchange risk relates to operating expense incurred in Canadian Dollars, British Pounds, Euros and Indian Rupees. During the first three months of fiscal 2012, approximately 48.1% of our operating expense was non-U.S. dollar denominated. If these currencies strengthen, costs reported in U.S. dollars will increase. During the first three months of fiscal 2012, research and development expense benefited from approximately $1.3 million, due to the weakening of the U.S. dollar in relation to the Canadian Dollar in comparison to the first three months of fiscal 2011.

From time to time, we use foreign currency forward contracts to reduce part of the variability in certain forecasted non-U.S. dollar denominated cash flows. Generally, these derivatives are for maturities of 12 months or less and are designated as cash flow hedges. We consider several factors when evaluating hedges of our forecasted foreign currency exposures, such as significance of the exposure, offsetting economic exposures, potential costs of hedging, and the potential for hedge ineffectiveness. We do not enter into derivative transactions for purposes other than hedging economic exposures. During fiscal 2011, we entered into forward contracts to reduce the variability in our Canadian Dollar and Indian Rupee denominated operating expenses which principally relate to our research and development activities.

Convertible Debt Outstanding. The fair market value of each of our outstanding issues of convertible notes is subject to interest rate and market price risk due to the convertible feature of the notes and other factors. Generally the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. The fair market value of the notes may also increase as the market price of our stock rises and decrease as the market price of the stock falls. Interest rate and market value changes affect the fair market value of the notes, and may affect the prices at which we would be able to repurchase such notes were we to do so. These changes do not impact our financial position, cash flows or results of operations. For additional information on the fair value of our outstanding notes, see Note 13 to our Condensed Consolidated Financial Statements included in Item 1 of Part I of this report.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the

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Securities Exchange Act of 1934, as amended) during the most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

On July 29, 2011, Cheetah Omni LLC filed a complaint in the United States District Court for the Eastern District of Texas against Ciena and several other defendants, alleging, among other things, that certain of the parties' products infringe upon multiple U.S. Patents relating to certain reconfigurable optical add-drop multiplexer (ROADM) technologies. The complaint seeks injunctive relief and damages. On November 8, 2011, Ciena filed an answer and counterclaims to Cheetah Omni's amended complaint. Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously.

On May 29, 2008, Graywire, LLC filed a complaint in the United States District Court for the Northern District of Georgia against Ciena and four other defendants, alleging, among other things, that certain of the parties' products infringe U.S. Patent 6,542,673 (the "'673 Patent"), relating to an identifier system and components for optical assemblies. The complaint seeks injunctive relief and damages. Ciena filed an answer to the complaint and counterclaims against Graywire on April 17, 2009. On April 27, 2009, Ciena and certain other defendants filed an application for inter partes reexamination of the '673 Patent with the U.S. Patent and Trademark Office (the "PTO"). On the same date, Ciena and the other defendants filed a motion to stay the case pending reexamination of all of the patents-in-suit. On July 17, 2009, the district court granted the defendants' motion to stay the case. On July 23, 2009, the PTO granted the defendants' application for reexamination with respect to certain claims of the '673 Patent and, on December 17, 2010, the PTO confirmed the validity of some claims and rejected the validity of other claims. On February 28, 2011, Ciena and the other defendants filed an appeal with respect to certain aspects of the PTO's determination. Separately, on March 17, 2011, the PTO granted a third party application for ex parte reexamination with respect to certain claims of the '673 Patent and, on September 2, 2011, the PTO issued a non-final rejection of those claims. On December 14, 2011, the PTO issued a Notice of Intent to Issue a Reexamination Certificate in the ex parte reexamination.
Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously in the event the stay of the case is lifted.

As a result of its June 2002 acquisition of ONI Systems Corp., Ciena became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The cause of action and history of the proceedings are more fully described in Ciena's Annual Report on Form 10-K for fiscal 2011 filed with the SEC on December 22, 2011. On January 9, 2012, the final appellant in this securities class action lawsuit withdrew and dismissed his appeal with prejudice in accordance with the terms of the settlement agreement. Ciena was not required to pay any amount toward the settlement or to make any other payments to plaintiffs in connection with the resolution of this matter.

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

Item 1A. Risk Factors

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

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

Our revenue and results of operations can fluctuate significantly and unpredictably from quarter to quarter. Our budgeted expense levels depend in part on our expectations of long-term, future revenue and gross margin, and substantial reductions in expense are difficult and can take time to implement. Uncertainty or lack of visibility into customer spending, and changes in economic or market conditions that affect customer spending, can make it difficult to forecast future revenue and corresponding expense levels. Consequently, our level of operating expense or inventory may be high relative to revenue, which could harm our profitability and cash flow. Increases in the percentage of quarterly revenue relating to orders placed in that quarter, along with significant order volume late in the quarter, could further result in variability and less predictability in our quarterly results.

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

- broader macroeconomic conditions, including weakness and volatility in global markets, affecting our customers and

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their consumer and enterprise end users;
- changes in capital spending by large communications service providers;
- seasonal effects in our business, including the timing and size of customer orders;
- the amount of backlog orders we have and our ability to recognize revenue relating to these sales;
- the mix of revenue by product segment, geography and customer in any particular quarter;
- the level of pricing pressure we encounter, particularly for our Packet-Optical Transport products which comprise a significant concentration of our revenue;
- the transition of product sales to new, next-generation technology platforms across our segments; and
- changes in material and labor costs, including our ability to optimize our resources, improve manufacturing efficiencies and achieve cost reductions in our supply chain.

Many factors affecting our results of operations are beyond our control, particularly in the case of large service provider orders and multi-vendor or multi-technology network infrastructure builds, where the achievement of certain thresholds for acceptance is subject to the readiness and performance of the customer or other providers, and changes in customer requirements or installation plans. The factors above may cause our revenue and operating results to fluctuate unpredictably from quarter to quarter. These fluctuations may cause our operating results to be below the expectations of securities analysts or investors, which may cause our stock price to decline.

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

We face an extremely competitive market for sales of communications networking equipment, software and services and increased competition could result in pricing pressure, reduced demand, lower gross margins and the loss of market share that could harm our business and results of operations. Competition is particularly intense as we and our competitors more aggressively seek to displace incumbent equipment vendors at large carrier customers and secure new customers and additional market share for new, next-generation products. In an effort to secure customer opportunities and capture market share, we have in the past, and may in the future, agree to onerous commercial terms or pricing that result in low or negative gross margins on a particular order or group of orders. We expect this level of competition to continue and potentially increase, particularly in the U.S., as larger Chinese equipment vendors such as Huawei seek to gain market entry and other global competitors seek to retain incumbent positions with customers in the region.

Competition in our markets, generally, is based on any one or a combination of the following factors: price; product features; functionality and performance; service offering; manufacturing capability and lead-times; incumbency and existing business relationships; scalability; and the flexibility of products to meet the immediate and future network and service requirements of customers. A small number of very large companies have dominated our industry, many of which have substantially greater financial and marketing resources, greater manufacturing capacity, broader product offerings and more established relationships with service providers and other customer segments than we do. In addition, a number of these vendors are putting forth competing visions for how next-generation network architectures should be designed. Because of their scale and resources, they may be perceived to be a better fit for the procurement, or network operating and management, strategies of large service providers. We also compete with a number of smaller companies that provide significant competition for a specific product, application, customer segment or geographic market. Due to the narrower focus of their efforts, these competitors may achieve commercial availability of their products more quickly or may be more attractive to customers.

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

- significant price competition, particularly for our Packet-Optical Transport platforms;
- early announcement of product development initiatives and new platform offerings;
- customer financing assistance provided by other vendors or their sponsors;
-

- assumption of onerous or atypical commercial terms that involve a greater assumption of liability or allocation of risk upon the vendor;
- offers to repurchase our equipment from existing customers; and
- intellectual property assertions and disputes.

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

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

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Global markets have experienced a recent period of significant volatility that has resulted in heightened uncertainty and cautious customer behavior. Broad macroeconomic weakness and market volatility have previously resulted in sustained periods of decreased demand for our products and services that have adversely affected our operating results. Continuation of or an increase in these challenging market conditions and macroeconomic weakness could result in:

- reductions in customer capital spending and delay or deferral of network initiatives;
- difficulty forecasting, budgeting and planning;
- increased competition for fewer network projects and sales opportunities;
- increased pricing pressure that may adversely affect revenue and gross margin;
- higher overhead costs as a percentage of revenue;
- tightening of credit markets to fund capital expenditures by our customers and us;
- customer financial difficulty, including longer collection cycles and other difficulties collecting accounts receivable; and
- increased risk of charges relating to excess and obsolete inventories and the write-off of other intangible assets.

Our business and operating results could be materially adversely affected by reduced customer spending in response to unfavorable or uncertain macroeconomic and market conditions, globally or specific to a particular region where we operate.

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

We rely upon third party contract manufacturers to perform substantially all of the manufacturing of our products and a significant portion of our component sourcing. We do not have contracts in place with some of our manufacturers, do not have guaranteed supply of components or access to manufacturing capacity, and in some cases are utilizing temporary or transitional commercial arrangements. Our reliance upon third party manufacturers could expose us to increased risks related to lead times, continuity of supply, on-time delivery, quality assurance, and compliance with environmental standards and other regulations. Reliance upon third party manufacturers exposes us to significant risks related to their operations, financial position, business continuity, sourcing relationships and labor relationships, that may affect their servicing of Ciena including their continued viability. Our operations may also be affected by geopolitical events, natural disasters, military actions or health pandemics in the countries where our products or critical components are manufactured. Our product manufacturing principally takes place in Mexico, Canada, China and Thailand. Significant disruptions in these countries including natural disasters, epidemics, acts of war or terrorism, social or political unrest or work stoppages, affecting the cost or availability or allocation of supply and manufacturing capacity, would negatively affect our business and results of operations.

In an effort to drive cost reductions and further optimize Ciena's operations, we are working to rationalize our supply chain and consolidate third party contract manufacturers and distribution facilities. We also intend to pursue additional opportunities for direct fulfillment of products from our manufacturers to our customers. There can be no assurance that these efforts, including any reallocation of the third party manufacturing and sourcing or changes in fulfillment involving our manufacturers, will not ultimately result in additional costs, changes in quality or disruptions in our operations and business.

Our reliance upon third party component suppliers, including sole and limited source suppliers, exposes our business to additional risk and could limit our sales capability, increase our costs and harm our customer relationships.

We maintain a global sourcing strategy and depend on third party suppliers for our product components and subsystems, as well as for equipment used to manufacture and test our products. Our products include key optical and electronic components for which reliable, high-volume supply is often available only from sole or limited sources.

Increases in market demand or scarcity of resources or manufacturing capability have previously resulted in shortages in availability of important components for our solutions, allocation challenges and increased lead times. Conversely, periods of economic weakness or difficulties in the business of our component suppliers can result in increased costs or discontinuation of components. Our business is also exposed to risk associated with the international locations from which we source our components, including natural disasters, political and social instability. In recent months, several regions of Thailand have experienced severe flooding that has affected the operations of certain component providers in our supply chain, or their suppliers of optical components based in Thailand. There can be no assurance that we will not encounter shortages, extended lead times or other disruptions in the availability or allocation of necessary optical components which could affect our business over the next several fiscal quarters. We are also exposed to risk relating to unfavorable economic conditions or other similar challenges affecting the businesses of our component providers that can affect their liquidity levels, ability to continue to invest in their business, and manufacturing capability.

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The difficulties above could result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships. We do not have any guarantee of supply from these third parties, and in certain cases are relying upon temporary or transitional commercial arrangements. As a result, there is no assurance that we will be able to secure the components or subsystems that we require in sufficient quantity and quality on reasonable terms. The loss of a source of supply, or lack of sufficient availability of key components, could require that we locate an alternate source or redesign our products, each of which could increase our costs and negatively affect our product gross margin and results of operations. Our business and results of operations would be negatively affected if we were to experience any significant disruption or difficulties with key suppliers affecting the price, quality, availability or timely delivery of required components.

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

A significant portion of our revenue is concentrated among a few, large global communications service providers. By way of example, AT&T accounted for approximately 15.5% of fiscal 2011 revenue and our largest ten customers contributed 55.9% of fiscal 2011 revenue. Consequently, our financial results are closely correlated with the spending of a relatively small number of service provider customers and can be significantly affected by market or industry changes that affect the businesses of service providers. These factors can include consumer and enterprise spending on communication services, macroeconomic volatility, the adoption of new communications products and services, the emergence of competing network operators and changing demands of end user customers. Because the terms of our frame contracts generally do not include any minimum purchase commitment and spending by these service providers can be unpredictable and sporadic, our revenue and operating results can fluctuate on a quarterly basis. Reliance upon a relatively small number of service providers increases our exposure to changes in the network and purchasing strategies. Some of our customers are pursuing efforts to outsource the management and operation of their networks, or have indicated a procurement strategy to reduce the number of vendors from which they purchase equipment, which may benefit our larger competitors. Our concentration in revenue has increased in the past as a result of consolidation among a number of our largest customers. Consolidation may increase the likelihood of temporary or indefinite reductions in customer spending or changes in network strategy that could harm our business and operating results. The loss of one or more of our large service provider customers, a significant reduction in their spending, or market or industry factors adversely affecting service providers generally, would have a material adverse effect on our business, financial condition and results of operations.

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

The market for communications networking equipment is characterized by rapidly evolving technologies and changes in market demand. We continually invest in research and development to sustain or enhance our existing products and develop or acquire new product technologies. Our current development efforts are focused upon the platform evolution of our CoreDirector Multiservice Optical Switch family to our 5430 Reconfigurable Switching System, expansion of our service delivery and aggregation switches, and extension of our 40G and 100G coherent technologies and capabilities for our Packet-Optical Transport platforms. There is often a lengthy period between commencing these development initiatives and bringing a new or improved product to market. During this time, technology preferences, customer demand and the market for our products, or those introduced by our competitors, may move in directions we had not anticipated. There is no guarantee that our new products or enhancements will achieve market acceptance or that the timing of market adoption will be as predicted. There is a significant possibility, therefore, that some of our development decisions, including significant expenditures on acquisitions, research and development costs, or investments in technologies, will not turn out as anticipated, and that our investment in some projects will be

unprofitable. There is also a possibility that we may miss a market opportunity because we failed to invest, or invested too late, in a technology, product or enhancement sought by our customers, or addressing growth markets or emerging customer segments or applications beyond our traditional customer base. Changes in market demand or investment priorities may also cause us to discontinue existing or planned development for new products or features, which can have a disruptive effect on our relationships with customers. If we fail to make the right investments or fail to make them at the right time, our competitive position may suffer and our revenue and profitability could be harmed.

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

Our products are based on complex technology, and we can experience unanticipated delays in developing and manufacturing these solutions. Delays in product development may affect our reputation with customers, affect our ability to seize market opportunities and impact the timing and level of demand for our products. Each step in the development life cycle

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of our products presents serious risks of failure, rework or delay, any one of which could adversely affect the cost-effective and timely development of our products. We may encounter delays relating to engineering development activities and software, design, sourcing and manufacture of critical components, and the development of prototypes. In addition, intellectual property disputes, failure of critical design elements, and other execution risks may delay or even prevent the release of these products. If we do not successfully develop products in a timely manner, our competitive position may suffer and our business, financial condition and results of operations would be harmed.

Product performance problems and undetected errors affecting the performance, reliability or security of our products could damage our business reputation and negatively affect our results of operations.

The development and production of sophisticated hardware and software for communications network equipment is complicated. Some of our products can be fully tested only when deployed in communications networks or when carrying traffic with other equipment. As a result, undetected defects or errors, and product quality, interoperability, reliability and performance problems are often more acute for initial deployments of new products and product enhancements. We are in the process of launching a number of new platforms across our product segments. Unanticipated product performance problems, including any unforeseen defects or security vulnerabilities, can relate to the design, manufacturing and installation of our products, as well as the exposure of our solutions to malicious software or cyber-attacks. Undetected errors or vulnerabilities can also arise as a result of defects in components, software or manufacturing, installation or maintenance services supplied by third parties, and technology acquired from or licensed by third parties. These product performance, reliability, security and quality problems can negatively affect our business, including:

- increased costs to remediate software or hardware defects or replace products;
- payment of liquidated damages, contractual or similar penalties, or other claims for performance failures or delays;
- increased inventory obsolescence;
- increased warranty expense or estimates resulting from higher failure rates, additional field service obligations or other rework costs related to defects;
- costs and claims that may not be covered by liability insurance coverage or recoverable from third parties;
- delays in recognizing revenue or collecting accounts receivable; and
- damage to our reputation, declining sales and order cancellations.

These consequences of product defects or problems relating to quality, reliability and security of our products, including any significant costs to remediate, could negatively affect our business and results of operations.

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

Our future success will depend in large part on our ability to maintain and expand our sales to large communications service providers. These sales typically involve lengthy sales cycles, extensive product testing, and demonstration laboratory or network certification, including network-specific or region-specific product certification or homologation processes. These sales also often involve protracted and sometimes difficult contract negotiations in which we may deem it necessary to agree to unfavorable contract terms or conditions that adversely affect pricing, expose us to penalties for delays or non-performance, allocate to us a disproportionate amount of risk, and extend the timing of payment and revenue recognition. We may also be requested to provide deferred payment terms, vendor or third-party financing, or offer other alternative purchase structures. These terms may negatively affect our revenue and results of operations and increase our risk and susceptibility to quarterly fluctuations in our results. Service providers may ultimately insist upon terms and conditions that we deem too onerous or not in our best interest. Moreover, our purchase agreements generally do not include minimum purchase commitments and customers often have the right to modify, delay, reduce or cancel previous orders. As a result, we may incur substantial expense and devote time and resources to potential sales opportunities that never materialize or result in lower than anticipated sales.

Efforts by us or our strategic third party channel partners to sell our solutions into targeted geographic markets and customer segments may be unsuccessful.

We continue to take steps, including sales initiatives and strategic channel relationships, to sell our products into new markets, growth geographies and diverse customer segments beyond our traditional service provider customer base. Specifically, we are targeting opportunities in Brazil, the Middle East, Russia, Japan and India. We are also targeting sales opportunities with enterprises, wireless operators, cable operators, submarine network operators, Internet content providers, cloud infrastructure providers, research and education institutions, and federal, state and local governments. We believe sales to these customer segments, as well as emerging network operators supporting new communications services and applications,

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will be an important component of our growth strategy. In many cases, we have less experience in these markets and customer segments and they may have less familiarity with our company. To succeed in some of these geographic markets and customer segments we intend to leverage strategic sales channels and distribution arrangements. We expect these relationships to be an important part of our business internationally as well as for sales in support of network applications including cloud-based enterprise opportunities. Difficulties selling into these markets and customer segments, whether through internal resources or strategic, third party channels, could limit our growth and results of operations.

The international scale of our operations could expose us to additional risks and expense and adversely affect our results of operations.

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

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

Moreover, while we have seen early progress and sales opportunities with new customers in the Middle East, there can be no assurance that recent instability and unrest in the region will not adversely affect our business, operations and financial results relating to these and other opportunities. We expect that we may enter new markets and withdraw from or reduce operations in others. In some countries, our success will depend in part on our ability to form relationships with local sales, service or fulfillment partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements could adversely affect our business and operations. Our global operations may result in increased risk and expense to our business and could give rise to unanticipated liabilities or difficulties that could adversely affect our operations and financial results.

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

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

affected.

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

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

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

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

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

Any of these events could adversely affect our business, results of operations and financial condition. Our exposure to risks associated with the use of intellectual property may be increased as a result of acquisitions, as we have a lower level of visibility into the development process with respect to such technology or the steps taken to safeguard against the risks of infringing the rights of third parties.

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

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

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

If we do not manage effectively our relationships with third party service partners, or they fail to perform these services in the manner or time required, our financial results and relationship with customers could be adversely

affected.

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

We have entered into agreements with strategic partners that permit us to distribute their products or technology. We may rely upon these relationships to add complementary products or technologies, diversify our product portfolio, or address a particular customer or geographic market. We may enter into additional original equipment manufacturer (OEM), resale or similar strategic arrangements in the future, including in support of our selection as a domain supply partner with AT&T. We may incur unanticipated costs or difficulties relating to our resale of third party products. Our third party relationships could

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expose us to risks associated with the business and viability of such partners, as well as delays in their development, manufacturing or delivery of products or technology. We may also be required by customers to assume warranty, indemnity, service and other commercial obligations, including potential liability to customers, greater than the commitments, if any, made to us by our technology partners. Some of our strategic partners are relatively small companies with limited financial resources. If they are unable to satisfy their obligations to us or our customers, we may have to expend our own resources to satisfy these obligations. Exposure to these risks could harm our reputation with key customers and negatively affect our business and our results of operations.

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

In the course of our sales to customers, we may have difficulty collecting receivables and could be exposed to risks associated with uncollectible accounts. We may be exposed to similar risks relating to third party resellers and other sales channel partners. Lack of liquidity in the capital markets, macroeconomic weakness and market volatility may increase our exposure to credit risks. Our attempts to monitor these situations carefully and take appropriate measures to protect ourselves may not be sufficient, and it is possible that we may have to write down or write off doubtful accounts. Such write-downs or write-offs could negatively affect our operating results for the period in which they occur, and, if large, could have a material adverse effect on our revenue and operating results.

Our business is dependent upon the proper functioning of our internal business processes and information systems and modification or interruption of such systems may disrupt our business, processes and internal controls.

The proper functioning of our internal business processes and information systems is critical to the efficient operation and management of our business. If these information technology systems fail or are interrupted, our operations may be adversely affected and operating results could be harmed. Our business processes and information systems need to be sufficiently scalable to support the future growth of our business and may require modifications or upgrades that expose us to a number of operational risks. We are currently pursuing initiatives to transform and optimize our business operations through the reengineering of certain processes, investment in automation and engagement of strategic partners or resources to assist with select business functions. These changes may be costly and disruptive to our operations, and could impose substantial demands on management time. These changes may also require changes in system design, the modification of internal control procedures and significant training of employees or third party resources. Our information technology systems, and those of third party providers, may also be vulnerable to damage or disruption caused by circumstances beyond our control. These include catastrophic events, power anomalies or outages, natural disasters, computer system or network failures, viruses or malware, physical or electronic break-ins, unauthorized access and cyber attacks affecting our systems or those of third party business partners. Any material disruption, malfunction or similar challenges with our business processes or information systems, or disruptions or challenges relating to the transition to new processes, systems or providers, could have a material adverse effect on the operation of our business and our results of operations.

Outstanding indebtedness under our convertible notes may adversely affect our liquidity and results of operations and could limit our business.

At January 31, 2012, indebtedness on our outstanding convertible notes totaled approximately $1.4 billion in aggregate principal. Our indebtedness could have important negative consequences, including:

- increasing our vulnerability to adverse economic and industry conditions;
- limiting our ability to obtain additional financing, particularly in light of unfavorable conditions in the capital and credit markets;
-

debt service and repayment obligations that reduce the availability of cash resources for other purposes, including capital expenditures;

- limiting our flexibility in planning for, or reacting to, changes in our business and the markets in which we compete; and
- placing us at a possible competitive disadvantage to competitors that have better access to capital resources.

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

Significant volatility and uncertainty in the capital markets may limit our access to funding.

We have accessed the capital markets in the past and successfully raised funds, through the issuance of equity or convertible debt, to increase our cash position, support our operations and undertake strategic growth initiatives, including the

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MEN Acquisition. We regularly evaluate our liquidity position, debt obligations, and anticipated cash needs to fund our long-term operating plans and may consider raising additional capital in the future. Global capital markets have undergone a sustained period of significant volatility and uncertainty and there can be no assurance that such financing alternatives would be available to us, should we determine it necessary or advisable to seek additional cash resources.

Facilities transitions could be disruptive to our operations and result in unanticipated expense.

We will be undertaking significant facilities transitions affecting our two largest employee populations, including our headquarters facility. In November 2011, we entered into a lease for our new corporate headquarters in Hanover, Maryland and anticipate transitioning affected employees and operations, including key management and administration resources, to this new facility commencing in fiscal 2012. This transition could be disruptive to our operations and could result in unanticipated expense that adversely affects our financial results. In addition, the lease of our “Lab 10” building on the Carling Campus in Ottawa, Canada will expire in fiscal 2016. This is our largest facility, which includes a sophisticated research and development lab and key engineering personnel. We are currently considering facilities and development alternatives, however locating appropriate alternative space for our engineering operations in Ottawa may be costly and there can be no assurance that the transition of key engineering functions to a successor facility will not be disruptive or adversely affect productivity.

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

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

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

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

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

As a global concern, we face exposure to adverse movements in foreign currency exchange rates. Historically, our sales were primarily denominated in U.S. dollars. As a result of our increased global presence, a larger percentage of our revenue and operating expense are now non-U.S. dollar denominated and therefore subject to foreign currency fluctuation. We face exposure to currency exchange rates as a result of the growth in our non-U.S. dollar denominated operating expense in Canada, Europe, Asia and Latin America. From time to time, we may hedge against currency

exposure associated with anticipated foreign currency cash flows. There can be no assurance that any hedging instruments will be effective and losses associated with these instruments and the adverse effect of foreign currency exchange rate fluctuation may negatively affect our results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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manufacturing, selling and removing our products. These regulations may also make it difficult to obtain supply of compliant components or require us to write off non-compliant inventory, which could have an adverse effect our business and operating results.

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

As of January 31, 2012, our balance sheet includes $482.0 million in long-lived assets, which includes $312.2 million of intangible assets. Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products. These assumptions are used to forecast future, undiscounted cash flows. Given the significant uncertainty and instability of macroeconomic conditions in recent periods, forecasting future business is difficult and subject to modification. If actual market conditions differ or our forecasts change, we may be required to reassess long-lived assets and could record an impairment charge. Any impairment charge relating to long-lived assets would have the effect of decreasing our earnings or increasing our losses in such period. If we are required to take a substantial impairment charge, our operating results could be materially adversely affected in such period.

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

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

Our stock price is volatile.

Our common stock price has experienced substantial volatility in the past and may remain volatile in the future. Volatility in our stock price can arise as a result of a number of the factors discussed in this “Risk Factors” section. During fiscal 2011, our closing stock price ranged from a high of $28.81 per share to a low of $10.28 per share. The stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, with such volatility often unrelated to the operating performance of these companies. Divergence between our actual or anticipated financial results and published expectations of analysts can cause significant swings in our stock price. Our stock price can also be affected by announcements that we, our competitors, or our customers may make, particularly announcements related to acquisitions or other significant transactions. Our common stock is included in a number of market indices and any change in the composition of these indices to exclude our company would adversely affect our stock price. These factors, as well as conditions affecting the general economy or financial markets, may materially adversely affect the market price of our common stock in the future.

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

Not applicable.

Item 3. Defaults Upon Senior Securities
Not applicable.

Item 4. Mine Safety Disclosures
Not applicable.

Item 5. Other Information
Not applicable.

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Item 6. Exhibits

10.1	Lab 10 Lease Amending Agreement dated February 13, 2012 (incorporated by reference to Ciena's Form 8-K dated February 5, 2012)
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

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

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SIGNATURES

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

Ciena Corporation

Date: March 8, 2012

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

Date: March 8, 2012

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