INFINERA CORP
Form S-1/A
May 21, 2007
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As filed with the Securities and Exchange Commission on May 21, 2007

Registration No. 333-140876

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 5

to

FORM S-1

REGISTRATION STATEMENT

Under

The Securities Act of 1933

INFINERA CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	**3661**	**77-0560433**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

169 Java Drive

Sunnyvale, CA 94089

(408) 572-5200

(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

Jagdeep Singh

President and Chief Executive Officer

Infinera Corporation

169 Java Drive

Sunnyvale, CA 94089

(408) 572-5200

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Aggregate Offering Price Per Share(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(3)
Common Stock, $0.001 par value	16,100,000	$12.00	$193,200,000	$5,932

(1) Includes 2,100,000 shares of common stock that may be purchased by the underwriters to cover over-allotments, if any.
(2) Estimated solely for the purpose of computing the registration fee pursuant to Rule 457(a) under the Securities Act.
(3) $4,605 of the registration fee was paid at the time of the initial filing of the registration statement.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Commission acting pursuant to said Section 8(a) may determine.

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The information in this preliminary prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell nor does it seek an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion. Dated May 18, 2007.

14,000,000 Shares

Infinera Corporation

Common Stock

This is an initial public offering of 14,000,000 shares of common stock of Infinera Corporation. All of the 14,000,000 shares of common stock are being sold by Infinera Corporation.

Prior to this offering, there has been no public market for our common stock. It is currently estimated that the initial public offering price per share will be between $10.00 and $12.00. Application has been made for the quotation of the common stock on the NASDAQ Global Market under the symbol INFN.

See Risk Factors on page 8 to read about factors you should consider before buying shares of our common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Initial public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to Infinera	$	$

To the extent that the underwriters sell more than 14,000,000 shares of common stock, the underwriters have the option to purchase up to an additional 2,100,000 shares from Infinera Corporation at the initial public offering price less the underwriting discount.

The underwriters expect to deliver the shares against payment in New York, New York on , 2007.

Goldman, Sachs & Co.

Citi

JPMorgan

Lehman Brothers

Thomas Weisel Partners LLC

Prospectus dated , 2007.

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PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the following summary together with the more detailed information appearing in this prospectus, including our financial statements and notes, and our risk factors beginning on page 8, before deciding whether to purchase shares of our common stock. Unless the context otherwise requires, we use the terms Infinera, the company, we, us and our in this prospectus to refer to Infinera Corporation and its subsidiaries.

INFINERA CORPORATION

Overview

Infinera has developed a solution that we believe will change the economics, operating simplicity, flexibility, reliability and scalability of optical communications networks. At the core of our Digital Optical Network architecture is what we believe to be the world s only commercially-deployed, large-scale photonic integrated circuit, or PIC. Our PICs transmit and receive 100 Gigabits per second, or Gbps, of optical capacity and incorporate the functionality of over 60 discrete optical components into a pair of indium phosphide chips approximately the size of a child s fingernail. We have used our PIC technology to design a new digital optical communications system called the DTN System. The DTN System is designed to enable cost-efficient optical to electrical to optical conversion of communications signals. The DTN System is architected to improve significantly communications service providers economics and service offerings as compared to optical systems that do not use large-scale photonic integration. We refer to these optical systems as traditional systems. Our carrier-class DTN System runs our Infinera IQ Network Operating System and is integrated with our Infinera Management Suite software, which together enhance and simplify network monitoring, management and control.

We believe that photonic integrated circuits can change optical communications networks in a fashion similar to the integrated circuit s impact on electronics beginning in the 1950 s. Our DTN System is designed to serve as the key element for long-haul and metro optical transport networks of U.S. and international communications service providers. Our DTN System currently competes in the wavelength division multiplexing segment of the nearly $12 billion global optical communications equipment market.

Our Digital Optical Network and our DTN System are designed to provide significant advantages over traditional systems, including:

Operating simplicity and cost savings. Our DTN System provides our customers with flexible management and control and is designed to simplify network planning, engineering and operation, consume less power, enable simplified testing and improve system reliability. In addition, our DTN System provides optical capacity in 100 Gbps increments, enabling our customers to more easily scale their optical networks;

Enhanced revenue generation. Our DTN System lowers the cost of optical to electrical to optical conversion, which enables our customers to access markets cost-effectively that had previously not been served due to cost constraints. We also believe that our DTN System enables communications service providers to add customers and provision new services more rapidly than traditional systems; and

Capital cost savings. Our DTN System incorporates the functionality of over 60 discrete optical components into a single PIC pair, reducing capital expenditures and the physical space required for a given amount of optical network capacity.

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We began commercial shipment of our DTN System in November 2004. In the third quarter of 2005, we believe we achieved, and have since maintained through the fourth quarter of 2006, the largest market share of 10 Gbps long-haul ports shipped worldwide. As of March 31, 2007, we have sold our DTN System for deployment in the optical networks of 28 customers worldwide, including Internet2, Interoute, Level 3 Communications and Qwest Communications. We do not have long-term purchase commitments with our customers. To date, a few of our customers have accounted for a significant percentage of our revenue. In 2006 and in the first quarter of 2007, Level 3 and Broadwing Corporation, which Level 3 acquired in January 2007, together accounted for approximately 75% and 57% of our revenue, respectively.

Industry Background

A number of trends in the communications industry are driving growth in demand for network capacity, including increases in total Internet users and bandwidth consumed per Internet user. We believe increasing demand for network capacity ultimately will increase demand for optical communications systems.

Most optical communications systems utilize wavelength division multiplexing technology that transmits multiple signals, each as separate colors of light, or wavelengths, on a single fiber in a communications service provider s network. These systems have historically used discrete optical components or sub-systems that can limit the quality and reliability of the optical communications system. Traditional systems use either optical to electrical to optical conversion to process digital data or an all-optical architecture to reduce the need for expensive optical to electrical to optical conversions. With traditional systems, communications service providers must choose at multiple network access points whether to utilize a wavelength division multiplexing system that enables high-performance digital management and processing but with high optical to electrical to optical conversion costs, or to use an all-optical architecture that reduces optical to electrical to optical conversion costs but may also limit service reach and add cost.

Most traditional systems involve significant capital expenditure, space and power consumption. Each wavelength in these systems requires its own optical to electrical to optical conversion, and discrete components are required for each optical to electrical to optical conversion, which adds significant cost and reduces reliability. Expanding optical communications networks with traditional systems is often manually intensive because communications service providers may need to redesign the network, re-allocate available wavelengths or deploy additional hardware at multiple locations each time a new circuit is added. Advanced features, such as network-wide provisioning or optical layer protection, often involve high costs because additional equipment may be required.

All-optical architectures, including reconfigurable optical add/drop multiplexers, often provide limited digital processing of data, which prevents these systems from efficiently adding and dropping communications traffic at intermediate network access points. This can result in a reduced network footprint and decreased revenue opportunities for communications service providers, particularly in smaller regions and markets. In addition, associated network planning and service provisioning can be more costly and time consuming. All-optical approaches can limit overall network capacity due to wavelength blocking, or the inability to use wavelengths of light because they are already in use in another part of the network.

We believe significant demand exists for an optical communications system that is simple and easy to operate and that reduces operating and capital costs for communications service providers.

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The Infinera Solution and Strategy

Our PIC technology facilitates a new network architecture, the Digital Optical Network architecture, that allows communications service providers to realize the benefits of both wavelength division multiplexing and digital processing more fully and cost-effectively. Our PICs enable our DTN System to provide lower-cost optical to electrical to optical conversions at every network access point to provide communications service providers with the ability to digitally process the information being transported across their optical networks. Our software enables our customers to leverage this digital information to simplify and speed the delivery of differentiated services and to optimize the utilization of their optical networks.

Our goal is to be a preeminent provider of optical systems to communications service providers. Key aspects of our strategy are:

Increase our customer footprint. We intend to increase penetration of our installed base of communications service providers while also targeting new U.S. and international communications service providers, including U.S. regional bell operating companies, international postal, telephone and telegraph companies, cable multiple system operators and U.S. competitive local exchange carriers;

Penetrate adjacent markets. We intend to increase our addressable market by adding functionality to our DTN System, by developing new products, including products specifically designed for metro applications, and by creating the service and support infrastructure needed to address these markets;

Maintain and extend our technology lead. We intend to incorporate the functionality of additional discrete components into our PICs and to pursue further functional integration in our DTN System in order to enhance the performance, scalability and economics of our DTN System; and

Continue investment in PIC manufacturing activities. We believe that our manufacturing capabilities serve as a significant competitive advantage and intend to continue investing in the manufacturing capabilities needed to produce new generations of our PICs.

Risks Associated With Our Business

Our business is subject to numerous risks, as discussed more fully in the section titled Risk Factors immediately following this prospectus summary. We incurred net losses of $66.5 million in 2004, $64.8 million in 2005, $89.9 million in 2006 and $19.8 million in the three months ended March 31, 2007. As of March 31, 2007, our accumulated deficit was $333.9 million. Our management determined, subsequent to their issuance, that our financial statements should be restated. In connection with the audit of our financial statements for 2005 and 2006, our management and our independent registered public accounting firm reported to our board of directors a material weakness for each year in the design and operation of our internal control over financial reporting. We believe we have remediated the material weakness identified in 2005 related to our inventory valuation process by implementing additional procedures and controls, hiring additional accounting personnel and increasing management review and oversight. We have developed a remediation plan to address the material weakness identified in 2006 related to non-routine manual accounting and reporting processes involving our revenue process in 2006 and net loss per common share computations in 2002 through 2006, but we cannot assure you that we will be able to remediate this material weakness.

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Corporate Information

Infinera was founded in December 2000, originally operated under the name Zepton Networks, and is headquartered in Sunnyvale, California. Our principal executive offices are located at 169 Java Drive, Sunnyvale, CA 94089. Our telephone number is (408) 572-5200. Our website address is www.infinera.com. Information contained on our website is not incorporated by reference into this prospectus, and you should not consider information contained on our website to be part of this prospectus.

Infinera, Infinera DTN, IQ, iPIC, Infinera Digital Optical Network and other trademarks or service marks of Infinera Corporation appearing in this prospectus are the property of Infinera Corporation. This prospectus contains additional trade names, trademarks and service marks of other companies. We do not intend our use or display of other companies trade names, trademarks or service marks to imply a relationship with, or endorsement or sponsorship of us by, these other companies.

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THE OFFERING

Common stock offered by Infinera	14,000,000 shares
Common stock to be outstanding after this offering	83,136,638 shares
Common stock offered by Infinera as a percentage of common stock to be outstanding after this offering	16.8%
Use of proceeds	We intend to use the net proceeds from this offering for working capital and other general corporate purposes. We may also use a portion of the net proceeds to repay our credit facilities or acquire other businesses, products or technologies. We do not, however, have agreements or commitments for any specific repayments or acquisitions at this time. See the section titled Use of Proceeds.
Dividend policy	Currently, we do not anticipate paying cash dividends.
Risk factors	You should read the Risk Factors section of this prospectus for a discussion of factors that you should consider carefully before deciding whether to invest in shares of our common stock.
Proposed NASDAQ Global Market symbol	INFN

The number of shares of our common stock to be outstanding following this offering is based on 69,136,638 shares of our common stock outstanding as of March 31, 2007, but excludes:

- 8,220,738 shares of common stock issuable upon exercise of options outstanding as of March 31, 2007 at a weighted average exercise price of $2.09 per share;
- 1,332,680 shares of common stock issuable upon the exercise of warrants outstanding as of March 31, 2007, at a weighted average exercise price of $5.23 per share; and
- 16,468,938 shares of common stock reserved for future issuance under our stock-based compensation plans, consisting of 1,056,438 shares of common stock reserved for issuance under our 2000 Stock Plan, of which 158,371 shares were granted on April 24, 2007, 13,600,000 shares of common stock reserved for issuance under our 2007 Equity Incentive Plan, of which 3,076,779 shares were approved for granting by our compensation committee on May 7, 2007 and will be effective as of the date the registration statement, of which this prospectus forms a part, is declared effective and 1,812,500 shares of common stock reserved for issuance under our 2007 Employee Stock Purchase Plan. The 2007 Equity Incentive Plan and the 2007 Employee Stock Purchase Plan will become effective on the date of this offering.

Unless otherwise indicated, this prospectus reflects and assumes the following:

- the conversion of all outstanding shares of our convertible preferred stock immediately prior to the closing of this offering;
- the filing of our amended and restated certificate of incorporation and the adoption of our amended and restated bylaws immediately prior to the closing of this offering; and

no exercise by the underwriters of their option to purchase up to an additional 2,100,000 shares to cover over-allotments.

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SUMMARY CONSOLIDATED FINANCIAL DATA

The following tables summarize our consolidated financial data. We have derived the statements of operations data for the years ended December 31, 2004, 2005 and 2006 from our audited consolidated financial statements appearing elsewhere in this prospectus. The statement of operations data for the three months ended March 31, 2006 and 2007 and the balance sheet data as of March 31, 2007 are derived from our unaudited consolidated financial statements that are included in this prospectus. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the information set forth therein. The results for any interim period are not necessarily indicative of the results that may be expected for a full year. Additionally, our historical results are not indicative of the results that should be expected in the future. You should read this summary consolidated financial data in conjunction with the sections titled Selected Consolidated Financial Data and Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes, all included elsewhere in this prospectus.

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
				(Unaudited)	
	(In thousands, except per share data)				
Statements of Operations Data:					
Revenue:					
Ratable product and related support and services	$	$ 4,127	$ 52,978	$ 2,653	$ 45,947
Product	599		5,258		3,245
Total revenue	599	4,127	58,236	2,653	49,192
Cost of revenue:					
Cost of ratable product and related support and services		17,759	48,072	5,485	34,843
Lower of cost or market adjustment	1,587	9,696	21,693	4,325	1,067
Cost of product	5,653		1,660		1,363
Total cost of revenue	7,240	27,455	71,425	9,810	37,273
Gross profit (loss)	(6,641)	(23,328)	(13,189)	(7,157)	11,919
Operating expenses:					
Sales and marketing	8,294	11,053	20,682	2,701	7,636
Research and development	46,306	24,986	38,967	6,446	16,058
General and administrative	2,888	4,328	12,650	1,378	5,557
Amortization of intangible assets			56		37
Total operating expenses	57,488	40,367	72,355	10,525	29,288
Loss from operations	(64,129)	(63,695)	(85,544)	(17,682)	(17,369)
Other income (expense), net	(2,351)	(2,256)	(4,319)	(496)	(2,415)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(66,480)	(65,951)	(89,863)	(18,178)	(19,784)
Provision for income taxes		12	72	15	29
Loss before cumulative effect of change in accounting principle	(66,480)	(65,963)	(89,935)	(18,193)	(19,813)
Cumulative effect of change in accounting principle		(1,137)			

Net loss	$ (66,480)	$ (64,826)	$ (89,935)	$ (18,193)	$ (19,813)
Net loss per common share, basic and diluted	$ (17.94)	$ (14.08)	$ (14.90)	$ (3.63)	$ (2.62)
Weighted average number of shares used in computing basic and diluted net loss per common share	3,705	4,605	6,036	5,010	7,560
Pro forma net loss per common share, basic and diluted (unaudited)			$ (1.49)	$ (0.36)	$ (0.30)
Weighted average number of shares used in computing pro forma basic and diluted net loss per common share (unaudited)			60,389	50,762	66,988

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	As of March 31, 2007		
	Actual	Pro Forma	Pro Forma As Adjusted
	(In thousands, unaudited)		
Balance Sheet Data:			
Cash, cash equivalents and short-term investments	$ 39,662	$ 39,662	$ 178,782
Working capital	(12,869)	(4,960)	134,160
Total assets	227,870	227,870	366,990
Preferred stock warrant liability	7,909		
Current and long-term debt	33,896	33,896	33,896
Convertible preferred stock	320,550		
Total stockholders equity (deficit)	(324,410)	4,049	143,169

The pro forma column in the balance sheet data table above reflects (i) the conversion of all outstanding shares of our convertible preferred stock into an aggregate of 59,427,606 shares of common stock immediately prior to the closing of the offering and (ii) the reclassification of the preferred stock warrant liability to common stock immediately prior to the closing of this offering.

The pro forma as adjusted column in the balance sheet data table above reflects (i) the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of the offering, (ii) the reclassification of the preferred stock warrant liability to common stock immediately prior to the closing of the offering, and (iii) our sale of 14,000,000 shares of common stock in this offering, at an assumed initial public offering price of $11.00 per share, which is the midpoint of the price range listed on the cover page of this prospectus, and after deducting the estimated underwriting discount and estimated offering expenses payable by us and the application of our net proceeds from this offering.

The pro forma as adjusted information discussed above is illustrative only and will adjust based on the actual initial public offering price and other terms of this offering determined at pricing.

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RISK FACTORS

Investing in our common stock involves a high degree of risk. You should consider carefully the risks and uncertainties described below, together with all of the other information in this prospectus, including the consolidated financial statements and the related notes, before deciding whether to purchase shares of our common stock. If any of the following risks is realized, our business, financial condition, operating results and prospects could be materially and adversely affected. In that event, the price of our common stock could decline and you could lose part or all of your investment.

Risk Related to Our Business

We have a limited operating history and have only recently begun selling our DTN System, both of which make it difficult to predict our future operating results.

We were incorporated in December 2000 and shipped our first DTN System in November 2004. Our limited operating history gives you very little basis upon which to evaluate our ability to accomplish our business objectives. In making an investment decision, you should evaluate our business in light of the risks, expenses and difficulties frequently encountered by companies in early stages of development, particularly companies in the rapidly changing optical communications market. We may not be successful in addressing these risks. It is difficult to accurately forecast our future revenue and plan expenses accordingly and, therefore, predict our future operating results.

We have a history of significant operating losses and may not achieve profitability in the future.

We have not achieved profitability. We experienced a net loss of $89.9 million for the year ended December 31, 2006 and $19.8 million for the three months ended March 31, 2007. As of March 31, 2007, our accumulated deficit was $333.9 million. We expect to continue to incur substantial losses, and we may not become profitable in the foreseeable future, if ever. We expect to continue to make significant expenditures related to the development of our business, including expenditures to hire additional personnel related to the sales, marketing and development of our DTN System and to maintain and expand our manufacturing facilities and research and development operations. In addition, as a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. We will have to generate and sustain significant increased revenue and product gross margins to achieve profitability. Accordingly, we may not be able to achieve or maintain profitability and we may continue to incur significant losses in the future.

Our operating results may fluctuate significantly, which could make our future results difficult to predict and could cause our operating results to fall below investor or analyst expectations.

Our operating results may fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on past results, in particular the recent growth in our revenue, as an indicator of our future performance. Fluctuations in our revenue can lead to even greater fluctuations in our operating results. Our budgeted expense levels depend in part on our expectations of long-term future revenue. Given relatively fixed operating costs related to our personnel and facilities, any substantial adjustment to our expenses to account for lower levels of revenue will be difficult and take time. Consequently, if our revenue does not meet projected levels, our inventory levels and operating expenses would be high relative to revenue, resulting in additional operating losses.

In addition to other risks discussed in this section, factors that may contribute to fluctuations in our revenue and our operating results include:

- fluctuations in demand, sales cycles, product mix and prices for our DTN System and our services;

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- reductions in customers budgets for optical communications purchases and delays in their purchasing cycles;
- order cancellations or reductions or delays in delivery schedules by our customers;
- timeliness of our customers payments for their purchases;
- the timing of recognizing revenue in any given quarter as a result of software revenue recognition requirements and any changes in U.S. generally accepted accounting principles or new interpretations of existing accounting rules;
- our ability to establish vendor specific objective evidence, or VSOE, in order to be able to recognize revenue once the four revenue recognition criteria have been met, rather than over the period represented by the longest undelivered service period;
- readiness of customer sites for installation of our DTN System;
- the timing of product releases or upgrades by us or by our competitors;
- availability of third party suppliers to provide contract engineering and installation services for us;
- any significant changes in the competitive dynamics of our market, including any new entrants, technological advances or substantial discounting of products;
- our ability to control costs, including our operating expenses and the costs of components we purchase; and
- general economic conditions in domestic and international markets.

Until we establish VSOE for training and product support services, all revenue for our bundled products will continue to be deferred and recognized ratably over the longest undelivered service period. If our revenue or operating results fall below the expectations of investors or securities analysts or below any guidance we may in the future provide to the market, the price of our common stock may decline substantially.

Our gross margin may fluctuate from quarter to quarter and may be adversely affected by a number of factors, some of which are beyond our control.

Our gross margin fluctuates from period to period and varies by customer and by product specification. Our gross margin may continue to be adversely affected by a number of factors, including:

- the mix in any period of higher and lower margin products and services;
- price discounts negotiated by our customers;

sales volume from each customer during the period;

the period of time over which ratable recognition of revenue occurs;

the amount of equipment we sell for a loss in a given quarter;

charges for excess or obsolete inventory;

changes in the price or availability of components for our DTN System;

our ability to reduce manufacturing costs;

introduction of new products, with initial sales at relatively small volumes with resulting higher product costs;

increased price competition, including competition from low-cost producers in China; and

increased warranty or repair costs.

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It is likely that the average unit prices of our DTN System will decrease over time in response to competitive pricing pressures, increased negotiated sales discounts, new product introductions by us or our competitors or other factors. In addition, some of our customer contracts contain annual technology discounts that require us to decrease the sales price of our DTN System to these customers. In response, we will likely need to reduce the cost of our DTN System through manufacturing efficiencies, design improvements and cost reductions or change the mix of DTN Systems we sell. If these efforts are not successful or if we are unable to reduce our costs to a greater extent than the reduction in the price of our DTN System, our revenue and gross margin will decline, causing our operating results to decline. Fluctuations in gross margin may make it difficult to manage our business and achieve or maintain profitability.

Aggressive business tactics by our competitors may harm our business.

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

- selling at a discount used equipment or inventory that a competitor had previously written down or written off;
- announcing competing products prior to market availability combined with extensive marketing efforts;
- offering to repurchase our equipment from existing customers;
- providing financing, marketing and advertising assistance to customers; and
- asserting intellectual property rights.

If we fail to compete successfully against our current and future competitors, or if our current or future competitors continue or expand aggressive business tactics, including those described above, demand for our DTN System could decline, we could experience delays or cancellations of customer orders, or we could be required to reduce our prices or increase our expenses.

The markets in which we compete are highly competitive and dominated by large corporations, and we may not be able to compete effectively.

Competition in the optical communications equipment market is intense, and we expect such competition to increase. A number of very large companies historically have dominated the optical communications network equipment industry. Our competitors include current wavelength division multiplexing suppliers, such as Alcatel-Lucent, Ciena Corporation, Cisco Systems, Fujitsu Limited, Huawei Technologies Co., LM Ericsson Telephone Co., NEC Corporation, Nortel Networks, Siemens Systems GmbH and ZTE Corporation. Competition in these markets is based on price, functionality, manufacturing capability, pre-existing installation, services, existing business and customer relationships, scalability and the ability of products and breadth and quality of services to meet our customers immediate and future network requirements. Other companies have, or may in the future develop, products that are or could be competitive with our DTN System. In particular, if a competitor develops a photonic integrated circuit with similar functionality, our business could be harmed. On June 19, 2006, Nokia and Siemens agreed to combine their communications service provider businesses to create a new joint venture and on November 30, 2006 Alcatel and Lucent announced the completion of their merger. These transactions and any future mergers, acquisitions or combinations between or among our competitors may adversely affect our competitive position by strengthening our competitors.

Many of our competitors have substantially greater name recognition and technical, financial and marketing resources, greater manufacturing capacity and better established relationships with

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incumbent carriers and other potential customers than we have. Many of our competitors have more resources to develop or acquire, and more experience in developing or acquiring, new products and technologies and in creating market awareness for those products and technologies. In addition, many of our competitors have the financial resources to offer competitive products at below market pricing levels that could prevent us from competing effectively. Further, many of our competitors have built long-standing relationships with some of our prospective customers and have the ability to provide financing to customers and could, therefore, have an inherent advantage in selling products to those customers.

We also compete with low-cost producers in China that can increase pricing pressure on us and a number of smaller companies that provide competition for a specific product, customer segment or geographic market. These competitors often base their products on the latest available technologies. Due to the narrower focus of their efforts, these competitors may achieve commercial availability of their products more quickly than we can and may provide attractive alternatives to our customers.

We are dependent on Level 3 Communications for a significant portion of our revenue and the loss of, or a significant reduction in orders from, Level 3 or one or more of our key customers would reduce our revenue and harm our operating results.

A relatively small number of customers account for a large percentage of our net revenue. In particular, for the year ended December 31, 2006, Level 3 Communications, or Level 3, and Broadwing, which Level 3 acquired in January 2007, together accounted for approximately 75% of our revenue. We expect Level 3 to continue to represent a large percentage of our revenue for the foreseeable future. Our business will be harmed if we do not generate as much revenue as we expect from our key customers, particularly from Level 3, if we experience a loss of Level 3 or of any of our other key customers or if we suffer a substantial reduction in orders from these customers. Our ability to continue to generate revenue from our key customers will depend on our ability to introduce new products that are desirable to these customers at competitive prices, and we may not be successful doing so. Because, in most cases, our sales are made to these customers pursuant to standard purchase orders rather than long-term purchase commitments, orders may be cancelled or reduced readily. In the event of a cancellation or reduction of an order, we may not have enough time to reduce operating expenses to minimize the effect of the lost revenue on our business. Our operating results will continue to depend on our ability to sell our DTN System to Level 3 and other large customers.

Our large customers have substantial negotiating leverage, which may require that we agree to terms and conditions that result in increased cost of sales, decreased revenue and lower average selling prices and gross margins, all of which would harm our operating results.

Substantial changes in the optical communications industry have occurred over the last few years. Many potential customers have confronted static or declining revenue. Many of our customers have substantial debt burdens, many have experienced financial distress, some have gone out of business or have been acquired by other service providers or announced their withdrawal from segments of the business. Consolidation in the markets in which we compete has resulted in the changes in the structure of the communications networking industry, with greater concentration of purchasing power in a small number of large service providers, cable operators and government agencies. In addition, it has resulted in a substantial reduction in the number of our potential customers. For example, service providers, such as Level 3, have recently acquired a number of other communications service providers, including one of our other customers. This increased concentration among our customer base may also lead to increased negotiating power for our customers and may require us to decrease our average selling prices.

Further, many of our customers are large communications service providers that have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers

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have and may continue to seek advantageous pricing and other commercial terms and may require us to develop additional features in the products we sell to them. We have and may continue to be required to reduce the average selling price, or increase the average cost, of our DTN System in response to these pressures or competitive pricing pressures. To maintain acceptable operating results, we will need to develop and introduce new products and product enhancements on a timely basis and continue to reduce our costs.

We expect the factors described above to continue to affect our business and operating results for an indeterminate period, in several ways, including:

- overall capital expenditures by many of our customers or potential customers may be flat or reduced;
- we will continue to have only limited ability to forecast the volume and product mix of our sales;
- managing expenditures and inventory will be difficult in light of the uncertainties surrounding our business; and
- increased competition will enable customers to insist on more favorable terms and conditions for sales, including product discounts, extended payment terms or financing assistance, as a condition of procuring their business.

If we are unable to offset any reductions in our average selling prices or increases in our average costs with increased sales volumes and reduced production costs, or if we fail to develop and introduce new products and enhancements on a timely basis, our operating results would be harmed.

We are dependent on a single product, and the lack of continued market acceptance of our DTN System would harm our business.

Our DTN System accounts for substantially all of our revenue and will continue to do so for the foreseeable future. As a result, our business could be harmed by:

- any decline in demand for our DTN System;
- the failure of our existing DTN System to achieve continued market acceptance;
- the introduction of products and technologies that serve as a replacement or substitute for, or represent an improvement over, our DTN System;
- technological innovations or new communications standards that our DTN System does not address; and
- our inability to release enhanced versions of our DTN System on a timely basis.

If we fail to expand sales of our DTN System into metro and international markets or to sell our products to new types of customers, such as U.S. regional bell operating companies, international postal, telephone and telegraph companies, cable multiple system operators and U.S. competitive local exchange carriers, our revenue will be harmed.

We believe that, in order to grow our revenue and business and to build a large and diverse customer base, we must successfully sell our DTN System in metro and international markets and ultimately to U.S. regional bell operating companies, international postal, telephone and telegraph companies, cable multiple system operators and U.S. competitive local exchange carriers. We have limited experience selling our DTN System internationally and to U.S. regional bell operating companies, international postal, telephone and telegraph companies, cable multiple system operators and U.S. competitive local exchange carriers. To succeed in these sales efforts, we believe we must hire additional sales personnel and develop and manage new sales channels through resellers,

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distributors and systems integrators. If we do not succeed in our efforts to sell to these target markets and customers, the size of our total addressable market will be limited. This, in turn, would harm our ability to grow our customer base and revenue.

If we fail to protect our intellectual property rights, our competitive position could be harmed or we could incur significant expense to enforce our rights.

We depend on our ability to protect our proprietary technology. We rely on trade secret, patent, copyright and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. The steps we have taken to protect our proprietary rights may not be adequate to preclude misappropriation of our proprietary information or infringement of our intellectual property rights, and our ability to police such misappropriation or infringement is uncertain, particularly in countries outside of the United States. This is likely to become an increasingly important issue as we expand our operations and product development into countries that provide a lower level of intellectual property protection. We do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims, and even if patents are issued, they may be contested, circumvented or invalidated. Moreover, the rights granted under any issued patents may not provide us with a competitive advantage, and, as with any technology, competitors may be able to develop similar or superior technologies to our own now or in the future.

Protecting against the unauthorized use of our DTN System, trademarks and other proprietary rights is expensive, difficult, time consuming and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity or scope of the proprietary rights of others. Such litigation could result in substantial cost and diversion of management resources, either of which could harm our business, financial condition and operating results. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to enforce their intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property.

Claims by others that we infringe their intellectual property could harm our business.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, many leading companies in the optical communications industry, including our competitors, have extensive patent portfolios with respect to optical communications technology. We expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps occur. In addition, to the extent that we gain greater visibility and market exposure as a public company, we face a higher risk of being the subject of intellectual property infringement claims. From time to time, third parties may assert exclusive patent, copyright, trademark and other intellectual property rights to technologies and related standards that are important to our business or seek to invalidate the proprietary rights that we hold. Competitors or other third parties have, and may continue to assert claims or initiate litigation or other proceedings against us or our manufacturers, suppliers or customers alleging infringement of their proprietary rights, or seeking to invalidate our proprietary rights, with respect to our DTN System and technology. In the event that we are unsuccessful in defending against any such claims, or any resulting lawsuit or proceedings, we could incur liability for damages and/or have valuable proprietary rights invalidated.

Any claim of infringement from a third party, even those without merit, could cause us to incur substantial costs defending against such claims, and could distract our management from running our business. Furthermore, a party making such a claim, if successful, could secure a judgment that

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requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering our DTN System. In addition, we might be required to seek a license for the use of such intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we may be required to develop non-infringing technology, which would require significant effort and expense and may ultimately not be successful. Any of these events could harm our business, financial condition and operating results. Competitors and other third parties have and may continue to assert infringement claims against our customers and sales partners. Any of these claims would require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims, because we generally indemnify our customers and sales partners from claims of infringement of proprietary rights of third parties. If any of these claims succeed, we may be forced to pay damages on behalf of our customers or sales partners, which could have an adverse effect on our business, financial condition and operating results.

On May 9, 2006, we and Level 3 were sued by Cheetah Omni LLC for alleged infringement of patent No. 6,795,605, and a continuation thereof. On May 16, 2006, Cheetah filed an amended complaint, which requested an order to enjoin the sale of our DTN System, recovery of all damages caused by the alleged infringement and an award of any and all compensatory damages available by law, including damages, attorneys fees, associated interest and Cheetah s costs incurred in the lawsuit. Cheetah s complaint does not request a specific dollar amount of damages. We are contractually obligated to indemnify Level 3 for damages suffered by Level 3 to the extent our product is found to infringe the rights of a third party, and we have assumed the defense of this matter. On July 20, 2006, we and Level 3 filed an amended response. On November 28, 2006, Cheetah filed a second amended complaint and added patent No. 7,142,347 to the lawsuit. On December 18, 2006, we and Level 3 filed responses to Cheetah s second amended complaint. On January 30, 2007, Cheetah filed a third amended complaint adding additional assertions of infringement for the two patents in suit. On February 16, 2007, we and Level 3 filed responses to Cheetah s third amended complaint. In the event that Cheetah is successful in obtaining a judgment requiring us to pay damages or obtains an injunction preventing the sale of our DTN System, our business could be harmed.

If we fail to accurately forecast demand for our DTN System, we may have excess or insufficient inventory, which may increase our operating costs, decrease our revenue and harm our business.

We are required to generate forecasts of future demands for our DTN System several months prior to the scheduled delivery to our prospective customers, which requires us to make significant investments before we know if corresponding revenue will be recognized. If we overestimate demand for our DTN System and increase our inventory in anticipation of customer orders that do not materialize, we will have excess inventory, we will face a risk of obsolescence and significant inventory write-downs and our capital infrastructure will be depreciated across fewer units raising our per unit costs. If we underestimate demand for our DTN System, we will have inadequate inventory, which could slow down or interrupt the manufacturing of our DTN System and result in delays in shipments and our ability to recognize revenue. In addition, we may be unable to meet our supply commitments to customers which could result in a breach of our customer agreements and require us to pay damages. Lead times for materials and components, including application-specific integrated circuits, that we need to order for the manufacturing of our DTN System vary significantly and depend on factors such as the specific supplier, contract terms and demand for each component at a given time.

Our manufacturing process is very complex and minor process deviations may reduce yields, require product write-downs or otherwise harm our business.

The manufacturing process of our DTN System is technically challenging. Minor deviations in the manufacturing process can cause substantial decreases in yields and, in some cases, cause

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production to be suspended. We have had production interruptions and suspensions in the past and may have additional interruptions or suspensions in the future. We expect our manufacturing yield for our next generation PICs to be lower initially and increase as we achieve full production. Poor yields from our PIC manufacturing process or defects, integration issues or other performance problems in our DTN System could cause us customer relations and business reputation problems, harming our business and operating results.

In addition, our manufacturing facilities may not have adequate capacity to meet the demand for our DTN System or we may not be able to increase our capacity to meet potential increases in demand for our DTN System. Our inability to obtain sufficient manufacturing capacity to meet demand, either in our own facilities or through foundry or similar arrangements with third parties, could harm our relationships with customers, our business and our operating results.

Product performance problems, including undetected errors in our hardware or software, could harm our business and reputation.

The development and production of new products with high technology content, such as our DTN System, is complicated and often involves problems with software, components and manufacturing methods. Complex hardware and software products, such as our DTN System, can often contain undetected errors when first introduced or as new versions are released. We have experienced errors in the past in connection with our DTN System, including failures with application-specific integrated circuits due to the receipt of faulty components from one of our suppliers. We suspect that errors, including potentially serious errors, will be found from time to time in our DTN System. We have only been shipping our DTN System since November 2004, which provides us with limited information on which to judge its reliability. Our DTN System may suffer degradation of performance and reliability over time.

If reliability, quality or network monitoring problems develop, a number of negative effects on our business could result, including:

- delays in our ability to recognize revenue;
- costs associated with fixing software or hardware defects or replacing products;
- high service and warranty expenses;
- delays in shipments;
- high inventory excess and obsolescence expense;
- high levels of product returns;
- diversion of our engineering personnel from our product development efforts;
- delays in collecting accounts receivable;
- payment of damages for performance failures;

reduced orders from existing customers; and

declining interest from potential customers.

Because we outsource the manufacturing of certain components of our DTN System, we may also be subject to product performance problems as a result of the acts or omissions of these third parties.

From time to time, we encounter interruptions or delays in the activation of our DTN System at a customer s site. These interruptions or delays may result from product performance problems or from

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issues with installation and activation, some of which are outside our control. If we experience significant interruptions or delays that we cannot promptly resolve, confidence in our DTN System could be undermined, which could cause us to lose customers and fail to add new customers.

We are dependent on sole source and limited source suppliers for several key components, and if we fail to obtain these components on a timely basis, we will not meet our customers product delivery requirements.

We currently purchase several key components from single or limited sources. In particular, we rely on third parties as sole source suppliers for certain of our components, including: application-specific integrated circuits, field-programmable gate arrays, processors, and other semiconductor and optical components. We purchase these items on a purchase order basis and have no long-term contracts with any of these sole source suppliers. If any of our sole or limited source suppliers suffer from capacity constraints, lower than expected yields, work stoppages or any other reduction or disruption in output, they may be unable to meet our delivery schedule. Further, our suppliers could enter into exclusive arrangements with our competitors, refuse to sell their products or components to us at commercially reasonable prices or at all, go out of business or discontinue their relationships with us. We may be unable to develop alternative sources for these components. If we do not receive critical components from our suppliers in a timely manner, we will be unable to deliver those components to our manufacturer in a timely manner and would, therefore, be unable to meet our prospective customers product delivery requirements. In addition, the sourcing from new suppliers may result in a re-design of our DTN System, which could cause delays in the manufacturing and delivery of our systems. In the past, we have experienced delivery delays because of lack of availability of components or reliability issues with components that we were purchasing. This may occur in the future, which could cause us to fail to meet a customer s delivery requirements and could harm our reputation and our customer relationships and result in the breach of our customer agreements.

Our ability to increase our revenue will depend upon continued growth of demand by consumers and businesses for additional network capacity.

Our future success depends on factors such as the continued growth of the Internet and internet protocol traffic and the continuing adoption of high capacity, revenue-generating services to increase the amount of data transmitted over communications networks and the growth of optical communications networks to meet the increased demand for bandwidth. If demand for such bandwidth does not continue, or slows down, the need for increased bandwidth across networks and the market for optical communications network products may not continue to grow. If this growth does not continue or slows down, our DTN System sales would be negatively impacted.

We have experienced delays in the development and introduction of our DTN System, and any future delays in releasing new products or in enhancements to our DTN System may harm our business.

Since our DTN System is based on complex technology, we may experience unanticipated delays in developing, improving, manufacturing or deploying it. Any modification to our PIC and to our DTN System entails similar development risks. At any given time, various enhancements to our DTN System are in the development phase and are not yet ready for commercial manufacturing or deployment. The maturing process from laboratory prototype to customer trials, and subsequently to general availability, involves a number of steps, including:

- completion of product development;
- the qualification and multiple sourcing of critical components;
- validation of manufacturing methods and processes;

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extensive quality assurance and reliability testing, and staffing of testing infrastructure;

validation of software; and

establishment of systems integration and systems test validation requirements.

Each of these steps, in turn, presents risks of failure, rework or delay, any one of which could decrease the speed and scope of product introduction and marketplace acceptance of our DTN System. New versions of our PICs, specialized application-specific integrated circuits and intensive software testing and validation are important to the timely introduction of enhancements to our DTN System and to our ability to enter new markets, and schedule delays are common in the final validation phase as well as in the manufacture of specialized application-specific integrated circuits. In addition, unexpected intellectual property disputes, failure of critical design elements, and a host of other execution risks may delay or even prevent the introduction of enhancements to our DTN System. If we do not develop and successfully introduce products in a timely manner, our competitive position may suffer.

We must respond to rapid technological change and comply with evolving industry standards and requirements for our DTN System to be successful.

The optical communications equipment market is characterized by rapid technological change, changes in customer requirements and evolving industry standards. The introduction of new communications technologies and the emergence of new industry standards or requirements could render our DTN System obsolete. Further, in developing our DTN System, we have made, and will continue to make, assumptions with respect to which standards or requirements will be adopted by our customers and competitors. If the standards or requirements adopted by our prospective customers are different from those on which we have focused our efforts, market acceptance of our DTN System would be reduced or delayed and our business would be harmed.

We expect our competitors to continue to improve the performance of their existing products and to introduce new products and technologies. To be competitive, we must continue to invest significant resources in research and development, sales and marketing and customer support. We may not have sufficient resources to make these investments, we may not be able to make the technological advances necessary to be competitive and we may not be able to effectively sell our DTN System to targeted customers who have prior relationships with our competitors.

If we fail to maintain effective internal control over financial reporting in the future, the accuracy and timing of our financial reporting may be adversely affected.

Our management and our independent registered public accounting firm have reported to our board of directors material weaknesses in the design and operation of our internal controls as of December 31, 2005 and 2006. A material weakness is defined by the standards issued by the American Institute of Certified Public Accountants as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

In 2005, our independent registered public accounting firm identified a material weakness related to our inventory valuation process. Specifically, certain manufacturing costs were not reflected or captured in a timely basis in the inventory records and the inventory analysis contained computational errors that resulted in adjustments to the financial statements prior to their issuance. This material weakness related to the following financial statement accounts: inventory, deferred inventory costs, research and development expenses and cost of ratable revenue. We believe we have remediated the material weakness identified in 2005 related to our inventory valuation process by implementing additional procedures and controls, hiring additional accounting personnel and increasing management review and oversight.

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In 2007, subsequent to the initial filing of the registration statement, of which this prospectus is a part, our management identified a material weakness related to non-routine manual accounting and reporting processes. Management s review of these transactions and disclosures was not sufficient to identify computational errors in the revenue accounting process in 2006 and the net loss per common share reporting and disclosure process in 2002 through 2006. Specifically, our review did not identify a manual computational error in our revenue analysis relating to the ratable revenue commencement date of a transaction with one of our customers. As a result, we have restated our 2006 consolidated financial statements to reflect a reduction in ratable revenue of $0.5 million. In addition, our review of the net loss per common share amount for all annual and interim periods did not identify an error in the manual calculation of the weighted average number of common shares outstanding for each period. The errors were primarily related to the misapplication of the reverse share split to a component of the weighted average common shares outstanding calculation and the inappropriate exclusion of certain outstanding shares used in computing the basic and diluted net loss per common share. This resulted in an understatement of the reported net loss per common share of $4.22 in 2002, $3.51 in 2003, $2.64 in 2004, $0.28 in 2005 and $0.22 in 2006. This material weakness relates to the following financial statement accounts: Ratable product and related support services, deferred revenue and our net loss per common share disclosures. We have developed a remediation plan to address the material weakness identified in 2006 related to our non-routine manual accounting and reporting processes involving our revenue and net loss per common share computations in 2002 through 2006.

In connection with the restatement of our 2006 consolidated financial statements, we also elected to restate our 2005 and 2006 consolidated financial statements to reflect an additional $0.2 million and $0.3 million of interest expense in 2005 and 2006, respectively, related to the accrual of a debt repayment obligation that had previously been omitted from our financial statements. The interest expense change was not a result of a material weakness, but arose from a significant deficiency in the design and operation of our internal controls.

Our management and independent registered public accounting firm did not perform an evaluation of our internal control over financial reporting during any period in accordance with the provisions of the Sarbanes-Oxley Act of 2002, as amended, or the Sarbanes-Oxley Act. Had we and our independent registered public accounting firm performed an evaluation of our internal control over financial reporting in accordance with the provisions of the Sarbanes-Oxley Act, additional material weaknesses may have been identified.

Preparing our financial statements involves a number of complex processes, many of which are done manually and are dependent upon individual data input or review. These processes include, but are not limited to, calculating ratable revenue, deferred revenue and inventory costs. While in some cases we are commencing or will shortly commence adoption of automatic processes with less likelihood for error and additional processes to detect errors that arise, we expect that for the foreseeable future many of these processes will remain manually intensive.

The remediation policies and procedures we have implemented and plan to implement may be insufficient to address our material weaknesses and additional material weaknesses may be discovered in the future. In addition, the manual processes discussed above may result in errors that may not be detected and could result in a material misstatement. If a material misstatement occurs in the future, we may fail to meet our future reporting obligations, we may need to restate our financial results and the price of our common stock may decline. Any failure of our internal controls could also adversely affect the results of the periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting that will be required when the rules of the Securities and Exchange Commission, or the SEC, under Section 404 of the Sarbanes-Oxley Act become applicable to us beginning with the required filing of our Annual Report on Form 10-K for the year ending December 31, 2008.

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If we lose key personnel or fail to attract and retain additional qualified personnel when needed, our business may be harmed.

Our success depends to a significant degree upon the continued contributions of our key management, engineering, sales and marketing, and finance personnel, many of whom would be difficult to replace. For example, senior members of our engineering team have unique technical experience that would be difficult to replace. We do not have long-term employment contracts or key person life insurance covering any of our key personnel. Because our DTN System is complex, we must hire and retain a large number of highly trained customer service and support personnel to ensure that the deployment of our DTN System does not result in network disruption for our customers. We believe our future success will depend in large part upon our ability to identify, attract and retain highly skilled managerial, engineering, sales, marketing, finance and customer service and support personnel. Competition for these individuals is intense in our industry, especially in the San Francisco Bay Area. We may not succeed in identifying, attracting and retaining appropriate personnel. Further, competitors and other entities have in the past attempted, and may in the future attempt, to recruit our employees. The loss of the services of any of our key personnel, the inability to identify, attract or retain qualified personnel in the future or delays in hiring qualified personnel, particularly engineers and sales personnel, could make it difficult for us to manage our business and meet key objectives, such as timely product introductions.

Our sales cycle can be long and unpredictable, which could result in an unexpected revenue shortfall in any given quarter.

Our DTN System has a lengthy sales cycle, which can extend from six to twelve months and may take even longer for larger prospective customers such as U.S. regional bell operating companies, international postal, telephone and telegraph companies and U.S. competitive local exchange carriers. Our prospective customers conduct significant evaluation, testing, implementation and acceptance procedures before they purchase our DTN System. We incur substantial sales and marketing expenses and expend significant management effort during this time, regardless of whether we make a sale.

Because the purchase of our equipment involves substantial cost, most of our customers wait to purchase our equipment until they are ready to deploy it in their network. As a result, it is difficult for us to accurately predict the timing of future purchases by our customers. In addition, product purchases are frequently subject to budget constraints, multiple approvals and unplanned administrative, processing and other delays. If sales expected from customers for a particular quarter are not realized in that quarter or at all, our revenue will be negatively impacted.

Our international sales and operations subject us to additional risks that may harm our operating results.

We market, sell and service our DTN System globally. In 2005, we derived approximately 36% of our revenue from customers outside of the United States. This number decreased to 14% in 2006. We have sales and support personnel in numerous countries worldwide. In addition, we have a large group of software development personnel located in Bangalore, India. We expect that significant management attention and financial resources will be required for our international activities over the foreseeable future as we enter new international markets. In some countries, our success will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements for international sales of our DTN System could impact our ability to maintain or increase international market demand for our DTN System.

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Our international operations are subject to inherent risks, and our future results could be adversely affected by a variety of factors, many of which are outside of our control, including:

- greater difficulty in collecting accounts receivable and longer collection periods;
- difficulties of managing and staffing international offices, and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- the impact of recessions in economies outside the United States;
- tariff and trade barriers and other regulatory requirements or contractual limitations on our ability to sell or develop our DTN System in certain foreign markets;
- certification requirements;
- greater difficulty documenting and testing our internal controls;
- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences;
- political and economic instability;
- effects of changes in currency exchange rates; and
- service provider and government spending patterns.

International customers may also require that we comply with certain testing or customization of our DTN System to conform to local standards. The product development costs to test or customize our DTN System could be extensive and a material expense for us.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks could harm our international operations and reduce our international sales.

If our contract manufacturers do not perform as we expect, our business may be harmed.

Our future success will depend on our ability to have sufficient volumes of our DTN System manufactured in a cost-effective and quality-controlled manner. We have engaged third parties to manufacture certain elements of our DTN System. There are a number of risks associated with our dependence on contract manufacturers, including:

reduced control over delivery schedules;

reliance on the quality assurance procedures of third parties;

potential uncertainty regarding manufacturing yields and costs;

potential lack of adequate capacity during periods of excess demand;

limited warranties on components supplied to us;

potential misappropriation of our intellectual property; and

potential manufacturing disruptions.

Any of these risks could impair our ability to fulfill orders. Our contract manufacturers may not be able to meet the delivery requirements of our customers, which could decrease customer satisfaction and harm our DTN System sales. We do not have long-term contracts or arrangements with our contract manufacturers that will guarantee product availability, or the continuation of particular pricing

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or payment terms. If our contract manufacturers are unable or unwilling to continue manufacturing our DTN System in required volumes or our relationship with any of our contract manufacturers is discontinued for any reason, we would be required to identify and qualify alternative manufacturers, which could cause us to be unable to meet our supply requirements to our customers and result in the breach of our customer agreements. Qualifying a new contract manufacturer and commencing volume production is expensive and time-consuming and if we are required to change or qualify a new contract manufacturer, we would likely lose sales revenue and damage our existing customer relationships.

Unforeseen health, safety and environmental costs could harm our business.

Our manufacturing operations use substances that are regulated by various federal, state and international laws governing health, safety and the environment. If we experience a problem with these substances, it could cause an interruption or delay in our manufacturing operations or could cause us to incur liabilities for any costs related to health, safety or environmental remediation. We could also be subject to liability if we do not handle these substances in compliance with safety standards for storage and transportation and applicable laws. If we experience a problem or fail to comply with such safety standards, our business, financial condition and operating results may be harmed.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

We are subject to export control laws that limit which products we sell and where and to whom we sell our DTN System. In addition, various countries regulate the import of certain technologies and have enacted laws that could limit our ability to distribute our DTN System or could limit our customers ability to implement our DTN System in those countries. Changes in our DTN System or changes in export and import regulations may create delays in the introduction of our DTN System in international markets, prevent our customers with international operations from deploying our DTN System throughout their global systems or, in some cases, prevent the export or import of our DTN System to certain countries altogether. Any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our DTN System by, or in our decreased ability to export or sell our DTN System to, existing or potential customers with international operations. For example, we need to comply with Waste from Electrical and Electronic Equipment and Restriction of Hazardous Substances laws, which have been adopted by certain European Economic Area countries on a country-by-country basis. Failure to comply with these and similar laws on a timely basis, or at all, decreased use of our DTN System or any limitation on our ability to export or sell our products would adversely affect our business, financial condition and operating results.

We will incur increased costs as a result of operating as a public company, and our management will be required to devote substantial time to new compliance initiatives.

As a public company, we will incur legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act, as well as rules subsequently implemented by the SEC and the NASDAQ Stock Market, impose additional requirements on public companies, including requiring changes in corporate governance practices. For example, the listing requirements of the NASDAQ Global Market require that we satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of conduct. Our management and other personnel will need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming

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and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial additional costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

In addition, U.S. securities laws require, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, for the year ending December 31, 2008, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 will require that we incur substantial accounting expense and expend significant management time on compliance-related issues. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to potential delisting by the NASDAQ Stock Market and review by the NASDAQ Stock Market, the SEC, or other regulatory authorities, which would require additional financial and management resources.

If we need additional capital in the future, it may not be available to us on favorable terms, or at all.

Our business requires significant capital. We have historically relied on significant outside financing as well as cash flow from operations to fund our operations, capital expenditures and expansion. We may require additional capital from equity or debt financings in the future to fund our operations or respond to competitive pressures or strategic opportunities in the event that we continue to incur significant losses or otherwise. We may not be able to secure timely additional financing on favorable terms, or at all. The terms of any additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer dilution in their percentage ownership of our company, and any new securities we issue could have rights, preferences and privileges senior to those of holders of our common stock, including shares of common stock sold in this offering. If we are unable to obtain adequate financing or financing on terms satisfactory to us, if and when we require it, our ability to grow or support our business and to respond to business challenges could be limited and our business will be harmed.

We are subject to government regulations that could adversely impact our business.

The Federal Communications Commission, or FCC, has jurisdiction over the entire U.S. communications industry and, as a result, our DTN System and our North American customers are subject to FCC rules and regulations. Current and future FCC regulations affecting communications services, our DTN System or our customers businesses could negatively affect our business. In addition, international regulatory standards could impair our ability to develop products for international customers in the future. Delays caused by our compliance with regulatory requirements could result in postponements or cancellations of product orders. Further, we may not be successful in obtaining or maintaining any regulatory approvals that may, in the future, be required to operate our business. Any failure to obtain such approvals could harm our business and operating results.

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Any acquisitions we make could disrupt our business and harm our financial condition and operations.

We have made strategic acquisitions of businesses, technologies and other assets in the past. While we have no current agreements or commitments, we may in the future acquire businesses, product lines or technologies. In the event of any future acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or they may be viewed negatively by customers, financial markets or investors and we could:

- issue stock that would dilute our current stockholders percentage ownership;
- incur debt and assume other liabilities; or
- incur amortization expenses related to goodwill and other intangible assets and/or incur large and immediate write-offs.

Acquisitions also involve numerous risks, including:

- problems integrating the acquired operations, technologies or products with our own;
- diversion of management s attention from our core business;
- assumption of unknown liabilities;
- adverse effects on existing business relationships with suppliers and customers;
- increased accounting compliance risk;
- risks associated with entering new markets; and
- potential loss of key employees.

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

Natural disasters, terrorist attacks or other catastrophic events could harm our operations.

Our headquarters and the majority of our infrastructure, including our PIC manufacturing facility, is located in Northern California, an area that is susceptible to earthquakes and other natural disasters. Further, a terrorist attack aimed at Northern California or at our nation s energy or telecommunications infrastructure could hinder or delay the development and sale of our DTN System. In the event that an earthquake, terrorist attack or other catastrophe were to destroy any part of our facilities, destroy or disrupt vital infrastructure systems or interrupt our operations for any extended period of time, our business, financial condition and operating results would be harmed.

Risks Related to this Offering and Ownership of Our Common Stock

The trading price of our common stock is likely to be volatile, and you might not be able to sell your shares at or above the initial public offering price.

The trading prices of the securities of technology companies have been highly volatile. Further, our common stock has no prior trading history. Factors affecting the trading price of our common stock will include:

- variations in our operating results;
- announcements of technological innovations, new services or service enhancements, strategic alliances or agreements by us or by our competitors;
- the gain or loss of customers;

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recruitment or departure of key personnel;

changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;

market conditions in our industry, the industries of our customers and the economy as a whole; and

adoption or modification of regulations, policies, procedures or programs applicable to our business.

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or operating results. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. Each of these factors, among others, could harm the value of your investment in our common stock. Some companies that have had volatile market prices for their securities have had securities class action lawsuits filed against them. If a suit were filed against us, regardless of its merits or outcome, it could result in substantial costs and divert management s attention and resources.

Our securities have no prior market and our stock price may decline after the offering.

Prior to this offering, there has been no public market for shares of our common stock. Although we have applied to have our common stock quoted on the NASDAQ Global Market, an active public trading market for our common stock may not develop or, if it develops, may not be maintained after this offering. Our company and the representatives of the underwriters will negotiate to determine the initial public offering price. The initial public offering price may be higher than the trading price of our common stock following this offering. As a result, you could lose all or part of your investment.

Future sales of shares by existing stockholders could cause our stock price to decline.

If our existing stockholders sell, or indicate an intention to sell, substantial amounts of our common stock in the public market after the 180-day contractual lock-up, which period may be extended in certain limited circumstances, and other legal restrictions on resale discussed in this prospectus lapse, the trading price of our common stock could decline below the initial public offering price. Based on shares outstanding as of March 31, 2007, upon completion of this offering, we will have outstanding 83,136,638 shares of common stock, assuming no exercise of the underwriters over-allotment option. Of these shares, only the 14,000,000 shares of common stock sold in this offering will be freely tradable, without restriction, in the public market. The managing underwriters may, in their sole discretion, permit our officers, directors, employees and current stockholders who are subject to the contractual lock-up to sell shares prior to the expiration of the lock-up agreements.

After the lock-up agreements pertaining to this offering expire 180 days from the date of this prospectus, which period may be extended in certain limited circumstances, up to an additional 68,665,254 shares will be eligible for sale in the public market, 26,767,349 of which are held by directors, executive officers and other affiliates and will be subject to volume limitations under Rule 144 under the Securities Act of 1933, as amended, or the Securities Act, and various vesting agreements. In addition, as of March 31, 2007, the 1,332,680 shares subject to outstanding warrants, the 8,220,738 shares that are subject to outstanding options and the 1,056,438 shares reserved for future issuance under our 2000 Stock Plan, and the 13,600,000 shares of common stock to be reserved for issuance under our 2007 Equity Incentive Plan and 1,812,500 shares of common stock to be reserved for issuance under our 2007 Employee Stock Purchase Plan upon the effective date of this offering, will become eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements, the lock-up agreements and Rules 144 and 701 under the Securities Act. If these

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additional shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline.

Some of our existing stockholders have contractual demand or piggyback rights to require us to register with the SEC up to 62,427,606 shares of our common stock. If we register these shares of common stock, the stockholders would be able to sell those shares freely in the public market. All of these shares are subject to lock-up agreements restricting their sale for 180 days after the date of this prospectus, which period may be extended in certain limited circumstances.

After this offering, we intend to register approximately 24,035,738 shares of our common stock that we have issued or may issue under our equity plans. Once we register these shares, they can be freely sold in the public market upon issuance, subject to the lock-up agreements, if applicable, described above.

If securities or industry analysts do not publish research or publish misleading or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. We do not currently have and may never obtain research coverage by securities and industry analysts. If no or few securities or industry analysts commence coverage of our company, the trading price for our stock would be negatively impacted. In the event we obtain securities or industry analyst coverage, if one or more of the analysts who covers us downgrades our stock or publishes misleading or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price or trading volume to decline.

Insiders will continue to have substantial control over us after this offering, which may limit our stockholders ability to influence corporate matters and delay or prevent a third party from acquiring control over us.

Upon completion of this offering, our directors and executive officers and their affiliates will beneficially own, in the aggregate, approximately 13.2% of our outstanding common stock, assuming no exercise of the underwriters over-allotment option, compared to 16.8% represented by the shares sold in this offering, assuming no exercise of the underwriters over-allotment option. As a result, these stockholders will be able to exercise influence over all matters requiring stockholder approval, including the election of directors and approval of corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit your ability to influence corporate matters and delay or prevent a third party from acquiring control over us. For information regarding the ownership of our outstanding stock by our executive officers and directors and their affiliates, please see the section titled Principal Stockholders.

As a new investor, you will experience substantial dilution as a result of this offering and future equity issuances.

The assumed initial public offering price per share is substantially higher than the pro forma net tangible book value per share of our common stock outstanding prior to this offering. As a result, investors purchasing common stock in this offering will experience immediate substantial dilution of $9.28 a share. In addition, we have issued options to acquire common stock at prices below the initial public offering price. To the extent outstanding options are ultimately exercised, there will be further dilution to investors in this offering. This dilution is due in large part to the fact that our earlier investors paid substantially less than the initial public offering price when they purchased their shares

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of common stock. In addition, if the underwriters exercise their over-allotment option, if outstanding warrants to purchase our common stock are exercised, or if we issue additional equity securities, you will experience additional dilution.

Anti-takeover provisions in our charter documents and Delaware law could discourage, delay or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law, which apply to us, may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. For more information, see the section titled Description of Capital Stock Anti-Takeover Effects of Our Charter and Bylaws and Delaware Law. In addition, our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our amended and restated certificate of incorporation and amended and restated bylaws, which will be in effect as of the closing of this offering:

- authorize the issuance of blank check convertible preferred stock that could be issued by our board of directors to thwart a takeover attempt;
- establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;
- require that directors only be removed from office for cause and only upon a supermajority stockholder vote;
- provide that vacancies on the board of directors, including newly-created directorships, may be filled only by a majority vote of directors then in office rather than by stockholders;
- prevent stockholders from calling special meetings; and
- prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders.

Our management will have broad discretion over the use of the proceeds we receive in this offering and might not apply the proceeds in ways that increase the value of your investment.

Our management will have broad discretion to use the net proceeds from this offering, and you will be relying on the judgment of our management regarding the application of these proceeds. Our management might not apply the net proceeds of this offering in ways that increase the value of your investment. We expect to use the net proceeds from this offering to possibly repay our credit facilities, and for general corporate purposes, including working capital and capital expenditures, which may in the future include investments in, or acquisitions of, complementary businesses, services or technologies. We have not allocated these net proceeds for any specific purposes. Our management might not be able to yield a significant return, if any, on any investment of these net proceeds. You will not have the opportunity to influence our decisions on how the net proceeds from this offering are used.

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FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements that relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. All statements contained in this prospectus other than statements of historical facts, including statements regarding our future operating results and financial position, our business strategy and plans and our objectives for future operations, are forward-looking statements. The words anticipate, architected, believe, continue, could, designed, en estimate, expect, intend, likely, may, plan, target, will, or would and similar expressions are intended to identify forwa statements.

Forward-looking statements made herein include, but are not limited to, statements about:

- anticipated trends and challenges in our business and the markets in which we operate;
- our ability to address market needs or develop new or enhanced products to meet those needs;
- expected adoption of our DTN System by our potential customers;
- our ability to compete in our industry;
- our ability to successfully manufacture our PICs and our DTN System;
- our ability to grow our revenue and improve our gross margins;
- our ability to protect our confidential information and intellectual property rights;
- our ability to manage our growth and anticipated expansion into new markets;
- the expected future impact of our deferred revenue and deferred inventory costs;
- our ability to establish VSOE;
- our need to obtain additional funding and our ability to obtain funding in the future on acceptable terms; and
- our expectations regarding the use of proceeds from this offering.

All forward-looking statements involve risks, assumptions and uncertainties. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, operating results, business strategy, short-term and long-term business operations and objectives, and financial needs.

The occurrence of the events described, and the achievement of the expected results, depend on many events, some or all of which are not predictable or within our control. Actual results may differ materially from expected results. See the section titled Risk Factors and elsewhere in this prospectus for a more complete discussion of these risks, assumptions and uncertainties and for other risks and uncertainties. These risks, assumptions and uncertainties are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors also could harm our results. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this prospectus might not occur. We undertake no obligation, and specifically decline any obligation, to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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USE OF PROCEEDS

We estimate that our net proceeds from the sale of the common stock that we are offering will be approximately $139,120,000, assuming an initial public offering price of $11.00 per share, which is the midpoint of the range listed on the cover page of this prospectus, and after deducting the estimated underwriting discount and estimated offering expenses payable by us. If the underwriters over-allotment option to purchase additional shares in this offering is exercised in full we estimate that our net proceeds will be approximately $160,603,000.

We intend to use the net proceeds to us from this offering for working capital and other general corporate purposes, including to finance our growth, develop new products, fund capital expenditures, or to expand our existing business through acquisitions of other businesses, products or technologies. However, we do not have agreements or commitments for any acquisitions at this time.

In addition, we may choose to repay our credit facilities, including:

- up to $5.4 million outstanding as of March 31, 2007 under our credit facility with Silicon Valley Bank and Gold Hill Ventures Lending 03, L.P. dated December 29, 2004 that has a maturity date of June 1, 2008 and had a weighted-average interest rate of 16.7% in 2006;

- up to $9.5 million outstanding as of March 31, 2007 under our credit facility with Silicon Valley Bank dated December 29, 2004 that has a maturity date of September 27, 2007 and had a weighted-average interest rate of 10.1% in 2006; and

- up to $14.1 million outstanding as of March 31, 2007 under our credit facility with United Commercial Bank dated June 21, 2005 that has a maturity date of October 31, 2009 and had an interest rate of 8.3% in 2006.

However, we do not have agreements or commitments for any specific repayments related to these credit facilities at this time.

The amount and timing of our expenditures will depend on several factors, including progress in our research and development efforts and the amount of cash used throughout our organization. Pending use of proceeds from this offering, we intend to invest the proceeds in a variety of capital preservation investments, including short- and intermediate-term interest bearing obligations, investment-grade instruments, certificates of deposit or direct or guaranteed obligations of the U.S. government.

DIVIDEND POLICY

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings to support the operation of and to finance the growth and development of our business. We do not anticipate paying any cash dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to compliance with certain covenants under our credit facilities, which restrict or limit our ability to pay dividends, and will depend on our financial condition, operating results, capital requirements, general business conditions and other factors that our board of directors may deem relevant.

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CAPITALIZATION

The following table presents our cash, cash equivalents and short-term investments and capitalization as of March 31, 2007:

- on an actual basis;
- on a pro forma basis after giving effect to (i) the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of the offering and (ii) the reclassification of the preferred stock warrant liability to common stock immediately prior to the closing of this offering; and
- on a pro forma as adjusted basis reflecting (i) the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of this offering, (ii) the reclassification of the convertible preferred stock warrant liabilities to common stock and additional paid-in-capital and (iii) the receipt of the estimated net proceeds from the sale of 14,000,000 shares of common stock offered by us at an assumed initial public offering price of $11.00 per share, which is the midpoint of the range listed on the cover page of this prospectus, and after deducting the estimated underwriting discount and estimated offering expenses and the filing of our amended and restated certificate of incorporation immediately prior to the closing of this offering.

You should read this table in conjunction with the sections titled Selected Consolidated Financial Data and Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes included elsewhere in this prospectus.

	As of March 31, 2007		
	Actual	Pro Forma (Unaudited)	Pro Forma As Adjusted
	(In thousands)		
Cash, cash equivalents and short-term investments	$ 39,662	$ 39,662	$ 178,782
Preferred stock warrant liability	$ 7,909	$	$
Current and long-term debt	33,896	33,896	33,896
Convertible preferred stock, $0.001 par value: 62,000 authorized and issuable in series, 58,806 shares issued and outstanding, actual; no shares authorized, no shares issued and outstanding, pro forma; no shares authorized, no shares issued and outstanding, pro forma as adjusted	320,550		
Stockholders equity (deficit):			
Convertible preferred stock, $0.001 par value: no shares authorized, issued and outstanding, actual; no shares authorized, no shares issued and outstanding, pro forma; 25,000 shares authorized, no shares issued and outstanding, pro forma as adjusted			
Common stock, $0.001 par value: 79,500 shares authorized, 9,710 shares issued and outstanding actual; 79,500 shares authorized, 69,137 shares issued and outstanding pro forma; 500,000 shares authorized, 83,137 shares issued and outstanding pro forma as adjusted	10	69	83
Additional paid-in capital	9,624	338,024	477,130
Accumulated other comprehensive loss	(143)	(143)	(143)
Accumulated deficit	(333,901)	(333,901)	(333,901)
Total stockholders equity (deficit)	(324,410)	4,049	143,169
Total capitalization	$ 37,945	$ 37,945	$ 177,065

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This table excludes the following shares:

- 8,220,738 shares of common stock issuable upon exercise of stock options outstanding as of March 31, 2007 at a weighted average exercise price of $2.09 per share;
- 1,332,680 shares of common stock issuable upon the exercise of warrants outstanding as of March 31, 2007 at a weighted average exercise price of $5.23 per share; and
- 16,468,938 shares of common stock reserved for future issuance under our stock-based compensation plans, consisting of 1,056,438 shares of common stock reserved for issuance under our 2000 Stock Plan, of which 158,371 shares were granted on April 24, 2007, 13,600,000 shares of common stock reserved for issuance under our 2007 Equity Incentive Plan, of which 3,076,779 shares were approved for granting by our compensation committee on May 7, 2007 and will be effective as the date the registration statement, of which this prospectus forms a part, is declared effective and 1,812,500 shares of common stock reserved for issuance under our 2007 Employee Stock Purchase Plan. The 2007 Equity Incentive Plan and the 2007 Employee Stock Purchase Plan will become effective on the date of this offering.

This table includes the following shares:

- 1,812,951 shares of restricted common stock issued upon the early exercise of stock options at a weighted average exercise price of $1.67 per share that are classified as outstanding for financial reporting purposes, except in the calculation of earnings per share.

See the section titled Management Equity Benefit Plans for a description of our equity plans.

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DILUTION

Our pro forma net tangible book value as of March 31, 2007 was $4.0 million, or approximately $0.06 per share. Net tangible book value per share represents the amount of stockholders equity divided by 69,136,638 shares of common stock outstanding after giving effect to the conversion of all outstanding shares of convertible preferred stock into shares of common stock upon the closing of this offering.

Net tangible book value dilution per share to new investors represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the net tangible book value per share of common stock immediately after the closing of this offering. After giving effect to our sale of 14,000,000 shares of common stock in this offering at an assumed initial public offering price of $11.00 per share, which is the midpoint of the range on the cover of the prospectus, and after deducting the estimated underwriting discount and estimated offering expenses, our net tangible book value as of March 31, 2007 would have been $143.2 million, or $1.72 per share. This represents an immediate increase in net tangible book value of $1.66 per share to existing stockholders and an immediate dilution in net tangible book value of $9.28 per share to purchasers of common stock in the offering, as illustrated in the following table:

Assumed initial public offering price per share		$ 11.00
Pro forma net tangible book value per share as of March 31, 2007	$ 0.06	
Increase in pro forma as adjusted net tangible book value per share attributable to new investors	1.66	
Pro forma as adjusted net tangible book value per share after the offering		1.72
Dilution per share to new investors		$ 9.28

If the underwriters exercise their option to purchase additional shares of our common stock in full in this offering, the pro forma as adjusted net tangible book value per share after the offering would be $1.93 per share, the increase in pro forma as adjusted net tangible book value per share to existing stockholders would be $1.87 per share and the dilution to new investors purchasing shares in this offering would be $9.07 per share.

If all of our outstanding stock options and warrants were exercised and the underwriters do not exercise their option to purchase additional shares of our common stock in full in this offering, the pro forma as adjusted net tangible book value per share after the offering would be $1.81 per share, the decrease in pro forma net tangible book value per share to existing stockholders would be $1.75 per share and the dilution to new investors purchasing shares in this offering would be $9.19 per share.

If all of our outstanding stock options and warrants were exercised and the underwriters exercise their option to purchase additional shares of our common stock in full in this offering, the pro forma as adjusted net tangible book value per share after the offering would be $1.99 per share, the decrease in pro forma net tangible book value per share to existing stockholders would be $1.93 per share and the dilution to new investors purchasing shares in this offering would be $9.01 per share.

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The following table presents on a pro forma basis as of March 31, 2007, after giving effect to the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of this offering, the differences between the existing stockholders and the purchasers of shares in the offering with respect to the number of shares purchased from us, the total consideration paid and the average price paid per share:

	Shares Purchased		Total Consideration		Average Price Per Share
	Number	Percent	Amount	Percent	
	(in thousands, except percentages and per share data)				
Existing stockholders	69,137	83.2%	$ 334,533	68.5%	$ 4.84
New stockholders	14,000	16.8	154,000	31.5	11.00
Totals	83,137	100.0%	$ 488,533	100.0%	$ 5.88

As of March 31, 2007, there were options outstanding to purchase a total of 8,220,738 shares of common stock at a weighted average exercise price of $2.09 per share. As of March 31, 2007 there were warrants outstanding to purchase 1,332,680 shares of common stock with a weighted average exercise price of $5.23 per share. The above discussion and table assumes no exercise of stock options or warrants outstanding as of March 31, 2007. If all of these options and warrants were exercised, our existing stockholders, including the holders of these options and warrants, would own 84.9% of the total number of shares of our common stock outstanding upon the closing of this offering and our new investors would own 15.1% of the total number of shares of our common stock upon the closing of this offering.

As of March 31, 2007, there were 1,812,951 shares of restricted common stock issued upon the early exercise of stock options at a weighted average exercise price of $1.67 per share that are classified as outstanding for financial reporting purposes, except in the calculation of net loss per common share. For a description of our equity plans, please see the section titled Management Equity Benefit Plans.

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SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated historical financial data below in conjunction with the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements, related notes and other financial information included elsewhere in this prospectus. The selected financial data in this section is not intended to replace the financial statements and is qualified in its entirety by the consolidated financial statements and related notes thereto included elsewhere in this prospectus.

We derived the statements of operations and cash flow data for the years ended December 31, 2004, 2005 and 2006 and the balance sheet data as of December 31, 2005 and 2006 from our audited consolidated financial statements and related notes, which are included elsewhere in this prospectus. We derived the statements of operations and cash flow data for the years ended December 31, 2002 and 2003 and the balance sheet data as of December 31, 2002, 2003 and 2004 from our audited consolidated financial statements and related notes which are not included in this prospectus. The statement of operations and cash flow data for the three months ended March 31, 2006 and 2007 and the balance sheet data as of March 31, 2007 are derived from our unaudited consolidated financial statements that are included in this prospectus. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the information set forth therein. The results for any interim period are not necessarily indicative of the results that may be expected for a full year. Additionally, our historical results are not necessarily indicative of the results that should be expected in the future.

The pro forma basic and diluted net loss per common share data in the statement of operations data for the year ended December 31, 2006 and three months ended March 31, 2006 and 2007 reflect the conversion of all of our outstanding shares of convertible preferred stock into 59,427,606 shares of common stock immediately prior to the closing of this offering.

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	Years Ended December 31,					Three Months Ended March 31,	
	2002	2003	2004	2005	2006	2006	2007
						(Unaudited)	
	(In thousands, except per share data)						
Statements of Operations Data:							
Revenue:							
Ratable product and related support and services	$	$	$	$ 4,127	$ 52,978	$ 2,653	$ 45,947
Product			599		5,258		3,245
Total revenue			599	4,127	58,236	2,653	49,192
Cost of revenue:							
Cost of ratable product and related support and services				17,759	48,072	5,485	34,843
Lower of cost or market adjustment			1,587	9,696	21,693	4,325	1,067
Cost of product			5,653		1,660		1,363
Total cost of revenue			7,240	27,455	71,425	9,810	37,273
Gross profit (loss)			(6,641)	(23,328)	(13,189)	(7,157)	11,919
Operating expenses:							
Sales and marketing	895	1,680	8,294	11,053	20,682	2,701	7,636
Research and development	26,759	41,951	46,306	24,986	38,967	6,446	16,058
General and administrative	4,938	4,587	2,888	4,328	12,650	1,378	5,557
Amortization of intangible assets					56		37
Total operating expenses	32,592	48,218	57,488	40,367	72,355	10,525	29,288
Loss from operations	(32,592)	(48,218)	(64,129)	(63,695)	(85,544)	(17,682)	(17,369)
Other income (expense), net	(1,470)	(2,013)	(2,351)	(2,256)	(4,319)	(496)	(2,415)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(34,062)	(50,231)	(66,480)	(65,951)	(89,863)	(18,178)	(19,784)
Provision for income taxes				12	72	15	29
Loss before cumulative effect of change in accounting principle	(34,062)	(50,231)	(66,480)	(65,963)	(89,935)	(18,193)	(19,813)
Cumulative effect of change in accounting principle				(1,137)			
Net loss	$ (34,062)	$ (50,231)	$ (66,480)	$ (64,826)	$ (89,935)	$ (18,193)	$ (19,813)
Net loss per common share, basic and diluted	$ (21.27)	$ (19.61)	$ (17.94)	$ (14.08)	$ (14.90)	$ (3.63)	$ (2.62)
Weighted average number of shares used in computing basic and diluted net loss per common share	1,602	2,561	3,705	4,605	6,036	5,010	7,560

Pro forma net loss per common share, basic and diluted (unaudited)	$ (1.49)	$ (0.36)	$ (0.30)
Weighted average number of shares used in computing pro forma basic and diluted net loss per common share (unaudited)	60,389	50,762	66,988

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	As of December 31,				As of
	2002	2003	2004	2005	2006	March 31, 2007 (Unaudited)
	(In thousands)					
Balance Sheet Data:						
Cash, cash equivalents and short-term investments	$ 49,997	$ 54,244	$ 40,017	$ 37,112	$ 29,572	$ 39,662
Working capital	40,956	43,976	37,665	29,579	2,218	(12,869)
Total assets	69,849	75,441	69,514	100,912	230,466	227,870
Current and long-term debt	16,638	10,256	6,359	23,773	28,382	33,896
Convertible preferred stock	91,870	151,865	207,315	247,147	320,550	320,550
Common and additional paid-in-capital	1,628	2,095	2,979	3,529	7,920	9,634
Stockholders deficit	(41,725)	(91,200)	(156,471)	(220,710)	(306,321)	(324,410)

	Years Ended December 31,				Three Months Ended
	2002	2003	2004	2005	2006	March 31, 2007 (Unaudited)
	(In thousands)					
Cash Flow Data:						
Cash provided by (used in) operating activities	$ (31,527)	$ (43,727)	$ (62,222)	$ (56,449)	$ (67,775)	$ 6,963
Cash provided by (used in) investing activities	(59,001)	(4,892)	9,283	29,451	(18,069)	(4,025)
Cash provided by financing activities	38,611	53,573	51,608	58,059	78,780	7,138

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the financial condition and results of our operations should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors included elsewhere in this prospectus.

Overview

We were founded in December 2000. Our objective is to change the economics, operating simplicity, flexibility, reliability and scalability of optical communications networks. At the core of our Digital Optical Network architecture is what we believe to be the world s only commercially-deployed, large-scale PIC. Our PICs transmit and receive 100 Gbps of optical capacity and incorporate the functionality of over 60 discrete optical components into a pair of indium phosphide chips. We have used our PIC technology to design a new digital optical communications system called the DTN System, which is architected to improve significantly communications service providers economics and service offerings as compared to traditional systems.

We began commercial shipment of our DTN System in November 2004. As of March 31, 2007, we had sold our DTN System for deployment in the optical networks of 28 customers worldwide. Our goal is to be a leading provider of optical communications systems to communications service providers. Our revenue growth will depend on the continued acceptance of our DTN System, growth of communications traffic and the proliferation of next-generation bandwidth-intensive services, which are expected to drive the need for increased levels of bandwidth. Our ability to increase revenue and achieve profitability will be directly affected by the level of acceptance of our products in the long-haul and metro markets and by our ability cost-effectively to develop and sell innovative products that leverage our technology advantage.

Since our inception, we have incurred significant losses, and as of March 31, 2007 we had an accumulated deficit of $333.9 million. We have not achieved profitability on a quarterly or annual basis, and we expect to continue to incur substantial losses. Our ability to become profitable will be affected by any additional expenses that we incur to expand our manufacturing capacity, sales, marketing, development and general and administrative capabilities in order to grow our business. The largest component of our expenses is personnel costs. Personnel costs consist of salaries, benefits and incentive compensation for our employees, including commissions for sales personnel and stock-based compensation for all employees. We expect that after this offering we will incur additional accounting and legal costs related to compliance with securities laws and other regulations, These costs include, but are not limited to, costs associated with compliance with the Sarbanes-Oxley Act of approximately $2.5 million and investor relations and additional insurance costs of approximately $1.5 million.

We primarily sell our products through our direct sales force, with a small proportion sold indirectly through resellers. We derived 85% and 98% of our revenue from direct sales to customers in 2005 and 2006, respectively, and 97% and 98% in the three months ended March 31, 2006 and 2007, respectively. We expect to continue generating a significant majority of our revenue from direct sales in the future.

We are headquartered in Sunnyvale, California, with employees located throughout the United States, Europe and the Asia Pacific region. We expect to continue to add personnel in the United States, and internationally to provide additional geographic sales and technical support coverage.

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Overview of Consolidated Financial Data

Revenue

We derive our revenue from sales of our products, support and services. Our revenue is comprised of two components: (1) ratable product and related support and services revenue, or ratable revenue, and (2) product revenue. Our DTN System is integrated with software that is more than incidental to the functionality of our equipment. We refer to the integration of our DTN System with our software and related support and services as a bundled product. Revenue related to these bundled products, which is ratable revenue, is the portion of our total revenue that we recognize pursuant to Statement of Position No. 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions*, or SOP 97-2. Product revenue consists of sales of products that are sold without related services and, therefore, is not recognized ratably in accordance with SOP 97-2.

The following table illustrates our revenue for the specified periods:

Revenue (In thousands)	Three Months Ended 2005 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended December 31, 2005	Three Months Ended 2006 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended December 31, 2006	Three Months Ended 2007 Mar. 31
	(Unaudited)					(Unaudited)					(Unaudited)
Ratable revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 6,118	$ 40,153	$ 52,978	$ 45,947
Product revenue								1,578	3,680	5,258	3,245
Total revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 7,696	$ 43,833	$ 58,236	$ 49,192

Ratable Revenue. Substantially all of our sales arrangements consist of product sales bundled with training and product support. Product support services consist of software warranty, updates and unspecified upgrades and product support. To date, we have not established vendor specific objective evidence, or VSOE, of fair value for training and software warranty or product support services. All revenue for these bundled products is deferred and recognized ratably over the longest undelivered service period. In order to establish VSOE, we must have a history of selling our training and product support services separately at a consistent price. Once we have a sufficiently consistent transactional history to establish VSOE for training, software warranty and product support services, we will be able to recognize revenue up front for new customer orders once all of the following have occurred: (1) we have entered into a legally binding arrangement with a customer; (2) delivery and acceptance have occurred, which is when product title and risk of loss has transferred to the customer; (3) customer payment is deemed fixed or determinable; and (4) collectibility is reasonably assured. Revenue for then existing customer orders will continue to be recognized over the applicable revenue recognition period.

Historically, our sales arrangements have included rights to software warranty services for a period of one to five years. This warranty obligation typically represented the longest undelivered service period and resulted in straight-line recognition of revenue over the warranty period. This average period was 3.7 years in the third quarter of 2006. In the fourth quarter of 2006, we amended three of our significant sales contracts to shorten our contractual software warranty period to between 90 days and one year, which we believe is more typical in our industry. We may amend other existing contracts to shorten the software warranty period and expect the software warranty period in future contracts generally to be within this range. This contractual change in the software warranty period resulted in the reduction in the revenue recognition period of these contracts and in each case shortened the period to one year. These contractual changes also shortened the average recognition period for ratable revenue to 1.3 years in both the fourth quarter of 2006 and the first quarter of 2007. We expect that our average recognition period for ratable revenue will fluctuate based on the terms of existing and future customer contracts and our customer mix until we establish VSOE.

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In the fourth quarter of 2006, we amended three of our significant customer contracts to shorten the software warranty period and eliminate annual training credits. As part of the contractual amendments, we (1) provided certain one-time credits, (2) agreed to make available for purchase certain minimum quantities of equipment and (3) agreed to an extension of the contract for an additional period for the limited purpose of buying additional Digital Line Modules, or DLMs, Tributary Adapter Modules, or TAMs, and Tributary Optical Modules, or TOMs.

The ratable revenue that is recognized in each quarter includes a ratable portion recognized from deferred revenue of prior invoiced shipments of bundled products together with a ratable portion of each new invoiced shipment of bundled products in that quarter. Invoiced shipments of bundled products represent sales of our DTN System and services delivered and accepted by the customer for which payment will be made in accordance with normal payment terms, but for which VSOE has not been established. Shipments of bundled products are invoiced when all products ordered on a purchase order have been shipped and the relevant customer acceptance criteria have been satisfied. Customer acceptance periods averaged 18.8 days in the fourth quarter of 2006 and 17.8 days in the first quarter of 2007. Invoiced shipments of bundled products are amortized and recognized as revenue over the longest undelivered service period in each customer contract.

Product Revenue. A small portion of our sales arrangements do not require significant customization and the software content is considered incidental to the product. Such product revenue is recognized upon shipment in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*, or SAB 104.

Deferred Revenue

Only a small amount of our invoiced shipments of bundled products within a quarter are recognized as revenue in such quarter and the majority is recorded as deferred revenue. Deferred revenue increases each quarter by the amount of invoiced shipments of bundled products in that quarter and decreases by the amount of ratable revenue recognized from invoiced shipments of bundled products.

The following table illustrates the changes in deferred revenue for the specified periods:

Deferred Revenue (In thousands)	Three Months Ended 2005 (Unaudited)				Year Ended December 31, 2005	Three Months Ended 2006 (Unaudited)				Year Ended December 31, 2006	Three Months Ended 2007 (Unaudited)
	Mar. 31	Jun. 30	Sept. 30	Dec. 31		Mar. 31	Jun. 30	Sept. 30	Dec. 31		Mar. 31
Beginning balance	$	$ 2,577	$ 4,020	$ 17,020	$	$ 23,200	$ 34,349	$ 49,977	$ 84,284	$ 23,200	$ 110,953
Invoiced shipments of bundled products	2,998	2,046	14,126	8,157	27,327	13,802	19,682	40,425	66,822	140,731	63,414
Ratable revenue	(421)	(603)	(1,126)	(1,977)	(4,127)	(2,653)	(4,054)	(6,118)	(40,153)	(52,978)	(45,947)
Ending balance	$ 2,577	$ 4,020	$ 17,020	$ 23,200	$ 23,200	$ 34,349	$ 49,977	$ 84,284	$ 110,953	$ 110,953	$ 128,420

In 2005, we recorded $27.3 million of invoiced shipments of bundled products, recognized $4.1 million of revenue and added $23.2 million to the deferred revenue balance. In 2006, we recorded $140.7 million of invoiced shipments of bundled products, recognized $53.0 million of revenue and added $87.8 million to the deferred revenue balance. In the three months ended March 31, 2007, we recorded $63.4 million of invoiced shipments of bundled products, recognized $45.9 million of revenue and added $17.5 million to the deferred revenue balance.

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When a contract amendment shortens the service obligation period for a customer, all invoiced shipments of bundled products that have not previously been fully recognized for such customer are amortized over this shorter period resulting in increased recognition of revenue beginning on the amendment date. Of the $53.0 million of ratable revenue recognized in 2006, $40.2 million was recognized in the fourth quarter reflecting a combination of increased invoiced shipments of bundled products and the shortening of the contractual service obligation period described above.

Cost of Revenue

Our cost of revenue is comprised of two components: cost of ratable revenue and cost of product revenue.

The following table illustrates our cost of revenue for the specified periods:

Cost of Revenue (In thousands)	Three Months Ended 2005 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended December 31, 2005	Three Months Ended 2006 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended December 31, 2006	Three Months Ended 2007 Mar. 31
		(Unaudited)					(Unaudited)				(Unaudited)
Cost of ratable revenue	$ 2,276	$ 7,032	$ 5,092	$ 3,359	$ 17,759	$ 5,485	$ 4,488	$ 7,967	$ 30,132	$ 48,072	$ 34,843
Lower of cost or market adjustment	104	1,438	3,604	4,550	9,696	4,325	3,657	4,172	9,539	21,693	1,067
Cost of product revenue								311	1,349	1,660	1,363
Total cost of revenue	$ 2,380	$ 8,470	$ 8,696	$ 7,909	$ 27,455	$ 9,810	$ 8,145	$ 12,450	$ 41,020	$ 71,425	$ 37,273

Cost of Ratable Revenue. Cost of ratable revenue consists primarily of the costs of manufacturing our network equipment, including personnel costs, stock-based compensation, raw materials, overhead and period costs. Period costs consist primarily of shipping fees, logistics costs, manufacturing ramp-up costs, expenses for inventory obsolescence and warranty obligations.

Certain manufacturing costs are recognized in the period in which they are incurred or can be estimated, including period costs and losses associated with products which are sold or anticipated to be sold at a loss. The initial deployment of our DTN System at a customer involves the installation of common equipment, including a chassis, optical line amplifiers and related equipment. This common equipment is typically sold at low or negative gross margins. When we sell equipment at a loss, the losses are recognized in the period in which they are incurred or reasonably estimatable. We refer to this loss as a lower of cost or market adjustment, or LCM adjustment. In the years ended December 31, 2005 and 2006 and in the three months ended March 31, 2007, our LCM adjustment was $9.7 million, $21.7 million and $1.1 million, respectively, and was recorded as part of cost of ratable revenue. In addition, we recorded inventory write-downs for excess and obsolete inventory in 2004, 2005 and 2006 of $2.2 million, $(0.7) million and $1.7 million, respectively, and in the three months ended March 31, 2007 of $1.4 million. The remainder of our cost of ratable revenue is recorded as deferred costs of invoiced shipments of bundled products and is recognized in the same period as the corresponding revenue.

Cost of Product Revenue. Cost of product revenue consists primarily of the costs of manufacturing network components, such as personnel costs, raw materials and application of overhead.

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Deferred Inventory Cost

Deferred inventory cost increases by the cost of invoiced shipments of bundled products in a period and decreases as cost of ratable revenue is amortized in that period.

The following table illustrates the increases in our deferred inventory cost for the specified periods:

Deferred Inventory Cost (In thousands)	Three Months Ended 2005				Year Ended December 31, 2005	Three Months Ended 2006				Year Ended December 31, 2006	Three Months Ended 2007
	Mar. 31	Jun. 30	Sept. 30	Dec. 31		Mar. 31	Jun. 30	Sept. 30	Dec. 31		Mar. 31
		(Unaudited)					(Unaudited)				(Unaudited)
Beginning balance	$	$ 2,090	$ 3,527	$ 11,637	$	$ 16,687	$ 26,548	$ 35,038	$ 55,612	$ 16,687	$ 67,253
Deferred cost of invoiced shipments of bundled products	2,365	1,872	8,954	6,428	19,619	11,880	11,298	24,442	38,986	86,606	33,164
Amortization to cost of ratable revenue	(275)	(435)	(844)	(1,378)	(2,932)	(2,019)	(2,808)	(3,868)	(27,345)	(36,040)	(26,959)
Ending balance	$ 2,090	$ 3,527	$ 11,637	$ 16,687	$ 16,687	$ 26,548	$ 35,038	$ 55,612	$ 67,253	$ 67,253	$ 73,458

Gross Margin

Gross margins have been and will continue to be affected by a variety of factors, including the product mix, average selling prices of our products, the sale of additional support and services, new product introductions and enhancements, the cost of our hardware and software products, the amount of revenue that is recognized ratably, the period over which our revenue is recognized ratably and the amount of common equipment sold at a loss causing an LCM adjustment.

To satisfy our customer s requirement of transmitting optical signals, our customer must purchase a combination of common equipment and some limited number of DLMs, TAMs and TOMs. If a customer wishes to add capacity to our DTN System after their initial deployment to satisfy their additional demands, they may purchase additional DLMs, TAMs and TOMs. When a customer wishes to expand the reach of the DTN System or deploy another DTN System on a route on which the customer has reached the maximum capacity for its existing DTN System they may purchase a combination of additional common equipment and additional DLMs, TAMs and TOMs. Pricing for optical communications systems, such as our DTN System, is very competitive and we must often respond to these competitive pressures by decreasing the initial purchase price of our product. As a result of these competitive pressures and in order to gain new customers, our common equipment is typically sold at low margins or at a loss. Our DLMs, TAMs or TOMs are typically sold at higher gross margins. These higher margin sales positively impact overall gross margin over the ratable revenue recognition period.

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The following table illustrates our gross margin for the specified periods:

Gross Margin (In thousands)	Three Months Ended 2005 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended December 31, 2005	Three Months Ended 2006 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended December 31, 2006	Three Months Ended 2007 Mar. 31
		(Unaudited)					(Unaudited)				(Unaudited)
Total revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 7,696	$ 43,833	$ 58,236	$ 49,192
Cost of revenue	2,380	8,470	8,696	7,909	27,455	9,810	8,145	12,450	41,020	71,425	37,273
Gross profit (loss)	$ (1,959)	$ (7,867)	$ (7,570)	$ (5,932)	$ (23,328)	$ (7,157)	$ (4,091)	$ (4,754)	$ 2,813	$ (13,189)	$ 11,919
Gross margin	-465%	-1,305%	-672%	-300%	-565%	-270%	-101%	-62%	6%	-23%	24%

During the three months ended March 31, 2007, we generated gross profit of $11.9 million. This improved gross profit reflects the impact of the recognition of $14.8 million of deferred gross margin related to invoiced shipments in prior periods. In addition, although we continued to sell common equipment at low or negative margins, we experienced a reduction in LCM adjustments in the period, primarily due to lower costs because of product design changes related to our common equipment that resulted in a transition to a number of lower cost components. In addition, we achieved other reductions in a number of our component costs during the period. These improvements were offset by an increase in our warranty expense due to an increase in the number of expected future returns related to a component quality issue on one specific product that ceased shipping in June 2006. We also increased the expected cost of replacing defective units due to a reduction in the expected volume of repaired units available to satisfy customer warranty claims.

We experienced negative gross profit of $23.3 million in 2005 and $13.2 million in 2006. These losses primarily reflect the impact of selling common equipment at low or negative margins, causing LCM adjustments of $9.7 million and $21.6 million in 2005 and 2006, respectively. In addition, these losses reflected high ramp up manufacturing costs and excess and obsolete inventory costs. The impact on our gross margins of these costs was greater because most of the corresponding revenue was deferred and will be recognized ratably.

The contractual prices paid for our DTN System vary by customer. In addition, the quantity of DTN Systems purchased by each of our customers varies from quarter-to-quarter depending on our customers needs for optical transport equipment. To the extent that a customer with lower contractual prices purchases significant quantities of our DTN System that comprise a significant portion of the DTN Systems we sell within a quarter, our gross margin for such quarter and, to a lesser extent, the next three quarters if we continue to recognize revenue ratably over approximately a 1 year period, would be lower. In addition, substituting a new customer with a higher requirement for common equipment could result in an increased inventory write-down in a given quarter, which can have a significant impact on our gross margin in that quarter.

We expect our gross margins to continue to improve in the future as deferred revenue is recognized and as average selling prices and product mix improve due to new and existing customers purchasing higher margin network components to increase the capacity of their installed DTN Systems. As of December 31, 2006, deferred revenue was $111.0 million and deferred inventory cost was $67.3 million. As of March 31, 2007, deferred revenue was $128.4 million and deferred inventory cost was $73.5 million.

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The table below, which only represents a portion of our results for the projected periods presented and may not be indicative of our future results, shows the expected future impact of the recognition of these deferred amounts on our Consolidated Statement of Operations (unaudited):

	Deferred Balance as of March 31, 2007	For The Three Months Ended 2007			For The Nine Months Ended December 31, 2007	Future Periods
		Jun. 30	Sept. 30	Dec. 31		
Revenue	$ 128,420	$ 46,877	$ 39,290	$ 24,795	$ 110,962	$ 17,458
Cost of Inventory	73,458	28,065	22,967	13,818	64,850	8,608
Gross Profit	$ 54,962	$ 18,812	$ 16,323	$ 10,977	$ 46,112	$ 8,850

Operating Expenses

Operating expenses consist of sales and marketing, research and development and general and administrative expenses, and are recognized as incurred. Personnel-related costs are the most significant component of each of these expense categories. We expect personnel costs to continue to increase as we hire new employees to support our anticipated growth. We expect that each of the categories of operating expenses below will increase in absolute dollars, but will decline as a percentage of total revenue over time.

Research and development expenses are the largest component of our operating expenses and primarily include salary and related benefit costs, including stock-based compensation expense, and facilities costs. We expense research and development expenses as incurred. We are devoting substantial resources to the continued development of additional functionality for existing products and the development of new products. We intend to continue to invest significantly in our research and development efforts because we believe that they are essential to maintaining our competitive position.

Sales and marketing expenses primarily include salary and related benefit costs, including stock-based compensation expense, sales commissions, marketing and facilities costs. We expect sales and marketing expenses to increase as we hire additional personnel both in the United States and internationally to support our expected revenue growth.

General and administrative expenses consist primarily of salary and related benefit costs, including stock-based compensation expense and facilities related to our executive, finance, human resource, information technology and legal organizations, and fees for professional services. Professional services principally consist of outside legal, audit and information technology consulting costs. We expect to incur significant additional expenses as a result of operating as a public company, including costs to comply with the Sarbanes-Oxley Act and the rules and regulations applicable to companies listed on the NASDAQ Global Market.

Other Income (expense), net

Other income (expense), net includes interest expense on short- and long-term debt, interest income on our cash balances, and losses or gains on conversion of foreign currency transactions into U.S. dollars. In 2005 and 2006, other income (expense), net, also included an adjustment to record our convertible preferred stock warrants at fair value as required by Staff Position 150-5, *Issuer s Accounting under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable*, or FSP 150-5, as described below. In the three months ended March 31, 2007, other income (expense), net also included a gain of $0.9 million related to the sale of assets acquired during the period under an asset purchase agreement as described in Note 4 of Notes to Consolidated Financial Statements.

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Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with GAAP in the United States. These accounting principles require us to make certain estimates and judgments that can affect the reported amounts of assets and liabilities as of the date of the consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Significant estimates and assumptions made by management include revenue recognition, inventory valuation and the determination of the fair value of stock awards issued. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. We believe that the estimates and judgments upon which we rely are reasonable based upon information available to us at the time that these estimates and judgments are made. To the extent there are material differences between these estimates and actual results, our consolidated financial statements will be affected.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

Our DTN System is generally integrated with software that is more than incidental to the functionality of such product. Accordingly, we account for revenue in accordance with SOP 97-2. We recognize product revenue when all of the following have occurred: (1) we have entered into a legally binding arrangement with a customer; (2) delivery and acceptance have occurred, which is when product title and risk of loss has transferred to the customer; (3) customer payment is deemed fixed or determinable; and (4) collectibility is reasonably assured. Revenue is recognized net of cash discounts.

Substantially all of our product sales have been sold in combination with training and product support services, which consist of software warranty and updates, and product support.

Software updates provide customers with rights to unspecified software product upgrades and to maintenance releases and patches released during the term of the support period. Product support includes internet access to technical content, telephone and internet access to technical support personnel. Training services include the right to a specified number of training classes over the term of the arrangement. Revenue for training and support services is recognized on a straight-line basis over the service contract term, which ranges from one to five years.

VSOE of fair value for training and product support services is determined by reference to the price a customer is required to pay when training and product support services are sold separately. To date, we have not established VSOE of fair value for training and product support services. Assuming all other revenue recognition criteria have been met and the only undelivered element is training or product support services, revenue is deferred and recognized ratably over the longest undelivered service period. The undelivered service periods range from one to five years. Revenue related to these arrangements is included in ratable revenue in our statements of operations.

Contracts and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery and transfer of title. Revenue is recognized only when title and risk of loss passes to customers. In instances where acceptance of the product is specified by the customer, revenue is deferred until all acceptance criteria have been met. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. Payment terms to customers generally range from net 30 to 90 days from invoice. In the event payment terms are provided that differ from our standard business practices, the fees are deemed to not be fixed or determinable and, therefore, revenue is deferred until the fees become fixed or determinable, which we

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believe is when they are legally due and payable. We assess the ability to collect from our customers based primarily on the creditworthiness of the customer and past payment history of the customer.

Revenue for products that does not require significant customization and with regard to which any software is considered incidental, is recognized under SAB 104. Under SAB 104, revenue is recognized provided that persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the fee is fixed or determinable and collectibility is reasonably assured. Revenue related to these arrangements is included in product revenue in our statements of operations.

Shipping charges billed to customers are included in product revenue and in ratable revenue. The related shipping costs are included in cost of product sales and cost of ratable revenue in our statements of operations.

Stock-Based Compensation

Prior to January 1, 2006, we accounted for employee stock options using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, or APB No. 25, and Financial Accounting Standards Board Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB No. 25*. The intrinsic value represents the difference between the per share market price of the stock on the date of grant and the per share exercise price of the respective stock option. We generally grant stock options to employees for a fixed number of shares with an exercise price equal to the fair value of the shares at the date of grant. Under APB No. 25, no compensation expense is recorded for employee stock options granted at an exercise price equal to the market price of the underlying stock on the date of grant.

During the period from January 1, 2006 through the date of filing this registration statement, we granted stock options with exercise prices as follows:

Stock Award Grant Dates	Number of Options Granted	Exercise Price Per Share	Valuation Prior to Grant Date	SFAS 123(R) Black-Scholes Option Fair Value
February 27, 2006	118,322	$ 1.32	$ 1.04	$0.80 - $0.92
April 5, 2006	128,311	1.32	1.04	0.80 - 0.92
August 8, 2006	3,229,735	2.00	2.00	1.16 - 1.36
August 29, 2006	193,750	2.00	2.00	1.16 - 1.36
September 7, 2006	999,766	2.00	2.00	1.16 - 1.36
January 3, 2007	224,999	4.04	4.04	2.12
January 4, 2007	683,287	4.04	4.04	2.52 - 2.53
February 7, 2007	75,000	7.68	7.68	4.04
February 12, 2007	103,075	7.68	7.68	4.79
April 24, 2007	158,371	10.72	10.72	6.68

We have increased the estimated fair value of our common stock from January 1, 2006 through the date of the filing of this registration statement based on, among other factors, contemporaneous valuations. If the Internal Revenue Service determines that certain of our stock options were granted at below the fair value of our common stock on the date of grant, the recipients of those stock option grants could be subject to an additional deferred compensation tax under Internal Revenue Code Section 409A and we could be liable for withholding obligations.

In the absence of a public trading market, our board of directors relied in part upon contemporaneous valuations presented by management, which utilized the enterprise value allocation method, in order to help the board determine the value of our common stock. As part of this enterprise

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value allocation method, the value of our common stock was measured on a per share basis utilizing a probability weighted scenario analysis. The common stock per share value was based on the probability weighted average of two possible future liquidity scenarios: (1) a scenario where an IPO is not completed, or a no IPO liquidity scenario, and (2) a scenario where an IPO is completed, or an IPO liquidity scenario.

In the no IPO liquidity scenario, the common stock per share value is based on the Black-Scholes option-pricing model and represents the current nominal value of the common stock plus its option value for potential future increases in our value until a liquidity event. The methodology used allocated the estimated aggregate value to each security. A value was first assigned to each series of convertible preferred stock and then the remaining equity securities were analyzed and the remaining enterprise value was apportioned to the remaining equity securities. The rights, preferences and privileges of each security were considered, including the liquidation and conversion rights, and the manner in which the value of each security affects the other securities.

In the no IPO liquidity scenario, a large proportion of our enterprise value is apportioned to our convertible preferred stock because the aggregate liquidation preference is approximately $325.2 million and each series of our convertible preferred stock participates with the common stock up to certain capped amounts after the payment of the aggregate liquidation preference.

In the IPO liquidity scenario, options and warrants are valued based solely on the Black-Scholes option-pricing model. The aggregate value related to options and warrants are subtracted from the aggregate equity value for purposes of determining the convertible preferred stock and common stock values on an as-if converted, per share basis. After accounting for the value of the options and warrants, the remaining enterprise value is apportioned equally among the shares of common stock and each series of convertible preferred stock, which causes our common stock to have a higher relative value per share than under the no IPO liquidity scenario.

Our board of directors also considered a number of factors, in addition to the valuations, to determine the estimated fair value of our common stock at each grant date, including:

- the shares of common stock underlying the options were and are illiquid securities in a private company that were not readily tradable at the time of grant and that there could be no assurance of such shares ever being readily tradable;
- the prices at which convertible preferred stock was issued and sold to outside investors in arm s-length transactions, and the rights, preferences and privileges of the convertible preferred stock relative to the common stock;
- important developments relating to achievement of our business objectives, including new product launches, customer wins and growth in our revenue and invoiced shipments;
- our stage of development and business strategy;
- the status of our efforts to build our management team;
- the status of our efforts to increase revenue and invoiced shipments while reducing losses, as well as our financial results;
- the likelihood of achieving a liquidity event for the shares of our common stock, such as an initial public offering or sale of the company, given prevailing market conditions and achievement of our business objectives;
- the state of the new issue market for similarly-situated technology companies; and

the market prices of publicly-held technology companies with similar business models.

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Our board of directors also considered the provisions of our Series A through G convertible preferred stock in determining the estimated fair value of our common stock at the time of each option grant, including the aggregate liquidation preference of the Series A through G convertible preferred stock of $325.2 million and the fact that in a sale of Infinera the Series A through G convertible preferred stock would participate with the common stock up to certain caps after the payment of the aggregate liquidation preference. As we approach our initial public offering, the per share value of our common stock moves closer to our enterprise value per share because the likelihood of a sale of Infinera where our convertible preferred stock receives a larger proportion of our enterprise value decreases.

The anticipated timing of a potential liquidity event, the estimated volatility, the discount rate, the discount for lack of marketability and the probability that we are able to complete an initial public offering of our common stock were the key assumptions used in the determination of the common stock value per share. These assumptions are as set forth below for each of our valuation dates since December 31, 2005:

	Dec. 31, 2005	June 30, 2006	Nov. 30, 2006	Jan. 15, 2007	Mar. 25, 2007
Common Stock Value Per Share	$ 1.04(1)	$ 2.00	$ 4.04	$ 7.68	$ 10.72
Time to Liquidity (in years)	N/A	1.4	1.0	0.5	0.25
Volatility	N/A	65%	60%	55%	55%
DCF Discount Rate	18-20%	30%	25%	20%	16%
Marketability Discount Rate	30%	25%	15%	5%	0%
Probability of an IPO	N/A	15%	25%	75%	90%

(1) For options granted in February and April 2006, our board of directors determined the fair value of our common stock to be $1.32 per share.

As can be seen in the table above, the increase in the valuation of our common stock from December 2005 to January 2007 can be attributed to declines in the anticipated time to liquidity, the volatility rate, the discount rate and the marketability discount rate and an increase in the probability that we are able to complete an initial public offering of our common stock. The most significant driver of the increase in the fair value of our common stock from the stock option grants we made on January 3 and 4, 2007 to the grants we made on April 24, 2007 was the increase in the probability that we are able to complete an initial public offering of our common stock. The probability of an IPO increased significantly as our 2006 financial statement audit neared completion and as we filed our initial registration statement and subsequent amendments on Form S-1 in 2007.

During 2006, we granted options to employees to purchase a total of 4,669,884 shares of common stock at exercise prices ranging from $1.32 to $2.00 per share. In 2007, excluding the equity grants subsequent to April 24, 2007 discussed in the section titled Certain Relationships and Related Party Transactions Equity Grants Since March 31, 2007, we have granted 1,244,732 shares of common stock at exercise prices ranging from $4.04 to $10.72.

Based upon an assumed initial public offering price of $11.00 per share, which is the midpoint of the price range listed on the cover page of the prospectus, the aggregate intrinsic value of outstanding options vested and expected to vest as of March 31, 2007 was $71.3 million, of which $24.3 million related to vested options and $47.0 million related to options expected to vest.

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	As of March 31, 2007 (in thousands)	Weighted Average Price	Assumed IPO Price (Unaudited)	Excess of IPO Price	Aggregate Intrinsic Value (in thousands)
Vested	2,614	$ 1.70	$ 11.00	$ 9.30	$ 24,311
Expected to vest	5,379	2.27	11.00	8.73	46,959
Total vested & expected to vest	7,993	$ 2.09	11.00	8.91	$ 71,270
Not expected to vest	228				
	8,221				

On January 1, 2006, we adopted the provisions of the Financial Accounting Standards Board, or FASB, SFAS 123(R), *Share-Based Payments*, or SFAS 123(R). Under SFAS 123(R), stock-based compensation costs for employees is measured at the grant date, based on the estimated fair value of the award at that date, and is recognized as expense over the employee s requisite service period, which is generally over the vesting period, on a straight-line basis. We adopted the provisions of SFAS 123(R) using the prospective transition method. Under this transition method, non-vested option awards outstanding at January 1, 2006, continue to be accounted for under the minimum value method as stipulated by SFAS 123(R). All awards granted, modified or settled after the date of adoption are accounted for using the measurement, recognition and attribution provisions of SFAS 123(R).

We make a number of estimates and assumptions related to SFAS 123(R). The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as an adjustment in the period estimates are revised. Actual results may differ substantially from these estimates. In valuing share-based awards under SFAS 123(R), significant judgment is required in determining the expected volatility of our common stock and the expected term individuals will hold their share-based awards prior to exercising. Expected volatility of the stock is based on our peer group in the industry in which we do business because we do not have sufficient historical volatility data for our own stock. The expected term of options granted represents the period of time that options granted are expected to be outstanding and was calculated based on historical information. In the future, as we gain historical data for volatility in our own stock and more data on the actual term employees hold our options, expected volatility and expected term may change which could substantially change the grant-date fair value of future awards of stock options and ultimately the expense we record.

The following table summarizes the effects of stock-based compensation related to employees, non-recourse notes and non-employees for 2004, 2005, 2006, and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
				(Unaudited)	
Cost of revenue	$	$	$ 151	$ 14	$ 88
Sales and marketing		36	198	12	87
Research and development	180	99	411	27	822
General and administrative	34	7	335	19	216
Total stock-based compensation effects in loss before taxes	$ 214	$ 142	$ 1,095	$ 72	$ 1,213

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For 2006, the total compensation cost related to stock-based awards granted under SFAS 123(R) to employees and directors but not yet amortized was approximately $5.2 million, net of estimated forfeitures of $0.4 million. These costs will be amortized on a straight-line basis over a weighted-average period of approximately 1.1 years. Amortization for 2006 was approximately $0.9 million, net of estimated forfeitures.

For the three months ended March 31, 2007, the total compensation cost related to stock-based awards granted under SFAS 123(R) to employees and directors but not yet amortized was approximately $7.4 million, net of estimated forfeitures of $0.6 million. Amortization for the three months ended March 31, 2007 was approximately $0.5 million, net of estimated forfeitures.

The fair value of each option grant is estimated on the date of grant using the following weighted-average assumptions used for grants in 2004, 2005, 2006 and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
				(Unaudited)	
Dividend					
Volatility	0%	0%	72% - 83%	77% - 83%	62% - 71%
Risk-free interest rate	3.00%	4.05%	4.57% - 5.08%	4.81% -4.82%	4.50% -4.51%
Weighted-average expected life	4 years	4 years	4.2 - 5.4 years	4.2 - 5.4 years	4.3 - 5.1 years
Weighted-average fair value of common stock	$ 0.15	$ 0.15	$0.81 - $1.35	$ 0.80 - $0.92	$ 2.12 - $4.80

We account for stock options granted to non-employees in accordance with Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction With Selling, Goods or Services,* or EITF No. 96-18, and related interpretations. We grant stock options to certain consultants and advisory board members for a fixed number of shares with an exercise price equal to the fair value of our common stock at the date of grant. Under EITF No. 96-18, compensation expense on non-employee stock options is calculated using the Black-Scholes option-pricing model and is recorded using the straight-line method over the vesting period, which approximates the service period.

Freestanding Preferred Stock Warrants

On June 29, 2005, the FASB issued FSP 150-5. This Staff Position affirms that such warrants are subject to the requirements in Statement 150, regardless of the timing of the redemption feature or the redemption price. Therefore, under Statement 150, the freestanding warrants that are related to our convertible preferred stock and common stock are liabilities that should be recorded at fair value. We previously accounted for freestanding warrants for the purchase of our convertible preferred stock and common stock under EITF Issue No. 96-18.

Effective July 1, 2005, we adopted FSP 150-5 and reclassified the fair value of the warrants from equity to liability and recorded a cumulative effect charge of approximately $1.1 million income. In addition, we recorded additional charges of approximately $0.2 million to reflect the increase in fair value between July 1, 2005 and December 31, 2005. In 2006, we recorded approximately $2.4 million of charges in other loss, to reflect the increase in fair value between January 1, 2006 and December 31, 2006. In the three months ended March 31, 2007, we recorded approximately $2.5 million of charges in other loss to reflect the increase in fair value between January 1, 2007 and March 31, 2007. The calculation of fair value requires the input of highly subjective assumptions and a change in our assumptions could materially affect the fair value estimates.

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We will continue to adjust the liabilities for changes in fair value until the earlier of the exercise of the warrants or the completion of a liquidation event, including the completion of this initial public offering, at which time the liabilities will be reclassified to stockholders equity (deficit).

We estimated the fair value of these warrants using the Black-Scholes model for change of control scenario and the Lattice model for a successful initial public offering scenario. We then used a probability weighted average of per-share values under the different scenarios to determine the fair value of these warrants at the respective balance sheet dates.

Both models require the input of highly subjective assumptions and a change in our assumptions could materially affect the fair value estimates.

The following table presents the pro forma effect of the adoption of FSP 150-5 on our results of operations for 2004 and 2005, if applied retroactively, assuming FSP 150-5 had been adopted in those years:

	December 31,	
	2004	2005
	(In thousands, except per share data)	
Net loss, as reported	$ (66,480)	$ (64,826)
Add: Cumulative effect of change in accounting principle included in net loss		1,137
Change in fair value of warrants	1,029	(229)
Pro forma net loss	$ (65,451)	$ (66,192)
Pro forma loss per common share, basic and diluted	$ (17.67)	$ (14.37)
Shares used in computing basic and diluted net loss per common share	3,705	4,605

Inventories

Inventories consist of hardware, work-in-process and related component parts and are stated at standard cost adjusted to approximate the lower of actual cost (first-in, first-out method) or market. Market value is based upon an estimated average selling price reduced by the estimated cost of disposal. The determination of market value involves numerous judgments including estimated average selling prices based upon recent sales volumes, industry trends, existing customer orders, current contract price, future demand and pricing for our products and technological obsolescence of our products.

Inventory that is obsolete or in excess of our forecasted demand or is anticipated to be sold at a loss is written down to its estimated net realizable value based on historical usage and expected demand. We recorded total inventory write-downs for LCM adjustments in 2004, 2005, and 2006 of $1.6 million, $9.7 million, and $21.7 million, respectively, and in the three months ended March 31, 2006 and 2007 of $4.3 million and $1.1 million, respectively. These adjustments related to our inventory and firm purchase commitments with suppliers and included the impact of expected losses on common equipment. In addition, we recorded inventory write-downs for excess and obsolete inventory in 2004, 2005 and 2006 of $2.2 million, $(0.7) million and $1.7 million, respectively, and in the three months ended March 31, 2006 and 2007 of $1.1 million and $1.4 million, respectively. These write-downs for excess and obsolete inventory were reflected as cost of product and cost of ratable product and related support and services.

In valuing our deferred inventory costs, we considered the valuation of inventory using the guidance of Accounting Research Bulletin 43, *Restatement and Revision of Accounting Research Bulletins*, or ARB 43. In particular, we considered ARB 43, Chapter 4, Statement 5 and whether the

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utility of the products delivered or expected to be delivered at less than cost, primarily comprised of common equipment, had declined. We concluded that, in the instances where the utility of the products delivered or expected to be delivered were less than cost, it was appropriate to value the deferred inventory costs and inventory costs at cost or market, whichever is lower, thereby recognizing the cost of the reduction in utility in the period in which the reduction occurred or can be reasonably estimated. We have, therefore, recorded inventory write-downs as necessary in each period in order to reflect common equipment inventory at the lower of cost or market. In addition, we considered the guidance provided in ARB 43, Chapter 4, Statement 10 relating to losses on firm purchase commitments related to inventory items. Given that the expected selling price of common equipment in the future remains below cost, we have also recorded losses on these firm purchase commitments in the period in which the commitment is made. When the inventory parts related to these firm purchase commitments are received, that inventory is recorded at the purchase price less the accrual for the loss on the purchase commitment.

If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Results of Operations

Revenue

The following table presents our revenue by type, geography and sales channel for 2004, 2005, 2006 and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
			(In thousands)	(Unaudited)	
Total revenue	$ 599	$ 4,127	$ 58,236	$ 2,653	$ 49,192
Total revenue by type					
Ratable product and related support and services	$	$ 4,127	$ 52,978	$ 2,653	$ 45,947
Product	599		5,258		3,245
% Revenue by type					
Ratable product and related support and services	0%	100%	91%	0%	93%
Product	100%	0%	9%	100%	7%
Total revenue by geography					
Domestic	$	$ 2,660	$ 49,901	$ 2,081	$ 39,945
International	599	1,467	8,335	572	9,247
% Revenue by geography					
Domestic	0%	64%	86%	78%	81%
International	100%	36%	14%	22%	19%
Total revenue by sales channel					
Direct	$	$ 3,488	$ 57,304	$ 2,564	$ 48,356
Indirect	599	639	932	89	836
% Revenue by sales channel					
Direct	0%	85%	98%	97%	98%
Indirect	100%	15%	2%	3%	2%

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2007. Total ratable revenue increased from $2.7 million in the three months ended March 31, 2006 to $45.9 million

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in the corresponding period in 2007. The increase reflected an increase in invoiced shipments of bundled products from $13.8 million in the three months ended March 31, 2006 to $63.4 million in the corresponding period in 2007. The increase in invoiced shipments of bundled products was due to increased purchases of our DTN System by existing customers and the addition of new customers. We added 19 new customers between March 31, 2006 and March 31, 2007 for a total of 28 customers as of March 31, 2007. In addition, in the first quarter of 2006, we recognized $2.0 million of deferred revenue from prior periods and $0.7 million from invoiced shipments of bundled products in the period. In the first quarter of 2007, we recognized $38.1 million of ratable revenue from prior periods and $7.8 million from current period invoiced shipments of bundled products.

In the three months ended March 31, 2007, we recorded $3.2 million of product revenue, consisting of $2.8 million related to the sale of 10 Gbps cards not for use in our DTN System and $0.4 million related to a product sale to a customer that did not require support services. We do not expect to generate significant revenue from product sales without related support services in the future.

2005 Compared to 2006. Total ratable revenue increased from $4.1 million in 2005 to $53.0 million in 2006. This increase reflected an increase in invoiced shipments of bundled products from $27.3 million in 2005 to $140.7 million in 2006 and the shortening of the ratable revenue recognition period from an average period of 3.7 years in the third quarter of 2006 to 1.3 years in the fourth quarter of 2006. The increase in invoiced shipments of bundled products was due to increased purchases of our DTN System by existing customers and the addition of customers in the United States and Europe.

Although our international revenue grew on an absolute basis from 2005 to 2006, international revenue as a percentage of total revenue declined by 61% from 2005 to 2006 primarily due to a significant increase in revenue from an existing U.S. customer and the addition of a number of new U.S. customers during 2006.

In 2006, we recorded $5.3 million of product revenue related to the sale of 10 Gbps cards not for use in our DTN System. We do not expect to generate significant revenues from the sale of these products in the foreseeable future.

2004 Compared to 2005. Total revenue increased from $0.6 million in 2004 to $4.1 million in 2005. This increase was primarily due to the fact that we signed a master purchase agreement with Level 3 in April 2005 and commenced shipments of our DTN System to Level 3 shortly thereafter. In addition, we signed a number of contracts with other customers in the United States and Europe. Revenue in 2004 consisted of one product sale of evaluation equipment to a customer in Asia Pacific. The product was sold without warranty or support services and revenue was recognized upon shipment.

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Cost of Revenue and Gross Margin

The following table presents our revenue, cost of revenue by revenue source, gross profit (loss) and gross margin for 2004, 2005, 2006 and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
			(In thousands)	(Unaudited)	
Total revenue	$ 599	$ 4,127	$ 58,236	$ 2,653	$ 49,192
Cost of ratable product and related support and services		17,759	48,072	5,485	34,843
Lower of cost or market adjustment	1,587	9,696	21,693	4,325	1,067
Cost of product	5,653		1,660		1,363
Gross profit (loss)	$ (6,641)	$ (23,328)	$ (13,189)	$ (7,157)	$ 11,919
Gross margin	N/M%(1)	-565%	-23%	-270%	24%

(1) N/M = Not Meaningful.

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2007. Gross margins improved from the three months ended March 31, 2006 to the corresponding period in 2007 due primarily to the impact of the recognition of $14.8 million of deferred gross margin related to invoiced shipments in prior periods. In addition, although we continued to sell common equipment at low or negative margins, we experienced a reduction of $3.3 million in LCM adjustments in the current period compared to the first quarter of 2006, primarily due to changes in the bill of materials on a number of common equipment components and a continued decline in component pricing. These improvements were offset by an increase to our warranty expense of $2.5 million due to an increase in the number of expected future returns related to a component quality issue on one specific product that ceased shipping in June 2006. We also increased the expected cost of replacing defective units due to a reduction in the expected volume of repaired units available to satisfy customer warranty claims.

2005 Compared to 2006. Gross margins improved from 2005 to 2006 due to increased ratable revenue, increased ASPs and improved product mix as customers purchased higher margin products to increase their network capacity. In addition, in 2006 we experienced reduced per unit manufacturing costs primarily due to improved yields and increased production volume, offset by an increase in LCM adjustments of $12.0 million and charges for excess and obsolete inventory of $2.3 million. Gross margins in 2005 were impacted primarily by negative manufacturing variances, comprised of lower yields and lower fixed cost absorption, due to low volume production. To the extent our production volume increases, we expect continued improvement in manufacturing and materials costs per unit.

2004 Compared to 2005. Cost of product revenue in 2004 is comprised of the cost of one evaluation equipment sale, excess and obsolete inventory, inventory reserves and manufacturing costs associated with the ramp up of production. Cost of ratable revenue in 2005 consisted of the amortization of deferred inventory costs and period costs including inventory reserves, LCM adjustments and increased costs related to the roll-out of our service organization. During 2005, we sold inventory that was previously reserved that resulted in a $1.3 million reduction in cost of revenue, gross loss, loss from operations and net loss for 2005.

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Research and Development Expenses

The following table presents our research and development expenses in absolute dollars and as a percent of total revenue for 2004, 2005, 2006 and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
			(In thousands)	(Unaudited)	
Research and development expenses	$ 46,306	$ 24,986	$ 38,967	$ 6,446	$ 16,058
Percent of total revenue[1]	N/M%	605%	67%	243%	33%

(1) Research and development expenses as a percent of total revenue is not a meaningful trend indicator because our revenue recognition policy requires the deferral of revenues over future periods.

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2007. Research and development expenses increased from the three months ended March 31, 2006 to the corresponding period in 2007 due primarily to $4.1 million of expense incurred in the three months ended March 31, 2007 related to software development services that we purchase from a third party to enable a supplier s products to operate in a regional bell operating company infrastructure. In addition, the increase resulted from a $2.2 million increase in personnel-related costs due to two asset acquisitions completed in the second half of 2006 and a $0.8 million increase in stock-based compensation expense.

2005 Compared to 2006. Research and development expenses increased from 2005 to 2006 due primarily to increased personnel-related costs of $7.3 million. In addition, during 2006 we wrote off $4.5 million of in-process research and development expenses related to an asset acquisition we completed in 2006 because technological feasibility had not been established and no alternative future uses existed.

2004 Compared to 2005. Research and development expenses decreased from 2004 to 2005 because we commenced shipment of products in 2005 and all production related costs were allocated to cost of sales. In addition, spending on prototypes and scrap decreased by $9.0 million from 2004 to 2005.

Sales and Marketing Expenses

The following table presents our sales and marketing expenses in absolute dollars and as a percent of total revenue for 2004, 2005, 2006 and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
			(In thousands)	(Unaudited)	
Sales and marketing expenses	$ 8,294	$ 11,053	$ 20,682	$ 2,701	$ 7,636
Percent of total revenue[1]	N/M%	268%	36%	102%	16%

(1) Sales and marketing expenses as a percent of total revenue is not a meaningful trend indicator because our revenue recognition policy requires the deferral of revenues over future periods.

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2007. Sales and marketing expenses increased from the three months ended March 31, 2006 to the corresponding period in 2007 due primarily to an increase of $2.7 million in headcount related expenses, including salaries and commission and $1.0 million of expenses related to demonstration units used in potential customer lab trials.

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2005 Compared to 2006. Sales and marketing expenses increased from 2005 to 2006 due primarily to an increase in commission expense of $7.5 million, reflecting significant increases in revenue and invoiced shipments and increased personnel-related costs in 2006. Other compensation expenses increased by $1.8 million in 2006 due to an increase in the number of sales and marketing employees. Our headcount growth reflected the expansion of our sales team in the United States and internationally.

2004 Compared to 2005. Sales and marketing expenses increased from 2004 to 2005 due primarily to increased personnel-related costs of $2.0 million. In addition, equipment expenses decreased due to fewer pre-sale evaluation units.

General and Administrative Expenses

The following table presents our general and administrative expenses in absolute dollars and as a percent of total revenue for 2004, 2005, 2006 and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
			(In thousands)	(Unaudited)	
General and administrative expenses	$ 2,888	$ 4,328	$ 12,650	$ 1,378	$ 5,557
Percent of total revenue(1)	482%	105%	22%	52%	11%

(1) General and administrative expenses as a percent of total revenue is not a meaningful trend indicator because our revenue recognition policy requires the deferral of revenues over future periods.

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2007. General and administrative expenses increased from the three months ended March 31, 2006 to the corresponding period in 2007 due primarily to increased personnel costs of $2.0 million and $1.3 million of legal and accounting expenses related to our preparation to become a public company.

2005 Compared to 2006. General and administrative expenses increased from 2005 to 2006 due primarily to increased legal and accounting fees related to our preparations to become a public company of $3.2 million, increased professional services and information technology consulting fees of $3.0 million and increased personnel-related costs of $2.1 million.

2004 Compared to 2005. General and administrative expenses increased from 2004 to 2005 due primarily to an increase in personnel-related costs of $1.0 million and professional services fees of $0.7 million.

Other Income (Expense), Net

The following table presents our interest income, interest expense and other loss, net for 2004, 2005, 2006 and the three months ended March 31, 2006 and 2007:

	Years Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
			(In thousands)	(Unaudited)	
Interest income	$ 1,166	$ 686	$ 2,100	$ 226	$ 185
Interest expense	(1,949)	(2,768)	(4,852)	(990)	(1,063)
Other gain (loss), net	(1,568)	(174)	(1,567)	268	(1,537)
Total other income (expense), net	$ (2,351)	$ (2,256)	$ (4,319)	$ (496)	$ (2,415)

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Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2007. The increase in interest expense was due to increased borrowings required to support our continued growth. Other loss, net primarily consisted of a $2.5 million charge related to the revaluation of preferred stock warrant liabilities at fair market value, partially offset by a $0.9 million gain related to the sale of assets acquired during the period under an asset purchase agreement as described in Note 4 of Notes to Consolidated Financial Statements.

2005 Compared to 2006. Interest income increased from 2005 to 2006 due to higher invested balances resulting from funds raised in our Series G convertible preferred stock financing. The increase in interest expense from 2005 to 2006 was due to increased borrowings required to support our continued growth. Other loss, net increased from 2005 to 2006 primarily due to charges related to the revaluation of preferred stock warrant liabilities at fair market value of $2.1 million, offset by a $0.5 million gain from foreign currency exchange translation.

2004 Compared to 2005. Interest expense increased from 2004 to 2005 due to the utilization of new credit facilities to support our continued growth. Interest income decreased due to lower invested balances as we continued to utilize cash. In 2004, other loss, net included a $1.5 million charge related to redemption of certain of our Series D convertible preferred stock. In 2005, other loss, net primarily consisted of $0.2 million charge related to the revaluation of preferred stock warrant liabilities at fair market value.

Provision for Income Taxes

Since inception, we have incurred operating losses and, accordingly, have not recorded a provision for income taxes for any of the periods presented other than foreign provisions for income tax. As of December 31, 2006, we had net operating loss carry-forwards for federal and state income tax purposes of $205.7 million and $193.6 million, respectively. As of March 31, 2007, we had net operating loss carry-forwards for federal and state income tax purposes of $211.3 million and $199.1 million, respectively. As of December 31, 2006 and March 31, 2007, we also had federal research and development tax credit carry-forwards of approximately $5.6 million and $6.0 million, respectively, and state research and development tax credit carry-forwards of approximately $3.7 million and $4.0 million, respectively. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance. If not utilized, the federal and state net operating loss and tax credit carry-forwards will begin to expire in 2021 and 2013 for federal and state tax purposes, respectively. Utilization of these net operating losses and credit carry-forwards may be subject to an annual limitation due to provisions of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, that are applicable if we have experienced an ownership change in the past, or if an ownership change occurs in the future, for example, as a result of this offering aggregated with certain other sales of our stock before or after this offering.

We adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), at the beginning of 2007. At the adoption date of January 1, 2007, the cumulative unrecognized tax benefit was $6.4 million which was netted against deferred tax assets with a full valuation allowance or other fully reserved amounts, and if recognized there would be no effect on the Company s effective tax rate. Upon adoption of FIN 48, we recognized no adjustment in the liability for unrecognized income tax benefits.

At March 31, 2007, the cumulative unrecognized tax benefit was $6.9 million that was substantially netted against deferred tax assets with a full valuation allowance. Included in the $6.9 million of cumulative unrecognized tax benefit, approximately $10,000 impacted our effective tax rate in the current quarter. At March 31, 2007, we had no liability for unrecognized tax benefits nor any

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accrued interest and penalties related to uncertain tax positions. Tax returns for all years after 2002 are subject to future examination by the major taxing jurisdictions to which we are subject.

We are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2003 through 2006. Infinera Corporation and our subsidiaries state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2002 through 2006.

For FIN 48 purposes, we recognize interest and penalties related to uncertain tax positions as part of its provision for federal, state and foreign income taxes.

Quarterly Results of Operations

The following table sets forth our unaudited quarterly consolidated statements of operations data for each of the nine quarters ended March 31, 2007. The data has been prepared on the same basis as the audited consolidated financial statements and related notes included in this prospectus and you should read the following table in conjunction with such financial statements. The table includes all necessary adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of this data. The results of historical periods are not necessarily indicative of the results of operations for a full year or any future period.

	For the Three Months Ended (Unaudited)								
	2005				2006				2007
	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Sep. 30	Dec. 31	Mar. 31
	(In thousands, except per share data)								
Revenue:									
Ratable product and related support and services	$ 421	$ 603	$ 1,126	$ 1,977	$ 2,653	$ 4,054	$ 6,118	$ 40,153	$ 45,947
Product							1,578	3,680	3,245
Total revenue	421	603	1,126	1,977	2,653	4,054	7,696	43,833	49,192
Cost of revenue:									
Cost of ratable product and related support and services	2,276	7,032	5,092	3,359	5,485	4,488	7,967	30,132	34,843
Lower of cost or market adjustment	104	1,438	3,604	4,550	4,325	3,657	4,172	9,539	1,067
Cost of product							311	1,349	1,363
Total cost of revenue	2,380	8,470	8,696	7,909	9,810	8,145	12,450	41,020	37,273
Gross margin (loss)	(1,959)	(7,867)	(7,570)	(5,932)	(7,157)	(4,091)	(4,754)	2,813	11,919
Operating expenses	10,265	9,393	9,682	11,027	10,524	13,720	22,928	25,183	29,288
Loss from operations	(12,224)	(17,260)	(17,252)	(16,959)	(17,681)	(17,811)	(27,682)	(22,370)	(17,369)
Other income (expense), net	141	413	611	1,091	496	370	892	2,561	(2,415)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(12,365)	(17,673)	(17,863)	(18,050)	(18,177)	(18,181)	(28,574)	(24,931)	(19,784)
Provision for income taxes				12	15	15	23	19	29
Loss before cumulative effect of change in accounting principle	(12,365)	(17,673)	(17,863)	(18,062)	(18,192)	(18,196)	(28,597)	(24,950)	(19,813)
Cumulative effect of change in accounting principle			(1,137)						
Net loss	$ (12,365)	$ (17,673)	$ (16,726)	$ (18,062)	$ (18,192)	$ (18,196)	$ (28,597)	$ (24,950)	$ (19,813)

Net loss per common share, basic and diluted	$	(2.84)	$	(3.90)	$	(3.59)	$	(3.71)	$	(3.63)	$	(3.23)	$	(4.42)	$	(3.55)	$	(2.62)		

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Our operating results may fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance.

Commencing with the first shipment of our DTN System in the fourth quarter of 2004, revenue has increased sequentially in each of the quarters presented due to increases in the number of products sold to new and existing customers and the shortening of our ratable revenue recognition period to 1.3 years in the fourth quarter of 2006. In the fourth quarter of 2006, we amended several of our significant sales contracts to shorten our contractual software warranty period. This shortening of the ratable revenue recognition period was responsible for $28.2 million of the $36.1 million increase in revenue and $20.0 million of the $28.6 million increase in cost of revenue from the third quarter of 2006 to the fourth quarter of 2006. The remainder of the increase in revenue of $7.9 million and cost of revenue of $8.6 million reflects the impact of increased levels of invoiced shipments throughout 2006.

Revenue increased by $5.4 million in the first quarter of 2007 reflecting the amortization of deferred revenue from prior periods of $38.1 million and of invoiced shipments of bundled products from the current period of $7.8 million. Although revenue increased by $5.4 million in the first quarter of 2007, cost of revenue decreased by $3.7 million primarily due to a reduction in LCM adjustments from $9.5 million in the fourth quarter of 2006 to $1.1 million in the first quarter of 2007.

Operating expenses fluctuated from quarter-to-quarter and increased significantly in the third quarter of 2006 due to increased research and development expenses related to two asset acquisitions completed in 2006. In addition, sales commission expense increased in the second half of 2006 due to significant increases in our invoiced shipments. We also invested heavily in finance, information systems and legal resources in 2006 as we prepared to become a public company. Operating expenses increased by $4.1 million in the first quarter of 2007 primarily due to software development services that we purchase from a third party and additional general and administrative expenses.

In the third quarter of 2005, we adopted FSP 150-5, which requires us to classify the warrants to purchase our convertible preferred stock and common stock as liabilities and to adjust the warrant instruments to fair value at each reporting period. We recorded a $1.1 million cumulative effect for adoption as of July 1, 2005, reflecting the fair value of the warrants as of that date, and $(29,000), $(0.2) million, $0.1 million, $(0.4) million, $(0.7) million and $(1.4) million of additional expense that was recorded in other income (expense), net in the quarters ended September 30, 2005, December 31, 2005, March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006, respectively, to reflect the increase in the fair value of the warrants. Additional expense of $2.5 million was incurred in the first quarter of 2007, reflecting a further increase in the fair value of the warrants.

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Liquidity and Capital Resources

	As of December 31,			As of March 31,	
	2004	2005	2006	2006	2007
				(Unaudited)	
			(In thousands)		
Working capital	$ 37,665	$ 29,579	$ 2,218	$ 18,819	$ (12,869)
Cash and cash equivalents	5,031	36,013	28,884	30,102	38,970

	For the Years Ended December 31,			For the Three Months Ended March 31,	
	2004	2005	2006	2006	2007
				(Unaudited)	
			(In thousands)		
Cash provided by (used in) operating activities	$ (62,222)	$ (56,449)	$ (67,775)	$ (21,625)	$ 6,963
Cash provided by (used in) investing activities	9,283	29,451	(18,069)	70	(4,025)
Cash provided by financing activities	51,608	58,059	78,780	15,652	7,138

Cash and cash equivalents consist of highly liquid investments in time deposits held at major banks, commercial paper, U.S. government agency discount notes, money market mutual funds and other money market securities with original maturities of 90 days or less. Since inception, we have financed our operations primarily through private sales of equity and from borrowings under credit facilities and more recently from cash collections on the sales of our DTN System.

Operating Activities

We experienced positive cash flows from operations of $7.0 million in the first quarter of 2007. We generated a net loss for the period of $19.8 million, and we had non-cash charges of $5.1 million consisting primarily of depreciation of $2.1 million and warrant expense of $2.5 million. In addition, the loss reflects the continued non-cash deferral of positive gross margin from invoiced shipments of bundled products of $11.3 million. This deferral of gross margin is one of the key drivers of the decrease of working capital in the period to a negative $12.9 million. We expect this trend to continue as we continue to increase invoiced shipments of bundled products, which may cause our working capital balance to continue to be negative. In addition, we experienced improved collections activities in the period offset by reductions in accounts payable terms. We also continued to invest in the development of our DTN System and in the expansion of our sales and marketing presence in the United States and internationally. We experienced negative cash flows from operations of $21.6 million in the first quarter of 2006. This reflected a net loss of $18.2 million with a non-cash deferral of gross margin on invoiced shipments of bundled products of $1.3 million. Other non-cash charges included $1.6 million of depreciation. Inventory and accounts receivables continued to increase in the period as we continued to ramp the business driving higher working capital requirements.

We experienced negative cash flows from operating activities of $67.8 million in 2006. We generated a net loss for the period of $89.9 million, and we had non-cash charges of $15.8 million consisting primarily of $7.0 million of depreciation, $4.5 million in-process research and development related to our acquisition of certain assets of Little Optics, Inc., $2.4 million related to revaluation of convertible preferred stock and common stock warrant liabilities and $1.1 million of stock-based compensation expense related to employees. The net loss also reflects the non-cash deferral of $87.8 million of deferred revenue and $50.6 million of deferred inventory cost to the balance sheet in the period. We funded increased working capital requirements of $27.4 million due to significant growth of the business. The decrease in working capital of $27.4 million from 2005 to 2006 was primarily due to an increase in short-term deferred revenue of $94.4 million compared to the increase in short-term deferred

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inventory costs of $57.8 million, reflecting the deferral of positive gross margin from invoiced shipments of bundled products. We expect this trend to continue as we continue to increase invoiced shipments of bundled products, which may cause our working capital balance to be negative. Our continued investment in the development of our DTN System and the expansion of our sales and marketing presence in the United States and internationally also negatively impacted our cash flow from operations.

Cash used in operating activities amounted to $56.4 million in 2005, primarily due to the generation of a net loss of $64.8 million. Results from operations in 2005 were negatively impacted by lower sales volumes, unfavorable manufacturing variances and the need to record charges for excess and obsolescent inventory. Deferred revenue increased by $22.8 million compared to an increase in deferred cost of inventory of $16.7 million. We commenced product shipments in November 2004 and inventory levels increased in 2005 by $16.5 million to support customer requirements. This increase was offset by increases in accounts payable of $7.8 million.

Cash used in operating activities in 2004 was $62.2 million, primarily due to the generation of a loss of $66.5 million in the period. The loss primarily reflected a significant investment in research and development of $46.3 million, increased sales and marketing expenses of $8.3 million and an increase in manufacturing costs in preparation for full product release in 2005. We were a development stage company for most of 2004 and the majority of our cash used in operating activities in 2004, $46.3 million reflected investment in research and development to develop our DTN System.

Investing Activities

Cash used in investing activities was $4.0 million in the first quarter of 2007, consisting of $5.2 million for the purchase of property, plant and equipment, partially offset by $1.1 million of proceeds from the subsequent sale of some of the purchased assets. Cash generated from investing activities in the first quarter of 2006 was $70,000 and consisted of $1.1 million of proceeds from the sale of acquired assets and $1.1 million of proceeds from the sale of short-term investments partially offset by $2.1 million for the purchase of property, plant and equipment.

Cash used in investing activities was $18.1 million in 2006, $15.3 million for the purchase of property and equipment related to the expansion of our manufacturing operations and $4.7 million related to our acquisition of certain assets of Little Optics Inc., a research and development company, partially offset by the sale of surplus assets acquired as part of a previous acquisition that generated $1.5 million.

We generated net cash from investing activities in 2005 of $29.5 million. $34.0 million was generated from the net sale of short-term investments, offset by $4.0 million from purchases of property and equipment and $0.7 million from the acquisition of certain assets from Big Bear Networks, Inc.

In 2004, net cash provided by investing activities was $9.3 million, primarily due to net proceeds of $13.0 million from the sale of short-term investments, offset by purchases of property and equipment of $3.3 million.

Financing Activities

Our financing activities provided cash of $7.1 million in the first quarter of 2007. The primary source of these funds was an increase in borrowings of $7.1 million under an existing variable rate term facility. In addition, we received $1.6 million from employee stock options exercised in the period offset by loan repayments of $1.6 million. Cash from financing activities amounted to $15.7 million in the first quarter of 2006. The primary sources of these funds were the issuance of convertible preferred stock of $8.4 million and a net increase in bank borrowings of $6.9 million.

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Our financing activities provided cash of $78.8 million in 2006. The primary source of these funds was the issuance of Series G convertible preferred stock. In 2006, we sold an aggregate of 14.1 million shares of our Series G convertible preferred stock for a net amount of $74.1 million to various investors. The purchase price for these shares of Series G convertible preferred stock was $5.40 per share, with the exception of a board member s purchase of 67,934 shares in October 2006 at $7.36 per share. We also received $4.4 million from employee stock options exercised during 2006.

Our financing activities provided cash of $58.1 million in 2005. $42.6 million was raised from the issuance of convertible preferred stock. In addition, we borrowed a net amount of $14.4 million under new and existing credit facilities.

Our financing activities provided cash of $51.6 million in 2004. $55.1 million was generated from the issuance of convertible preferred stock, proceeds from loans amounted to $7.1 million and we raised $0.7 million from the sale of common stock, offset by $11.4 million for principal payments on our outstanding loan obligations.

Credit Facilities

We entered into a borrowing arrangement in December 2004 with our primary financial institution, Silicon Valley Bank, which provides for two related facilities, an operating line of credit and a revolving line of credit. The operating line of credit allows us to borrow against our accounts receivables. The revolving line of credit allows for borrowing subject to our maintaining certain minimum cash balances. These facilities are secured by our assets, including our intellectual property. Total available credit under the arrangement is $25.0 million, and the weighted average interest rate on this facility for 2006 was 10.1%. Borrowings under these two facilities amounted to $9.5 million of debt and $3.2 million of outstanding stand-by letters of credit as of December 31, 2006 and March 31, 2007.

In June 2005, we put in place a variable rate term facility with United Commercial Bank. Total borrowings under this facility may not exceed $15.0 million and are secured by certain of our equipment and other assets, including our intellectual property. The interest rate on this variable rate facility is set at the bank s prime rate. The principal balance outstanding under this facility was $7.8 million and $14.1 million at December 31, 2006 and March 31, 2007, respectively. At December 31, 2006, the weighted average interest rate for the year was 8.3%. Amounts under this facility are paid in equal monthly installments from the date the funds are drawn to October 2009.

We also have a growth capital loan agreement with two co-lender financial institutions, Silicon Valley Bank and Gold Hill Ventures Lending 03, L.P., that we entered into in December 2004 under which we had $5.4 million outstanding as of December 31, 2006 and March 31, 2007. This loan is secured by our assets, including our intellectual property, and had a weighted average interest rate of 16.7% for 2006. Amounts under this facility are due in equal monthly installments from the date the funds are drawn to June 1, 2008 at which point we must make a final payment of $0.8 million.

The loan agreements described above require us to maintain compliance with certain operating covenants. At December 31, 2006 and March 31, 2007, we had access to an additional $19.5 million and $12.3 million, respectively, of incremental funds under our existing credit facilities. In the next twelve months, capital expenditures are expected to be approximately $15 million, primarily for product development and manufacturing expansion and upgrades. We believe that our existing cash and cash equivalents, combined with our existing credit facilities and the net proceeds from this offering will be sufficient to meet our anticipated cash needs for at least the next twelve months. However, we may require additional capital from equity or debt financings in the future to fund our operations, respond to competitive pressures or for strategic opportunities in the event that we continue to incur significant losses or otherwise. We may not be able to secure timely additional financing on favorable terms, or at

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all. The terms of any additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer dilution in their percentage ownership of us, and any new securities we issue could have rights, preferences and privileges senior to those of holders of our common stock, including shares of common stock sold in this offering.

Contractual Obligations

The following is a summary of our contractual obligations as of December 31, 2006:

		Years Ended December 31,				
	Total	2007	2008	2009	2010	2011 and beyond
			(In thousands)			
Principal payments on credit facility	$ 28,382	$ 20,025	$ 5,393	$ 2,649	$	$ 315
Purchase obligations(1)	39,176	39,176				
Interest payments on credit facility(2)	2,411	1,809	432	131	19	20
Operating leases	14,987	3,119	2,940	2,929	2,650	3,349
Total contractual obligations	$ 84,956	$ 64,129	$ 8,765	$ 5,709	$ 2,669	$ 3,684

(1) We have service agreements with our major production suppliers under which we are committed to purchase certain parts.
(2) Represents estimated interest payments on our debt using an effective rate of 8.5% at December 31, 2006.

Off-Balance Sheet Arrangements

During 2004, 2005, 2006 and the three months ended March 31, 2007, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Recent Accounting Pronouncements

See Note 19 of Notes to Consolidated Financial Statements for recent accounting pronouncements that could have an effect on us.

Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Risk

Certain of our sales contracts are priced in Euros and, therefore a portion of our revenue is subject to foreign currency risks. Our operating expenses and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the British pound and Euro. The effect of an immediate 10% adverse change in exchange rates on foreign denominated receivables as of December 31, 2006 would result in a loss of approximately $1.3 million. To date, we have not entered into any hedging contracts although we may do so in the future. Fluctuations in currency exchange rates could harm our business in the future.

Interest Rate Sensitivity

We had unrestricted cash and cash equivalents totaling $36.0 million, $28.9 million and $39.0 million at December 31, 2005, December 31, 2006 and March 31, 2007, respectively. These amounts were invested primarily in money market funds. The unrestricted cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We

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believe that we do not have any material exposure to changes in the fair value as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income. If overall interest rates fell by 10% in 2006, our interest income would have declined approximately $46,000, assuming consistent investment levels.

At December 31, 2005, December 31, 2006 and March 31, 2007, we had $23.8 million, $28.4 million and $34.0 million, respectively, of debt outstanding. Our debt interest rate is variable and adjusts periodically based on the prime rate. If overall interest rates increased by 10% in 2006, our interest expense would have increased approximately $0.2 million.

Controls and Procedures

In connection with the audit of our financial statements for 2005 and 2006, our management and our independent registered public accounting firm have reported to our board of directors material weaknesses in the design and operation of our internal control over financial reporting. A material weakness is defined by the standards issued by the American Institute of Certified Public Accountants as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Our management and independent registered public accounting firm did not perform an evaluation of our internal control over financial reporting during any period in accordance with the provisions of the Sarbanes-Oxley Act. Had we and our independent registered public accounting firm performed an evaluation of our internal control over financial reporting in accordance with the provisions of the Sarbanes-Oxley Act, additional material weaknesses may have been identified.

Our independent registered public accounting firm communicated the following material weaknesses:

- in 2005, we did not timely reflect or capture certain manufacturing costs in our inventory records and our inventory analysis contained computational errors; and

- in 2006, our review did not identify manual computational errors in our ratable revenue analysis and our net loss per common share calculations.

The material weakness in 2005 related to our inventory valuation process existed as of December 31, 2005 and resulted in adjustments to our financial statements for 2005 prior to their issuance, affecting our inventory, deferred inventory costs, research and development expenses and cost of ratable revenue. We believe we have remediated the material weakness identified in 2005 related to our inventory valuation process by implementing additional procedures and controls, hiring additional accounting personnel and increasing management review and oversight.

The material weakness in 2006 relates to our non-routine manual accounting and reporting processes involving our revenue and net loss per common share disclosure processes that existed as of December 31, 2006 and resulted in restatements of our financial statements for 2006, reducing our ratable revenue by $0.5 million in 2006 and increasing our annual net loss per common share in 2002, 2003, 2004, 2005 and 2006. We have developed a remediation plan to address the material weakness identified in 2006 related to our non-routine manual accounting and reporting processes involving our revenue and net loss per common share disclosure process. We intend to hire additional personnel and implement new accounting procedures and controls and documentation standards. We also intend to explore having developed customized modules for our financial reporting system to minimize our reliance on manual processes and procedures in calculating revenue, deferred revenue, inventory costs and net loss per common share.

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The remediation policies and procedures we have implemented and plan to implement may be insufficient to address our material weaknesses and additional material weaknesses may be discovered in the future. The existence of one or more material weaknesses precludes a conclusion that we maintain effective internal control over financial reporting. Such conclusion would be required to be disclosed in our future Annual Reports on Form 10-K and may impact the accuracy and timing of our financial reporting and the reliability of our internal control over financial reporting.

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BUSINESS

Overview

Infinera has developed a solution that we believe will change the economics, operating simplicity, flexibility, reliability and scalability of optical communications networks. At the core of our Digital Optical Network architecture is what we believe to be the world s only commercially-deployed, large-scale photonic integrated circuit, or PIC. Our PICs transmit and receive 100 Gbps of optical capacity and incorporate the functionality of over 60 discrete optical components into a pair of indium phosphide chips approximately the size of a child s fingernail. We have used our PIC technology to design a new digital optical communications system called the DTN System. The DTN System is designed to enable cost-efficient optical to electrical to optical conversion of communications signals. The DTN System is architected to improve significantly communications service providers economics and service offerings as compared to traditional systems. Our DTN System is designed to provide greater signal quality and network management flexibility. Our carrier-class DTN System runs our Infinera IQ Network Operating System and is integrated with our Infinera Management Suite software, which together enhance and simplify network monitoring, management and control.

Our goal is to establish our Digital Optical Network as a leading architecture for optical communications networks. We believe that photonic integrated circuits will significantly change optical communications networks in a fashion similar to the integrated circuit s impact on electronics beginning in the 1950 s. We also believe that our DTN System can provide benefits to our customers in the $3.7 billion wavelength division multiplexing segment of the global optical communications equipment market, which is estimated by Ovum-RHK, a third-party industry analyst, to be nearly $12 billion in 2006. As of March 31, 2007, we have sold our DTN System for deployment in the optical networks of 28 customers worldwide, including Internet2, Interoute, Level 3 Communications and Qwest Communications.

We believe that rapid growth of communications traffic and proliferation of next-generation bandwidth-intensive services such as video will expand the need and increase demand for optical network capacity. Our DTN System is designed to serve as the key element for long-haul and metro optical transport networks of U.S. and international communications service providers. Customer deployments of our DTN System have ranged from two to hundreds of network access points.

Our DTN System is designed to provide several advantages over traditional systems, including:

Operating simplicity and cost savings

Ease of deployment and scalability. Our DTN System provides optical capacity in 100 Gbps increments (10 channels at 10 Gbps), enabling our customers to more easily scale their optical networks with the initial installation of the DTN System and to add capacity to existing DTN Systems in less time and with fewer service calls;

Management and personnel. Our DTN System offers built-in software intelligence to route services across complex optical communications networks and is designed to simplify our customers network planning, engineering and operations; and

Efficiency and reliability. Given the high level of photonic integration and digital processing, our DTN System is designed to consume less power, enable simplified testing and improve system reliability;

Enhanced revenue generation

Expand services reach. Our DTN System lowers the cost of optical to electrical to optical conversion, which enables our customers to access markets cost-effectively that had previously not been served due to cost

constraints;

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Optimal use of network capacity. Our DTN System enables communications service providers to combine streams of network traffic from various points throughout the network onto a single wavelength, thereby optimizing existing capacity and increasing revenue opportunities; and

Accelerate service provisioning. Our DTN System s ability to deploy optical capacity in 100 Gbps increments and to process and manage data at each DTN System location remotely enables communications service providers to add customers and provision new services more rapidly than traditional systems; and

Capital cost savings. Our DTN System integrates the functionality of over 60 discrete optical components into a single PIC pair, reducing capital expenditures and the physical space required for a given amount of optical network capacity.

We began commercial shipment of our DTN System in November 2004. In the third quarter of 2005 we believe we achieved, and have since maintained through the fourth quarter of 2006, the largest market share of 10 Gbps long-haul ports shipped worldwide. We believe we achieved over 30% of the market share for all 10 Gbps long-haul interface ports shipped worldwide in 2006. We believe this rapid customer acceptance is due to the benefits that our PIC-based digital optical communications system offers over traditional systems.

Industry Background

Optical communications equipment carries digital information as analog light waves over fiber optic networks. Fiber optic networks provide significantly greater data transport capacity than traditional electrical over copper transport technology. The advent of wavelength division multiplexing systems has enabled the transmission of larger amounts of data by using multiple wavelengths over a single optical fiber. Service providers often use wavelength division multiplexing systems to carry communications traffic between cities, referred to as long-haul networks, and within large metropolitan areas, referred to as metro networks. Most fiber optic networks carry all types of communications traffic, from conventional long-distance telephone calls to e-mails and web sessions to high-definition video streams. As traffic grows, service providers add capacity to existing networks or purchase and deploy additional systems to keep pace with bandwidth demands and service expansion. Fiber optic networks are expensive and complex, and service providers have traditionally experienced significant challenges in generating new revenue while reducing operating and capital costs.

Increased Demand for Network Capacity

The global market for optical communications equipment is estimated by Ovum-RHK, a third party industry analyst, to be nearly $12 billion in 2006. Our DTN System currently competes in the wavelength division multiplexing segments of this market, which we estimate to be $3.7 billion in 2006. We intend to address a larger portion of the optical communications equipment market opportunity with enhancements to our existing DTN System and with new product releases in the future.

Drivers of Increases in Demand for Network Capacity

We believe that a number of trends in the communications industry are driving growth in demand for network capacity and ultimately will increase demand for optical communications systems, including our DTN System. These trends include:

Growth of Internet usage and Internet protocol traffic. Internet protocol network traffic continues to grow significantly as bandwidth consumed per Internet user and the total number of Internet users increases;

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Increasing broadband penetration and high capacity services. Communications service providers are offering broadband internet access to an increasing number of subscribers to support voice, video and high speed data offerings. In addition, adoption of new consumer applications such as video and music downloads and business applications such as videoconferencing necessitates an increase in network capacity to accommodate high-quality delivery of these bandwidth-intensive services; and

Availability of more bandwidth capacity. Competition, particularly in the United States, among cable and communications service providers in providing bundled services such as the Triple Play (voice, video and data) has encouraged greater consumption of bandwidth.

Challenges Faced by Communications Service Providers

Service providers face significant challenges in meeting increasing bandwidth demands, including:

Price competition pressuring network costs. Competition between communications service providers places pressure on service pricing and thus network costs. The optical communications network is a significant source of overall network cost, and thus service providers are aggressively seeking ways to reduce their optical network operating and capital costs;

Operational complexity. Optical communications network design, planning and engineering involves considerable complexity. This complexity is costly and may slow network expansion and service delivery which, in some cases, results in lost revenue;

Limited service reach. Many network operators have optical facilities that pass through small- to mid-sized cities but determine that it is cost-prohibitive to deploy expensive optical systems that would allow them to offer services to potential customers in these locations;

Slow service provisioning. Optical communications networks often require fixed allocation of bandwidth between customer sites. Communications service providers often must add capacity to their networks to accommodate new subscribers and services. Adding capacity generally involves complex and costly re-engineering of the existing network and a lengthy time period to implement, test and prepare the network to provide service;

Lack of protection and management features. Most traditional long-haul optical communications systems do not offer protection capabilities to restore service in the event of equipment or fiber failure. As a result, communications service providers must purchase, deploy, and manage additional equipment to support protected services, which further increases cost and network complexity; and

Exposure to equipment failures. Traditional optical communications systems and sub-systems contain dozens of discrete interconnected optical components. Most failures occur at these connections resulting in reduced system reliability and potential loss of service.

Limitations of Traditional Optical Approaches

Optical Components and Sub-systems

Optical component technology today shares many characteristics with electronic component technology in the 1950 s. At that time, all electronic devices were comprised of discrete components, each requiring a separate package to perform a given function. As in traditional systems today, individual components were largely manually-wired to their packages, resulting in higher cost and lower reliability. Due to the numerous discrete connected parts, electronic systems were physically

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large, consumed significant amounts of power and were prone to failure. These problems were significantly reduced with the advent of the integrated circuit, which led to the proliferation of high-performance, mass-market, low-cost and reliable semiconductor chips suitable for a wide range of computing applications.

Several companies have developed forms of optical sub-system integration, which consist of co-packaging discrete components within a common module. Optical subsystems provide modest space and package savings and some cost reductions in final production and testing. However, we believe that the total cost savings associated with these devices is limited because each must undergo its own manufacturing, separation, testing and production process steps before final integration within a subsystem package. In addition, we believe that these optical subsystems approaches provide minimal improvement in quality or reliability compared to discrete optical components.

Optical Communications Systems

Optical components and sub-systems are the key building blocks of traditional systems. Traditional systems vendors typically rely on a limited number of component and sub-system suppliers, resulting in limited product differentiation. In addition, the ability of traditional systems vendors to benefit from photonic integration is constrained by the development efforts of their optical component and sub-system suppliers.

Optical communications systems typically transport communications signals between cities as wavelengths and switch or add/drop those signals using digital electronics at network access points where services are provided. Most optical communications networks utilize wavelength division multiplexing technology that transmits multiple signals, each as separate colors of light, or wavelengths, on a single fiber in a communications service provider s network. The principal benefit of wavelength division multiplexing systems is that they enable the transmission of large amounts of data on multiple wavelengths over a single optical fiber. In optical communications networks, communications service providers cannot access or manage these wavelengths of light, or analog signals, and must convert the wavelengths of light to electrical or digital signals. Once this traffic has been converted into the digital domain, it can be processed by the communications service provider. This processing can include adding/dropping, monitoring or regenerating the traffic. After the digital signal is processed, it is converted back to wavelengths of light so that it can be transported to the next network destination. The process of converting the optical signal to an electrical signal for processing and then converting it back to an optical signal to enable digital processing is known as optical to electrical to optical conversion. Optical to electrical to optical conversion enables access to data that allows communications service providers to differentiate their networks and to generate revenue through value-added services. Optical to electrical to optical conversion utilizing traditional systems can be expensive.

With some traditional systems, communications service providers must choose at multiple network access points whether to utilize a wavelength division multiplexing system that enables high-performance digital management and processing but with high optical to electrical to optical conversion costs, or to use an all-optical architecture that reduces optical to electrical to optical conversion costs but also may limit service reach and add cost.

Traditional Wavelength Division Multiplexing Systems

Traditional wavelength division multiplexing systems have several disadvantages, including:

- significant capital cost, space and power requirements;
- requirement of discrete components to execute optical to electrical to optical conversions for each wavelength, which adds significant cost and reduces reliability;

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expansion of the network is often manually intensive as communications service providers may need to redesign the network, re-allocate available wavelengths or deploy additional hardware at multiple locations each time a new circuit is added;

limited flexibility to alter traffic flows because dedicated network capacity must be purchased and deployed in advance; and

high costs associated with implementing advanced features, such as network-wide provisioning or optical layer protection, because additional equipment may be required.

All-Optical Communications Systems

Several optical communications systems vendors have attempted to reduce the cost of transporting data on optical networks by limiting the need for optical to electrical to optical conversions. The resulting architecture, known as the all-optical network, utilizes a new generation of wavelength division multiplexing systems to manage and switch traffic as analog light waves. Reconfigurable optical add/drop multiplexers and wavelength selectable switches are examples of all-optical systems. However, we believe these all-optical approaches possess inherent weaknesses, including:

limited ability to digitally process the data, which prevents these systems from efficiently adding and dropping traffic at intermediate network access points; this can result in a reduced network footprint and decreased revenue opportunities for communications service providers, particularly in smaller regions and markets;

more costly and time-consuming network planning and service provisioning, because adding new services requires complex engineering calculations involving power levels, dispersion compensation and other optical non-linear effects;

higher installation costs, because this process may require complicated components to minimize signal degradation over long distances; all-optical systems also lack the ability to effectively view network performance statistics and reconfigure traffic patterns; and

overall network capacity can be limited by wavelength blocking, which is the inability to use wavelengths of light because they are already in use in another part of the network.

We believe significant demand exists for an optical communications system that is simple and easy to operate and that reduces operating and capital costs for communications service providers.

The Infinera Solution

Our PIC technology facilitates a network architecture that allows communications service providers to realize the benefits of both wavelength division multiplexing and digital processing more fully and cost-effectively. We believe that our DTN System and our Digital Optical Network architecture enables the improvement of the economics, operating simplicity, flexibility, reliability and scalability of our customers optical networks.

Our PICs enable our DTN System to provide lower-cost optical to electrical to optical conversions at every network access point to provide communications service providers with the ability to digitally process the information being transported across their optical networks. Our DTN System s software enables our customers to leverage this digital information to simplify and speed the delivery of differentiated services and to optimize the utilization of their optical networks.

Our DTN System is designed to enable the Digital Optical Network architecture for long-haul and metro optical transport systems of communications service providers and to offer the following key technical benefits:

Photonic integration. Our DTN System integrates the functionality of over 60 discrete optical components within a single PIC pair, reducing capital expenditure and physical space

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requirements for a given amount of optical network capacity. Our PIC technology also enables our DTN System to allow service providers to add 10 wavelengths of 10 Gbps capacity concurrently, as compared to one wavelength in traditional systems;

Digital processing. Our DTN System processes traffic digitally, which ensures significantly greater signal quality and network management flexibility than analog, or all optical, systems. With our DTN System, communications traffic can be cost-effectively added/dropped, monitored and regenerated through digital processing of data; and

High value-add software content. Our DTN System s software utilizes digital data to enable network provisioning, management, testing and control that provides intelligence not available in traditional optical communications systems.

These distinctive technical features provide significant advantages to our customers, including:

Operating simplicity and cost savings

- *Ease of deployment and scalability*. Our DTN System deploys optical capacity in 100 Gbps increments, which enables our customers to rapidly deploy the initial DTN System and to add capacity to existing DTN Systems in less time and with fewer service calls than with traditional systems;

- *Management and personnel*. Our DTN System offers built-in software intelligence to route and signal services across complex optical communications networks. In addition, our DTN System s digital protection and manageability enables carriers to offer a broad range of service qualities without requiring a separate synchronous optical network, or its international equivalent, synchronous digital hierarchy, or optical switching layer for protection and management. These features are designed to provide our customers with flexible management and control of their networks while significantly reducing the amount of information technology personnel and hours dedicated to planning, engineering and operating their optical communications networks; and

- *Efficiency and reliability*. Given its high level photonic integration and digital processing, our DTN System occupies a fraction of the physical space, generally consumes less power than traditional systems for a given amount of capacity, enables simplified testing and is designed to improve system reliability. We are able to deliver both increased simplicity and reliability to our customers through our differentiated PIC technology and unique approach to optical networking architecture. By enabling frequent optical to electrical to optical conversions across their optical networks, we allow our customers to manipulate traffic in the digital domain, which we believe is simpler than architecting traffic and provisioning services with all-optical systems. Likewise, our PICs efficiently perform optical to electrical to optical conversions without a need for dozens of discrete components, which in turn require hundreds of failure-prone individual connections. As such, we believe our customers service quality can be improved significantly due to our DTN System s simplified product design.

Enhanced revenue generation

- *Expand services reach*. Our DTN System significantly lowers optical to electrical to optical conversion cost, which enables our customers to access markets cost-effectively that had previously not been served due to cost constraints. This provides our customers with new revenue opportunities and can reduce or eliminate the cost paid to other service providers for use of their networks to complete a services connection. Our DTN System also supports a variety of communications interfaces, including separate synchronous optical network/synchronous digital hierarchy, Gigabit and 10 Gigabit Ethernet;

- *Optimal use of network capacity*. Our DTN System enables communications service providers to combine streams of network traffic from various points throughout the network

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onto a single wavelength, thereby optimizing existing capacity and increasing revenue opportunities. In contrast, traditional systems often require that communications service providers reserve an entire wavelength for a single stream of traffic, which may consume only a fraction of the available capacity; and

- *Accelerate service provisioning*. Our DTN System s ability to deploy optical capacity in 100 Gbps increments and to process and manage data at each DTN System location remotely enables communications service providers to add customers and provision new services more rapidly than traditional optical communications systems; and

Capital cost savings. Our DTN System can require less capital expenditure for a given amount of optical network capacity. We believe that photonic integration enables a faster rate of innovation than is possible using conventional discrete optical components and will result in a continued decline in costs and complexity.

The Infinera Strategy

Our goal is to be a preeminent provider of optical systems to communications service providers. Key aspects of our strategy are:

Increase our customer footprint. We initially targeted North American competitive long-haul service providers. We intend to increase penetration of our installed base of communications service providers while also targeting new U.S. and international communications service providers, including U.S. regional bell operating companies, international postal, telephone and telegraph companies, cable multiple system operators and U.S. competitive local exchange carriers;

Penetrate adjacent markets. We believe that our PIC technology can benefit the metro core and metro access networks in the same way it does long-haul networks. We intend to increase our addressable market by adding functionality to our DTN System by developing new products and by creating the service and support infrastructure needed to address these markets;

Maintain and extend our technology lead. We intend to incorporate the functionality of additional discrete components into our PICs and to pursue further functional integration in our DTN System in order to enhance the performance, scalability and economics of our DTN System;

Deliver systems to scale and deliver additional functionality. Our DTN System is, to our knowledge, the only commercially-available system which provides 100 Gbps of transport capacity on a single line card. We recognize the need to continually increase our scalability and functionality to maintain product leadership in optical transport networks as demonstrated by expanding our system transport capacity from 400 Gbps to 800 Gbps in 2006; and

Continue investment in PIC manufacturing activities. We believe that our manufacturing capabilities serve as a competitive advantage and intend to continue to invest in the manufacturing capabilities needed to produce new generations of our PICs.

Products

Infinera DTN System

Our DTN System utilizes our PIC technology to enable digital processing and management of data with the capability both to generate wavelength division multiplexing wavelengths and to add, drop, switch, manage, protect and restore network traffic digitally. Our DTN System is comprised of two elements, a Digital Transport Node, or DTN, which houses our PIC and enables optical to electrical to optical conversion, and an optical line amplifier, or OLA, which extends the optical reach between

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DTNs. The DTN can automate the connection of circuits and provisioning of new services without costly and cumbersome manual intervention.

Our DTN System is modular in design to enable our customers with the ability to add capacity in a cost-efficient manner. The initial deployment of our DTN System at a customer involves the installation of common equipment, which includes a chassis, optical line amplifiers and related equipment. Customers can purchase additional common equipment to expand the reach of the DTN System and can increase the capacity of existing common equipment for the DTN System by purchasing our Digital Line Modules, or DLMs, Tributary Adapter Modules, or TAMs and Tributary Optical Modules, or TOMs. Each DTN System is composed of one or two half rack chassis, each of which supports up to 4 DLM cards. Each DLM card in turn supports up to 5 TAMs. Each DLM contains a pair of PICs that provide 100 Gbps of transport capacity; thus, a single DTN System supports up to 800 Gbps (8 DLMs x 100 Gbps each) of transmit/receive capacity per fiber pair. The individual TAMs serve as client-side interface modules, which support line rates from 155 Mbps to 10 Gbps. Given both the density and the modular architecture of each DTN, our DTN System enables significant flexibility and scalability for communications service providers.

Our DTN System is carrier-class, which means that it complies with applicable Telcordia and equivalent major international standards for central office-based network elements. Our DTN System supports a broad range of optical service interfaces including Ethernet (Gigabit Ethernet and 10 GbE) and separate synchronous optical network/synchronous digital hierarchy (OC-3/STM-1, or 155 Mbps, to OC-192/STM-64, or 10 Gbps).

Infinera Optical Line Amplifier

Our OLA is a bidirectional amplifier that extends the optical reach between DTNs. Communications service providers purchase our OLAs for network access points where customer access to data is not required. Our OLA is a small form-factor device that can be managed seamlessly within the DTN System.

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Infinera IQ Network Operating System and Management Suite

Our DTN System utilizes proprietary embedded software, the IQ Network Operating System, to enable our customers to simplify and speed up the tasks they perform to deliver, differentiate, and manage services and to optimize the utilization of their networks. The IQ Network Operating System software utilizes the DTN System s digital switching and IP-based technologies, including generalized multiprotocal label switching for end-to-end provisioning, protection and restoration services, and a host of performance monitoring and software-definable testing capabilities.

In addition to our IQ Network Operating System software, we offer a broad set of standards-based network and element management tools and Operations Support System integration interfaces. Our management suite software includes our Digital Network Administrator, a scalable, robust, feature-rich Element Management System, and our Graphical Node Manager, an easy-to-use web-based management interface.

Technology

Digital Optical Network Architecture

Our founders have experience in the optical communications market and understood the inherent limitations of both traditional wavelength division multiplexing systems and all-optical networking systems and sought to develop a product that offered the key benefits of both approaches. They founded Infinera with a vision to increase the functionality and improve the economics of optical transport systems. To that end, our core engineering team is comprised of optical component and systems experts who have collaborated to create an innovative optical communications architecture that is designed to combine enhanced performance, system-wide simplicity and efficiency, with the ability to be manufactured in a cost-efficient manner. We have focused our efforts, time and capital on developing our Digital Optical Network architecture and DTN System based on our PIC technology.

Our Digital Optical Network architecture is based on our belief that network operators can expand service reach, expedite service provisioning, ensure reliability and more effectively manage, monitor and scale their networks by processing data digitally rather than in analog format. We further believe that the key to delivering this capability in a cost-effective manner is integrating the functionality of multiple discrete devices into a single set of semiconductor chips. This integration allows us to eliminate separate optical packages for each discrete optical device, which we believe is the largest cost challenge facing traditional systems. This integration has further enabled us to provide additional functionality and intelligence to our optical communications systems.

Infinera PIC

We believe that our proprietary PICs are a key source of our value proposition and competitive advantage. We manufacture and package our PICs at our own facilities for use exclusively with our DTN System. We began the simultaneous design and manufacture of our PICs shortly after we were founded in December 2000. We employ a multi-disciplinary approach towards the development and manufacturing of our PICs, with significant interaction between our manufacturing, system engineering and advanced technology groups. As a leader in the development of photonic integration, we have protected the intellectual property associated with our PIC manufacturing through a combination of trade secrets, patents and contractual protections. We believe that as a result of the combination of the multiple disciplines that were required to develop our PIC, together with the intellectual property protections that we have established, it will be difficult for others to duplicate the technology we have developed.

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Our DTN System transmits 100 Gbps of optical capacity, utilizing a pair of PICs, one transmitter PIC and one receiver PIC. Our transmitter PIC integrates the functionality of 51 optical components onto a single chip, including lasers and modulators. In addition, our receiver PIC integrates the functionality of 11 components onto a single chip, including photodetectors and an optical de-multiplexer.

We expect our PIC technology to enable continued innovation in additional applications and systems beyond the optical transport market currently being served by the DTN System. In March 2006, we demonstrated a next generation PIC prototype that is capable of transporting 1.6 terabits of data. We believe this is 40 times the capacity of the most advanced commercial discrete photonics devices today.

Customers

Our DTN System has been sold to telecommunications carriers, cable operators, internet content providers and other service providers. As of March 31, 2007, we have sold our DTN System for deployment in the optical network of 28 customers worldwide, including:

BOREAS Net;

Citynet, LLC;

FLAG Telecom Group Limited;

FPL Fibernet;

Freenet Cityline GmbH;

Global Crossing International Networks Ltd.;

Integra Telecom Holdings, Inc.;

Internet2;

Interoute Communications Limited;

Level 3 Communications;

Mid-Atlantic Broadband Cooperative;

Qwest Communications International, Inc.; and

XO Communications Services, Inc.

Level 3 and Broadwing Corporation, which Level 3 acquired in January 2007, together accounted for approximately 75% of our revenue in 2006.

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Support and Services

We offer our customers a range of support offerings, including product training, installation and deployment services, extended warranties and 24x7 multi-level technical support. These product support services consist of software warranty, updates and unspecified upgrades and product support. Our support services are provided by our employees and third-party support partners. We believe that providing ongoing support is critical to successful long-term relationships with, and follow-on sales to, our customers. We are committed to providing our customers with the highest levels of support and service.

Sales and Marketing

We market and sell our DTN System and related support services primarily through our direct sales force, supported by marketing and product management personnel. We may also use distribution or support partners to enter new markets or when requested by a potential customer. Our sales team has significant previous experience with the buying process and sales cycles typical of high-value telecommunications products. We expect to continue to add sales and support employees as we grow our business.

The sales process for our DTN System entails discussions with prospective customers, analyzing their existing networks and identifying how they can utilize our DTN System capabilities within their network. This process requires developing strong customer relationships, and we expect to leverage our sales force and customer support capabilities to establish relationships with both domestic and international service providers.

Over the course of the sales cycle, service providers often test our DTN System before buying. Prior to commercial deployment, the service provider will generally perform a field trial of our DTN System. Upon successful completion, the service provider generally accepts the products installed in its network and may continue with commercial deployment of additional DTN systems. We anticipate that our sales cycle, from initial contact with a service provider through the signing of a purchase agreement, may, in some cases, take several quarters.

Direct Sales Force. Our sales team sells directly to service providers worldwide. We maintain sales presences throughout the United States as well as in China, France, Germany, Japan, South Korea and the United Kingdom.

Indirect Sales Force. We have and will continue to employ business consultants, resale partners and sales agents to assist in our sales efforts to accelerate and strengthen our customer relationships. We expect to work with business partners to assist our customers in the deployment and maintenance of our systems and have entered into distribution and resale agreements to facilitate the sale of our DTN System in certain international markets.

Marketing and Product Management. Our product management team is responsible for defining the product features and roadmap required to maximize our success in the marketplace. Product management supports our sales efforts with product and application expertise. Our marketing team works to create demand for our DTN System by communicating our value proposition and differentiation in direct customer interaction, public relations, tradeshows, events and web and other marketing channels.

Research and Development

Continued investment in research and development is critical to our business. To this end, we have assembled a team of engineers with expertise in various fields, including systems, sub-systems

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and components. Our research and development efforts are currently focused in Sunnyvale, California, Allentown, Pennsylvania, Columbia, Maryland and Bangalore, India. We have invested significant time and financial resources into the development of our Digital Optical Network architecture, our DTN System, including the IQ Network Operating System and Management Suite software, the PIC and our manufacturing capabilities. We will continue to expand our product offerings and capabilities in the future and plan to dedicate significant resources to these continued research and development efforts. We are continually increasing the scalability and software features of our current DTN System, and developing additional functionality and new products, including products for metro applications. We are also working to develop new generations of PICs, and we intend to leverage further integration in our Digital Optical Network architecture and our DTN System through continued research and development and investments in our manufacturing capabilities.

Our research and development expenses were $46.3 million in 2004, $25.0 million in 2005, $39.0 million in 2006 and $16.1 million in the three months ended March 31, 2007.

Manufacturing

We have invested significant time and capital to develop and improve the manufacturing process that we use to produce and package our PIC. This includes significant investments in personnel and the facilities to manufacture and package our PIC in Sunnyvale, California and Allentown, Pennsylvania. We also have invested in automating our manufacturing process and in training and maintaining the quality of our manufacturing workforce. As a leader in the development of photonic integration, we have protected the intellectual property associated with our PIC manufacturing through a combination of trade secrets, patents and contractual provisions. We believe that as a result of the combination of the multiple disciplines that were required to develop our PIC, together with the intellectual property protections that we have established, it will be difficult for others to duplicate the technology we have developed. Our manufacturing process has been developed over several years and is protected by a significant number of trade secrets. We believe that the trade secrets associated with the manufacturing and packaging of our PIC provide us with a significant competitive advantage.

We outsource manufacturing of certain components of our DTN System. Our contract manufacturers manufacture our DTN System based on our specifications and bill of materials. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in product specifications or delivery schedules. To date, we have not experienced any significant delays or material unanticipated costs resulting from the use of these contract manufacturers; however, such a strategy involves certain risks, including the potential absence of adequate capacity, the unavailability of or interruptions in access to certain process technologies, and reduced control over delivery schedules, manufacturing yields, quality and costs. Despite outsourcing manufacturing operations for cost-effective scale and flexibility, we perform rigorous in-house quality control testing to ensure the reliability of our DTN Systems.

Shortages in components that we use in our DTN System are possible and our ability to predict the availability of such components may be limited. Some of these components are available only from single or limited sources of supply. Our DTN System includes some components that are proprietary in nature and only available from a single source, as well as some components that are generally available from a number of suppliers. In some cases, significant time would be required to establish relationships with alternate suppliers or providers of proprietary components. We do not have any long-term contracts with any component providers that guarantee supply of components or their manufacturing services. If we encounter difficulty continuing our relationship with a supplier, or if a supplier is unable to meet our needs, we may encounter manufacturing delays that could adversely affect our business. Our ability to timely deliver products to our customers would be materially adversely impacted if we needed to qualify replacements for any of a number of the components used in our DTN Systems.

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We believe that our current manufacturing facilities can accommodate an increase in capacity for PIC production sufficient for the foreseeable future. Given the competitive advantage we believe is provided by our PIC product capabilities, we are continually investing in our manufacturing processes; however, we anticipate that increasing and enhancing production at this facility will not result in significant additional capital expenditures and personnel costs.

Backlog

As of December 31, 2006, our backlog was $32.8 million. These orders are subject to future events that could cause the amount or timing of the related revenue to change, and, in certain cases, may be cancelled without penalty. We do not believe that backlog should be viewed as an indicator of future performance. A backlogged order may not result in revenue in a particular period, and the actual revenue may not be equal to our backlog estimates. Our presentation of backlog may not be comparable with that of other companies in our industry.

Competition

The optical communications network equipment market is highly competitive. Competition in this market is based on any one or a combination of the following factors:

- price;
- functionality;
- existing business and customer relationships;
- the ability of products and services to meet customers immediate and future network requirements;
- installation capability;
- services;
- scalability; and
- manufacturing capability.

Competition in the optical communications market is dominated by a small number of very large, multi-national companies. Many of our competitors have substantially greater name recognition and technical, financial, and marketing resources, and greater manufacturing capacity, as well as better established relationships with the incumbent carriers, than we do. Many of our competitors have more resources to develop or acquire, and more experience in developing or acquiring, new products and technologies and in creating market awareness for these products and technologies. In addition, many of our competitors have the financial resources to offer competitive products at below market pricing levels that could prevent us from competing effectively. Further, many of our competitors have built long-standing relationships with some of our prospective customers and have the ability to provide financing to customers and could, therefore, have an inherent advantage in selling products to those customers.

Our competitors include current wavelength division multiplexing suppliers, such as Alcatel-Lucent, Ciena, Cisco Systems, Fujitsu Limited, Huawei Technologies Co. Ltd., LM Ericsson Telephone Co., NEC Corporation, Nortel Networks, Siemens Systems GmbH, and ZTE Corporation. These companies have historically set the competitive benchmarks for price and functionality. There are also

smaller companies, including startups, which have announced plans or developed products that would compete for long-haul and metro optical transport business. We believe that we achieved over 30% of the market share for all 10 Gbps long-haul interface ports shipped worldwide in 2006.

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We also face additional competition in certain market segments from companies which offer one or more products that compete directly or indirectly with our DTN System. In addition, we may compete with other companies as we expand into new markets or as other companies develop products that are competitive with us.

Intellectual Property

Our success as a company depends upon our ability to protect our core technology and intellectual property. To accomplish this, we rely on a combination of intellectual property rights, including patents, trade secrets, copyrights and trademarks, as well as customary contractual protections.

We rely primarily on trade secret protection for our PIC and PIC manufacturing processes, including design, fabrication and testing of our PICs. However, there can be no assurances that trade secrets will be sufficient to provide us with a competitive advantage or that others have not or will not reverse engineer our designs or discover, develop or disclose the same or similar designs and manufacturing processes.

As of March 31, 2007, we held 57 U.S. patents and one international patent expiring between 2021 and 2024, and have 75 U.S. and 30 foreign pending patent applications. We do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims.

We may not receive competitive advantages from the rights granted under our patents and other intellectual property. Any patents granted to us may be contested, circumvented or invalidated over the course of our business, and we may not be able to prevent third parties from infringing these patents. Therefore, the exact effect of the protection of these patents cannot be predicted with certainty.

We believe that the frequency of assertions of patent infringement is increasing as patent holders, including entities that are not in our industry and who purchase patents as an investment or to monetize such rights by obtaining royalties, use such actions as a competitive tactic as well as a source of additional revenue. We have been sued by Cheetah Omni for alleged infringement of their patent. See the section titled Legal Proceedings for additional information regarding this lawsuit. Any claim of infringement from a third party, even those without merit, could cause us to incur substantial costs defending against such claims, and could distract our management from running our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our DTN System. In addition, we might be required to seek a license for the use of such intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we may be required to develop non-infringing technology, which would require significant effort and expense and may ultimately not be successful.

In addition to these protections, we generally control access to and the use of our proprietary software and other confidential information. This protection is accomplished through a combination of internal and external controls, including contractual protections with employees, contractors, customers, and partners, and through a combination of U.S. and international copyright laws. We incorporate a number of third party software programs into our DTN System pursuant to license agreements.

We license some of our software pursuant to agreements that impose restrictions on our customers ability to use such software, such as prohibiting reverse engineering and limiting the use of copies. We also seek to avoid disclosure of our intellectual property by relying on non-disclosure and assignment of intellectual property agreements with our employees and consultants that acknowledge our exclusive ownership of all intellectual property developed by the individual during the course of his

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or her work with us. The agreements also require that each person maintain the confidentiality of all proprietary information disclosed to them. Other parties may not comply with the terms of their agreements with us, and we may not be able to enforce our rights adequately against these parties. We also rely on contractual rights to establish and protect our proprietary rights in our DTN System.

Employees

As of March 31, 2007, we had 617 employees. A total of 124 of those employees were located outside of the United States. None of our employees is represented by labor unions or covered by a collective bargaining agreement. We have not experienced any work stoppages, and we consider our employee relationships to be good.

Facilities

In Sunnyvale, California, we lease approximately 120,000 square feet of office and manufacturing space pursuant to leases that expire between 2007 and 2014. We lease approximately 38,500 square feet of office and manufacturing space in Columbia, Maryland, 35,000 square feet in Annapolis Junction, Maryland and 25,000 square feet in Allentown, Pennsylvania pursuant to leases that expire in 2008, 2012, and 2009, respectively. Internationally, we lease sales office space in Beijing, China that expires in 2007 and we have two leases in Bangalore, India for approximately 40,000 square feet used for research and development that expire in 2009 and 2011. We intend to add new facilities and to expand existing facilities as we add employees, and we believe that suitable additional or substitute space will be available as needed to accommodate any such expansion of our operations.

Legal Proceedings

On May 9, 2006, we and Level 3 were sued by Cheetah Omni LLC for alleged infringement of patent No. 6,795,605, and a continuation thereof. On May 16, 2006, Cheetah filed an amended complaint, which requested an order to enjoin the sale of our DTN System and to recover all damages caused by the alleged willful infringement including any and all compensatory damages available by law, such as actual and punitive damages, attorneys fees, associated interest and Cheetah s costs incurred in the lawsuit. Cheetah s complaint does not request a specific dollar amount for these compensatory damages. We are contractually obligated to indemnify Level 3 for damages suffered by Level 3 to the extent our product is found to infringe, and we have assumed the defense of this matter. On July 20, 2006, we and Level 3 filed an amended response denying all infringement claims under patent No. 6,795,605 and asserting that the claims of the patent are invalid and that the DTN System does not infringe the patent. On November 28, 2006, Cheetah filed a second amended complaint and added patent No. 7,142,347 to the lawsuit. On December 18, 2006, we and Level 3 filed responses to Cheetah s second amended complaint denying all infringement claims under patent No. 7,142,347, and we and Level 3 asserted counterclaims against Cheetah asserting that the claims are invalid and that the DTN System does not infringe the patents.

On January 30, 2007, Cheetah filed a third amended complaint adding additional assertions of infringement for the two patents in suit. On February 16, 2007, we and Level 3 filed responses to Cheetah s third amended complaint denying all infringement claims, and we and Level 3 asserted counterclaims against Cheetah asserting that the claims of the patents are invalid and that the DTN System does not infringe the patents.

On March 14, 2007, we submitted requests to the U.S. Patent and Trademark Office for inter partes reexamination of U.S. Patent Nos. 6,795,605 and 7,142,347. On March 21, 2007, we and Level 3 filed a motion with the court to stay all proceedings in the lawsuit pending the reexamination of U.S. Patent Nos. 6,795,605 and 7,142,347 asking the U.S. Patent and Trademark Office to reexamine the patents based on prior art.

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On April 11, 2007, we and Cheetah filed a joint motion with the court, agreeing to the following: (1) to stay all proceedings in the lawsuit pending a determination by the U.S. Patent and Trademark Office as to whether it will reexamine U.S. Patent Nos. 6,795,605 and 7,142,347; and (2) if the U.S. Patent and Trademark Office decides to reexamine either U.S. Patent No. 6,795,605 or 7,142,347, to stay all proceedings in the lawsuit pending final resolution of the reexamination(s) by the U.S. Patent and Trademark Office. On April 12, 2007, the court granted the motion staying all proceedings in the lawsuit. We believe the suit is without merit and intend to defend ourselves vigorously, but we are unable to predict the likelihood of an unfavorable outcome.

From time to time, we may be subject to other legal proceedings and claims in the ordinary course of our business.

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MANAGEMENT

Executive Officers, Key Employees and Directors

Our executive officers, key employees and directors, and their ages and positions as of March 31, 2007, are set forth below:

Name	Age	Position
Jagdeep Singh	39	Chairman, President and Chief Executive Officer
Thomas J. Fallon	45	Chief Operating Officer
David F. Welch, Ph.D.	46	Chief Marketing and Strategy Officer
Duston M. Williams	48	Chief Financial Officer
Scott A. Chandler	39	Vice President, Worldwide Sales
Michael O. McCarthy III	41	Vice President and General Counsel
William R. Cumpston	45	Vice President, Systems Engineering
Frederick A. Kish, Jr., Ph.D.(1)	40	Vice President, PIC Development and Manufacturing
Drew D. Perkins(1)	43	Chief Technology Officer
Paul M. Whitney(1)	49	Vice President, Human Resources
Alexandre Balkanski, Ph.D.(3)(4)	46	Director
Kenneth A. Goldman(2)	57	Director
Reed E. Hundt(4)	59	Director
Hugh C. Martin(2)(3)	53	Director
Dan Maydan, Ph.D.(2)	71	Director
Carl Redfield(3)(4)	60	Director
Pradeep S. Sindhu, Ph.D.	54	Director

(1) Key employee
(2) Member of Audit Committee
(3) Member of Compensation Committee
(4) Member of Nominating and Corporate Governance Committee

Jagdeep Singh co-founded our company and has served as our President and Chief Executive Officer since January 2001, and as Chairman of our board of directors since March 2001. From December 1999 to December 2000, Mr. Singh served as co-founder and Chief Executive Officer of OnFiber Communications, Inc., or OnFiber, an optical telecommunications carrier. From January 1998 to March 1999, Mr. Singh served as co-founder and Chief Executive Officer of Lightera Networks, or Lightera, an optical switching equipment company, and upon Ciena Corporation s acquisition of Lightera in March 1999, served as President of Ciena s Core Switching Division. Mr. Singh holds a B.S. in Computer Science from the University of Maryland, an M.S. in Computer Science from Stanford University and an M.B.A. from the University of California, Berkeley.

Thomas J. Fallon has served as our Chief Operating Officer since October 2006. From April 2004 to September 2006, Mr. Fallon was our Vice President of Engineering and Operations. From August 2003 to March 2004, Mr. Fallon was Vice President, Corporate Quality and Development Operations of Cisco Systems, Inc., a networking and telecommunications company. From May 2001 to August 2003, Mr. Fallon served as Cisco s General Manager of the Optical Transport Business Unit. Mr. Fallon holds a B.S.M.E. and M.B.A. from the University of Texas at Austin.

David F. Welch, Ph.D. co-founded our company and has served as our Chief Marketing and Strategy Officer since January 2007. From May 2004 to January 2007, Dr. Welch served as our Chief Strategy Officer. From May 2001 to May 2004, he served as our Chief Development Officer/Chief Technology Officer. From May 2001 to November 2006, Dr. Welch also served as a member of our board of directors. From February 2001 to April 2001, Dr. Welch served as Chief Technology Officer of the Transmission Division of JDS Uniphase Corporation, an optical component company. From

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January 1985 to February 2001, Dr. Welch served in various executive roles, including Chief Technology Officer and Vice President of Corporate Development of SDL, an optical component company. Dr. Welch holds a B.S. in Electrical Engineering from the University of Delaware and a Ph.D. in Electrical Engineering from Cornell University.

Duston M. Williams has served as our Chief Financial Officer since June 2006. From December 2004 to June 2006, Mr. Williams was Executive Vice President and Chief Financial Officer of Maxtor Corporation, an information storage solutions company. From July 2003 to November 2004, Mr. Williams served as Chief Financial Officer of Aruba Networks, Inc., a network infrastructure company. From July 2001 to February 2003, Mr. Williams served as Chief Financial Officer of Rhapsody Networks, Inc., a storage networking provider. Mr. Williams holds a B.S. in Accounting from Bentley College and an M.B.A. from the University of Southern California.

Scott A. Chandler has served as our Vice President, Worldwide Sales since November 2004. From May 2003 to November 2004, Mr. Chandler served as our Vice President, Sales for North America. From October 1999 to May 2003, Mr. Chandler held a number of senior sales positions at Sonus Networks, Inc., a voice over IP infrastructure solutions company, including Vice President of Strategic Sales. Mr. Chandler holds a B.S. in Business Administration from Plymouth State College.

Michael O. McCarthy III has served as our Vice President and General Counsel since May 2003. From May 2001 to February 2003, Mr. McCarthy served as Senior Vice President of Worldwide Sales and Support at Ciena Corporation, a communications equipment company. From July 1999 to May 2001, Mr. McCarthy served as Ciena s Senior Vice President and General Counsel. Mr. McCarthy holds a B.A. in Mathematical-Economics from Colgate University and a J.D. from Vanderbilt University s School of Law.

William R. Cumpston has served as our Vice President, Systems Engineering since June 2006. From September 2005 to June 2006, Mr. Cumpston served as the Senior Vice President of Engineering at XenSource Inc., an enterprise grade platform virtualization solution company. From March 2003 to May 2005, Mr. Cumpston served as Chief Executive Officer of CloudShield Technologies, Inc., a provider of IP services control and security. From June 2002 to August 2002, Mr. Cumpston served as a Senior Vice President of Metro Products at Ciena Corporation. From August 1998 to June 2002, Mr. Cumpston served as Vice President, Engineering and Chief Operating Officer at ONI Systems Corporation, a fiber-optic communications equipment company. Mr. Cumpston holds a B.S. in Mathematics from the University of North Carolina.

Frederick A. Kish, Jr., Ph.D. has served as our Vice President, PIC Development and Manufacturing since May 2001. From November 1999 to May 2001, Dr. Kish served as R&D and Manufacturing Development Manager for the Fiber Optics Communications Division of Agilent Technologies, Inc., a measurement and technology company for communications, electronics, life sciences and chemical analysis. Dr. Kish holds B.S., M.S. and Ph.D. degrees in electrical engineering from the University of Illinois at Urbana-Champaign.

Drew D. Perkins co-founded our company and has served as our Chief Technology Officer since May 2001, and as a member of our board of directors from May 2001 to November 2006. From December 1999 to April 2001, he served as co-founder and Chief Technology Officer of OnFiber. From February 1998 to March 1999, Mr. Perkins served as co-founder and Chief Technology Officer of Lightera, and upon Ciena Corporation s acquisition of Lightera in March 1999, served as Chief Technology Officer of Ciena s Core Switching Division. From February 1993 to March 1997, he served in various senior engineering and management roles at FORE Systems, an internet switching equipment company. Mr. Perkins holds a B.S. in Electrical Engineering, Computer Engineering and Mathematics from Carnegie Mellon University.

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Paul M. Whitney has served as our Vice President of Human Resources since October 2006. From June 2004 to August 2006, Mr. Whitney was Vice President, Human Resources for Portal Software, a provider of billing and revenue management products. From December 2001 to November 2003, Mr. Whitney was International HR Director of Ascential Software, a maker of data integration tools. Mr. Whitney holds a B.S in Managerial and Administrative Science and an M.S in Human Resource Management from the University of Aston in Birmingham, United Kingdom.

Alexandre Balkanski, Ph.D. has been a member of our board of directors since October 2001. Dr. Balkanski has been a General Partner at Benchmark Capital, a venture capital firm, since April 2000. From August 1988 to April 2000, Dr. Balkanski was a co-founder and Chief Executive Officer of C-Cube Microsystems Inc., a digital video company. Dr. Balkanski holds a B.S. from Harvard College and an M.A. and a Ph.D. from Harvard University.

Kenneth A. Goldman has been a member of our board of directors since February 2005. Mr. Goldman has been the Executive Vice President and Chief Financial Officer of Dexterra, Inc., a provider of mobile enterprise software, since November 2006. From August 2000 until March 2006, Mr. Goldman served as Senior Vice President, Finance and Administration and Chief Financial Officer of Siebel Systems, Inc., a supplier of customer software solutions and services. From December 1999 to December 2003, Mr. Goldman served as an advisory council member of the Financial Accounting Standards Board Advisory Council. Mr. Goldman serves on the boards of directors of BigBand Networks, Inc., a provider of broadband multimedia infrastructure, Juniper Networks, Inc., an IP network solutions company, and Leadis Technology Inc., a semiconductor company. Mr. Goldman holds a B.S. in Electrical Engineering from Cornell University and an M.B.A. from the Harvard Business School.

Reed E. Hundt joined our board of directors in February 2007. Since 1998, he has acted as Co-Chairman of the Forum on Communications and Society at The Aspen Institute, a public policy organization, and as an independent advisor on information industries to McKinsey & Company, Inc., a management consulting firm. Mr. Hundt served as Chairman of the Federal Communications Commission from 1993 to 1997. Mr. Hundt currently serves on the board of directors of Intel Corporation. Mr. Hundt holds a B.A. in History from Yale University and a J.D. from Yale Law School.

Hugh C. Martin has been a member of our board of directors since July 2003. Since April 2004, Mr. Martin has served as Chairman and Chief Executive Officer of Pacific Biosciences, Inc., a biotechnology company. From September 2003 to April 2004, Mr. Martin acted as a consultant to Kleiner, Perkins, Caufield & Byers, a venture capital firm. From May 2002 to May 2003, Mr. Martin was a consultant to Ciena Corporation. From January 1998 to May 2002, Mr. Martin was the Chairman, President and Chief Executive Officer of ONI Systems Corporation, a fiber-optic communications equipment company. Mr. Martin holds a B.S.E.E. from Rutgers University.

Dan Maydan, Ph.D. has been a member of our board of directors since September 2001. From April 2003 to September 2005, Dr. Maydan served as the President Emeritus of Applied Materials, Inc., a company that manufactures semiconductor equipment, and was a member of its board of directors from June 1992 until March 2006. From December 1993 to April 2003, Dr. Maydan served as President of Applied Materials. Dr. Maydan serves on the boards of directors of Electronics for Imaging, Inc., a digital imaging and print management solutions company, and LaserCard Corporation, a secure ID solutions company. Dr. Maydan holds a B.S. and M.S. in Electrical Engineering from the Israel Institute of Technology and a Ph.D. in Physics from Edinburgh University of Scotland.

Carl Redfield has been a member of our board of directors since August 2006. Since September 2004, Mr. Redfield has served as Senior Vice President, New England executive sponsor, of Cisco Systems, Inc. From February 1997 through September 2004, Mr. Redfield served as Cisco s Senior Vice President, Manufacturing and Logistics. From September 1993 until February 1997,

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Mr. Redfield served as Vice President of Manufacturing of Cisco. Mr. Redfield is a member of the board of directors of VA Software Corporation, an online media, software and e-commerce company. Mr. Redfield holds a B.S. in Materials Engineering from Rensselaer Polytechnic Institute and has completed post-graduate studies at the Harvard Business School.

Pradeep S. Sindhu, Ph.D. has been a member of our board of directors since September 2001. In February 1996, Dr. Sindhu co-founded Juniper Networks, Inc., an IP network solutions company, and served as its Chief Executive Officer and Chairman of its board of directors until September 1996. Since September 1996, Dr. Sindhu has served as Chief Technical Officer and Vice Chairman of the board of directors of Juniper Networks. Dr. Sindhu holds a B.S.E.E. from the Indian Institute of Technology in Kanpur, an M.S.E.E. from the University of Hawaii and a Masters in Computer Science and Ph.D. in Computer Science from Carnegie-Mellon University.

Board Composition

Independent Directors

Our board of directors is currently composed of 8 members. Messrs. Goldman, Hundt, Martin and Redfield and Drs. Balkanski, Maydan and Sindhu qualify as independent directors in accordance with the listing requirements of NASDAQ. The NASDAQ definition of independence includes a series of objective tests, such as that the director is not, and has not been for at least three years, one of our employees and that neither the director, nor any of his family members, has engaged in various types of business dealings with us. In addition, as further required by the NASDAQ rules, our board of directors has made a subjective determination as to each independent director that no relationships exist that, in the opinion of our board of directors, would interfere with his exercise of independent judgment in carrying out the responsibilities of a director. In making these determinations, our directors reviewed and discussed information provided by the directors and us with regard to each director s business and personal activities as they may relate to us and our management.

Selection Arrangements

Two of our current directors were elected pursuant to a voting agreement that we entered into with certain holders of our common and convertible preferred stock. The provisions of this voting agreement will terminate upon the closing of this offering, and there will be no further contractual obligations regarding the election of our directors. Our directors hold office until their successors have been elected and qualified or their earlier death, resignation or removal.

Classified Board

Our amended and restated certificate of incorporation that will become effective as of the closing of this offering provides for a classified board of directors consisting of three classes of directors, each serving a staggered three-year term. Commencing in 2008, a portion of our board of directors will be elected each year for three-year terms. Upon the closing of this offering:

- Drs. Balkanski and Sindhu will be designated Class I directors whose term will expire at the 2008 annual meeting of stockholders;
- Messrs. Martin and Singh and Dr. Maydan will be designated Class II directors whose term will expire at the 2009 annual meeting of stockholders; and
- Messrs. Goldman, Hundt and Redfield will be designated Class III directors whose term expires at the 2010 annual meeting of stockholders.

Our amended and restated certificate of incorporation and amended and restated bylaws that will become effective as of the closing of this offering provide that the number of authorized directors shall

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be determined from time to time by resolution of the board of directors. Any additional directorships resulting from an increase in the number of authorized directors will be distributed among the three classes so that, as nearly as reasonably possible, each class will consist of one-third of the directors. The classification of the board of directors may have the effect of delaying or preventing changes in control of our company. Under Delaware law, our directors may be removed for cause by the affirmative vote of the holders of a majority of our voting stock.

Board Committees

Our board of directors has established an audit committee, a compensation committee and a nominating and governance committee. Our board of directors and its committees set schedules to meet throughout the year and also can hold special meetings and act by written consent from time to time, as appropriate. The independent members of our board of directors also will hold separate executive session meetings regularly at which only independent directors are present, generally at the regularly scheduled meetings of the board of directors. Our board of directors has delegated various responsibilities and authority to its committees as generally described below. The committees will report, as appropriate, their activities and actions to the full board of directors. Each member of each committee of our board of directors qualifies as an independent director in accordance with the NASDAQ standards described above. Each committee of our board of directors has a written charter approved by our board of directors. Upon the effectiveness of the registration statement of which this prospectus forms a part, copies of each charter will be posted on our web site at http://www.infinera.com. The inclusion of our web site address in this prospectus does not include or incorporate by reference the information on our web site into this prospectus.

Audit Committee

The current members of the audit committee of our board of directors are Messrs. Goldman and Martin and Dr. Maydan, each of whom is independent under the rules and regulations of the SEC and the listing standards of NASDAQ. Mr. Goldman chairs our audit committee. In addition to qualifying as independent under the NASDAQ rules, each member of our audit committee can read and understand fundamental financial statements in accordance with NASDAQ Audit Committee requirements.

The audit committee of our board of directors reviews and monitors our corporate financial statements and reporting and our external audits, including, among other things, our internal controls and audit functions, the results and scope of the annual audit and other services provided by our independent registered public accounting firm and our compliance with legal matters that have a significant impact on our financial statements. Our audit committee also consults with our management and our independent registered public accounting firm prior to the presentation of financial statements to stockholders and, as appropriate, initiates inquiries into aspects of our financial affairs. Our audit committee is responsible for establishing procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, and for the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters. In addition, our audit committee is directly responsible for the appointment, retention, compensation and oversight of the work of our independent registered public accounting firm, including approving services and fee arrangements. All related party transactions are subject to approval by our audit committee.

Our board of directors has determined that Mr. Goldman is an audit committee financial expert as defined under SEC regulations and the NASDAQ listing standards. The designation does not impose on Mr. Goldman any duties, obligations or liability greater than that generally imposed on him as a member of our audit committee and our board of directors. Both our independent registered public accounting firm and management periodically meet privately with our audit committee.

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Compensation Committee

The current members of the compensation committee of our board of directors are Messrs. Martin and Redfield and Dr. Balkanski. Dr. Balkanski chairs the compensation committee. The compensation committee reviews, makes recommendations to the board of directors on and approves our compensation policies and all forms of compensation to be provided to our executive officers and directors, including, among other things, annual salaries, bonuses, equity, severance arrangements, change-of-control protections and any other compensatory arrangements (including, without limitation, perquisites and any other form of compensation). In addition, our compensation committee will administer our stock option plans, having the ability to grant stock options and other equity-based awards to individuals eligible for such grants (including our executive officers, but excluding the non-employee members of our board of directors). The compensation committee will also oversee the administration of other material employee benefit plans, including our 401(k) plan, and review and approve various other compensation policies and matters. Among the committee s responsibilities are the preparation of the Compensation Discussion and Analysis and Compensation Committee Report required by the rules of the SEC. Each member of our compensation committee is a non-employee director, as defined in Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act, an outside director, as defined pursuant to Section 162(m) of the Internal Revenue Code and satisfies the NASDAQ independence requirements.

Nominating and Governance Committee

The current members of the nominating and governance committee of our board of directors are Messrs. Hundt and Redfield and Dr. Balkanski. Mr. Redfield chairs the nominating and governance committee. The nominating and governance committee will review and report to our board of directors on a periodic basis with regard to matters of corporate governance, and will review, assess and make recommendations on the effectiveness of our corporate governance policies. In addition, our nominating and governance committee will review and make recommendations to our board of directors regarding the size and composition of our board of directors and the appropriate qualities and skills required of our directors in the context of the then-current make-up of our board of directors. This will include an assessment of each candidate s independence, personal and professional integrity, financial literacy or other professional or business experience relevant to an understanding of our business, ability to think and act independently and with sound judgment, and ability to serve our stockholders long-term interests. These factors, and others as considered useful by our nominating and governance committee, will be reviewed in the context of an assessment of the perceived needs of our board of directors at a particular point in time. As a result, the priorities and emphasis of our nominating and governance committee and of our board of directors may change from time to time to take into account changes in business and other trends, as well as the portfolio of skills and experience of current and prospective directors.

Our nominating and governance committee will lead the search for, select and recommend candidates for election to our board of directors. Consideration of new director candidates typically will involve a series of committee discussions, review of information concerning candidates and interviews with selected candidates. Candidates for nomination to our board of directors typically have been suggested by other members of our board of directors or by our executive officers. From time to time, our nominating and governance committee may engage the services of a third-party search firm to identify director candidates. Our nominating and governance committee will consider candidates proposed in writing by stockholders, provided such proposal meets the eligibility requirements for submitting stockholder proposals for inclusion in our next proxy statement and is accompanied by the required information about the candidate specified in our amended and restated bylaws. Candidates proposed by stockholders will be evaluated by our nominating and governance committee using the same criteria as for all other candidates.

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Code of Business Conduct and Ethics

Our board of directors has adopted a code of business conduct and ethics. The code applies to all of our employees, officers (including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions), agents and representatives, including directors and consultants. Upon the effectiveness of the registration statement of which this prospectus forms a part, the full text of our code of business conduct and ethics will be posted on our web site at http://www.infinera.com. We intend to disclose future amendments to certain provisions of our code of business conduct and ethics, or waivers of such provisions, applicable to any principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions or our directors on our web site identified above. The inclusion of our web site address in this prospectus does not include or incorporate by reference the information on our web site into this prospectus.

Compensation Committee Interlocks and Insider Participation

The compensation committee of the board of directors currently consists of Messrs. Martin and Redfield and Dr. Balkanski. None of our executive officers has ever served as a member of the board of directors or compensation committee of any other entity that has or has had one or more executive officers serving as a member of our board of directors or our compensation committee.

Limitation of Liability and Indemnification

Our amended and restated certificate of incorporation contains provisions that limit the liability of our directors for monetary damages to the fullest extent permitted by Delaware law. Consequently, our directors will not be personally liable to us or our stockholders for monetary damages for any breach of fiduciary duties as directors, except liability for:

- any breach of the director s duty of loyalty to us or our stockholders;
- any act or omission not in good faith or that involves intentional misconduct or a knowing violation of law;
- unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law; or
- any transaction from which the director derived an improper personal benefit.

These limitations of liability do not apply to liabilities arising under federal securities laws and do not affect the availability of equitable remedies such as injunctive relief or rescission.

Our amended and restated certificate of incorporation and amended and restated bylaws, which will each become effective upon the closing of this offering, provide that we are required to indemnify our directors and officers, in each case to the fullest extent permitted by Delaware law. Any repeal of or modification to our amended and restated certificate of incorporation or amended and restated bylaws may not adversely affect any right or protection of a director or officer for or with respect to any acts or omissions of that director or officer occurring prior to that amendment or repeal. Our amended and restated bylaws also provide that we will advance expenses incurred by a director or officer in advance of the final disposition of any action or proceeding, and permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in that capacity regardless of whether we would otherwise be permitted to indemnify him or her under the provisions of Delaware law. We have obtained such a directors and officers liability insurance policy. We have entered and expect to continue to enter into agreements to indemnify our directors and executive officers. With certain exceptions, these agreements provide for indemnification for related expenses including, among other things, attorneys fees, judgments, fines and settlement amounts incurred by

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any of these individuals in any action or proceeding. We believe that these bylaw provisions and indemnification agreements are necessary to attract and retain qualified persons as directors and executive officers. We also maintain directors and officers liability insurance.

The limitation of liability and indemnification provisions in our amended and restated certificate of incorporation and amended and restated bylaws may discourage stockholders from bringing a lawsuit against our directors for breach of their fiduciary duties. They may also reduce the likelihood of derivative litigation against our directors and officers, even though an action, if successful, might benefit us and other stockholders. Further, a stockholder s investment may be adversely affected to the extent that we pay the costs of settlement and damage awards against directors and officers as required by these indemnification provisions. At present, there is no pending litigation or proceeding involving any of our directors or executive officers for which indemnification is sought, and we are not aware of any threatened litigation that may result in claims for indemnification. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, executive officers or persons controlling us, we have been informed that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

Director and Executive Compensation

Director Compensation

Our directors do not currently receive any cash compensation for their services as members of our board of directors or any committee of our board of directors nor do we have a policy of reimbursing directors for travel, lodging and other expenses incurred in connection with their attendance at board or committee meetings. During 2006, each of our non-employee directors who was not a significant stockholder or affiliated with a significant stockholder of ours received an initial stock option award to purchase 75,000 shares of our common stock upon such director becoming a member of our board of directors, plus an additional annual stock option award of 18,750 shares. Furthermore, such directors received an option award of 12,500 shares if they served on our audit committee or compensation committee and an additional 6,250 shares if they served as chairman of our audit committee.

Beginning with the first day of the first full fiscal quarter after the closing of this offering, each non-employee member of our board of directors will be entitled to receive an annual retainer of $20,000 and fees of $2,000 per meeting attended in person and $1,000 per meeting attended telephonically. In addition, each non-employee director serving on our audit committee, compensation committee and nominating and governance committee will be entitled to fees of $1,000 per meeting attended in person or telephonically, and the chair of each such committee will be entitled to additional fees of $1,000, $500 and $500, respectively, per meeting attended in person or telephonically.

Non-employee directors will be entitled to an initial stock option award to purchase 50,000 shares of our common stock upon such director becoming a member of our board of directors. Each initial option will become exercisable for the shares in 48 equal monthly installments. Each year thereafter, each non-employee director will receive an annual stock option award to purchase 12,500 shares of our common stock on the date of our annual stockholders meeting, each of which will vest in 12 equal monthly installments. All such options will be granted at the fair market value on the date of the award.

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The following table sets forth the annual director compensation paid or accrued by us to individuals who were directors during any part of 2006. The table excludes Mr. Singh and Dr. Welch who are named executive officers and who did not receive any compensation from us in their roles as directors in 2006. Dr. Welch s term as a director ended on November 20, 2006.

Director Compensation

For Year Ended December 31, 2006

Name	Option Awards(1) ($)	Options(#)	Grant Date Fair Value of Option Awards($)
Alexandre Balkanski, Ph.D.	$		$
Gregory Galanos(2)			
Kenneth A. Goldman	5,350	37,500	43,650
Vinod Khosla(2)			
Hugh C. Martin	8,999	43,750	50,925
Dan Maydan, Ph.D.	2,804	18,750	21,825
Drew D. Perkins(3)			
Carl Redfield	7,409	75,000	87,300
Thurman J. Rodgers, Ph.D.(4)	507		
Pradeep S. Sindhu, Ph.D.	5,549	18,750	21,825

(1) The value reported above in the Option Awards column is the amount we expensed during 2006 for each director s option award calculated in accordance with SFAS No. 123(R). All awards were granted under our 2000 Stock Plan.
(2) The terms of Messrs. Galanos and Khosla as directors ended on November 20, 2006.
(3) Mr. Perkins did not receive any options for his role as a director, and his term as a director ended on November 21, 2006.
(4) Dr. Rodgers term as a director ended on August 16, 2006.

Executive Compensation

COMPENSATION DISCUSSION AND ANALYSIS

For Named Executive Officers

Overview Compensation Objectives

Our compensation and benefits programs seek to attract and retain our senior executives and to motivate them to pursue our corporate objectives. Through our annual goal setting process, individual objectives are aligned with organizational objectives. We evaluate and reward our executive officers based on their willingness to take a leadership position in improving our internal structures and processes and their ability to identify and exploit opportunities to grow our business. In addition, at the beginning of each year, our compensation committee establishes specific goals and objectives for compensating our employees, including our named executive officers.

Specifically, we have created a compensation program that has a mix of short- and long-term components, cash and equity elements and fixed and contingent payments in the proportions we believe will provide the proper incentives, reward our senior management team and help us achieve the following goals:

- foster a goal oriented, highly-motivated management team whose participants have a clear understanding of business objectives and shared corporate values;

- allocate company resources most effectively in the development of market-leading technology and products;

control costs in each facet of our business to maximize our efficiency;

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enable us to attract, retain and motivate a world class leadership team; and

achieve internal equity across our organization.

Our executive compensation program has been targeted at below median cash compensation and equity compensation at or above the median. With the relatively large equity weighting, this approach seeks to reward our executive officers when we achieve our goals and objectives and generate stockholder returns. At the same time, if our corporate goals are not achieved, a significant portion of the compensation for our key managers is at risk. In this way, our executive compensation is aligned with the interests of our stockholders.

Role of Our Compensation Committee

Our compensation committee approves, administers and interprets our executive compensation and benefit policies. Our compensation committee was appointed by our board of directors, and consists entirely of directors who are outside directors for purposes of Section 162(m) of the Internal Revenue Code and non-employee directors for purposes of Rule 16b-3 under the Exchange Act. Our compensation committee is comprised of Messrs. Martin and Redfield and Dr. Balkanski, and is chaired by Dr. Balkanski.

Our compensation committee has taken the following steps, in consultation with Compensia, a compensation consulting firm that our compensation committee retained, to ensure that our executive compensation and benefit programs are consistent with both our compensation philosophy and our corporate governance guidelines:

evaluated our compensation practices and assisted in developing and implementing the executive compensation program and philosophy;

with input from our management team, developed a competitive peer group composed of public networking equipment companies and performed analyses of competitive performance and compensation levels for us and each of our competitive companies;

developed recommendations with regard to executive compensation structures based on targeting a competitive level of pay as measured against the peer group of companies that were reviewed and approved by our compensation committee and board of directors;

established a practice, in accordance with the rules of NASDAQ, of prospectively reviewing the performance and determining the compensation earned, paid or awarded to our chief executive officer independent of input from him;

established a policy, in accordance with the rules of NASDAQ, to review on an annual basis the performance of our other executive officers with assistance from our chief executive officer and determining what we believe to be appropriate total compensation based on competitive levels as measured against our peer group; and

established a policy to specify grant dates for both new hire and annual retention equity awards as a public company.

Competitive Market Review

The market for experienced management is highly competitive in our industry. We aim to attract and retain the most highly qualified executives to manage each of our business functions. In doing so, we aim to draw upon a pool of talent that is highly sought after by both large and established networking equipment and transport companies in our geographic area and by other competitive companies in development or early stage phases. Established organizations in our industry seek to recruit top talent from emerging

companies in the sector just as smaller organizations look to attract

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and retain the best talent from the industry as a whole. The competition for technical and commercial skills is fierce across the sector and we expect it to remain high for the foreseeable future.

We must match market cash compensation levels and satisfy the day-to-day financial requirements of our candidates through competitive base salaries and cash bonuses. We also compete for key personnel on the basis of our vision of future success; our culture and company values; the cohesiveness and productivity of our teams; and the excellence of our technical and management personnel. In all of these areas, we compete with other emerging networking equipment/optical transport companies. In order to succeed in attracting and retaining top executive talent, we continuously draw upon surveys presented by Compensia, as well as other nationally recognized surveys. Our management and compensation committee review data that analyzes various cross-sections of our industry, as well as relevant geographical areas.

Market Benchmarks: How We Define Our Market and How We Use Market Compensation Data

In 2006, Compensia conducted an executive total compensation review that compares our executive s total compensation levels to those of other executives at our peer companies. Compensia works directly with the compensation committee and management to interpret the results, make certain specific and general recommendations and assist in setting compensation levels for our executive officers.

Defining the Market. For 2006, we used two market references to compare our total compensation practices for our executives and levels to those in the market:

- *Select Peer Group*. We benchmarked our compensation levels for our executives against 17 companies, including a mix of publicly-traded U.S. networking and optical transport companies; and
- *Radford High Technology Industry Report by Aon Consulting*. We reviewed and considered 166 companies with revenue between $200 million and $500 million that were part of a national survey of executive compensation levels and practices that covers approximately 80 positions in over 700 organizations.

Our peer group for benchmarking purposes consisted of the following companies:

- Acme Packet, Inc.
- Agilent Technologies, Inc.
- Broadcom Corporation
- Ciena Corporation
- Cisco Systems, Inc.
- F5 Networks, Inc.
- Foundry Networks, Inc.
- Isilon Systems, Inc.
- JDS Uniphase Corporation
- Juniper Networks, Inc.
- Motorola, Inc.
- Polycom, Inc.
- QUALCOMM Incorporated
- Redback Networks, Inc.
- Riverbed Technology, Inc.
- Sonus Networks, Inc.
- Tellabs, Inc.

Determining Market Levels and Specific Comparisons. We compare our practices and levels by each compensation component, by target annual cash compensation, which includes base salary and target annual incentive opportunity, and by total direct compensation, including base salary, target annual incentive opportunity and annual equity compensation components. The competitive comparisons made in this process are used to determine our approximate position relative to the appropriate market benchmark by compensation component and in the aggregate.

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Executive Compensation Program

Components of our Compensation Program

Our performance-driven compensation program consists of five components:

- base salary;
- annual cash bonuses;
- equity-based incentives;
- benefits; and
- severance/termination protection.

We chose to build our executive compensation program around each of the above elements because each individual component is useful in achieving one or more of the objectives of the program and we believe that, together, they have been and will continue to be effective in achieving our overall objectives. We utilize short-term compensation, including base salary and cash bonuses, to motivate and reward our key executives in accordance with our pay for performance philosophy. We are in the process of implementing and systematizing our review process, with the objective of measuring and providing feedback on individual performance as it relates to the goals we wish to achieve for the company as a whole and the employee individually.

Basis for our Compensation Program

We have an annual goal setting process that is open and collaborative in nature. Executive team members establish their functional objectives taking into account overall corporate goals and incorporating the feedback and commentary of their senior management colleagues and the board of directors. Towards the end of each calendar year, we engage in our annual goal setting process driven by our chief operating officer. In line with established financial objectives, each functional vice president who reports directly to our chief executive officer, submits departmental goals in support of that plan which are then consolidated by our chief operating officer. A meeting is convened and these same vice presidents attend and present their goals to their colleagues for comment and approval. Ultimately, our chief executive officer has final authority with respect to the goals that are established through this process.

To more successfully promote a team-oriented approach to company performance, each executive s annual incentive compensation is based on achievement against the same company performance objectives. We establish one set of company performance-oriented goals against which the entire management team is measured for purposes of determining annual incentive compensation. Annual incentive compensation is paid based on the average of percentage achievement against each of the corporate goals. We see this approach to our annual incentive compensation as an integral part of our culture of collaborative, team-oriented management. Individual performance and achievement against individual goals and objectives is only taken into account in setting base salaries and annual equity awards. The value of equity awards made to our senior executives will vary in value based on our stock price performance. Our senior executives total compensation may vary significantly from year-to-year based on company and individual performance.

Weighting of Elements in our Compensation Program

The use and weight of each compensation element is based on a subjective determination by the compensation committee of the importance of each element in meeting our overall objectives. In general, we seek to put a significant amount of each executive s total potential compensation at risk based on corporate and individual performance. As a result, compensation paid in the form of

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salary and benefits represented less than half of each continuing executive s potential total compensation at target performance levels for 2007. We believe that, as is common in the technology sector, stock option and other equity-based awards are the primary compensation-related motivator in attracting and retaining employees and that salary and bonus levels are secondary considerations to many employees.

Base Salary. Base salary will typically be used to recognize the experience, skills, knowledge and responsibilities required of each executive officer, as well as competitive market conditions. In establishing the 2007 base salaries of our named executive officers, our compensation committee took into account a number of factors, including the executive s seniority, position and functional role and level of responsibility. For executives hired in 2006, we considered the base salary of the individual at his or her prior employment and any unique personal circumstances that motivated the executive to leave that prior position and join our company. In addition, in both cases we considered the competitive market for corresponding positions within comparable geographic areas and industries. For 2006 and 2007, base salaries for our senior executives were and are generally positioned below the median of our peer companies, consistent with our philosophy of linking total reward with performance objectives of the company.

The base salary of our named executive group will be reviewed on an annual basis and adjustments will be made to reflect performance-based factors, as well as competitive conditions. We will not apply specific formulas to determine increases. Generally, executive salaries will be adjusted effective January 1 of each year.

Bonuses. Annual performance bonuses for our executive officers are based on the achievement of company annual goals and objectives and are paid in cash. These objectives may change from year-to-year as the company continues to evolve and different priorities are established, but are subject to the review and approval of the compensation committee. Awards under our bonus programs are based on a thorough quantitative and qualitative review of all the facts and circumstances related to company performance when determining each individual s annual bonus. The compensation committee approves the annual incentive award for the chief executive officer. For all other executive officers, the compensation committee approves the annual incentive award with input from the chief executive officer.

During 2006, we introduced for the first time a management bonus plan which was applicable only to the second half of that year. Bonus targets were tied to revenue and gross margin. There were two levels of bonus dependent upon job title. The chief executive officer and all non-sales vice presidents could achieve 15% of base salary as a bonus for 100% achievement of goals for the second half of 2006 only. For all non-sales employees with a job title at Director level, the target bonus was 7.5% of 2006 base salary. For 2006, there was no maximum on these bonus amounts. For Mr. Chandler, our Vice President of Global Sales, a different variable compensation arrangement was put in place for 2006 that applied to all employees within the sales organization and that was in the form of a commission plan with targets based on invoiced shipments. This directly linked Mr. Chandler s earnings to the key sales related metric and aligned him directly with the rest of the sales team. This variable compensation arrangement provided for Mr. Chandler to be paid a percentage of his base salary as a bonus based on customer orders that were received by us prior to December 31, 2006, and shipped by us and accepted by the customer on or prior to January 31, 2007. The percentage paid to Mr. Chandler was determined so as to provide Mr. Chandler with a compensation payment equal to his base salary upon the achievement of a pre-determined shipment and acceptance threshold or a percentage of his base salary upon the achievement of a percentage of the shipment and acceptance threshold. This arrangement also provided for Mr. Chandler to be paid two times this predetermined percentage for all customer orders that were shipped and accepted by the customer prior to January 31, 2007 above one hundred percent and up to one hundred and twelve and one half percent (112.5%) of the predetermined base shipment and acceptance threshold and for Mr. Chandler

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to be paid three times this percentage for the amount of all customer orders that were shipped and accepted by the customer prior to January 31, 2007 above one hundred and twelve and one half percent (112.5%) of the predetermined base shipment and acceptance amount. Further details of the actual bonus payouts can be reviewed in the table titled Summary Compensation Table.

Under our 2007 Executive Bonus Plan, the corporate objectives for bonuses are a combination of financial related measures. The payouts under the bonus plan will be capped at 200% of targeted bonuses. Failure to achieve threshold performance against operating profit as adjusted for certain items, regardless of the achievement against other measures, will result in no bonus being paid. For 2007, the following target bonus percentages, as a percentage of base salary, will apply: Mr. Singh 100%, Mr. Williams 50%, Mr. McCarthy 40% and Dr. Welch 40%. The targets for our officer bonuses are tied to four financial metrics invoiced shipments, gross margin on invoiced shipments, cash from operations and operating income based on invoiced shipments and have been set to be challenging to achieve. In the future, cash bonuses are expected to be paid in a single installment during the month of February of the year following the measurement year.

Equity-based incentives. We believe that strong long-term corporate performance is achieved with a corporate culture that encourages long-term performance by our executive officers through the use of stock-based awards. Our equity incentive plans have been established to provide certain of our employees, including our executive officers, with incentives to help align those employees interests with the interests of our stockholders. We have not adopted stock ownership guidelines, and, other than for our co-founders, our equity incentive plans have provided the principal method for our executive officers to acquire equity or equity-linked interests in our company. Prior to this offering, we granted equity awards under our 2000 Stock Plan. In connection with our initial public offering, our board of directors has adopted a 2007 Equity Incentive Plan, which permits the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, performance shares and other stock-based awards. Our equity awards are designed to align management s performance objectives with the interests of our stockholders. Our compensation committee grants equity awards to key executives in order to enable them to participate in the long-term appreciation of our stockholder value, while reducing or eliminating the economic benefit of such awards in the event we do not perform well. Additionally, to the extent that stock options and other equity awards are given in the form of option grants these provide an important retention tool for key executives, as they are in almost all cases subject to vesting over an extended period of time.

In general, stock options for executive officers are granted annually in connection with our annual performance review in May of each year and are subject to vesting based on the executive s continued service. Most new hire option grants vest over a four year period with 25% vesting after the first twelve months of service and the remainder vesting ratably each month thereafter over the next three years. Annual option grants also vest over a four year period and vest ratably each month subject to continued service through each vesting date. All options are granted at the fair market value on the date of grant. Our compensation committee will consider alternative forms of equity, such as performance shares, restricted stock units or restricted stock awards, and alternative vesting strategies based on the achievement of milestones when we become a public reporting company.

The size and terms of the initial option grant made to each executive officer upon joining the company are primarily based on competitive conditions applicable to the executive officer s specific position. In addition, the compensation committee considers the number of options owned by other executives in comparable positions within our company using a blended model that considers options awarded as a percentage of shares outstanding and the aggregate value for each option grant. For 2006, the compensation committee recommended to the board of directors the annual equity-based incentive award for our chief executive officer. For all other executive officers in 2006, the compensation committee s recommendations were made with input from the chief executive officer.

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The compensation committee has established stock option targets for specified categories of executive officers.

We use a number of methodologies to make external comparisons when we set the number of options to be granted to each executive officer. On an individual basis, we compare the fair value of the grant to those to executives made at peer companies using a Black-Scholes valuation for equity awards that is consistent with SFAS 123(R), and the number of option shares granted by position as a percentage of total common shares outstanding. We believe these comparisons provide important additional context for comparing the competitiveness of our equity-based compensation practices versus the market.

The annual performance equity awards we make to our executive officers will be driven by our sustained performance over time, our executive officers ability to impact our results that drive stockholder value, their organization level, their potential to take on roles of increasing responsibility, and competitive equity award levels for similar positions and organization levels in comparable companies. Equity forms a key part of the overall compensation for each executive officer and will be considered each year as part of the annual performance review process and incentive payout calculation.

During 2006, our board of directors granted stock options to our executive officers based upon the recommendations of our compensation committee in connection with our annual performance stock option grant process. All of these grants were made during meetings of our board of directors. The exercise price of options was determined by our board or directors after taking into account a wide variety of factors, including external valuation reports received from our independent valuation firms; the pricing of our most recently completed convertible preferred stock financing; the quality and growth of our management team; and market comparables within our industry. Subsequent to our initial public offering, our compensation committee intends to grant options for new hires on a monthly basis on the first business day of the month. All equity awards to our employees, including executive officers, and to our directors have been granted and reflected in our consolidated financial statements, based upon the applicable accounting guidance, with the exercise price equal to the fair market value on the grant date based on the valuation determined by our board of directors with the assistance of our independent valuation firms.

Benefits. We provide the following benefits to our named executive officers, generally on the same basis provided to all of our employees:

- health, dental insurance and vision;
- life insurance;
- employee stock purchase plan;
- employee assistance plan;
- medical and dependant care flexible spending account;
- short-and long-term disability, accidental death and dismemberment; and
- a 401(k) plan.

We believe these benefits are consistent with companies with which we compete for employees.

Severance Compensation & Termination Protection. We intend to enter into change of control agreements with each of our vice president level officers and above. Our chief executive officer, chief financial officer and chief operating officer will receive the following benefits if we undergo a change of

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control transaction and such officer is terminated without cause or is constructively terminated within 12 months following the change of control, subject to the individual s prior execution of a general release in our favor:

- 50% of the shares subject to the new hire option grant or stock award made to such officer will vest;
- 100% of the unvested shares of each subsequent option or stock award will vest; and
- the officer will be paid a lump sum equal to 12 months of base salary and will be provided with up to 12 months of COBRA.

Our other vice president level officers and above will receive the following benefits if we undergo a change of control transaction and such officer is terminated without cause or is constructively terminated within 12 months following the change of control, subject to the individual s prior execution of a general release in our favor:

- 50% of the shares subject to the new hire option grant or stock award made to such officer will vest;
- 50% of the unvested shares of each subsequent option or stock award will vest; and
- the officer will be paid a lump sum equal to six months of base salary plus up to six months of COBRA.

Accounting and Tax Considerations

Internal Revenue Code Section 162(m) limits the amount that we may deduct for compensation paid to our chief executive officer and to each of our four most highly compensated officers to $1,000,000 per person, unless certain exemption requirements are met. Exemptions to this deductibility limit may be made for various forms of performance-based compensation. In addition to salary and bonus compensation, upon the exercise of stock options that are not treated as incentive stock options, the excess of the current market price over the option price, or option spread, is treated as compensation and accordingly, in any year, such exercise may cause an officer s total compensation to exceed $1,000,000. Under certain regulations, option spread compensation from options that meet certain requirements will not be subject to the $1,000,000 cap on deductibility, and in the past we have granted options that we believe met those requirements. While the compensation committee cannot predict how the deductibility limit may impact our compensation program in future years, the compensation committee intends to maintain an approach to executive compensation that strongly links pay to performance. While the compensation committee has not adopted a formal policy regarding tax deductibility of compensation paid to our chief executive officer and our four most highly compensated officers, the compensation committee intends to consider tax deductibility under Rule 162(m) as a factor in compensation decisions.

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Summary Compensation Table

The following table provides information regarding the compensation of our principal executive officer, principal financial officer, former principal financial officer and each of the next three most highly compensated executive officers during our year ended December 31, 2006. We refer to these executive officers as our named executive officers.

Name and Principal Position	Salary($)	Option Grants ($)(1)	Non-Equity Incentive Plan Compensation ($)(2)	All Other Compensation ($)	Total ($)
Jagdeep Singh President and Chief Executive Officer	$ 200,000	$ 44,572	$ 32,526	$	$ 280,098
Duston M. Williams(4) Chief Financial Officer	129,808	44,856	40,657		215,321
William R. Zerella(5) former Chief Financial Officer	142,109			125,000(3)	267,109
Scott A. Chandler Vice President, Worldwide Sales	225,000	7,429	984,946(6)		1,217,375
Michael O. McCarthy III Vice President and General Counsel	230,000	11,886	37,405		279,291
David F. Welch, Ph.D. Chief Marketing and Strategy Officer	200,000	22,286	32,526		254,812

(1) Amounts represent the aggregate expense recognized for financial statement reporting purposes in 2006, calculated in accordance with SFAS No. 123(R), for awards of stock options to our named executive officers. See Note 1 of Notes to Consolidated Financial Statements for a discussion of assumptions made in determining the grant date fair value and compensation expense of our stock options.

(2) The amounts in this column represent total performance-based bonuses earned for services rendered during 2006 under our 2006 Executive Bonus Plan, in which all executives who do not receive sales commissions participate. During 2006, we introduced the bonus plan which was applicable only to the second half of that year. Bonus targets were set related to revenue and margin, which were the key metrics in support of the business plan in effect at that time. 50% of the bonus was based on our performance relative to our revenue plan and the other 50% of the bonus was based on our performance relative to our gross margin plan. Payment of any bonus was contingent on our having achieved both (i) at least 80% of our revenue plan and (ii) at least 80% of our gross margin plan. Target bonus for each named executive officer was 15% of base salary. Bonuses earned in 2006 are anticipated to be paid in April 2007.

(3) This amount represents the amount paid to Mr. Zerella as severance in connection with his termination of employment. See the section titled Separation Agreement for a discussion of Mr. Zerella s severance arrangement.

(4) Mr. Williams became our chief financial officer in June 2006.

(5) Mr. Zerella left Infinera in July 2006.

(6) Mr. Chandler earned this amount during 2006 solely through sales commissions related to certain individual performance targets. $158,633 of Mr. Chandler s non-equity incentive plan compensation was based on individual performance targets set in 2006 for which payment was contingent on shipments made in January 2007 and was paid in February 2007.

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Grants of Plan-Based Awards

The following table provides information regarding grants of plan-based awards to each of our named executive officers during the year ended December 31, 2006.

Grants of Plan-Based Awards

For Year Ended December 31, 2006

Name	Estimated Future Payouts Under Non-Equity Incentive Plan Awards Threshold($)(1)	Target($)(2)	Grant Date	All Other Option Awards: Number of Securities Underlying Options(#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Option Awards(3)
Jagdeep Singh(4)	$ 24,000	$ 30,000	8/8/2006	50,000	$ 2.00	$ 58,200
			8/8/2006	325,000	2.00	378,300
President and Chief Executive Officer						
Duston M. Williams(5)						