CIENA CORP
Form 10-Q
September 08, 2011

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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 July 31, 2011

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	**23-2725311**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1201 Winterson Road, Linthicum, MD	**21090**
(Address of Principal Executive Offices)	(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 August 27, 2011
common stock, $.01 par value	96,884,073

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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 July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Revenue:				
Products	$ 312,378	$ 350,030	$ 667,852	$ 1,038,483
Services	77,297	85,283	151,170	248,032
Total revenue	389,675	435,313	819,022	1,286,515
Cost of goods sold:				
Products	201,559	198,217	396,449	615,283
Services	44,107	52,199	93,462	151,996
Total cost of goods sold	245,666	250,416	489,911	767,279
Gross profit	144,009	184,897	329,111	519,236
Operating expenses:				
Research and development	100,869	93,216	222,044	288,630
Selling and marketing	52,127	61,895	131,692	180,755
General and administrative	32,649	28,172	66,915	98,966
Acquisition and integration costs	17,033	4,822	83,285	39,748
Amortization of intangible assets	38,727	13,673	61,829	56,131
Restructuring costs	2,157	504	3,985	5,190
Change in fair value of contingent consideration				(3,289)
Total operating expenses	243,562	202,282	569,750	666,131
Loss from operations	(99,553)	(17,385)	(240,639)	(146,895)
Interest and other income (loss), net	(2,668)	(3,160)	307	7,334
Interest expense	(5,990)	(9,470)	(11,931)	(28,426)
Loss before income taxes	(108,211)	(30,015)	(252,263)	(167,987)
Provision for income taxes	1,644	1,435	934	5,205
Net loss	$ (109,855)	$ (31,450)	$ (253,197)	$ (173,192)
Basic net loss per common share	$ (1.18)	$ (0.33)	$ (2.73)	$ (1.82)
Diluted net loss per potential common share	$ (1.18)	$ (0.33)	$ (2.73)	$ (1.82)

Weighted average basic common shares outstanding	92,906	96,313	92,851	95,389
Weighted average dilutive potential common shares outstanding	92,906	96,313	92,851	95,389

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, 2010	July 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 688,687	$ 486,332
Accounts receivable, net	343,582	414,826
Inventories	261,619	243,827
Prepaid expenses and other	147,680	141,401
Total current assets	1,441,568	1,286,386
Long-term investments		50,227
Equipment, furniture and fixtures, net	120,294	126,174
Other intangible assets, net	426,412	349,845
Other long-term assets	129,819	125,801
Total assets	$ 2,118,093	$ 1,938,433
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 200,617	$ 140,806
Accrued liabilities	193,994	182,563
Deferred revenue	75,334	100,988
Total current liabilities	469,945	424,357
Long-term deferred revenue	29,715	26,302
Other long-term obligations	16,435	16,754
Convertible notes payable	1,442,705	1,442,449
Total liabilities	1,958,800	1,909,862
Commitments and contingencies Stockholders equity:		
Preferred stock par value $0.01; 20,000,000 shares authorized; zero shares issued and outstanding		
Common stock par value $0.01; 290,000,000 shares authorized; 94,060,300 and 96,883,868 shares issued and outstanding	941	969
Additional paid-in capital	5,702,137	5,743,211
Accumulated other comprehensive income	1,062	2,430
Accumulated deficit	(5,544,847)	(5,718,039)
Total stockholders equity	159,293	28,571

Total liabilities and stockholders equity	$ 2,118,093	$ 1,938,433

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

CIENA CORPORATION

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

	Nine Months Ended July 31, 2010	2011
Cash flows from operating activities:		
Net loss	$ (253,197)	$ (173,192)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of premium (discount) on marketable securities	574	(25)
Change in fair value of embedded redemption feature	(2,570)	(3,380)
Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements	28,146	44,765
Share-based compensation costs	26,451	27,919
Amortization of intangible assets	82,476	76,567
Provision for inventory excess and obsolescence	10,749	11,461
Provision for warranty	16,388	10,538
Other	1,955	2,170
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	(134,844)	(72,030)
Inventories	(30,765)	6,331
Prepaid expenses and other	(29,528)	(4,462)
Accounts payable, accruals and other obligations	84,886	(81,388)
Deferred revenue	(3,957)	22,241
Net cash used in operating activities	(203,236)	(132,485)
Cash flows used in investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(34,646)	(41,138)
Restricted cash	(18,845)	(8,727)
Purchase of available for sale securities	(63,591)	(49,894)
Proceeds from maturities of available for sale securities	454,141	
Proceeds from sales of available for sale securities	179,380	
Acquisition of business	(693,247)	
Receipt of contingent consideration related to business acquisition		16,394
Net cash used in investing activities	(176,808)	(83,365)
Cash flows from financing activities:		
Proceeds from issuance of 4.0% convertible notes payable, net	364,316	
Proceeds from issuance of common stock	924	13,183
Net cash provided by financing activities	365,240	13,183
Effect of exchange rate changes on cash and cash equivalents	(664)	312
Net decrease in cash and cash equivalents	(14,804)	(202,667)
Cash and cash equivalents at beginning of period	485,705	688,687

Cash and cash equivalents at end of period	$ 470,237	$ 486,332
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$ 4,748	$ 18,869
Cash paid during the period for income taxes, net	$ 2,037	$ 1,781
Non-cash investing and financing activities		
Purchase of equipment in accounts payable	$ 4,421	$ 5,186
Fixed assets acquired under capital leases	$	$ 1,268

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

CIENA CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) INTERIM FINANCIAL STATEMENTS

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

On March 19, 2010, Ciena completed its acquisition of substantially all of the optical networking and Carrier Ethernet assets of Nortel s Metro Ethernet Networks (MEN Business). Ciena s results of operations for the nine-month period ended July 31, 2010 reflect the operations of the MEN Business beginning on the March 19, 2010 acquisition date. See Note 3 below.

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

(2) SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

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

Cash and Cash Equivalents

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

Investments

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

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

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Inventories

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

Segment Reporting

Ciena s chief operating decision maker, its chief executive officer, evaluates performance and allocates resources based on multiple factors, including segment profit (loss) information for the following product categories: (i) Packet-Optical Transport; (ii) Packet-Optical Switching; (iii) Carrier Ethernet Service Delivery; and (iv) Software and Services. Operating segments are defined as components of an enterprise: that engage in business activities which may earn revenue and incur expense; for which discrete financial information is available; and for which such information is evaluated regularly by the chief operating decision maker for purposes of allocating resources and assessing performance. Ciena considers the four product categories above to be its operating segments for reporting purposes. See Note 18.

Long-lived Assets

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

Equipment, Furniture and Fixtures

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

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

Intangible Assets

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

Maintenance Spares

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

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 Notes 7 and 18 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 services rendered. Ciena assesses whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. Ciena assesses collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer s payment history. Revenue for maintenance services is generally deferred and recognized ratably over the period during which the services are to be performed.

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

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

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

Accounting for multiple element arrangements entered into prior to fiscal 2011

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

Accounting for multiple element arrangements entered into or materially modified in fiscal 2011

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

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

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each 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 VSOE of selling price, if it exists, or TPE of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, Ciena uses its BESP for that deliverable.

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

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

Warranty Accruals

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

Accounts Receivable, Net

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

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

Ciena accounts for proceeds from government grants as a reduction of 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 Condensed Consolidated Statement of Operations to which the grant activity relates. See Note 19 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 share-based award based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense to its consolidated statement of operations for those options or shares that are expected ultimately to vest. Ciena uses two attribution methods to record expense, the straight-line method for grants with only service-based vesting and the graded-vesting method, which considers each performance period or tranche separately, for all other awards. See Note 16 below.

Income Taxes

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

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

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

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

Loss Contingencies

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

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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 14 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 4 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

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 Condensed 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 13 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 15.

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. 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) BUSINESS COMBINATIONS

Acquisition of MEN Business

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

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

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

On October 19, 2010, Nortel issued a public announcement that it had entered into a sale agreement of its Carling campus with Public Works and Government Services Canada (PWGSC) and had been directed to exercise its early termination rights under the Carling lease, shortening the lease term from ten years to five years. As a result, and based on this change in circumstances and expected outcome probability, during the fourth quarter of fiscal 2010

Ciena recorded an unrealized gain of $13.8. million, resulting in a fair value of $30.2 million for the contingent consideration right. During the first quarter of fiscal 2011, Ciena received notice of early termination from Nortel and the corresponding $33.5 million payment described above, resulting in a gain of $3.3 million.

During fiscal 2010, Ciena incurred $101.4 million in transaction, consulting and third party service fees, $8.5 million in restructuring expense, and an additional $12.4 million in costs primarily related to purchases of capitalized information technology equipment. During the first nine months of fiscal 2011, Ciena incurred $39.7 million in transaction, consulting and third party service fees, $5.9 million in restructuring expense, and an additional $10.2 million in costs primarily related to purchases of capitalized information technology equipment.

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

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

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

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

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

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

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

Customer relationships, outstanding purchase orders and contracts represent agreements with existing customers of the MEN Business. These intangible assets are expected to have estimated useful lives of nine months to seven years, with the exception of $14.6 million related to a contract asset for acquired in-process projects to be billed by Ciena and recognized as a reduction in revenue. As of July 31, 2011, Ciena has billed $13.8 million of these contract assets. The remaining $0.8 million will be billed during the remainder of fiscal 2011. Trade name represents acquired product trade names that are expected to have a useful life of nine months.

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

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

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

	Quarter Ended July 31, 2010	Nine Months Ended July 31, 2010
Pro forma revenue	$ 393,843	$ 1,174,719
Pro forma net loss	$ (77,080)	$ (463,150)

(4) RESTRUCTURING COSTS

Since the acquisition of the MEN Business, Ciena has undertaken a number of restructuring activities intended to reduce operating expense and better align its workforce and operating costs with market opportunities, product development and business strategies for the combined operations.

The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the nine months ended July 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	5,941		5,941
Adjustment to previous estimates		(751)	(751)
Cash payments	(5,800)	(1,723)	(7,523)
Balance at July 31, 2011	$ 1,717	$ 3,918	$ 5,635
Current restructuring liabilities	$ 1,717	$ 975	$ 2,692
Non-current restructuring liabilities	$	$ 2,943	$ 2,943

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

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

Non-current restructuring liabilities	$	$ 5,995	$ 5,995

(5) MARKETABLE SECURITIES

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

	July 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations	$ 49,920	$ 307	$	$ 50,227
	$ 49,920	$ 307	$	$ 50,227

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The following table summarizes final legal maturities of debt investments at July 31, 2011 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than one year	$	$
Due in 1-2 years	49,920	50,227
	$ 49,920	$ 50,227

At October 31, 2010, Ciena did not have any investments in marketable debt securities.

(6) FAIR VALUE MEASUREMENTS

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

	July 31, 2011			
	Level 1	Level 2	Level 3	Total
Assets:				
U.S. government obligations	$ 50,227	$	$	$ 50,227
Foreign currency forward contracts		137		137
Embedded redemption feature			7,600	7,600
Total assets measured at fair value	$ 50,227	$ 137	$ 7,600	$ 57,964

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

	July 31, 2011			
	Level 1	Level 2	Level 3	Total
Assets:				
Prepaid expenses and other	$	$ 137	$	$ 137
Long-term investments	50,227			50,227
Other long-term assets			7,600	7,600
Total assets measured at fair value	$ 50,227	$ 137	$ 7,600	$ 57,964

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 14 below. The embedded redemption feature is bifurcated from Ciena s 4.0% convertible senior notes using the with-and-without approach. As such, the total value of the embedded redemption feature is calculated as the difference between the value of the 4.0% convertible senior notes (the Hybrid Instrument) and the value of an identical instrument without the embedded redemption feature (the Host Instrument). Both the Host Instrument and the Hybrid Instrument are valued using a modified binomial model. The modified binomial model utilizes a risk free interest rate, an implied volatility of Ciena s stock, the recovery rates of bonds and the implied default intensity of the 4.0% convertible senior notes.

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

	Level 3
Balance at October 31, 2010	$ 34,415
Issuances	

Settlements	(30,195)
Changes in unrealized gain (loss)	3,380
Transfers into Level 3	
Transfers out of Level 3	
Balance at July 31, 2011	$ 7,600

(7) ACCOUNTS RECEIVABLE

Allowance for doubtful accounts was $0.1 million and $0.9 million as of October 31, 2010 and July 31, 2011, respectively. Ciena has not historically experienced a significant amount of bad debt expense.

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(8) INVENTORIES

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

	October 31, 2010	July 31, 2011
Raw materials	$ 30,569	$ 41,970
Work-in-process	6,993	12,271
Finished goods	177,994	154,161
Deferred cost of goods sold	76,830	66,758
	292,386	275,160
Provision for excess and obsolescence	(30,767)	(31,333)
	$ 261,619	$ 243,827

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 nine months of fiscal 2011, Ciena recorded a provision for excess and obsolescence of $11.5 million, primarily related to changes in forecasted sales for certain products. Deductions from the provision for excess and obsolete inventory relate to disposal activities.

(9) PREPAID EXPENSES AND OTHER

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

	October 31, 2010	July 31, 2011
Prepaid VAT and other taxes	$ 46,352	$ 37,295
Deferred deployment expense	6,918	13,779
Product demonstration equipment, net	29,449	45,048
Prepaid expenses	15,087	13,537
Restricted cash	12,994	21,566
Contingent consideration	30,195	
Other non-trade receivables	6,685	10,176
	$ 147,680	$ 141,401

Depreciation of product demonstration equipment was $2.3 million and $7.1 million for the first nine months of fiscal 2010 and 2011, respectively.

(10) EQUIPMENT, FURNITURE AND FIXTURES

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

	October 31, 2010	July 31, 2011
Equipment, furniture and fixtures	$ 360,908	$ 398,332
Leasehold improvements	49,595	54,289
	410,503	452,621
Accumulated depreciation and amortization	(290,209)	(326,447)
	$ 120,294	$ 126,174

Depreciation of equipment, furniture and fixtures, and amortization of leasehold improvements was $25.8 million and $37.7 million for the first nine months of fiscal 2010 and 2011, respectively.

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(11) OTHER INTANGIBLE ASSETS

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

	October 31, 2010			July 31, 2011		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Developed technology	$ 417,833	$ (186,129)	$ 231,704	$ 417,833	$ (222,327)	$ 195,506
Patents and licenses	45,388	(45,167)	221	45,388	(45,272)	116
Customer relationships, covenants not to compete, outstanding purchase orders and contracts	323,573	(129,086)	194,487	323,573	(169,350)	154,223
Total other intangible assets	$ 786,794	$ (360,382)	$ 426,412	$ 786,794	$ (436,949)	$ 349,845

The amortization of finite-lived other intangible assets was $82.5 million and $76.6 million for the first nine months of fiscal 2010 and 2011, respectively. Expected future amortization of finite-lived other intangible assets for the fiscal years indicated is as follows (in thousands):

Period ended October 31,	
2011 (remaining three months)	$ 20,102
2012	73,564
2013	71,145
2014	56,987
2015	52,714
Thereafter	75,333
	$ 349,845

(12) OTHER BALANCE SHEET DETAILS

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

	October 31, 2010	July 31, 2011
Maintenance spares inventory, net	$ 53,654	$ 50,117
Deferred debt issuance costs, net	28,853	24,815
Embedded redemption feature	4,220	7,600
Restricted cash	37,796	37,951
Other	5,296	5,318
	$ 129,819	$ 125,801

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 $2.6 million and $4.0 million during the first nine months of fiscal 2010 and fiscal 2011, respectively.

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

	October 31, 2010	July 31, 2011
Warranty	$ 54,372	$ 45,705
Compensation, payroll related tax and benefits	39,391	40,728
Vacation	20,412	27,614
Current restructuring liabilities	2,784	2,692
Interest payable	4,345	10,096
Other	72,690	55,728
	$ 193,994	$ 182,563

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

Nine months ended July 31,	Beginning Balance	Acquired	Provisions	Settlements	Balance at end of period
2010	$ 40,196	26,000	16,388	(18,074)	$ 64,510
2011	$ 54,372		10,538	(19,205)	$ 45,705

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

As a result of the substantial completion of integration activities related to the MEN 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, 2010	July 31, 2011
Products	$ 31,187	$ 39,811
Services	73,862	87,479
	105,049	127,290
Less current portion	(75,334)	(100,988)
Long-term deferred revenue	$ 29,715	$ 26,302

(13) FOREIGN CURRENCY FORWARD CONTRACTS

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 12 months or less and are designated as cash flow hedges. Ciena considers several factors when evaluating hedges of its forecasted foreign currency exposures, such as significance of the exposure, offsetting economic exposures, potential costs of hedging, and the potential for hedge ineffectiveness. Ciena does not enter into derivative transactions for purposes other than hedging economic exposures. Beginning in the second quarter of fiscal 2011, Ciena entered into forward contracts to reduce the variability in its Canadian Dollar and Indian Rupee 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.

(14) CONVERTIBLE NOTES PAYABLE

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

	July 31, 2011	
Description	Carrying Value	Fair Value
0.25% Convertible Senior Notes due May 1, 2013	$ 216,210	$ 209,048
4.0% Convertible Senior Notes due March 15, 2015 [1]	376,239	410,156

0.875% Convertible Senior Notes due June 15, 2017	500,000	406,875
3.75% Convertible Senior Notes due October 15, 2018	350,000	370,125
	$ 1,442,449	$ 1,396,204

(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.

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(15) 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.

	Quarter Ended July 31,		Nine Months Ended July 31,	
Numerator	2010	2011	2010	2011
Net loss	$ (109,855)	$ (31,450)	$ (253,197)	$ (173,192)

	Quarter Ended July 31,		Nine Months Ended July 31,	
Denominator	2010	2011	2010	2011
Basic weighted average shares outstanding	92,906	96,313	92,851	95,389
Dilutive weighted average shares outstanding	92,906	96,313	92,851	95,389

	Quarter Ended July 31,		Nine Months Ended July 31,	
EPS	2010	2011	2010	2011
Basic EPS	$ (1.18)	$ (0.33)	$ (2.73)	$ (1.82)
Diluted EPS	$ (1.18)	$ (0.33)	$ (2.73)	$ (1.82)

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 July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Shares underlying stock options, restricted stock units and warrants	7,171	6,032	8,171	6,295
0.25% Convertible Senior Notes due May 1, 2013	7,539	5,470	7,539	5,470
4.00% Convertible Senior Notes due March 15, 2015	18,396	18,396	9,333	18,396
0.875% Convertible Senior Notes due June 15, 2017	13,108	13,108	13,108	13,108
3.75% Convertible Senior Notes due October 15, 2018		17,355		17,355
Total excluded due to anti-dilutive effect	46,214	60,361	38,151	60,624

(16) 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 July 31, 2011, there were approximately 4.0 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 as of October 31, 2010	5,002	$ 40.96
Granted		
Exercised	(405)	15.03
Canceled	(442)	87.94
Balance as of July 31, 2011	4,155	$ 38.49

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The total intrinsic value of options exercised during the first nine months of fiscal 2010 and fiscal 2011 was $0.8 million and $3.3 million, respectively. The weighted average fair value of each stock option granted by Ciena during the first nine months of fiscal 2010 was $6.95. There were no stock options granted by Ciena during the first nine months of fiscal 2011.

The following table summarizes information with respect to stock options outstanding at July 31, 2011, based on Ciena s closing stock price on the last trading day of Ciena s third fiscal quarter of 2011 (shares and intrinsic value in thousands):

Range of Exercise Price		Options Outstanding at July 31, 2011 Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Vested Options at July 31, 2011 Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
$0.01	$ 16.52	635	5.41	$ 11.37	$ 2,852	511	4.82	$ 11.68	$ 2,188
$16.53	$ 17.43	351	4.12	17.20		337	3.99	17.20	
$17.44	$ 22.96	339	3.75	21.80		326	3.61	21.85	
$22.97	$ 31.71	1,253	3.36	29.42		1,226	3.29	29.45	
$31.72	$ 46.90	755	4.67	39.25		712	4.57	39.40	
$46.91	$ 73.78	399	1.37	59.14		399	1.37	59.14	
$73.79	$ 267.52	423	0.22	116.21		423	0.22	116.21	
$0.01	$ 267.52	4,155	3.50	$ 38.49	$ 2,852	3,934	3.28	$ 39.61	$ 2,188

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 nine months of fiscal 2011. During the first nine months of fiscal 2010, Ciena estimated the fair value of each option award on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions:

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

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

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

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

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

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

Restricted Stock Units

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

	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value Per Share	Aggregate Fair Value
Balance as of October 31, 2010	5,191	$ 13.81	$ 71,681
Granted	1,855		
Vested	(1,916)		
Canceled or forfeited	(483)		
Balance as of July 31, 2011	4,647	$ 16.12	$ 71,849

The total fair value of restricted stock units that vested and were converted into common stock during the first nine months of fiscal 2010 and fiscal 2011 was $19.0 million and $38.3 million, respectively. The weighted average fair value of each restricted stock unit granted by Ciena during the first nine months of fiscal 2010 and fiscal 2011 was $13.43 and $20.16, respectively.

Assumptions for Restricted Stock Unit Awards

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

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

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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 nine months of fiscal 2011, Ciena issued 0.5 million shares under the ESPP. At July 31, 2011, 3.2 million shares remained available for issuance under the ESPP.

Ciena estimated the fair value of each ESPP option on the first date of the offer period using the Black-Scholes option-pricing model, with the following weighted average assumptions:

	Quarter Ended July 31, 2011	Nine Months Ended July 31, 2011
Expected volatility	39.8 - 48.4%	39.8 - 49.1%
Risk-free interest rate	0.19 - .20%	0.19 - .64%
Expected life (years)	0.5	0.25 - 0.50
Expected dividend yield	0.0%	0.0%

Share-Based Compensation Expense for Periods Reported

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Product costs	$ 548	$ 578	$ 1,475	$ 1,658
Service costs	432	510	1,315	1,516
Share-based compensation expense included in cost of sales	980	1,088	2,790	3,174
Research and development	2,302	2,423	6,948	7,591
Sales and marketing	2,902	2,737	8,025	8,871
General and administrative	2,473	2,883	7,349	8,023
Acquisition and integration costs	883	54	1,229	288
Share-based compensation expense included in operating expense	8,560	8,097	23,551	24,773
Share-based compensation expense capitalized in inventory, net	111	(152)	110	(28)
Total share-based compensation	$ 9,651	$ 9,033	$ 26,451	$ 27,919

As of July 31, 2011, total unrecognized share-based compensation expense was $67.8 million (i) $1.8 million related to unvested stock options and expected to be recognized over a weighted-average period of 0.6 years and (ii) $66.0 million related to unvested restricted stock units and expected to be recognized over a weighted-average period of 1.7 years.

(17) COMPREHENSIVE LOSS

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Net loss	$ (109,855)	$ (31,450)	$ (253,197)	$ (173,192)
Change in unrealized gain (loss) on available-for-sale securities, net of tax		3	(458)	378
Change in unrealized gain (loss) on foreign currency forward contracts, net of tax		(88)		87
Change in accumulated translation adjustments	(728)	(4,290)	(1,263)	903
Total comprehensive loss	$ (110,583)	$ (35,825)	$ (254,918)	$ (171,824)

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(18) SEGMENT AND ENTITY WIDE DISCLOSURES

Segment Reporting

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

Packet-Optical Transport includes optical transport solutions that increase network capacity and enable more rapid delivery of a broader mix of high-bandwidth services. These products are used by network operators to facilitate the cost effective and efficient transport of voice, video and data traffic in core networks, as well as regional, metro and access networks. 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 Condensed Consolidated Statement of Operations.

Packet-Optical Switching includes optical switching platforms that enable automated optical infrastructures for the delivery of a wide variety of enterprise and consumer-oriented network services. Ciena s principal products in this segment include its family of CoreDirector® Multiservice Optical Switches, its 5430 Reconfigurable Switching System and its packet 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 Condensed Consolidated Statement of Operations.

Carrier Ethernet Service Delivery 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 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 includes the legacy metro Ethernet routing switch (MERS) product line, from the MEN Business, and Ciena s 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 Condensed Consolidated Statement of Operations.

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

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

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Revenue:				
Packet-Optical Transport	$ 242,057	$ 266,551	$ 423,216	$ 825,667
Packet-Optical Switching	34,806	40,682	90,638	107,223
Carrier Ethernet Service Delivery	33,802	40,475	149,047	99,034
Software and Services	79,010	87,605	156,121	254,591
Consolidated revenue	$ 389,675	$ 435,313	$ 819,022	$ 1,286,515

Segment Profit (Loss)

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

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Segment profit (loss):				
Packet-Optical Transport	$ 12,874	$ 51,827	$ 26,402	$ 127,359
Packet-Optical Switching	10,320	12,783	13,749	34,147
Carrier Ethernet Service Delivery	(3,212)	6,519	31,642	12,409
Software and Services	23,158	20,552	35,274	56,691
Total segment profit (loss)	43,140	91,681	107,067	230,606
Other nonperformance items:				
Selling and marketing	(52,127)	(61,895)	(131,692)	(180,755)
General and administrative	(32,649)	(28,172)	(66,915)	(98,966)
Acquisition and integration costs	(17,033)	(4,822)	(83,285)	(39,748)
Amortization of intangible assets	(38,727)	(13,673)	(61,829)	(56,131)
Restructuring costs	(2,157)	(504)	(3,985)	(5,190)
Change in fair value of contingent consideration				3,289
Interest and other financial charges, net	(8,658)	(12,630)	(11,624)	(21,092)
Provision for income taxes	(1,644)	(1,435)	(934)	(5,205)
Consolidated net loss	$ (109,855)	$ (31,450)	$ (253,197)	$ (173,192)

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, except percentage data):

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
United States	$ 229,739	$ 227,524	$ 534,174	$ 678,674
Canada	22,840	43,815	65,125	128,770
Other International	137,096	163,974	219,723	479,071
Total	$ 389,675	$ 435,313	$ 819,022	$ 1,286,515

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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, except percentage data):

	October 31, 2010	July 31, 2011
United States	$ 63,675	$ 64,624
Canada	45,103	47,424
Other International	11,516	14,126
Total	$ 120,294	$ 126,174

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

	Quarter Ended July 31,		Nine Months Ended July 31,	
	2010	2011	2010	2011
Company A	$ 90,769	$ 75,068	$ 204,092	$ 202,009
Company B	40,556	n/a	n/a	131,721
Total	$ 131,325	$ 75,068	$ 204,092	$ 333,730

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

(19) 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 CAD$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 CAD$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 July 31, 2011, Ciena has recorded a CAD$4.1 million benefit as a reduction in research and development expenses because it believes it has complied with the conditions entitling it to this disbursement and that the grant proceeds will be 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, 2010 and July 31, 2011, Ciena had accrued liabilities of $1.4 million and $1.6 million, respectively, related to these contingencies, which are reported as a component of other current accrued liabilities. As of July 31, 2011, Ciena estimates that it could be exposed to possible losses of up to $5.8 million, for which it has not accrued liabilities. Ciena has not accrued the additional income tax liabilities because it does not believe that such losses are 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 our 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. 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 amended 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. Ciena believes that it has valid defenses to the lawsuit and intends to defend it vigorously in the event the stay of the case is lifted.

As a result of its June 2002 merger with ONI Systems Corp., Ciena became a defendant in a securities class action lawsuit filed in the United States District Court for the Southern District of New York in August 2001. The complaint named ONI, certain former ONI officers, and certain underwriters of ONI s initial public offering (IPO) as defendants, and alleges, among other things, that the underwriter defendants violated the securities laws by failing to disclose alleged compensation arrangements in ONI s registration statement and by engaging in manipulative practices to artificially inflate ONI s stock price after the IPO. The complaint also alleges that ONI and the named former officers violated the securities laws by failing to disclose the underwriters alleged compensation arrangements and manipulative practices. The former ONI officers have been dismissed from the action without prejudice. Similar complaints have been filed against more than 300 other issuers that have had initial public offerings since 1998, and all of these actions have been included in a single coordinated proceeding. On October 6, 2009, the Court entered an opinion granting final approval to a settlement among the plaintiffs, issuer defendants and underwriter defendants, and directing that the Clerk of the Court close these actions. All appeals of the opinion granting final approval have been either resolved or dismissed, except one. On August 25, 2011, on remand from the Second Circuit, the District Court determined that the last remaining appellant did not have standing to assert his appeal. A description of this litigation and the history of the proceedings can be found in Item 3. Legal Proceedings of Part I of Ciena s Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 22, 2010. No specific amount of damages has been claimed in this action. Due to the inherent uncertainties of litigation and because the settlement remains subject to appeal, the ultimate outcome of the matter is uncertain.

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

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

Some of the statements contained, or incorporated by reference, in this quarterly report discuss future events or expectations, contain projections of results of operations or financial condition, changes in the markets for our products and services, or state other forward-looking information. Ciena s forward-looking information is based on various factors and was derived using numerous assumptions. In some cases, you can identify these forward-looking statements by words like may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continue or the negative of those words and other comparable words. You should be aware that these statements only reflect our current predictions and beliefs. These statements are subject to known and unknown risks, uncertainties and other factors, and actual events or results may differ materially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly in Item 1A Risk Factors of Part II of this report below. You should review these risk factors and the rest of this quarterly report in combination with the more detailed description of our business and management s discussion and analysis of financial condition in our annual report on

Form 10-K, which we filed with the Securities and Exchange Commission on December 22, 2010, for a more complete understanding of the risks associated with an investment in Ciena s securities. Ciena undertakes no obligation to revise or update any forward-looking statements.

Overview

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

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

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

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

Effect of MEN Acquisition upon Results of Operations and Financial Condition

Due to the relative scale of its operations, the MEN Acquisition has materially affected our operations, financial results and liquidity and may make period to period comparisons difficult. Our revenue and operating expense increased materially compared to periods prior to the MEN Acquisition. We also experienced increases in our concentration of Packet-Optical Transport revenue and revenue from outside of the United States, each of which has contributed to somewhat lower gross margins since the MEN Acquisition. From the closing of the MEN Acquisition through the third quarter of fiscal 2011, we incurred significant integration costs and transition services expense. Integration activities resulted in $141.1 million in transaction, consulting and third party service fees, $14.5 million in severance expense, and an additional $22.6 million, primarily related to purchases of capitalized information technology equipment through the third quarter of fiscal 2011. We anticipate that we will incur approximately $8.0 million to $12.0 million in additional integration costs during the remainder of fiscal 2011. From the date of the MEN Acquisition through the second quarter of fiscal 2011, Ciena incurred significant transition service expense, principally reflected in operating expense, for services performed by a Nortel affiliate relating to finance and accounting functions, supply chain and logistics management, maintenance and product support, order management and fulfillment, trade compliance, and information technology. In addition, as a result of the MEN Acquisition, we recorded $492.4 million in other intangible assets that will be amortized over their useful lives and increase our operating expense.

Gross margin was also adversely affected by the valuation, required under accounting rules, of the acquired finished goods inventory of the MEN Business to fair value upon closing. This valuation increased marketable inventory carrying value by $62.3 million, of which $48.0 million and $14.3 million were recognized in cost of goods sold during fiscal 2010 and the first nine months of fiscal 2011, respectively. See Critical Accounting Policies and Estimates- Long-lived Assets and Note 3 of the Condensed Consolidated Financial Statements found under Item 1 of this report.

Restructuring Activities

Since the MEN Acquisition, we have undertaken a number of restructuring activities intended to reduce operating expense and better align our workforce and operating costs with market opportunities, product development initiatives and business strategies for the combined operations. During the first nine months of fiscal 2011, we incurred approximately $5.9 million in restructuring costs and expect these actions to result in an additional restructuring charge in the range of $1.0 million to $2.0 million during the remainder of fiscal 2011. As we look to manage operating expense and optimize the resources of the combined operations, we will continue to assess the allocation of headcount, facilities and other resources toward key growth opportunities for our business and evaluate additional cost reduction measures.

Global Market Conditions and Competitive Landscape

The recent period of macroeconomic weakness and volatility in global markets has resulted in heightened uncertainty and cautious customer behavior in our industry and markets. We have experienced 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 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 more aggressively sought to capture market share and displace incumbent vendors at large carrier customers. We have also encountered increased competition as we have expanded our business in emerging geographies and new markets or applications for our communications networking products. For example, we have made early progress in the sale of our products for application in submarine networks and with sales to customers in the Middle East. In this competitive environment, securing new opportunities, particularly in international markets, often requires that we agree to less favorable commercial terms or pricing, 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. 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.

Strategy

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

To capitalize on the market dynamics above, we have been investing heavily in our business and are in the process of introducing, or transitioning to new solutions offerings in each of our product segments. These developments include the enhancement of our 100G coherent optical transport solution to further improve network flexibility, performance, spectral efficiency and reach. We are also bringing to market a re-architected, integrated network management software platform that unifies visibility, control and service enablement across our product portfolio. Within Packet-Optical Switching, we are transitioning from our CoreDirector platform to our data-optimized, 5430 Reconfigurable Switching System, to enable an end-to-end Optical Transport Network (OTN) architecture that offers improved cost per bit, flexibility and reliability. We are also expanding our Carrier Ethernet Service Delivery portfolio to include the Carrier-Ethernet configuration of our 5410 Reconfigurable Switching Solution, a high-capacity (terabit scale) Ethernet metro aggregation switch to support wireless backhaul, Ethernet business services and residential broadband applications. Simultaneously, we have also been investing in market entry into multiple, new geographies and vertical segments, as well as the expansion of footprint and market share within our traditional customer base across our segments. Managing these platform introductions, market share capture initiatives and market expansions has required increased investment that has impacted and continues to impact a number of financial and operational metrics, including margin, operating expense and cash flows. These investments are a critical element of our effort to address evolving industry trends and end user network requirements, and we believe they will position us to seize market opportunities for long-term growth. Additional components of our overall corporate strategy include:

Optimize operations, infrastructure and resources to achieve desired operating leverage. With critical integration activities relating to the MEN Acquisition substantially complete, we are focused on optimizing and gaining leverage from our business processes, systems, infrastructure and resources. These initiatives include the enhancement and further automation of business processes and systems, and the consolidation of our supply chain, third party manufacturers, logistics providers and facilities. We seek to leverage these and other longer-term opportunities, to improve operating efficiencies and promote the growth of the business.

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

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Expand our geographic reach. We seek to enhance our brand internationally and build upon the broader global presence of our business following the MEN Acquisition. In particular, we seek to expand our geographic reach and market share in growing markets including Brazil, the Middle East, Russia and India. Some of these jurisdictions maintain restrictions on importation, trade protection measures and other domestic preference requirements that could limit our access or success in these markets. For example, India has recently implemented certain security requirements affecting network equipment vendors and has imposed significant tariffs upon certain telecommunications equipment manufactured in China, where we assemble certain products and source many components and parts. These requirements may make sales in these markets costly or necessitate changes in our supply chain and operations.

Increase sales of Packet-Optical Switching and Carrier Ethernet Service Delivery solutions. Through cross-selling and other sales initiatives, we seek to increase the number of customers of and revenue contribution from our Packet-Optical Switching and Carrier Ethernet Service Delivery products, particularly in international markets. By extending our technology leadership in next-generation, coherent transport technology, we seek to drive additional business opportunities for our Packet-Optical Switching and Carrier Ethernet Service Delivery products. Each of these product segments is in the early stages of significant platform transitions and we expect our revenue, gross margin and results of operations may fluctuate in the future in large part depending upon our success in selling new platforms within these segments.

Leverage our consultative, network specialist approach to drive service and software sales. Our close, consultative relationship with customers enables us to bring strategic value to customer relationships beyond the sale of next-generation communications networking solutions. By understanding and addressing their business needs and the challenging markets in which they compete, we can offer solutions that create additional business and operational value for our customers. We intend to leverage this approach to drive customized opportunities for our Ciena specialist services and sales of integrated, network management software solutions that enable service level management across network layers, rapid service provisioning and increased automation.

Financial Results

Revenue for the third quarter of fiscal 2011 was $435.3 million, representing a sequential increase of 4.2% from $417.9 million in the second quarter of fiscal 2011. Revenue-related details reflecting sequential changes from the second quarter of fiscal 2011 include:

- Product revenue for the third quarter of fiscal 2011 increased by $14.0 million, reflecting increases of $9.5 million in sales of Carrier Ethernet Service Delivery products, $9.4 million in Packet-Optical Switching revenue and $1.1 million in sales of integrated network and service management software. These increases were partially offset by a $6.1 million decrease in Packet-Optical Transport revenue.
- Service revenue for the third quarter of fiscal 2011 increased by $3.4 million.
- Revenue from the United States for the third quarter of fiscal 2011 was $227.5 million, a decrease from $230.8 million in the second quarter of fiscal 2011.
- International revenue for the third quarter of fiscal 2011 was $207.8 million, an increase from $187.1 million in the second quarter of fiscal 2011.
- As a percentage of revenue, international revenue was 47.7% during the third quarter of fiscal 2011, an increase from 44.8% during the second quarter of fiscal 2011.
- For the third quarter of fiscal 2011, one customer accounted for greater than 10% of revenue, representing 17.2% of total revenue. This compares to two customers that accounted for 25.9% of total revenue in the second quarter of fiscal 2011.

Gross margin for the third quarter