CALIX, INC
Form 10-Q
November 02, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 29, 2012

OR

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

For the transition period from to

Commission File Number: 001-34674

Calix, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	68-0438710
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1035 N. McDowell Blvd., Petaluma, CA 94954
(Address of Principal Executive Offices) (Zip Code)
(707) 766-3000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: x No: o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes: x No: o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	o	Accelerated Filer	x
Non-accelerated filer	o (Do not check if a smaller reporting Company)	Smaller Reporting Company	o

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

As of October 27, 2012, there were 48,418,075 shares of the Registrant's common stock, par value $0.025 outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements
CALIX, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	September 29, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$57,422	$38,938
Restricted cash	—	754
Accounts receivable, net	56,392	47,943
Inventory	30,175	44,604
Deferred cost of revenue	16,960	8,324
Prepaids and other current assets	4,383	4,429
Total current assets	165,332	144,992
Property and equipment, net	17,381	16,130
Goodwill	116,175	116,175
Intangible assets, net	66,941	80,048
Other assets	1,774	2,194
Total assets	$367,603	$359,539
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$16,436	$14,250
Accrued liabilities	34,137	36,214
Deferred revenue	30,674	16,783
Total current liabilities	81,247	67,247
Long-term portion of deferred revenue	15,299	13,347
Other long-term liabilities	896	1,528
Total liabilities	97,442	82,122
Commitments and contingencies (See Note 7)		
Stockholders' equity:		
Preferred stock, $0.025 par value; 5,000,000 shares authorized; no shares issued and outstanding as of September 29, 2012 and December 31, 2011	—	—
Common stock, $0.025 par value; 100,000,000 shares authorized; 48,417,915 shares and 47,825,200 shares issued and outstanding as of September 29, 2012 and December 31, 2011, respectively	1,210	1,195
Additional paid-in capital	754,755	740,309
Accumulated other comprehensive income	133	98
Accumulated deficit	(485,937)	(464,185)
Total stockholders' equity	270,161	277,417
Total liabilities and stockholders' equity	$367,603	$359,539

See accompanying notes to condensed consolidated financial statements.

CALIX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
Revenue	$81,301	$ 83,655	$238,794	$ 253,084
Cost of revenue:				
Products and services (1)	45,707	49,002	132,797	143,209
Merger-related expenses	—	—	—	19,966
Amortization of intangible assets	2,088	2,806	5,451	7,510
Total cost of revenue	47,795	51,808	138,248	170,685
Gross profit	33,506	31,847	100,546	82,399
Operating expenses:				
Research and development (1)	16,165	16,717	49,604	50,340
Sales and marketing (1)	15,093	12,593	44,880	38,831
General and administrative (1)	6,773	5,475	19,682	21,450
Merger-related and other expenses (1)	—	1,404	—	12,927
Amortization of intangible assets	2,552	2,552	7,656	6,016
Total operating expenses	40,583	38,741	121,822	129,564
Loss from operations	(7,077)	(6,894)	(21,276)	(47,165)
Interest and other income (expense), net:				
Interest income	3	11	14	80
Interest expense	(41)	(48)	(140)	(139)
Other income (expense), net	19	35	(70)	64
Loss before provision for income taxes	(7,096)	(6,896)	(21,472)	(47,160)
Provision for income taxes	44	38	280	176
Net loss	$(7,140)	$ (6,934)	$(21,752)	$ (47,336)
Net loss per common share:				
Basic and diluted	$(0.15)	$ (0.15)	$(0.45)	$ (1.06)
Weighted-average number of shares used to compute net loss per common share:				
Basic and diluted	48,353	47,128	48,059	44,866
Other comprehensive income, net of tax:				
Unrealized loss on investment, net	$—	$ (2)	$—	$ (22)
Foreign currency translation adjustment, net	24	42	35	76
Total other comprehensive income, net of tax	24	40	35	54
Comprehensive loss	$(7,116)	$ (6,894)	$(21,717)	$ (47,282)

(1) Includes stock-based compensation as follows:				
Cost of revenue	$345	$ 306	$1,089	$ 1,141
Research and development	1,017	886	3,129	3,761
Sales and marketing	1,263	1,127	3,840	3,256
General and administrative	1,682	1,407	4,903	7,845
Merger-related and other expenses	—	70	—	1,234
	$4,307	$ 3,796	$12,961	$ 17,237

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended	
	September 29, 2012	September 24, 2011
Operating activities:		
Net loss	$(21,752)	$(47,336)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of premiums relating to available-for-sale securities	—	229
Depreciation and amortization	6,351	5,949
Loss on retirement of property and equipment	262	2,278
Amortization of intangible assets	13,107	13,526
Stock-based compensation	12,961	17,237
Changes in operating assets and liabilities:		
Restricted cash	754	—
Accounts receivable, net	(8,449)	12,329
Inventory	14,429	9,634
Deferred cost of revenue	(8,636)	(1,161)
Prepaids and other assets	491	(2,291)
Accounts payable	2,186	(10,126)
Accrued liabilities	(2,098)	2,850
Deferred revenue	15,844	5,800
Other long-term liabilities	(633)	(179)
Net cash provided by operating activities	24,817	8,739
Investing activities:		
Purchase of property and equipment	(7,879)	(6,271)
Sales and maturities of marketable securities	—	29,755
Acquisition of Occam Networks, net of cash acquired	—	(60,809)
Net cash used in investing activities	(7,879)	(37,325)
Financing activities:		
Proceeds from exercise of stock options and other	158	766
Proceeds from employee stock purchase plan	2,222	2,062
Taxes withheld upon vesting of restricted stock units and restricted stock awards	(880)	(10,373)
Net cash provided by (used in) financing activities	1,500	(7,545)
Effect of exchange rate changes on cash and cash equivalents	46	76
Net increase (decrease) in cash and cash equivalents	18,484	(36,055)
Cash and cash equivalents at beginning of period	38,938	66,304
Cash and cash equivalents at end of period	$57,422	$30,249
Non-cash investing activities:		
Value of common stock issued in acquisition	—	117,258
Fair value of equity awards assumed in connection with acquisition	—	1,370

See accompanying notes to condensed consolidated financial statements.

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CALIX, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Company and Basis of Presentation

Company

Calix, Inc. (together with its subsidiaries, “Calix,” the “Company,” “our,” “we,” or “us”) was incorporated in August 1999, and is a Delaware corporation. We are a leading provider in North America of broadband communications access systems and software for fiber- and copper-based network architectures that enable communications service providers ("CSPs") to transform their networks and connect to their residential and business subscribers. We enable CSPs to provide a wide range of revenue-generating services, from basic voice and data to advanced broadband services, over legacy and next-generation access networks. We focus solely on CSP access networks, the portion of the network that governs available bandwidth and determines the range and quality of services that can be offered to subscribers. We develop and sell carrier-class hardware and software products, which we refer to as the Unified Access portfolio that are designed to enhance and transform CSP access networks to meet the changing demands of subscribers rapidly and cost-effectively.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, including the accounts of Calix, Inc. and its wholly owned subsidiaries, have been prepared in accordance with the requirements of the U.S. Securities and Exchange Commission (“SEC”) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by U.S. generally accepted accounting principles (“GAAP”) can be condensed or omitted. In the opinion of management, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of the Company’s financial position and operating results. All significant intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated balance sheet at December 31, 2011 has been derived from the audited financial statements at that date. The results of the Company’s operations can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year or any future periods. The information included in this quarterly report on Form 10-Q should be read in conjunction with the audited financial statements for the year ended December 31, 2011, included in the Company’s Form 10-K.

The Company operates on a 4-4-5 fiscal calendar which divides the year into four quarters, with each quarter grouped into two 4-week months and one 5-week month. The Company’s fiscal year ends on December 31. The preparation of financial statements in conformity with GAAP for interim financial reporting requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

2. Significant Accounting Policies

The Company’s significant accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011. Our significant accounting policies did not materially change during the nine months ended September 29, 2012.

Recent Accounting Pronouncements

In the nine months ended September 29, 2012, there were no accounting standard updates that would materially impact the Company’s financial statements.

3. Goodwill

Goodwill is not amortized but instead is subject to an annual impairment test or more frequently if events or changes in circumstances indicate that it may be impaired. We evaluate goodwill on an annual basis as of the end of the second quarter of each year. Management has determined that we operate as a single reporting unit and, therefore, evaluates goodwill impairment at the enterprise level.

To evaluate for impairment, the Company utilizes a two-step process. The first step requires the Company to compare its fair value to its carrying value including goodwill. The Company determines its fair value using both an income approach and a market approach. Under the income approach, the Company determines fair value based on estimated future cash flows, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of the Company and the rate of return an outside investor would expect to earn. Under the market-based approach, the Company utilizes

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information regarding the Company as well as publicly available industry information to determine earnings multiples that are used to value the Company. If the carrying value of the Company exceeds its fair value, the Company performs the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of goodwill with the carrying value of goodwill. An impairment charge is recognized for the excess of the carrying value of goodwill over its implied fair value.

In accordance with our annual goodwill impairment test and in consideration of the recent significant decline in our stock price, we evaluated the potential impairment of goodwill as of June 30, 2012 in July 2012. The goodwill impairment testing process involved the use of significant assumptions, estimates and judgments, and is subject to inherent uncertainties and subjectivity in determination of the fair value of our sole reporting unit. In performing the first step of the goodwill impairment test, we determined the fair value of our reporting unit by combining two valuation methods, a discounted cash flow analysis (DCF) and market multiples of comparable publicly traded companies. Under the DCF method, we prepared annual projections of future cash flows over a period of five years (the "discrete projection period") and applied a terminal value assumption to the final year within the discrete projection period to estimate the total value of the cash flows beyond the final year. These projected cash flow estimates were then discounted using a discount rate that reflected market-based estimates based on comparable publicly traded companies, and included an additional risk premium specific to Calix. Under the market multiples method, fair value was determined by applying multiples of Revenue and EBITDA (earnings before interest, taxes, depreciation and amortization). In addition, we analyzed the fair value of our reporting unit and our total market capitalization for reasonableness, taking into account certain factors, including control premium, which were based on values observed in market transactions. Based on our analyses, we determined that the fair value of our reporting unit exceeded the carrying value by approximately 15%, and therefore the second step of the goodwill test did not need to be performed. However, significant changes in these estimates and assumptions could create future impairment losses to goodwill.

At the end of the third quarter of 2012, the Company reviewed events and changes to its business subsequent to the impairment test performed in July 2012 and concluded that there were no indicators of impairment to the carrying value of its goodwill during the three months ended September 29, 2012. As of September 29, 2012, there was no impairment to the carrying value of the Company's goodwill.

4. Intangible Assets

Intangible assets are carried at cost, less accumulated amortization. The details of intangible assets as of September 29, 2012 and December 31, 2011 are disclosed in the following table (in thousands):

	September 29, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Core developed technology	$68,964	$ (36,897)	$32,067	$52,694	$ (31,447)	$21,247
Customer relationships	54,740	(19,866)	34,874	54,740	(12,209)	42,531
Purchase order backlog	—	—	—	4,260	(4,260)	—
Trade name	—	—	—	2,290	(2,290)	—
Total amortizable intangible assets	123,704	(56,763)	66,941	113,984	(50,206)	63,778
In-process technology	—	—	—	16,270	—	16,270
Total intangible assets, excluding goodwill	$123,704	$ (56,763)	$66,941	$130,254	$ (50,206)	$80,048

At the end of the first quarter of 2012, upon the completion of the research and development efforts associated with our $16.3 million in-process technology that was acquired from Occam, we determined that this technology had a useful life of 5 years and therefore reclassified it as core developed technology. We began amortizing this intangible asset to cost of revenue during the second quarter of 2012.

Amortization expense was $4.6 million and $13.1 million for the three and nine months ended September 29, 2012, respectively, and $5.4 million and $13.5 million for the three and nine months ended September 24, 2011, respectively.

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Expected future amortization expense for the fiscal years indicated is as follows (in thousands):

Period	Expected Amortization Expense
Remainder of 2012	$4,640
2013	18,561
2014	18,561
2015	18,561
2016	5,805
2017	813
Total	$66,941

5. Cash and Cash Equivalents

Cash and cash equivalents consisted of the following (in thousands):

	September 29, 2012	December 31, 2011
Cash	$37,586	$19,109
Money market funds	19,836	19,829
Total cash and cash equivalents	$57,422	$38,938

As of September 29, 2012, the Company did not hold any marketable securities and therefore there were no unrealized gains or losses. Realized gains and losses on the investments are determined on the specific identification method and are reflected in results of operations. The Company did not experience any significant realized gains or losses on its investments through September 29, 2012.

6. Balance Sheet Details

Inventory consisted of the following (in thousands):

	September 29, 2012	December 31, 2011
Raw materials	$2,351	$3,077
Finished goods	27,824	41,527
Total inventory	$30,175	$44,604

Accounts receivable, net consisted of the following (in thousands):

	September 29, 2012	December 31, 2011
Accounts receivable	$57,608	$49,180
Allowance for doubtful accounts	(439)	(402)
Product return reserve	(777)	(835)
Accounts receivable, net	$56,392	$47,943

Property and equipment, net consisted of the following (in thousands):

	September 29, 2012	December 31, 2011
Computer equipment and purchased software	$30,210	$28,477
Test equipment	33,562	29,849
Furniture and fixtures	1,469	1,480
Leasehold improvements	6,622	6,342
Total	71,863	66,148
Accumulated depreciation and amortization	(54,482)	(50,018)
Property and equipment, net	$17,381	$16,130

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Accrued liabilities consisted of the following (in thousands):

	September 29, 2012	December 31, 2011
Accrued warranty	$11,697	$12,104
Accrued compensation and related benefits	11,168	12,406
Accrued professional and consulting fees	2,128	1,741
Accrued excess and obsolete inventory at contract manufacturers	1,745	3,784
Accrued customer rebates	1,506	1,549
Accrued business travel expenses	1,137	383
Sales and use tax payable	1,065	861
Accrued other	3,691	3,386
Total accrued liabilities	$34,137	$36,214

7. Commitments and Contingencies

Commitments

The Company's principal commitments consist of obligations under operating leases for office space and non-cancelable outstanding purchase obligations. These commitments as of December 31, 2011 are disclosed in our Annual Report on Form 10-K, and have not changed materially during the nine months ended September 29, 2012.

In addition, on August 20, 2012, Calix and Ericsson Inc. ("Ericsson") entered into an Asset Purchase Agreement under which Calix will make a one-time cash payment to acquire Ericsson's fiber access assets ("EFAA"), including the Ericsson EDA 1500 GPON solution and its complementary ONT portfolio. The transaction is expected to close in the fourth quarter of 2012, and will be accounted for using the acquisition method of accounting in accordance with the accounting standard for business combinations.

Accrued Warranty

The Company provides a warranty for its hardware products. Hardware generally has a one to five-year warranty from the date of shipment. The Company accrues for potential warranty claims based on the Company's historical claims experience. The adequacy of the accrual is reviewed on a periodic basis and adjusted, if necessary, based on additional information as it becomes available.

Changes in the Company's warranty reserve were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
Balance at beginning of period	$11,277	$13,133	$12,104	$3,789
Accrued warranty from the Occam acquisition	—	—	—	8,500
Warranty charged to cost of revenue	1,416	1,341	3,436	4,560
Utilization of warranty	(996)	(2,218)	(3,843)	(4,593)
Balance at end of period	$11,697	$12,256	$11,697	$12,256

Litigation

From time to time, the Company is involved in various legal proceedings arising from the normal course of business activities.

On September 16, 2010, the Company, two direct, wholly owned subsidiaries of the Company, and Occam entered into an Agreement and Plan of Merger and Reorganization (the "Merger Agreement"). In response to the announcement of the Merger Agreement, on September 17, 2010, September 20, 2010 and September 21, 2010, three purported class action complaints were filed in the California Superior Court for Santa Barbara County: Kardosh v. Occam Networks, Inc., et al. (Case No. 1371748), or the Kardosh complaint; Kennedy v. Occam Networks, Inc., et al. (Case No. 1371762); and Moghaddam v. Occam Networks, Inc., et al. (Case No. 1371802). The three complaints, which are referred to collectively as the California class action complaints, were substantially similar. Each of the California class action complaints named Occam, the pre-acquisition members of the Occam board of directors and us as defendants.

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On November 2, 2010, the three California class action complaints were consolidated into a single action, with the plaintiffs in the Kardosh complaint appointed as the lead plaintiffs, and on November 19, 2010, the California Superior Court issued an order staying the California class action complaints in favor of a substantively identical stockholder class action pending in the Delaware Court of Chancery (see below). On July 31, 2012, the consolidated California class action complaints were dismissed without prejudice as to all defendants.

On October 6, 2010, a purported class action complaint was filed by stockholders of Occam in the Delaware Court of Chancery: Steinhardt v. Howard-Anderson, et al. (Case No. 5878-VCL). On November 24, 2010, these stockholders filed an amended complaint, or the amended Steinhardt complaint. The amended Steinhardt complaint names Occam and the members of the Occam board of directors as defendants. The amended Steinhardt complaint does not name Calix as a defendant.

The amended Steinhardt complaint generally alleges that the members of the Occam board breached their fiduciary duties in connection with the acquisition of Occam by Calix, by, among other things, engaging in an allegedly unfair process and agreeing to an allegedly unfair price for the merger transaction. The amended Steinhardt complaint also alleges that Occam and the former members of the Occam board breached their fiduciary duties by failing to disclose certain allegedly material facts about the merger transaction in the preliminary proxy statement and prospectus included in the Registration Statement on Form S-4 that Calix filed with the SEC on November 2, 2010. The amended Steinhardt complaint sought injunctive relief rescinding the merger transaction and award of damages in an unspecified amount, as well as plaintiffs' costs, attorney's fees, and other relief.

The merger transaction was completed on February 22, 2011. On January 6, 2012, the Delaware court ruled on a motion for sanctions brought by the defendants in the Delaware case against certain of the lead plaintiffs. The Delaware court found that lead plaintiffs Michael Steinhardt, Steinhardt Overseas Management, L.P., and Ilex Partners, L.L.C., collectively the "Steinhardt Plaintiffs," had engaged in improper trading of Calix shares, and dismissed the Steinhardt Plaintiffs from the case with prejudice. The court further held that the Steinhardt Plaintiffs are: (i) barred from receiving any recovery from the litigation, (ii) required to self-report to the SEC, (iii) directed to disclose their improper trading in any future application to serve as lead plaintiff, and (iv) ordered to disgorge trading profits of $0.5 million, to be distributed to the remaining members of the class of former Occam stockholders. The Delaware court also granted the motion of the remaining lead plaintiffs, Herbert Chen and Derek Sheeler, for class certification, and certified Messrs. Chen and Sheeler as class representatives. Chen and Sheeler, on behalf of the class of similarly situated former Occam stockholders, continue to seek an award of damages in an unspecified amount.

The Company believes that the allegations in the Delaware action are without merit and intends to continue to vigorously contest the action. However, there can be no assurance that the Company will be successful in defending this ongoing action. In addition, the Company has obligations, under certain circumstances, to hold harmless and indemnify each of the former Occam directors against judgments, fines, settlements and expenses related to claims against such directors and otherwise to the fullest extent permitted under Delaware law and Occam's bylaws and certificate of incorporation. Such obligations may apply to this lawsuit.

The Company is not currently a party to any other legal proceedings that, if determined adversely to the Company, would individually or in the aggregate have a material adverse effect on the Company's business, operating results or financial condition.

8. Fair Value Measurements

In accordance with Accounting Standard Codification Topic 820, Fair Value Measurements and Disclosures, ("ASC Topic 820"), the Company measures its cash equivalents and marketable securities at fair value on a recurring basis. ASC Topic 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC Topic 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Observable inputs other than quoted prices included in Level 1 for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-driven valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – Unobservable inputs to the valuation derived from fair valuation techniques in which one or more significant inputs or significant value drivers are unobservable. The fair value hierarchy also requires the Company to maximize the use of observable inputs, when available, and to minimize the use of unobservable inputs when determining inputs and determining

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fair value.

As of September 29, 2012 and December 31, 2011, the fair values of certain of the Company’s financial assets were determined using the following inputs (in thousands):

As of September 29, 2012	Level 1	Total
Money market funds	$19,836	$19,836
Total	$19,836	$19,836

As of December 31, 2011	Level 1	Total
Money market funds	$19,829	$19,829
Total	$19,829	$19,829

The Company’s valuation techniques used to measure the fair values of money market funds were derived from quoted market prices as active markets for these instruments exist. The Company has no level 2 or level 3 financial assets.

9. Net Loss per Share

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
Numerator:				
Net loss	$(7,140)	$(6,934)	$(21,752)	$(47,336)
Denominator:				
Weighted-average common shares outstanding	48,353	47,128	48,059	44,866
Basic and diluted net loss per common share	$(0.15)	$(0.15)	$(0.45)	$(1.06)

As the Company incurred net losses in the periods presented, the following table displays the Company’s other outstanding common stock equivalents that were excluded from the computation of diluted net loss per share, as the effect of including them would have been anti-dilutive (in thousands):

	September 29, 2012	September 24, 2011
Restricted stock units	2,016	$2,074
Stock options	2,204	1,647
Employee stock purchase plan	349	119
Warrants	23	24
Total common stock equivalents	4,592	3,864

10. Stockholders’ Equity

Capital Structure

The Company maintains three equity incentive plans, the 2000 Stock Plan, the 2002 Stock Plan and the 2010 Equity Incentive Award Plan (together, the “Plans”). These plans were approved by the stockholders and are described in the Company’s Form 10-K filed with the SEC on February 24, 2012. In January 2012, the board, upon recommendation by our compensation committee, approved the Long Term Incentive Program, under the 2010 Equity Incentive Award Plan. Under the Long Term Incentive Program certain key employees of the Company are eligible for equity awards based on the Company’s stock price performance.

Preferred Stock

The board of directors has the authority, without action by stockholders with the exception of stockholders who hold board positions, to designate and issue up to 5.0 million shares of preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof. These rights, preferences and privileges could include dividend rights,

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conversion rights, voting rights, terms of redemption, liquidation preferences, sinking fund terms and the number of shares constituting any series or the designation of such series, any or all of which may be greater than the rights of common stock. The issuance of the Company's preferred stock could adversely affect the voting power of holders of common stock and the likelihood that such holders will receive dividend payments and payments upon liquidation. In addition, the issuance of preferred stock could have the effect of delaying, deferring or preventing a change in control of the Company or other corporate action. Subsequent to the Company's initial public offering and the conversion of all preferred stock outstanding at that date, the board of directors has not designated any rights, preference or powers of any preferred stock and no shares of preferred stock have been issued.

Stock Based Compensation

Stock-based compensation expense associated with stock options, restricted stock units ("RSUs"), performance restricted stock units, restricted stock awards ("RSAs") and purchase rights under our Employee Stock Purchase Plan ("ESPP") is measured at the grant date, based on the fair value of the award, and is recognized as expense over the remaining requisite service period. During the three and nine months ended September 29, 2012, the Company recorded stock-based compensation expense of $4.3 million and $13.0 million, respectively. During the three and nine months ended September 24, 2011, the Company recorded stock-based compensation expense of $3.8 million and $17.2 million, respectively.

Stock Options

The Company estimates the fair value of stock options in accordance with ASC Topic 718, Compensation – Stock Compensation, ("ASC Topic 718"). The fair value of each option grant is estimated at the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

Stock Options	Three Months Ended				Nine Months Ended			
	September 29, 2012		September 24, 2011		September 29, 2012		September 24, 2011	
Expected volatility	55	%	52	%	56	%	52	%
Expected life (years)	6.25		6.25		6.25		6.25	
Expected dividend yield	—		—		—		—	
Risk-free interest rate	0.96	%	1.41	%	1.07	%	2.20	%

The Company's computation of expected volatility is based on the Company's peer group of similar companies. The Company's computation of expected term utilizes the simplified method in accordance with Staff Accounting Bulletin No. 110, (SAB 110). The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with maturities approximating the grant's expected life. In addition, ASC Topic 718 requires the Company to estimate the number of options that are expected to vest. Thus, the Company applies an estimated forfeiture rate based on actual forfeiture experience. The Company recognizes stock-based compensation expense for the fair values of these awards on a straight-line basis over the requisite service period of each of these awards.

During the three months ended September 29, 2012, the Company granted 235,000 stock options at a weighted-average grant date fair value of $3.47 per share. During the nine months ended September 29, 2012, the Company granted 732,420 stock options at a weighted-average grant date fair value of $4.75 per share. During the three months ended September 29, 2012, 33,123 stock options were exercised at a weighted-average exercise price of $0.57 per share. During the nine months ended September 29, 2012, 91,362 stock options were exercised at a weighted-average exercise price of $1.73 per share. As of September 29, 2012, unrecognized stock-based compensation expense related to stock options of $8.4 million, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 2.7 years.

Restricted Stock Units

In September 2009, the Company began to grant RSUs to eligible employees, executives and outside directors. Each RSU represents a right to receive one share of the Company's common stock (subject to adjustment for certain specified changes in the capital structure of the Company) upon the completion of a specific period of continued service.

The Company values the RSUs at fair value, or the market price of the Company’s common stock on the date of grant. The Company recognizes stock-based compensation expense for the fair values of these RSUs on a straight-line basis over the requisite service period of these awards.

During the three months ended September 29, 2012, the Company granted 116,851 RSUs with a weighted-average grant date fair value of $5.15 per share. During the nine months ended September 29, 2012, the Company granted 514,001 RSUs

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with a weighted-average grant date fair value of $6.56 per share. During the three and nine months ended September 29, 2012, 219,952 and 235,651 RSUs were released, respectively. As of September 29, 2012, unrecognized stock-based compensation expense related to RSUs of $16.3 million, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 2.3 years.

Performance Restricted Stock Units

In the first quarter of 2012, the Company began to grant performance RSUs to its executives. The performance criterion is based on the relative total shareholder return ("TSR") of Calix common stock as compared to the TSR of the Company's peer group. The Company established two-year and three-year performance periods that are from January 1, 2012 to December 31, 2013 and 2014, respectively. The TSR is calculated by dividing (a) the average closing trading price for the 90-day period ending on the last day of the applicable performance period by (b) the average closing trading price for the 90-day period immediately preceding January 1, 2012. This TSR is then used to derive the achievement ratio which is then multiplied by the number of units in the grant to derive the common stock to be issued for each performance period.

These performance RSUs are valued in accordance with the guidance of Topic 718, using the Monte Carlo Simulation Technique, which simulates a range of possible future stock prices for Calix and its peer group to determine the fair value for each performance period.

In the first quarter of 2012, the Company granted 170,000 performance RSUs with a weighted-average grant date fair value per RSU of $15.61. In the third quarter of 2012, the Company granted 20,000 performance RSUs with a weighted-average grant date fair value per RSU of $8.04. As of September 29, 2012, unrecognized stock-based compensation expense related to performance RSUs of $1.8 million, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 1.6 years.

Restricted Stock Awards

The Company values RSAs at fair value or the market price of the Company's common stock on the date of grant. The Company recognizes stock-based compensation expense for the fair values of these RSAs on a straight-line basis over the requisite service period of these awards. As of September 29, 2012, unrecognized stock-based compensation expense related to RSAs of $5.8 million, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 2.8 years.

Employee Stock Purchase Plan

The Company's 2010 Employee Stock Purchase Plan, as amended ("2010 ESPP") allows employees to purchase shares of the Company's common stock through payroll deductions of up to 15 percent of their annual compensation subject to certain Internal Revenue Code limitations. The price of common stock purchased under the plan is 85 percent of the lower of the fair market value of the common stock on the commencement date and exercise date of each six-month offering period.

At the 2012 Annual Meeting of Stockholders, stockholders approved an amendment to our 2010 ESPP to increase the number of shares of common stock reserved for issuance from 1,000,000 shares to 4,300,000 shares. During the nine months ended September 29, 2012, 325,617 shares were purchased under the 2010 ESPP. As of September 29, 2012, there were 3,552,979 shares available for issuance.

As of September 29, 2012, unrecognized stock-based compensation expense related to the ESPP of $0.2 million was expected to be recognized over a remaining service period of 2 months.

11. Credit Facility

The Company has a revolving credit facility of $30.0 million based upon a percentage of eligible accounts receivable. Included in the revolving line are amounts available under letters of credit and cash management services. The Company had outstanding letters of credit totaling $3.6 million and $2.8 million as of September 29, 2012 and December 31, 2011, respectively. There were no outstanding borrowings under the revolving credit facility as of September 29, 2012 and December 31, 2011. As of September 29, 2012, there was approximately $26.4 million available for borrowing under this revolving credit facility. The Company is also required to pay commitment fees of 0.25% per year on any unused portions of the facility. As of September 29, 2012 and December 31, 2011, the Company was in compliance with its financial covenants under the credit facility. The revolving credit facility matures on June 30, 2013.

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12. Income Taxes

The Company has incurred operating losses since inception and, as such, has not received a tax benefit for these losses.The provision relates to state taxes not based on income, alternative minimum tax, and foreign income tax. Significant components affecting the tax rate include alternative minimum taxes, state tax, foreign tax and the utilization of losses carried forward.

ASC Topic 740, Accounting for Income Taxes, provides for the recognition of deferred tax assets if realization of such assets is more likely than not. The Company has established and continues to maintain a full valuation allowance against the Company's net deferred tax assets as the Company does not believe that realization of those assets is more likely than not.

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

This report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Securities and Exchange Act of 1934, as amended. All statements other than statements of historical facts are "forward-looking statements" for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statement of the plans and objectives of management for future operations, any statements concerning proposed new products or licensing, any statements regarding product development, any statements regarding future economic conditions or performance, and any statement of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as "may," "will," "expects," "plans," "anticipates," "estimates," "potential," or "continue" or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including but not limited to the Risk Factors set forth under Part II, Item 1A below, and for the reasons described elsewhere in this report. All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof, and we assume no obligation to update these forward-looking statements or reasons why actual results might differ.

Overview

We are a leading provider in North America of broadband communications access systems and software for fiber- and copper-based network architectures that enable communications service providers ("CSPs") to connect to their residential and business subscribers. We enable CSPs to provide a wide range of revenue-generating services, from basic voice and data to advanced broadband services, over legacy and next-generation access networks. We focus solely on CSP access networks, the portion of the network that governs available bandwidth and determines the range and quality of services that can be offered to subscribers. We develop and sell carrier-class hardware and software products, which is referred to as the Unified Access portfolio that are designed to enhance and transform CSP access networks to meet the changing demands of subscribers rapidly and cost-effectively.

We market our access systems and software to CSPs globally through our direct sales force as well as a limited number of resellers. As of September 29, 2012, we have shipped over fifteen million ports of our Unified Access portfolio to more than 1,000 customers worldwide, whose networks serve over 50 million subscriber lines in total. Our customers include 18 of the 20 largest U.S. Incumbent Local Exchange Carriers, or ILECs. In addition, we have over 400 commercial video customers and have enabled over 750 customers to deploy gigabit passive optical network, or GPON, Active Ethernet and point-to-point Ethernet fiber access networks.

Our revenue decreased to $81.3 million and $238.8 million for the three and nine months ended September 29, 2012, respectively, from $83.7 million and $253.1 million for the three and nine months ended September 24, 2011, respectively. Revenue growth will depend on our ability to continue to sell our access systems and software to existing customers and to attract new customers, including in particular, those customers in the large CSP and international markets. During the second and the third quarters of fiscal 2012, we experienced softness in our business due to lower demand across multiple customer markets. We believe this was due to a slowdown in capital expenditures by service providers increasingly concerned about macro-economic conditions and uncertainties associated with the implementation of regulatory reforms. We expect these issues to continue and these issues may negatively impact our results for the remainder of 2012. Additionally, we expect that our planned acquisition of Ericsson's fiber access assets will have a positive impact to revenue beyond 2012. Since our inception we have incurred significant losses, and as of September 29, 2012, we had an accumulated deficit of $485.9 million. Our net loss was $7.1 million and $21.8 million for the three and nine months ended September 29, 2012, respectively. Our net loss was $6.9 million and $47.3 million for the three and nine months ended September 24, 2011, respectively.

Revenue fluctuations result from many factors, including but not limited to: increases or decreases in customer orders for

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our products and services, large customer purchase agreements with special revenue considerations, varying budget cycles for our customers and seasonal buying patterns of our customers. More specifically, our customers tend to spend less in the first fiscal quarter as they are finalizing their annual budgets. Customers then typically decide to purchase our products during our second fiscal quarter. In our third fiscal quarter, customers are in the process of deploying such products and as a result there is typically less spending. In addition, difficulties related to deploying products during the winter also tend to limit spending in the third quarter. Finally, in our fourth fiscal quarter, customer purchases typically increase as customers are attempting to spend the rest of their budget for the year. As of September 29, 2012, our deferred revenue of $46.0 million primarily included certain contracts with customers who receive government supported loans and grants from the U.S. Department of Agriculture’s Rural Utility Service (“RUS”) that include installation services, services, special customer arrangements and ratably recognized services. The timing of deferred recognition may cause significant fluctuations in our revenue and operating results from period to period. Cost of revenue is strongly correlated to revenue and will tend to fluctuate from all of the aforementioned factors that could impact revenue. Other factors that impact cost of revenue include changes in the mix of products delivered to our customers and changes in the cost of our inventory. Cost of revenue includes fixed expenses related to our internal operations which could impact our cost of revenue as a percentage of revenue, if there are large sequential fluctuations to revenue.

Our gross profit and gross margin have been, and will likely be, impacted by several factors, including new product introduction or upgrades to existing products, changes in customer mix, changes in the mix of products demanded and sold, shipment volumes, changes in our product costs, changes in pricing and the extent of customer rebates and incentive programs. We believe our gross margin could increase due to favorable changes in these factors, for example, increases in sales of our advanced E-Series Ethernet service access platforms, upgrades to our C7 platform, new introductions of our P-Series optical network terminals and reductions in the impact of rebate or similar programs. We believe our gross margin could decrease due to unfavorable changes in factors such as increased product costs, pricing decreases due to competitive pressure and an unfavorable customer or product mix. Changes in these factors could have a material impact on our future average selling prices and unit costs. Also, the timing of deferred revenue recognition and related deferred costs can have a material impact on our gross profit and gross margin results. The timing of recognition and the relative size of these arrangements could cause large fluctuations in our gross profit from period to period.

Our operating expenses have fluctuated based on the following factors: timing of variable compensation expenses due to fluctuations in order volumes, timing of salary increases which have historically occurred in the second quarter, timing of bonus accrual due to changes in the Company’s performance, timing of research and development expenses including prototype builds and intermittent outsourced development projects and increases in stock-based compensation expenses resulting from modifications to outstanding stock options. Our operating expenses for fiscal 2011 include merger-related expenses and amortization of intangible assets from our acquisition of Occam as discussed in more detail below. As a result of the acquisition we have also incurred increased compensation costs across all operating expense categories due to additional headcount and increased facility related costs. We anticipate that our operating expenses will increase as a result of our planned acquisition of Ericsson's fiber access assets as discussed in more detail below.

As a result of the fluctuations described above and a number of other factors, many of which are outside our control, our quarterly operating results fluctuate from period to period. Comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance.

Planned Acquisition of Ericsson's Fiber Access Assets

On August 20, 2012, Calix and Ericsson Inc. (“Ericsson”) entered into an Asset Purchase Agreement under which Calix will make a one-time cash payment to acquire Ericsson's fiber access assets (“EFAA”), including the Ericsson EDA 1500 GPON solution and its complementary ONT portfolio. In connection with this planned acquisition, Calix will offer employment to up to 61 U.S.-based employees of Ericsson, and will transition ongoing support of the acquired products from Ericsson to Calix.

On August 22, 2012, Calix and Ericsson also signed a global reseller agreement, under which Calix will become Ericsson's preferred global partner for broadband access applications. We expect this agreement to provide Calix with an extensive new global reseller channel, while our acquisition of Ericsson's fiber access portfolio delivers powerful new complements to our industry-leading Unified Access portfolio. This agreement will also provide Ericsson's existing fiber access customers with world-class support and maintenance, and an expanded portfolio of access systems and software from a leading company totally focused on access.

The transaction is expected to close in the fourth quarter of 2012 and will be accounted for using the acquisition method of accounting in accordance with the accounting standard for business combinations. We will consolidate EFAA's financial results in the condensed consolidated financial statement from the date of acquisition. We expect the acquisition to have a

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positive impact on our international business over time.

Acquisition of Occam Networks

On February 22, 2011, we completed our acquisition of Occam Networks, Inc. ("Occam"), a provider of innovative broadband access products designed to enable telecommunications service providers to offer bundled voice, video and high speed internet, or Triple Play, services over both fiber optic and copper networks in a stock and cash transaction valued at approximately $213.1 million which consisted of $94.5 million of cash consideration and a value of $118.6 million of common stock issued and equity awards assumed.

As a result of this acquisition, we recorded $50.6 million in goodwill and $97.7 million in other intangible assets. We are amortizing the definite-lived intangible assets over their useful lives. Under the acquisition method of accounting rules, we revalued the Occam assets and liabilities acquired at the time of the acquisition, based on their fair value.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with U.S. generally accepted accounting principles, or GAAP. 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 financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Management bases its estimates, assumptions and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. To the extent there are material differences between these estimates and actual results, our financial statements will be affected. Our management evaluates its estimates, assumptions and judgments on an ongoing basis.

Our critical accounting policies and estimates are described under "Critical Accounting Policies and Estimates" in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K for the year ended December 31, 2011. During the nine months ended September 29, 2012, there have been no significant changes in our critical accounting policies and estimates.

Impairment of Goodwill and Intangible Assets

Goodwill is not amortized but instead is subject to an annual impairment test or more frequently if events or changes in circumstances indicate that it may be impaired. We evaluate goodwill on an annual basis as of the end of the second quarter of each year. Management has determined that we operate as a single reporting unit and, therefore, evaluates goodwill impairment at the enterprise level. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate an asset's carrying value may not be recoverable.

To evaluate for impairment, the Company utilizes a two-step process. The first step requires the Company to compare its fair value to its carrying value including goodwill. The Company determines its fair value using both an income approach and a market approach. Under the income approach, the Company determines fair value based on estimated future cash flows, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of the Company and the rate of return an outside investor would expect to earn. Under the market-based approach, the Company utilizes information regarding the Company as well as publicly available industry information to determine earnings multiples that are used to value the Company. If the carrying value of the Company exceeds its fair value, the Company performs the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of goodwill with the carrying value of goodwill. An impairment charge is recognized for the excess of the carrying value of goodwill over its implied fair value.

In accordance with our annual goodwill impairment test and in consideration of the recent significant decline in our stock price, we evaluated the potential impairment of goodwill as of June 30, 2012 in July 2012. The goodwill impairment testing process involved the use of significant assumptions, estimates and judgments, and is subject to inherent uncertainties and subjectivity in determination of the fair value of our sole reporting unit. In performing the first step of the goodwill impairment test, we determined the fair value of our reporting unit by combining two valuation methods, a discounted cash flow analysis (DCF) and market multiples of comparable publicly traded companies. Under the DCF method, we prepared annual projections of future cash flows over a period of five years (the "discrete projection period") and applied a terminal value assumption to the final year within the discrete projection period to estimate the total value of the cash flows beyond the final year. These projected cash flow estimates were then discounted using a discount rate that reflected market-based estimates based on comparable publicly traded companies, and included an additional risk premium specific to Calix. Under the market multiples method, fair value was determined by applying multiples of Revenue and EBITDA (earnings before interest, taxes, depreciation and amortization). In addition, we analyzed the fair value of our reporting unit and our total market capitalization for reasonableness, taking into account certain factors, including control premium, which were based on values observed in market transactions. Based on our analyses, we determined that the fair value of our reporting unit exceeded the carrying value

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by approximately 15%, and therefore the second step of the goodwill test did not need to be performed. However, significant changes in these estimates and assumptions could create future impairment losses to goodwill.
At the end of the third quarter of 2012, we reviewed events and changes to our business subsequent to the impairment test performed in July 2012 and concluded that there were no indicators of impairment to the carrying value of goodwill during the three months ended September 29, 2012. As of September 29, 2012, there was no impairment to the carrying value of goodwill.

Recent Accounting Pronouncements

In the nine months ended September 29, 2012, there were no new accounting standard updates that would materially impact the Company's financial statements.

Results of Operations

Comparison of the Three and Nine Months Ended September 29, 2012 and September 24, 2011

Revenue

The following table sets forth our revenue:

	Three Months Ended				Nine Months Ended			
	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent
	(in thousands, except percentages)							
Revenue	$81,301	$ 83,655	$(2,354)	(3)%	$238,794	$ 253,084	$(14,290)	(6)%

Our revenue is principally derived in the United States. During the three and nine months ended September 29, 2012 and September 24, 2011, revenue generated in the United States represented approximately 94% and 93%, respectively. Revenue decreased during the three and nine months ended September 29, 2012 compared with the corresponding periods of fiscal 2011, primarily due to a decrease in shipment volume resulting from the softness in demand across multiple customer markets which the company believes is due to a slowdown in capital expenditures by service providers increasingly concerned about macro-economic conditions and uncertainties associated with the implementation of regulatory reforms. We expect these issues to continue and these issues may negatively impact our results for the remainder of 2012.

Cost of Revenue and Gross Profit

The following table sets forth our costs of revenue:

	Three Months Ended				Nine Months Ended			
	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent
	(in thousands, except percentages)							
Cost of revenue:								
Products and services	$45,707	$ 49,002	$(3,295)	(7)%	$132,797	$ 143,209	$(10,412)	(7)%
Merger-related expenses	—	—	—	— %	—	19,966	(19,966)	(100)%
Amortization of intangible assets	2,088	2,806	(718)	(26)%	5,451	7,510	(2,059)	(27)%
Total cost of revenue	$47,795	$ 51,808	$(4,013)	(8)%	$138,248	$ 170,685	$(32,437)	(19)%
Gross profit	$33,506	$ 31,847	$1,659	5 %	$100,546	$ 82,399	$18,147	22 %
Gross margin	41 %	38 %			42 %	33 %		

Cost of revenues decreased during the three and nine months ended September 29, 2012 compared with the corresponding periods of fiscal 2011, primarily due to the fact that we did not incur any further merger-related expenses subsequent to 2011, a decrease in cost of products and service revenues resulting from decreased revenues and decreased write-down charges for excess and obsolete inventory as a result of improved inventory management, and a decrease in amortization of intangible assets.

The decreases in amortization of intangible assets during the three and nine months ended September 29, 2012 are due to the completion of the amortization of certain intangibles that we acquired from Occam, offset in part by an increase in the

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amortization of core developed technologies that began amortizing during the second quarter of 2012 as discussed below. At the end of the first quarter of 2012, upon the completion of the research and development efforts associated with the in-process technology, we determined that this technology had a useful life of 5 years and therefore reclassified it as core developed technology. We began amortizing this intangible asset to cost of revenue during the second quarter of 2012.

Gross margin increased during the three and nine months ended September 29, 2012 compared with the corresponding periods of fiscal 2011, primarily due to the absence of merger-related expenses, lower excess and obsolete inventory write-down charges, and lower intangible assets amortization expenses. Excluding merger-related expenses, gross margin increased slightly from 38% and 40% for the three and nine months ended September 29, 2011, respectively, to 41% and 42% for the three and nine months ended September 29, 2012, respectively, primarily due to a combination of product mix and cost reductions.

Operating Expenses

Research and Development Expenses

The following table sets forth our research and development expenses:

	Three Months Ended				Nine Months Ended			
	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent
	(in thousands, except percentages)							
Research and development	$16,165	$ 16,717	$(552)	(3)%	$49,604	$ 50,340	$(736)	(1)%
Percent of total revenue	20 %	20 %			21 %	20 %		

Research and development expenses decreased during the three months ended September 29, 2012 compared with the corresponding period in fiscal 2011, primarily due to a decrease in prototype and consulting expenses resulting from the timing of new product development activities, offset in part by an increase in compensation expenses due to increased headcount.

Research and development expenses decreased during the nine months ended September 29, 2012 compared with the corresponding period in fiscal 2011, primarily due to a decrease in prototype expenses resulting from the timing of new product development activities, and a decrease in stock-based compensation expense. These decreases were offset in part by an increase in compensation expenses due to increased headcount resulting from the acquisition of Occam on February 22, 2011 and the expansion of our China development center, and an increase in consulting expenses in connection with our pursuit of OSMINE certification.

Research and development expenses as a percentage of revenue for the three and nine months ended September 29, 2012 compared to the corresponding periods in fiscal 2011 remained relatively flat.

We are continuing our strategic investments in our Unified Access portfolio. We intend to continue to dedicate significant resources to research and development and to develop new product capabilities to support the performance, scalability and management of our Unified Access portfolio.

Sales and Marketing Expenses

The following table sets forth our sales and marketing expenses:

	Three Months Ended				Nine Months Ended			
	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent
	(in thousands, except percentages)							
Sales and marketing	$15,093	$ 12,593	$2,500	20 %	$44,880	$ 38,831	$6,049	16 %
Percent of total revenue	19 %	15 %			19 %	15 %		

Sales and marketing expenses increased during the three months ended September 29, 2012 compared with the corresponding period in fiscal 2011, primarily due to an increase in compensation and related costs driven by an increase in headcount resulting from the hiring of additional employees to pursue our international expansion. Sales and marketing expenses increased during the nine months ended September 29, 2012 compared with the corresponding period in fiscal 2011, primarily due to an increase in compensation and related costs, an increase in travel-related

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costs, which were driven by an increase in headcount resulting from our acquisition of Occam on February 22, 2011 and to pursue our international expansion.

The increases in sales and marketing expenses as a percentage of revenue for the three and nine months ended September 29, 2012 compared to the corresponding periods in fiscal 2011 were primarily due to the increase in expenses in the respective periods.

We will continue our investments in sales and marketing in order to extend our market reach and grow our business in support of our key strategic initiatives.

General and Administrative Expenses

The following table sets forth our general and administrative expenses:

	Three Months Ended				Nine Months Ended			
	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent
	(in thousands, except percentages)							
General and administrative	$6,773	$ 5,475	$1,298	24 %	$19,682	$ 21,450	$(1,768)	(8)%
Percent of total revenue	8 %	7 %			8 %	8 %		

General and administrative expenses increased during the three months ended September 29, 2012 compared with the corresponding period in fiscal 2011, primarily due to an increase in compensation and related costs resulting from increased headcount, as well as increases in consulting and professional service expenses.

General and administrative expenses decreased during the nine months ended September 29, 2012 compared with the corresponding period in fiscal 2011, primarily due to a decrease in stock-based compensation expense, offset in part by increases in professional and consulting service expenses as well as an increase in compensation expenses due to increased headcount.

General and administrative expenses as a percentage of revenue for the three and nine months ended September 29, 2012 compared to the corresponding periods in fiscal 2011 remained relatively flat.

Merger-related and Other Expenses

The following table sets forth our merger-related and other expenses included in operating expenses:

	Three Months Ended				Nine Months Ended			
	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent
	(in thousands, except percentages)							
Merger-related and other expenses	$—	$ 1,404	$(1,404)	(100)%	$—	$ 12,927	$(12,927)	(100)%
Percent of total revenue	— %	2 %			— %	5 %		

In connection with our acquisition of Occam in the first quarter of 2011, we incurred operating merger-related and other expenses, which primarily consist of legal and professional expenses, severance for terminated Occam employees, and salaries paid to transitional Occam employees. In addition, we incurred expenses associated with consolidating facilities and stock-based compensation expense primarily related to accelerated vesting for certain Occam executives that terminated subsequent to the acquisition date. In connection with the planned acquisition of Ericsson fiber access assets, we expect to incur merger-related expenses in the fourth quarter of 2012.

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Amortization of Intangible Assets

The following table sets forth our amortization of intangible asset expenses included in operating expenses:

	Three Months Ended				Nine Months Ended			
	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent	September 29, 2012	September 24, 2011	Variance in Dollars	Variance in Percent
	(in thousands, except percentages)							
Amortization of intangible assets	$2,552	$ 2,552	$—	— %	$7,656	$ 6,016	$1,640	27 %
Percent of total revenue	3 %	3 %			3 %	2 %		

In connection with the acquisition of Occam on February 22, 2011, $51.0 million of the total purchase price was allocated to the amortizable intangible asset, customer relationships, which are being amortized to operating expenses over their estimated useful lives.

Liquidity and Capital Resources

We have funded our operations primarily through cash generated from operations and the 2010 initial public offering of our common stock. At September 29, 2012, we had cash and cash equivalents of $57.4 million, which consisted of deposits held at banks and money market mutual funds held at major financial institutions. We also have a revolving credit facility of $30.0 million based upon a percentage of eligible accounts receivable. Included in the revolving line are amounts available under letters of credit and cash management services.

Operating Activities

Our operating activities provided cash of $24.8 million and $8.7 million in the nine months ended September 29, 2012 and September 24, 2011, respectively. The increase in cash provided by operating activities was due primarily to a favorable change of $19.0 million in our operating results after adjustment of non-cash charges, offset partially by a $3.0 million decrease in net cash inflow resulting from changes in operating assets and liabilities.

In the nine months ended September 29, 2012, non-cash charges were $32.7 million (the majority of which consist of depreciation and amortization expense and stock-based compensation expense). Cash inflows from changes in operating assets and liabilities primarily resulted from a $14.4 million decrease in inventory due to improved inventory management, a $15.8 million increase in deferred revenue as a result of increased shipments relating to certain RUS-funded contracts, and a $2.2 million increase in accounts payable due to the timing of inventory receipts and payments. Cash outflows from changes in operating assets and liabilities included primarily an $8.4 million increase in net accounts receivable due to the timing of sale and billing activities, an $8.6 million increase in deferred cost of revenue primarily related to the deferral of certain RUS-funded contracts, and a $2.1 million decrease in accrued liabilities.

Our operating activities provided cash of $8.7 million in the nine months ended September 24, 2011. This resulted primarily from non-cash charges of $39.2 million (the majority of which consist of stock-based compensation expense and depreciation and amortization expense) and positive net changes in operating assets and liabilities, largely offset by our net loss of $47.3 million. Cash inflows from changes in operating assets and liabilities included a net decrease of $12.3 million in accounts receivable due to strong cash collections, $9.6 million related to the sell through of inventory, an increase in deferred revenue of $5.8 million of certain RUS-funded contracts and an increase in accrued liabilities of $2.9 million. These inflows were partially offset by cash outflows from accounts payable of $10.1 million resulting primarily from payments of accounts payable assumed from Occam, an increase of $2.3 million in prepaid and other current assets and an increase in deferred cost of revenue of $1.2 million, primarily related to the deferral of revenue of certain RUS-funded contracts.

Investing Activities

Our investing activities used cash of $7.9 million and $37.3 million in the nine months ended September 29, 2012 and September 24, 2011, respectively.

Our cash used in investing activities in the nine months ended September 29, 2012 consisted of capital expenditures primarily as a result of purchases of computer equipment and software.

Our cash used in investing activities in the nine months ended September 24, 2011 primarily consisted of our acquisition of Occam for $60.8 million, net of $33.6 million of Occam cash assumed in the transaction, and capital expenditures of $6.3 million, partially offset by maturities of marketable securities of $29.8 million.

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Financing Activities

Our financing activities provided cash of $1.5 million in the nine months ended September 29, 2012, which consisted of proceeds of $2.2 million from the issuance of common stock under the employee stock purchase plan (“ESPP”) and proceeds of $0.2 million from the exercises of stock options, offset by $0.9 million payment of payroll taxes for the vesting of restricted stock units and restricted stock awards.

Our cash used in financing activities of $7.5 million in the nine months ended September 24, 2011, primarily consisted of payment of payroll taxes for the vesting of restricted stock units of $10.4 million, offset by proceeds of $2.1 million from the issuance of common stock under the ESPP and proceeds of $0.8 million from the exercise of stock options.

Working Capital and Capital Expenditure Needs

Other than our cash commitment in connection with our planned acquisition of Ericsson's fiber access assets as discussed in the section below, we currently have no material cash commitments, except for normal recurring trade payables, expense accruals, operating leases and firm purchase commitments. In addition, we believe that our outsourced approach to manufacturing provides us significant flexibility in both managing inventory levels and financing our inventory. We may be required to issue performance bonds to satisfy requirements under our RUS-funded contracts. We issue letters of credit under our existing credit facility to support these performance bonds. In the event we do not have sufficient capacity under our credit facility to support these bonds, we will have to purchase certificates of deposit, which could materially impact our working capital or limit our ability to satisfy such contract requirements. At December 31, 2011, we had cash of $0.8 million restricted for the issuance of surety performance bonds we acquired through our acquisition of Occam. There were no restrictions on our cash at September 29, 2012. In the event that our revenue plan does not meet our expectations, we may eliminate or curtail expenditures to mitigate the impact on our working capital.

We believe based on our current operating plan, our existing cash, cash equivalents and existing amounts available under our revolving line of credit will be sufficient to meet our anticipated cash needs for at least the next twelve months. Our future capital requirements will depend on many factors including our rate of revenue growth, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the timing of introductions of new products and enhancements to existing products, the acquisition of new capabilities or technologies and the continued market acceptance of our products. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition would be harmed.

Contractual Obligations and Commitments

The Company’s principal commitments consist of obligations under operating leases for office space and non-cancelable outstanding purchase obligations. These commitments as of December 31, 2011 are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011, and have not changed materially during the nine months ended September 29, 2012.

In addition, on August 20, 2012, Calix and Ericsson Inc. (“Ericsson”) entered into an Asset Purchase Agreement under which Calix will make a one-time cash payment to acquire Ericsson's fiber access assets, including the Ericsson EDA 1500 GPON solution and its complementary ONT portfolio. The transaction is expected to close in the fourth quarter of 2012.

Off-Balance Sheet Arrangements

As of September 29, 2012 and December 31, 2011, we did not have any off-balance sheet arrangements.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

The primary objectives of our investment activity are to preserve principal, provide liquidity and maximize income without significantly increasing risk. By policy, we do not enter into investments for trading or speculative purposes. At September 29, 2012, we had cash and cash equivalents of $57.4 million, which was held primarily in cash or money market funds. Due to the nature of these money-market funds, we believe that we do not have any material exposure to changes in the fair value of our cash equivalents as a result of changes in interest rates.

Our exposure to interest rate risk also relates to the amount of interest we must pay on our outstanding debt instruments. Any outstanding borrowings under our revolving credit facility bear a variable rate of interest based upon the applicable LIBOR or prime rate and is adjusted monthly based upon changes in the Federal Reserve's prime rate. As of September 29,

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2012, we had no outstanding borrowings under the revolving credit facility.

Foreign Currency Exchange Risk

Our sales contracts and vendor payables are primarily denominated in U.S. dollars and, therefore, the majority of our revenues and operating expenses are not subject to foreign currency exchange risk.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on their evaluation as of September 29, 2012, our Chief Executive Officer and Chief Financial Officer, with the participation of our management, have concluded that our disclosure controls and procedures (as defined in Rules 13a–15(e) and 15d–15(e) of the Securities Exchange Act of 1934) were effective at the reasonable assurance level.

Limitations on the Effectiveness of Controls

Our disclosure controls and procedures provide our Chief Executive Officer and Chief Financial Officer reasonable assurances that our disclosure controls and procedures will achieve their objectives. However, our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting can or will prevent all human error. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Furthermore, the design of a control system must reflect the fact that there are internal resource constraints, and the benefit of controls must be weighed relative to their corresponding costs. Because of the limitations in all control systems, no evaluation of controls can provide complete assurance that all control issues and instances of error, if any, within our company are detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur due to human error or mistake. Additionally, controls, no matter how well designed, could be circumvented by the individual acts of specific persons within the organization. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated objectives under all potential future conditions.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

For a description of our material pending legal proceedings, please refer to Note 7 "Commitments and Contingencies – Litigation" of the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated by reference.

ITEM 1A. Risk Factors

We have identified the following additional risks and uncertainties that may affect our business, financial condition and/or results of operations. The risks described below include any material changes to and supersede the description of the risk factors disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission on February 24, 2012. Investors should carefully consider the risks described below, together with the other information set forth in this Quarterly Report on Form 10-Q, before making any investment decision. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently believe are immaterial may also significantly impair our business operations. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and investors may lose all or part of their investment.

Risks Related to Our Business and Industry

Our markets are rapidly changing and we have a limited operating history, which make it difficult to predict our future revenue and plan our expenses appropriately.

We were incorporated in August 1999 and shipped our first product in December 2001. We have a limited operating history and compete in markets characterized by rapid technological change, changing needs of communications service providers, or CSPs, evolving industry standards and frequent introductions of new products and services. We have limited historical data and have had a relatively limited time period in which to implement and evaluate our business strategies as compared to companies with longer operating histories. In addition, we likely will be required to reposition our product and service offerings and introduce new products and services as we encounter rapidly changing CSP requirements and increasing competitive pressures. We may not be successful in doing so in a timely and responsive manner, or at all. Also, softness in demand across any of our customer markets, including due to macro-economic conditions beyond our control or uncertainties associated with the implementation of regulatory reforms, could lead to unexpected slowdown in capital expenditures by service providers, such as what occurred in the second quarter of 2012. As a result, it is difficult to forecast our future revenues and plan our operating expenses appropriately, which also makes it difficult to predict our future operating results.

We have a history of losses, and we may not be able to generate positive operating income and cash flows in the future.

We have experienced net losses in each year of our existence. For the year ended December 31, 2011, December 31, 2010, and December 31, 2009, we incurred net losses of $52.6 million, $18.6 million, and $22.4 million, respectively. For the nine months ended September 29, 2012, we incurred a net loss of $21.8 million. As of September 29, 2012, we had an accumulated deficit of $485.9 million.

We expect to continue to incur significant expenses for research and development, sales and marketing, customer support and general and administrative functions as we expand our operations. Given our rapid growth rate and the intense competitive pressures we face, we may be unable to control our operating costs.

We cannot guarantee that we will achieve profitability in the future. We will have to generate and sustain significant and consistent increased revenue, while continuing to control our expenses, in order to achieve and then maintain profitability. We may also incur significant losses in the future for a number of reasons, including the risks discussed in this "Risk Factors" section and factors that we cannot anticipate. If we are unable to generate positive operating income and cash flow from operations, our liquidity, results of operations and financial condition will be adversely affected.

Fluctuations in our quarterly and annual operating results may make it difficult to predict our future performance, which could cause our operating results to fall below investor or analyst expectations, which could adversely affect

the trading price of our stock.
A number of factors, many of which are outside of our control, may cause or contribute to significant fluctuations in our quarterly and annual operating results. These fluctuations may make financial planning and forecasting difficult. Comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. If our revenue or operating results fall below the expectations of investors or securities analysts, or below any guidance we may provide to the market, the price of our common stock would likely decline. Moreover,

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we may experience delays in recognizing revenue under applicable revenue recognition rules, particularly from government-funded contracts, such as those funded by RUS. The extent of these delays and their impact on our revenues can fluctuate over a given time period depending on the number and size of purchase orders under these contracts during such time period. In addition, unanticipated decreases in our available liquidity due to fluctuating operating results could limit our growth and delay implementation of our expansion plans.

In addition to the other risk factors listed in this "Risk Factors" section, factors that may contribute to the variability of our operating results include:

- our ability to predict our revenue and plan our expenses appropriately;
- the capital spending patterns of CSPs and any decrease or delay in capital spending by CSPs due to macro-economic conditions, regulatory implementation or uncertainties, or other reasons;
- the impact of government-sponsored programs on our customers;
- intense competition;
- our ability to develop new products or enhancements that support technological advances and meet changing CSP requirements;
- our ability to achieve market acceptance of our products and CSPs' willingness to deploy our new products;
- the concentration of our customer base;
- the length and unpredictability of our sales cycles;
- our focus on CSPs with limited revenue potential;
- our lack of long-term, committed-volume purchase contracts with our customers;
- our ability to increase our sales to larger North American as well as international CSPs;
- our exposure to the credit risks of our customers;
- fluctuations in our gross margin;
- the interoperability of our products with CSP networks;
- our dependence on sole and limited source suppliers;
- our ability to manage our relationships with our contract manufacturers;
- our ability to forecast our manufacturing requirements and manage our inventory;
- our products' compliance with industry standards;
- our ability to expand our international operations;
- our ability to protect our intellectual property and the cost of doing so;
- the quality of our products, including any undetected hardware errors or bugs in our software;
- our ability to estimate future warranty obligations due to product failure rates;
- our ability to obtain necessary third-party technology licenses;
- any obligation to issue performance bonds to satisfy requirements under RUS contracts;
- the attraction and retention of qualified employees and key personnel; and
- our ability to maintain proper and effective internal controls.

Our business is dependent on the capital spending patterns of CSPs, and any decrease or delay in capital spending by CSPs, in response to economic conditions, uncertainties associated with the implementation of regulatory reforms, or otherwise, would reduce our revenues and harm our business.

Demand for our products depends on the magnitude and timing of capital spending by CSPs as they construct, expand and upgrade their access networks. For the year ended December 31, 2011, CenturyLink, Inc., or CenturyLink, purchased a significant amount of our access systems and software. However, we cannot anticipate the level of CenturyLink's purchases in the future. On April 1, 2011, CenturyLink completed their merger with Qwest Communications. This merger could create uncertainty for us as to whether we will continue to be chosen as a preferred network equipment vendor for the combined organization. In addition, the recent economic downturn has contributed to a slowdown in telecommunications industry spending, including in the specific geographies and markets in which we operate. In response to reduced consumer spending, challenging capital markets or declining liquidity trends, capital spending for network infrastructure projects of CSPs could be delayed or cancelled. In addition, capital spending is cyclical in our industry and sporadic among individual CSPs, and can change on short notice. As a result, we may not have visibility into changes in spending behavior until nearly the end of a given quarter. CSP spending on network construction, maintenance, expansion and upgrades is also affected by seasonality in their purchasing cycles, reductions in their budgets and delays in their purchasing cycles. In addition, we believe the capital

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expenditures amongst some CSPs have also been adversely affected due to recent fiber shortages in certain portions of the market. Many factors affecting our results of operations are beyond our control, particularly in the case of large CSP orders and network infrastructure deployments involving multiple vendors and technologies where the achievement of certain thresholds for acceptance is subject to the readiness and performance of the customer or other providers, and changes in customer requirements or installation plans. Further, CSPs may not pursue infrastructure upgrades that require our access systems and software. Infrastructure improvements may be delayed or prevented by a variety of factors including cost, regulatory obstacles (including uncertainties associated with the implementation of regulatory reforms), mergers, lack of consumer demand for advanced communications services and alternative approaches to service delivery. Reductions in capital expenditures by CSPs may slow our rate of revenue growth. As a consequence, our results for a particular quarter may be difficult to predict, and our prior results are not necessarily indicative of results likely in future periods.

Government-sponsored programs could impact the timing and buying patterns of CSPs, which may cause fluctuations in our operating results.

Many of our customers are Independent Operating Companies, or IOCs, which have revenues that are particularly dependent upon interstate and intrastate access charges, and federal and state subsidies. The Federal Communications Commission, or FCC, and some states are considering changes to such payments and subsidies, and these changes could reduce IOC revenues. Furthermore, many IOCs use or expect to use, government-supported loan programs or grants, such as RUS loans and grants and the Broadband Stimulus programs under the American Recovery and Reinvestment Act of 2009, or ARRA, to finance capital spending. Changes to these programs could reduce the ability of IOCs to access capital and reduce our revenue opportunities.

To the extent that our customers do receive grants or loans under these stimulus programs, our customers may be encouraged to accelerate their network development plans and purchase substantial quantities of products, from us or other suppliers, while the programs and funding are in place. Customers may thereafter substantially curtail future purchases of products as ARRA funding winds down or because all purchases have been completed. Award grants under the Broadband Stimulus programs have been issued between December 2009 and September 2010. The timetable for completion of funded projects varies between the two agencies administering the awards. Projects funded under the Broadband Technology Opportunities Program (BTOP), which is administered by the National Telecommunications and Information Administration (NTIA), must be completed by September 30, 2013. Projects funded under the Broadband Initiatives Program (BIP), which is administered by the Rural Utilities Service, must be completed by June 30, 2015.

We have experienced continued delays in purchasing commitments from our customers who have been awarded Broadband Stimulus funds, which have negatively impacted our operating results and additional delays could continue to adversely impact our operating results. In addition, the revenue recognition guidelines related to the sales of our access systems to CSPs who have received Broadband Stimulus funds may create uncertainties around the timing of our revenue, which could harm our financial results. In addition, any changes in government regulations and subsidies could cause our customers to change their purchasing decisions which could have an adverse effect on our operating results and financial condition.

We face intense competition that could reduce our revenue and adversely affect our financial results.

The market for our products is highly competitive, and we expect competition from both established and new companies to increase. Our competitors include companies such as ADTRAN, Inc., Alcatel- Lucent S.A., Ciena Corporation, Huawei Technologies Co., Ltd., Tellabs, Inc., ZTE Corporation.

Our ability to compete successfully depends on a number of factors, including:

- the successful development of new products;
- our ability to anticipate CSP and market requirements and changes in technology and industry standards;
- our ability to differentiate our products from our competitors' offerings based on performance, cost-effectiveness or other factors;
- our ability to gain customer acceptance of our products; and
- our ability to market and sell our products.

The market for broadband access equipment is dominated primarily by large, established vendors. In addition, some of our competitors have merged, made acquisitions or entered into partnerships or other strategic relationships with one another to offer more comprehensive solutions than they individually had offered. Examples include Ciena Corporation's acquisitions of World Wide Packets, Inc. in 2008 and Nortel's Metro Ethernet Networks business in March 2010, Enablence Technologies, Inc.'s acquisition of Teledata Networks, Ltd. in June 2010, our acquisitions of Occam in February 2011 and of Ericsson's fiber access business expected to close in the fourth quarter of 2012, and Adtran's acquisition of Nokia Siemens' broadband access line business in May 2012. We expect this trend to continue as companies attempt to strengthen or maintain their market

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positions in an evolving industry. Many of our current or potential competitors have longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than we do and are better positioned to acquire and offer complementary products and services technologies. Many of our competitors have broader product lines and can offer bundled solutions, which may appeal to certain customers. Our competitors may invest additional resources in developing more compelling product offerings. Potential customers may also prefer to purchase from their existing suppliers rather than a new supplier, regardless of product performance or features, because the products that we and our competitors offer require a substantial investment of time and funds to install. In addition, as a result of these transition costs, competition to secure contracts with potential customers is particularly intense. Some of our competitors may offer substantial discounts or rebates to win new customers. If we are forced to reduce prices in order to secure customers, we may be unable to sustain gross margins at desired levels or achieve profitability. Competitive pressures could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and failure to increase, or the loss of, market share, any of which could reduce our revenue and adversely affect our financial results.
Product development is costly and if we fail to develop new products or enhancements that meet changing CSP requirements, we could experience lower sales.
Our market is characterized by rapid technological advances, frequent new product introductions, evolving industry standards and unanticipated changes in subscriber requirements. Our future success will depend significantly on our ability to anticipate and adapt to such changes, and to offer, on a timely and cost-effective basis, products and features that meet changing CSP demands and industry standards.
We intend to continue making significant investments in developing new products and enhancing the functionality of our existing products. Developing our products is expensive, complex and involves uncertainties. We may not have sufficient resources to successfully manage lengthy product development cycles. For the years ended December 31, 2011, 2010 and 2009, our research and development expenses were $67.7 million, or 20% of our revenue, $55.4 million, or 19% of our revenue, and $46.1 million or 20% of our revenue, respectively. For the nine months ended September 29, 2012, our research and development expenses were $49.6 million, or 21% of our revenue. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. These investments may take several years to generate positive returns, if ever. In addition, we may experience design, manufacturing, marketing and other difficulties that could delay or prevent the development, introduction or marketing of new products and enhancements. If we fail to meet our development targets, demand for our products will decline.
In addition, the introduction of new or enhanced products also requires that we manage the transition from older products to these new or enhanced products in order to minimize disruption in customer ordering patterns, fulfill ongoing customer commitments and ensure that adequate supplies of new products are available for delivery to meet anticipated customer demand. If we fail to maintain compatibility with other software or equipment found in our customers' existing and planned networks, we may face substantially reduced demand for our products, which would reduce our revenue opportunities and market share. Moreover, as customers complete infrastructure deployments, they may require greater levels of service and support than we have provided in the past. We may not be able to provide products, services and support to compete effectively for these market opportunities. If we are unable to anticipate and develop new products or enhancements to our existing products on a timely and cost-effective basis, we could experience lower sales which would harm our business.
Our new products are early in their life cycles and are subject to uncertain market demand. If our customers are unwilling to install our products or deploy new services or we are unable to achieve market acceptance of our new products, our business and financial results will be harmed.
Our new products are early in their life cycles and are subject to uncertain market demand. They also may face obstacles in manufacturing, deployment and competitive response. Potential customers may choose not to invest the additional capital required for initial system deployment. In addition, demand for our products is dependent on the success of our customers in deploying and selling services to their subscribers. Our products support a variety of advanced broadband services, such as high-speed Internet, Internet protocol television, mobile broadband, high-definition video and online gaming, and basic voice and data services. If subscriber demand for such services

does not grow as expected or declines, or if our customers are unable or unwilling to deploy and market these services, demand for our products may decrease or fail to grow at rates we anticipate.
Our customer base is concentrated, and there are a limited number of potential customers for our products. The loss of any of our key customers, a decrease in purchases by our key customers or our inability to grow our customer base would adversely impact our revenues.
Historically, a large portion of our sales has been to a limited number of customers. For example, for the years ended December 31, 2011, 2010 and 2009, CenturyLink accounted for 20%, 29% and 38%, respectively, of our revenue.

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We anticipate that a large portion of our revenues will continue to depend on sales to a limited number of customers. In addition, some larger customers may demand discounts and rebates or desire to purchase their access systems and software from multiple providers. As a result of these factors, our future revenue opportunities may be limited and our margins could be reduced, and our profitability may be adversely impacted. The loss of, or reduction in, orders from any key customer would significantly reduce our revenues and harm our business.

Furthermore, in recent years, the CSP market has undergone substantial consolidation. Industry consolidation generally has negative implications for equipment suppliers, including a reduction in the number of potential customers, a decrease in aggregate capital spending, and greater pricing leverage on the part of CSPs over equipment suppliers. Continued consolidation of the CSP industry, including the merger between CenturyLink and Qwest Communications, which closed in April 2011, and among the Incumbent Local Exchange Carrier, or ILEC, and IOC customers, who represent a large part of our business, could make it more difficult for us to grow our customer base, increase sales of our products and maintain adequate gross margins.

Our sales cycles can be long and unpredictable, and our sales efforts require considerable time and expense. As a result, our sales are difficult to predict and may vary substantially from quarter to quarter, which may cause our operating results to fluctuate significantly.

The timing of our revenues is difficult to predict. Our sales efforts often involve educating CSPs about the use and benefits of our products. CSPs typically undertake a significant evaluation process, which frequently involves not only our products but also those of our competitors and results in a lengthy sales cycle. We spend substantial time, effort and money in our sales efforts without any assurance that our efforts will produce any sales. In addition, product purchases are frequently subject to budget constraints, multiple approvals and unplanned administrative, processing and other delays. If sales expected from a specific customer for a particular quarter are not realized in that quarter or at all, we may not achieve our revenue forecasts and our financial results would be adversely affected.

Our focus on CSPs with relatively small networks limits our revenues from sales to any one customer and makes our future operating results difficult to predict.

We currently focus a large portion of our sales efforts on IOCs, cable multiple system operators and selected international CSPs. In general, our current and potential customers generally operate small networks with limited capital expenditure budgets. Accordingly, we believe the potential revenues from the sale of our products to any one of these customers is limited. As a result, we must identify and sell products to new customers each quarter to continue to increase our sales. In addition, the spending patterns of many of our customers are characterized by small and sporadic purchases. As a consequence, we have limited backlog and will likely continue to have limited visibility into future operating results.

We do not have long-term, committed-volume purchase contracts with our customers, and therefore have no guarantee of future revenues from any customer.

Our sales are made predominantly pursuant to purchase orders, and typically we have not entered into long-term, committed-volume purchase contracts with our customers, including our key customers which account for a material portion of our revenues. As a result, any of our customers may cease to purchase our products at any time. In addition, our customers may attempt to renegotiate the terms of our agreements, including price and quantity. If any of our key customers stop purchasing our access systems and software for any reason, our business and results of operations would be harmed.

Our efforts to increase our sales to larger North American as well as international CSPs, including MSOs, may be unsuccessful.

Our sales and marketing efforts have been focused on Communication Service Providers (CSPs), including Multi System Operators ("MSOs"), in North America. A part of our long-term strategy is to increase sales to larger North American as well as international CSPs, including MSOs. We will be required to devote substantial technical, marketing and sales resources to the pursuit of these CSPs, who have lengthy equipment qualification and sales cycles, without any assurance of generating sales. In particular, sales to these CSPs may require us to upgrade our products to meet more stringent performance criteria, develop new customer-specific features or adapt our product to meet international standards. If we are unable to successfully increase our sales to larger CSPs, our operating results and long-term growth may be negatively impacted.

We are exposed to the credit risks of our customers, and if we have inadequately assessed their credit we may have more exposure to accounts receivable risk than we anticipate, and failure to collect our accounts receivable in amounts that we anticipate could adversely affect our operating results and financial condition.

In the course of our sales to customers, we may encounter difficulty collecting accounts receivable and could be exposed to risks associated with uncollectible accounts receivable. We maintain an allowance for doubtful accounts for estimated losses

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resulting from the inability or unwillingness of our customers to make required payments. However, these allowances are based on our judgment and a variety of factors about which our judgment may be wrong or that may change. For example, we perform credit evaluations of our customers' financial condition. Our evaluation of the creditworthiness of customers may not be accurate if they do not provide us with accurate financial information, or if their situation changes since the time we last evaluated their credit. While we attempt to monitor these situations carefully and attempt to adjust our allowances for doubtful accounts as appropriate, and take appropriate measures to collect accounts receivable balances, we have written down accounts receivable and written off doubtful accounts in prior periods and may be unable to avoid additional write-downs or write-offs of doubtful accounts in the future. Such write-downs or write-offs could negatively affect our operating results for the period in which they occur, and could harm our operating results.

Our gross margin may fluctuate over time and our current level of product gross margins may not be sustainable.

Our current level of product gross margins may not be sustainable and may be adversely affected by numerous factors, including:

- changes in customer, geographic or product mix, including the mix of configurations within each product group;
- increased price competition, including the impact of customer discounts and rebates;
- our ability to reduce and control product costs;
- loss of cost savings due to changes in component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand;
- introduction of new products;
- changes in shipment volume;
- changes in distribution channels;
- increased warranty costs;
- excess and obsolete inventory and inventory holding charges;
- expediting costs incurred to meet customer delivery requirements; and
- liquidated damages relating to customer contractual terms.

Our products must interoperate with many software applications and hardware products found in our customers' networks. If we are unable to ensure that our products interoperate properly, our business would be harmed.

Our products must interoperate with our customers' existing and planned networks, which often have varied and complex specifications, utilize multiple protocol standards, software applications and products from multiple vendors and contain multiple generations of products that have been added over time. As a result, we must continually ensure that our products interoperate properly with these existing and planned networks. To meet these requirements, we must undertake development efforts that require substantial capital investment and employee resources. We may not accomplish these development efforts quickly or cost-effectively, if at all. If we fail to maintain compatibility with other software or equipment found in our customers' existing and planned networks, we may face substantially reduced demand for our products, which would reduce our revenue opportunities and market share.

We have entered into interoperability arrangements with a number of equipment and software vendors for the use or integration of their technology with our products. These arrangements give us access to, and enable interoperability with, various products that we do not otherwise offer. If these relationships fail, we may have to devote substantially more resources to the development of alternative products and processes, and our efforts may not be as effective as the combined solutions under our current arrangements. In some cases, these other vendors are either companies that we compete with directly, or companies that have extensive relationships with our existing and potential customers and may have influence over the purchasing decisions of those customers. Some of our competitors have stronger relationships with some of our existing and potential other vendors and, as a result, our ability to have successful interoperability arrangements with these companies may be harmed. Our failure to establish or maintain key relationships with third-party equipment and software vendors may harm our ability to successfully sell and market our products.

As we do not have manufacturing capabilities, we depend upon a small number of outside contract manufacturers and we do not have supply contracts with these manufacturers. Our operations could be disrupted if we encounter problems with these contract manufacturers.

We do not have internal manufacturing capabilities, and rely upon a small number of contract manufacturers to build our products. In particular, we rely on Flextronics International Ltd., or Flextronics, for the manufacture of most of our products. Our reliance on a small number of contract manufacturers makes us vulnerable to possible capacity constraints and reduced control over component availability, delivery schedules, manufacturing yields and costs. We do not have supply contracts with

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Flextronics or our other manufacturers. Consequently, these manufacturers are not obligated to supply products to us for any specific period, in any specific quantity or at any certain price. In addition, we have limited control over our contract manufacturers' quality systems and controls, and therefore may not be able to ensure levels of quality manufacture suitable for our customers.

The revenues that Flextronics generates from our orders represent a relatively small percentage of Flextronics' overall revenues. As a result, fulfilling our orders may not be considered a priority in the event Flextronics is constrained in its ability to fulfill all of its customer obligations in a timely manner. In addition, a substantial part of our manufacturing is done in Flextronics facilities that are located outside of the United States. We believe that the location of these facilities outside of the United States increases supply risk, including the risk of supply interruptions or reductions in manufacturing quality or controls. If Flextronics or any of our other contract manufacturers were unable or unwilling to continue manufacturing our products in required volumes and at high quality levels, we would have to identify, qualify and select acceptable alternative contract manufacturers. An alternative contract manufacturer may not be available to us when needed or may not be in a position to satisfy our production requirements at commercially reasonable prices and quality. Any significant interruption in manufacturing would require us to reduce our supply of products to our customers, which in turn would reduce our revenues and harm our relationships with our customers.

We depend on sole source and limited source suppliers for key components and products. If we are unable to source these components on a timely basis, we will not be able to deliver our products to our customers.

We depend on sole source and limited source suppliers for key components of our products. For example, certain of our application-specific integrated circuits processors and resistor networks are purchased from sole source suppliers. We may from time to time enter into original equipment manufacturer, or OEM, or original design manufacturer, or ODM, agreements to manufacture and/or design certain products in order to enable us to offer products into key markets on an accelerated basis. For example, a third party assisted in the design and manufacture of our E5-100 platform family. Any of the sole source and limited source suppliers, OEMs and ODMs upon whom we rely could stop producing our components or products, cease operations or be acquired by, or enter into exclusive arrangements with, our competitors. We generally purchase our products through purchase orders and our purchase volumes are currently too low for us to be considered a priority customer by most of our suppliers. As a result, most of these suppliers could stop selling to us at commercially reasonable prices, or at all. Any such interruption or delay may force us to seek similar components or products from alternative sources, which may not be available. Switching suppliers, OEMs or ODMs may require that we redesign our products to accommodate new components, and may potentially require us to re-qualify our products with our customers, which would be costly and time-consuming. Any interruption in the supply of sole source or limited source components for our products would adversely affect our ability to meet scheduled product deliveries to our customers, could result in lost revenue or higher expenses and would harm our business.

Although we do not have manufacturing facilities in Japan, a small number of Japanese factories produce some of the components we use in our products and other components that our customers use that are required to be secured as a precursor to buying our products. A few of these manufacturers have reported disruptions in to their production because of damage to their facilities as a result of the natural disasters in March 2011 and their aftermath in Japan. Although most of these factories are back on line, such interruptions or delays may force us or our customers to seek similar components from alternative sources, which may not be available at favorable prices, or at all. Interruptions in supply resulting from such unforeseen natural disasters could result in lost revenue or higher expenses and would harm our business.

If we fail to forecast our manufacturing requirements accurately and manage our inventory with our contract manufacturers, we could incur additional costs, experience manufacturing delays and lose revenue.

We bear inventory risk under our contract manufacturing arrangements. Lead times for the materials and components that we order through our contract manufacturers vary significantly and depend on numerous factors, including the specific supplier, contract terms and market demand for a component at a given time. Lead times for certain key materials and components incorporated into our products are currently lengthy, requiring us or our contract manufacturers to order materials and components several months in advance of manufacture. If we overestimate our production requirements, we or our contract manufacturers may purchase excess components and build excess inventory. If our contract manufacturers, at our request, purchase excess components that are unique to our products or build excess products, we could be required to pay for these excess parts or products and recognize related inventory write-down costs. Historically, we have reimbursed our primary contract manufacturer for a portion of inventory purchases when our inventory has been rendered obsolete, for example due to manufacturing and engineering change orders resulting from design changes manufacturing discontinuation of parts by our suppliers, or in cases where inventory levels greatly exceed projected demand. If we experience inventory write-downs associated with excess or obsolete inventory, this would have an adverse effect on our gross margins, financial condition and results of operations. We have experienced unanticipated increases in demand from customers, which resulted in delayed

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shipments and variable shipping patterns. If we underestimate our product requirements, our contract manufacturers may have inadequate component inventory, which could interrupt manufacturing of our products and result in delays or cancellation of sales.

If we fail to comply with evolving industry standards, sales of our existing and future products would be adversely affected.

The markets for our products are characterized by a significant number of standards, both domestic and international, which are evolving as new technologies are deployed. Our products must comply with these standards in order to be widely marketable. In some cases, we are compelled to obtain certifications or authorizations before our products can be introduced, marketed or sold in new markets or to customers that we have not historically served. For example, our ability to obtain OSMINE certification for our products will affect our ongoing ability to sell our products to CenturyLink and other Tier 1 CSPs. In addition, our ability to expand our international operations and create international market demand for our products may be limited by regulations or standards adopted by other countries that may require us to redesign our existing products or develop new products suitable for sale in those countries. Although we believe our products are currently in compliance with domestic and international standards and regulations in countries in which we currently sell, we may not be able to design our products to comply with evolving standards and regulations in the future. Accordingly, this ongoing evolution of standards may directly affect our ability to market or sell our products. Further, the cost of complying with the evolving standards and regulations, or the failure to obtain timely domestic or foreign regulatory approvals or certification such that we may not be able to sell our products where these standards or regulations apply, would result in lower revenues and lost market share.

We may be unable to successfully expand our international operations. In addition, we may be subject to a variety of risks that could harm our business.

We currently generate most of our sales from customers in North America and have limited experience marketing, selling and supporting our products and services outside North America or managing the administrative aspects of a worldwide operation. While we are in the process of expanding our international operations, we may not be able to create or maintain international market demand for our products. In addition, as we expand our operations internationally, our support organization will face additional challenges including those associated with delivering support, training and documentation in languages other than English. If we invest substantial time and resources to expand our international operations and are unable to do so successfully and in a timely manner, our business, financial condition and results of operations will suffer.

In the course of expanding our international operations and operating overseas, we will be subject to a variety of risks, including:

- differing regulatory requirements, including tax laws, trade laws, labor regulations, tariffs, export quotas, custom duties or other trade restrictions;
- greater difficulty supporting and localizing our products;
- different or unique competitive pressures as a result of, among other things, the presence of local equipment suppliers;
- challenges inherent in efficiently managing an increased number of employees over large geographic distances, including the need to implement appropriate systems, policies, compensation and benefits and compliance programs;
- limited or unfavorable intellectual property protection;
- risk of change in international political or economic conditions; and
- restrictions on the repatriation of earnings.

We may have difficulty managing our growth, which could limit our ability to increase sales.

We have experienced significant growth in sales and operations in recent years. We expect to continue to expand our research and development, sales, marketing and support activities. Our historical growth has placed, and planned future growth is expected to continue to place, significant demands on our management, as well as our financial and operational resources, to:

- manage a larger organization;
- expand our manufacturing and distribution capacity;
- increase our sales and marketing efforts;
- broaden our customer support capabilities;

- implement appropriate operational and financial systems; and
- maintain effective financial disclosure controls and procedures.

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If we cannot grow, or fail to manage our growth effectively, we may not be able to execute our business strategies and our business, financial condition and results of operations would be adversely affected.

We may not be able to protect our intellectual property, which could impair our ability to compete effectively.

We depend on certain proprietary technology for our success and ability to compete. As of September 29, 2012, we held 67 U.S. patents and had 39 pending U.S. patent applications. Two of the U.S. patents are also covered by granted international patents, one in five countries and the other in three countries. We currently have no pending international patent applications. We rely on intellectual property laws, as well as nondisclosure agreements, licensing arrangements and confidentiality provisions, to establish and protect our proprietary rights. U.S. patent, copyright and trade secret laws afford us only limited protection, and the laws of some foreign countries do not protect proprietary rights to the same extent. Our pending patent applications may not result in issued patents, and our issued patents may not be enforceable. Any infringement of our proprietary rights could result in significant litigation costs. Further, any failure by us to adequately protect our proprietary rights could result in our competitors offering similar products, resulting in the loss of our competitive advantage and decreased sales.

Despite our efforts to protect our proprietary rights, attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may be unable to protect our proprietary rights against unauthorized third-party copying or use. Furthermore, policing the unauthorized use of our intellectual property would be difficult for us. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Litigation could result in substantial costs and diversion of resources and could harm our business.

We could become subject to litigation regarding intellectual property rights that could harm our business.

We may be subject to intellectual property infringement claims that are costly to defend and could limit our ability to use some technologies in the future. Third parties may assert patent, copyright, trademark or other intellectual property rights to technologies or rights that are important to our business. Such claims may involve patent holding companies or other adverse patent owners who have no relevant product revenue, and therefore our own issued and pending patents may provide little or no deterrence. We have received in the past and expect that in the future we may receive, particularly as a public company, communications from competitors and other companies alleging that we may be infringing their patents, trade secrets or other intellectual property rights and/or offering licenses to such intellectual property or threatening litigation. In addition, we have agreed, and may in the future agree, to indemnify our customers for any expenses or liabilities resulting from claimed infringements of patents, trademarks or copyrights of third parties. Any claims asserting that our products infringe, or may infringe on, the proprietary rights of third parties, with or without merit, could be time-consuming, resulting in costly litigation and diverting the efforts of our engineering teams and management. These claims could also result in product shipment delays or require us to modify our products or enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available to us on acceptable terms, if at all.

The quality of our support and services offerings is important to our customers, and if we fail to continue to offer high quality support and services, we could lose customers, which would harm our business.

Once our products are deployed within our customers' networks, they depend on our support organization to resolve any issues relating to those products. A high level of support is critical for the successful marketing and sale of our products. If we do not effectively assist our customers in deploying our products, succeed in helping them quickly resolve post-deployment issues or provide effective ongoing support, it could adversely affect our ability to sell our products to existing customers and harm our reputation with potential new customers. As a result, our failure to maintain high quality support and services could result in the loss of customers, which would harm our business.

Our products are highly technical and may contain undetected hardware errors or software bugs, which could harm our reputation and adversely affect our business.

Our products are highly technical and, when deployed, are critical to the operation of many networks. Our products have contained and may contain undetected errors, bugs or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by customers, and may in some cases only be detected under certain circumstances or after extended use. Any errors, bugs, defects or security vulnerabilities discovered in our products after commercial release could result in loss of revenues or delay in revenue recognition, loss of customer goodwill and customers and increased service and warranty cost, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort or breach of warranty. Our contracts with customers contain provisions relating to warranty disclaimers and liability limitations, which may not be upheld. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention and adversely affect the market's perception of us and

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our products. In addition, if our business liability insurance coverage proves inadequate or future coverage is unavailable on acceptable terms or at all, our business, operating results and financial condition could be adversely impacted.

Our estimates regarding future warranty obligations may change due to product failure rates, shipment volumes, field service obligations and rework costs incurred in correcting product failures. If our estimates change, the liability for warranty obligations may be increased, impacting future cost of revenue.

Our products are highly complex, and our product development, manufacturing and integration testing may not be adequate to detect all defects, errors, failures and quality issues. Quality or performance problems for products covered under warranty could adversely impact our reputation and negatively affect our operating results and financial position. The development and production of new products with high complexity often involves problems with software, components and manufacturing methods. If significant warranty obligations arise due to reliability or quality issues arising from defects in software, faulty components or manufacturing methods, our operating results and financial position could be negatively impacted by:

- cost associated with fixing software or hardware defects;
- high service and warranty expenses;
- high inventory obsolescence expense;
- delays in collecting accounts receivable;
- payment of liquidated damages for performance failures; and
- declining sales to existing customers.

Our use of open source software could impose limitations on our ability to commercialize our products.

We incorporate open source software into our products. Although we closely monitor our use of open source software, the terms of many open source software licenses have not been interpreted by the courts, and there is a risk that such licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to sell our products. In such event, we could be required to make our proprietary software generally available to third parties, including competitors, at no cost, to seek licenses from third parties in order to continue offering our products, to re-engineer our products or to discontinue the sale of our products in the event re-engineering cannot be accomplished on a timely basis or at all, any of which could adversely affect our revenues and operating expenses.

If we are unable to obtain necessary third-party technology licenses, our ability to develop new products or product enhancements may be impaired.

While our current licenses of third-party technology relate to commercially available off-the-shelf technology, we may in the future be required to license additional technology from third parties to develop new products or product enhancements. These third-party licenses may be unavailable to us on commercially reasonable terms, if at all. Our inability to obtain necessary third-party licenses may force us to obtain substitute technology of lower quality or performance standards or at greater cost, any of which could harm the competitiveness of our products and result in lost revenues.

We may pursue acquisitions, which involve a number of risks. If we are unable to address and resolve these risks successfully, such acquisitions could disrupt our business.

On August 20, 2012, we signed a definitive agreement to acquire Ericsson's fiber access assets; the acquisition transaction is expected to close in the fourth quarter of 2012. On February 22, 2011, we acquired Occam Networks. We may in the future acquire other businesses, products or technologies to expand our product offerings and capabilities, customer base and business. We have evaluated, and expect to continue to evaluate, a wide array of potential strategic transactions. We have limited experience making such acquisitions. Any of these transactions could be material to our financial condition and results of operations. The anticipated benefit of acquisitions may never materialize. In addition, the process of integrating acquired businesses, products or technologies may create unforeseen operating difficulties and expenditures. Some of the areas where we may face acquisition-related risks include:

- diversion of management time and potential business disruptions;
- expenses, distractions and potential claims resulting from acquisitions, whether or not they are completed;
- retaining and integrating employees from any businesses we may acquire;

- issuance of dilutive equity securities or incurrence of debt;
- integrating various accounting, management, information, human resource and other systems to permit effective management;
- incurring possible write-offs, impairment charges, contingent liabilities, amortization expense or write-offs of

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goodwill;

- difficulties integrating and supporting acquired products or technologies;
- unexpected capital expenditure requirements;
- insufficient revenues to offset increased expenses associated with the acquisition;
- opportunity costs associated with committing capital to such acquisitions; and
- acquisition-related litigation.

Foreign acquisitions would involve risks in addition to those mentioned above, including those related to integration of operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries. We may not be able to address these risks successfully, or at all, without incurring significant costs, delays or other operating problems. Our inability to address successfully such risks could disrupt our business.

Our obligation to issue performance bonds to satisfy requirements under RUS and ARRA-related contracts may negatively impact our working capital and financial condition.

We are sometimes required to issue performance bonds to satisfy requirements under our RUS contracts, and expect that we may also be required to issue such bonds under the terms of contracts required by Broadband Stimulus programs under ARRA. The performance bonds generally cover the full amount of the RUS contract, and may be the same for ARRA contracts. Upon our performance under the contract and acceptance by the customer, the performance bond is released. The time period between issuing the performance bond and its release can be lengthy. We issue letters of credit under our existing credit facility to support these performance bonds. In the event we do not have sufficient capacity under our credit facility to support these bonds, we will have to provide certificates of deposit or other security, which could materially impact our working capital or limit our ability to satisfy such contract requirements. In the event that we are unable to issue such bonds, we may lose business and customers who purchase under RUS and ARRA contracts. In addition, if we exhaust our credit facility or working capital reserves in issuing such bonds, we may be required to eliminate or curtail expenditures to mitigate the impact on our working capital or financial condition.

Our use of and reliance upon development resources in China may expose us to unanticipated costs or liabilities.

We operate a wholly foreign owned enterprise, in Nanjing, China, where a dedicated team of engineers performs quality assurance, cost reduction and other engineering work. We also outsource a portion of our software development to a team of software engineers based in Shenyang, China. Our reliance upon development resources in China may not enable us to achieve meaningful product cost reductions or greater resource efficiency. Further, our development efforts and other operations in China involve significant risks, including:

- difficulty hiring and retaining appropriate engineering resources due to intense competition for such resources and resulting wage inflation;
- the knowledge transfer related to our technology and exposure to misappropriation of intellectual property or confidential information, including information that is proprietary to us, our customers and third parties;
- heightened exposure to changes in the economic, security and political conditions of China;
- fluctuation in currency exchange rates and tax risks associated with international operations; and
- development efforts that do not meet our requirements because of language, cultural or other differences associated with international operations, resulting in errors or delays.

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

Our customers are subject to government regulation, and changes in current or future laws or regulations that negatively impact our customers could harm our business.

The FCC has jurisdiction over all of our U.S. customers. FCC regulatory policies that create disincentives for investment in access network infrastructure or impact the competitive environment in which our customers operate may harm our business. For example, future FCC regulation affecting providers of broadband Internet access services could impede the penetration of our customers into certain markets or affect the prices they may charge in such markets. Furthermore, many of our customers are subject to FCC rate regulation of interstate telecommunications services, and are recipients of federal universal service fund payments, which are intended to subsidize telecommunications services in areas that are expensive to serve. In early October 2011, the chairman of the FCC outlined a plan to transform the Universal Service Fund, an $8 billion fund that is paid for by the nation's telephone customers and used to subsidize basic telephone service in rural areas, into one that will help expand broadband Internet service to 18 million Americans who lack high-speed access. Changes to these programs could change the

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ability of IOCs to access capital and reduce our revenue opportunities. In addition, many of our customers are subject to state regulation of intrastate telecommunications services, including rates for such services, and may also receive funding from state universal service funds. Changes in rate regulations or universal service funding rules, either at the federal or state level, could adversely affect our customers' revenues and capital spending plans. In addition, various international regulatory bodies have jurisdiction over certain of our non-U.S. customers. Changes in these domestic and international standards, laws and regulations, or judgments in favor of plaintiffs in lawsuits against CSPs based on changed standards, laws and regulations could adversely affect the development of broadband networks and services. This, in turn, could directly or indirectly adversely impact the communications industry in which our customers operate. To the extent our customers are adversely affected by laws or regulations regarding their business, products or service offerings, our business, financial condition and results of operations would suffer.

We engage resellers, including Ericsson, to promote, sell, install and support our products to some customers in North America, and internationally. Their failure to do so or our inability to recruit or retain resellers may reduce our sales and thus harm our business.

We engage some value added resellers, or VARs, who provide sales and support services for our products. In particular, we expect the reseller agreement signed with Ericsson on August 22, 2012 to provide us with an extensive new global reseller channel. We compete with other telecommunications systems providers for our VARs' business and many of our VARs, including Ericsson, are free to market competing products. If Ericsson or any other VAR promotes a competitor's products to the detriment of our products or otherwise fails to market our products and services effectively, we could lose market share. In addition, the loss of a key VAR or the failure of VARs to provide adequate customer service could have a negative effect on customer satisfaction and could cause harm to our business. If we do not properly train our VARs to sell, install and service our products, our business, financial condition and results of operations may suffer. Our use of VARs and other third party support partners, and the associated risks, are likely to increase as we expand sales outside of North America.

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

Our products may be or become subject to U.S. export controls that will restrict our ability to export them outside of the free-trade zones covered by the North American Free Trade Agreement, Central American Free Trade Agreement and other treaties and laws. Therefore, future international shipments of our products may require export licenses or export license exceptions. In addition, the import laws of other countries may limit our ability to distribute our products, or our customers' ability to buy and use our products, in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products or, in some cases, prevent the export or import of our products 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 negatively impact our ability to sell our products to existing or potential international customers.

If we lose any of our key personnel, or are unable to attract, train and retain qualified personnel, our ability to manage our business and continue our growth would be negatively impacted.

Our success depends, in large part, on the continued contributions of our key management, engineering, sales and marketing personnel, many of whom are highly skilled and would be difficult to replace. None of our senior management or key technical or sales personnel is bound by a written employment contract to remain with us for a specified period. In addition, we do not currently maintain key man life insurance covering our key personnel. If we lose the services of any key personnel, our business, financial condition and results of operations may suffer. Competition for skilled personnel, particularly those specializing in engineering and sales, is intense. We cannot be certain that we will be successful in attracting and retaining qualified personnel, or that newly hired personnel will function effectively, both individually and as a group. In particular, we must continue to expand our direct sales force, including hiring additional sales managers, to grow our customer base and increase sales. In addition, if we offer employment to personnel employed by competitors, we may become subject to claims of unfair hiring practices, and incur substantial costs in defending ourselves against these claims, regardless of their merits. If we are unable to effectively recruit, hire and utilize new employees, execution of our business strategy and our ability to react to changing market conditions may be impeded, and our business, financial condition and results of operations may suffer.

Volatility or lack of performance in our stock price may also affect our ability to attract and retain our key personnel. Our executive officers and employees hold a substantial number of shares of our common stock and vested stock options. Employees may be more likely to leave us if the shares they own or the shares underlying their vested options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options, or if

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the exercise prices of the options that they hold are significantly above the market price of our common stock. If we are unable to retain our employees, our business, operating results and financial condition will be harmed.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements on a timely basis could be impaired, which would adversely affect our operating results, our ability to operate our business and our stock price.

Ensuring that we have adequate internal financial and accounting controls and procedures in place to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. We have in the past discovered, and may in the future discover, areas of our internal financial and accounting controls and procedures that need improvement.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Our management does not expect that our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company will have been detected.

We have to comply with Section 404 of the Sarbanes-Oxley Act, which requires us to expend significant resources in developing the required documentation and testing procedures. We cannot be certain that the actions we have taken and are taking to improve our internal controls over financial reporting will be sufficient to maintain effective internal controls over financial reporting in subsequent reporting periods, or that we will be able to implement our planned processes and procedures in a timely manner. In addition, new and revised accounting standards and financial reporting requirements may occur in the future, and implementing changes required by new standards, requirements or laws may require a significant expenditure of our management's time, attention and resources and may adversely affect our reported financial results. If we are unable to produce accurate financial statements on a timely basis, investors could lose confidence in the reliability of our financial statements, which could cause the market price of our common stock to decline and make it more difficult for us to finance our operations and growth.

Interruptions, failures or material breaches in our information technology and communications systems could harm our business, customer relations and financial condition.

Information technology helps us operate efficiently, interface with customers, maintain financial accuracy and efficiency and accurately produce our financial statements. If we do not allocate and effectively manage the resources necessary to build and sustain the proper technology infrastructure, we could be subject to transaction errors, processing inefficiencies, the loss of customers, business disruptions or the loss of or damage to intellectual property through security breach. If our data management systems do not effectively collect, store, process and report relevant data for the operation of our business, whether due to equipment malfunction or constraints, software deficiencies or human error, our ability to effectively plan, forecast and execute our business plan and comply with applicable laws and regulations will be impaired, perhaps materially. Any such impairment could materially and adversely affect our financial condition, results of operations, cash flows and the timeliness with which we report our internal and external operating results.

We require user names and passwords in order to access our information technology systems. We also use encryption and authentication technologies to secure the transmission and storage of data. These security measures may be compromised as a result of third-party security breaches, employee error, malfeasance, faulty password management or other irregularity, and result in persons obtaining unauthorized access to our data or accounts. Third parties may attempt to fraudulently induce employees into disclosing user names, passwords or other sensitive information, which may in turn be used to access our information technology systems.

While we devote significant resources to network security, data encryption and other security measures to protect our information technology and communications systems and data, these security measures cannot provide absolute security. We may experience a breach of our systems and may be unable to protect sensitive data. The costs to us to eliminate or alleviate network security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in unexpected interruptions, delays, cessation of service and may harm our business operations.

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We incur significant increased costs as a result of operating as a public company, which may adversely affect our operating results and financial condition.

As a public company, we incur significant accounting, legal and other expenses that we did not incur as a private company, including costs associated with our public company reporting requirements. We also anticipate that we will continue to incur costs associated with corporate governance requirements, including requirements under the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as rules implemented by the Securities Exchange Commission, or SEC, and the New York Stock Exchange, or NYSE. Furthermore, these laws and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these requirements 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.

New laws and regulations as well as changes to existing laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act and rules adopted by the SEC and the NYSE, would likely result in increased costs to us as we respond to their requirements. We are investing resources to comply with evolving laws and regulations, and this investment may result in increased general and administrative expense and a diversion of management’s time and attention from revenue generating activities to compliance activities.

Risks Related to Our Merger Transaction with Occam and Our Pending Acquisition of the Fiber Access Business of Ericsson

Future results of the combined organization may differ materially from those in our current financial statements and financial forecasts, and the potential benefits of the transactions may not be realized.

The future results of the combined organization may be materially different from those contained in our current financial statements and financial forecasts. In addition, potential growth, expected financial results, perceived synergies and anticipated opportunities may not be realized through the ongoing integration of our business with those of Occam and Ericsson.

The Occam and Ericsson transactions could cause disruptions and materially adversely affect the future business and operations of the combined organization.

In connection with the transactions, it is possible that some customers, suppliers and other persons with whom we, Occam or Ericsson have had a business relationship may delay or defer certain business decisions, or determine to purchase a competitor's products. In particular, customers could be reluctant to purchase products due to uncertainty about the direction of our combined technology and product road map, and uncertainty regarding the willingness of the combined organization to support and service existing products after the transactions. If customers, suppliers or other persons, delay or defer business decisions, or purchase a competitor's products, it could negatively impact revenues, earnings and cash flows of the combined organization, as well as the market price of our common stock.

A class action lawsuit is pending against Occam and its former directors challenging the acquisition of Occam by us, and an unfavorable judgment or ruling in this lawsuit could result in substantial costs.

On September 16, 2010, the Company, Occam, Ocean Sub I, Inc., and two direct, wholly owned subsidiaries of the Company, entered into an Agreement and Plan of Merger and Reorganization, or the Merger Agreement. In response to the announcement of the Merger Agreement, four separate purported class action complaints were filed by purported stockholders of Occam against Occam and the former members of its board of directors , including three complaints in the California Superior Court for Santa Barbara County and one complaint in the Delaware Court of Chancery. Each complaint generally alleged that the former members of the Occam board breached their fiduciary duties in connection with the acquisition of Occam by Calix, by, among other things, engaging in an allegedly unfair process and agreeing to an allegedly unfair price for the merger transaction, and each complaint sought rescission of the merger transaction as well as other remedies including unspecified damages and costs and fees. The three California class actions have been dismissed without prejudice in favor of the Delaware class action. On January 6, 2012, the Delaware court found that certain lead plaintiffs, Michael Steinhardt, Steinhardt Overseas Management, L.P. and Ilex Partners, L.L.C., collectively the “Steinhardt Plaintiffs", had engaged in improper trading of Calix shares and dismissed the Steinhardt Plaintiffs from the case with prejudice. The remaining lead plaintiffs are expected to continue to seek an award of damages in an unspecified amount.

We believe that the allegations in the pending action are without merit and intend to vigorously contest the action. However, there can be no assurance that we will be successful in our defense. In addition, under the Merger Agreement and Delaware law, we have obligations, under certain circumstances, to hold harmless and indemnify each of the former directors of Occam against judgments, fines, settlements and expenses related to claims against such directors and otherwise to the fullest extent permitted under Delaware law and Occam's bylaws and certificate of incorporation. Such obligations may apply to this lawsuit, and therefore an unfavorable outcome in this lawsuit could result in substantial costs for us.

Risks Related to Ownership of Our Common Stock

Our stock price may be volatile, and the value of an investment in our common stock may decline.

The trading price of our common stock has been, and is likely to continue to be, volatile, which means that it could decline substantially within a short period of time and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. These factors include those discussed in this “Risk Factors” section of this Form 10-Q and others such as:

- quarterly variations in our results of operations or those of our competitors;
- failures by us to meet any guidance regarding our anticipated results that we have previously provided;
- changes in earnings estimates or recommendations by securities analysts;
- announcements by us or our competitors of new products, significant contracts, commercial relationships, acquisitions or capital commitments;
- developments with respect to intellectual property rights;
- our ability to develop and market new and enhanced products on a timely basis;
- our commencement of, or involvement in, litigation;
- changes in governmental regulations or in the status of our regulatory approvals; and
- a slowdown in the communications industry or the general economy.

In recent years, the stock market in general, and the market for technology companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Broad market and industry factors may seriously affect the market price of our common stock, regardless of our actual operating performance. In addition, in the past, following periods of volatility in the overall market and the market price of a particular company’s securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management’s attention and resources.

If securities or industry analysts do not publish research or reports about our business or if they issue an adverse or misleading opinion regarding our stock, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If any of the analysts who cover us issue an adverse or misleading opinion regarding our stock, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable and may lead to entrenchment of management.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that could have the effect of delaying or preventing changes in control or changes in our management without the consent of our board of directors. These provisions include:

- a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board of directors;
- no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;
- the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;
-

a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

- the requirement that a special meeting of stockholders may be called only by the chairman of the board of

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directors, the chief executive officer or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and

- advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of us.

We are also subject to certain anti-takeover provisions under Delaware law. Under Delaware law, a corporation may not, in general, engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction.

We may need additional capital in the future to finance our business.

We may need to raise additional capital to fund operations in the future. Although we believe that, based on our current level of operations and anticipated growth, our existing cash, cash equivalents will provide adequate funds for ongoing operations, planned capital expenditures and working capital requirements for at least the next 12 months, we may need additional capital if our current plans and assumptions change. If future financings involve the issuance of equity securities, our then-existing stockholders would suffer dilution. If we raised additional debt financing, we may be subject to restrictive covenants that limit our ability to conduct our business. We may not be able to raise sufficient additional funds on terms that are favorable to us, if at all. If we fail to raise sufficient funds and continue to incur losses, our ability to fund our operations, take advantage of strategic opportunities, develop products or technologies or otherwise respond to competitive pressures could be significantly limited. Any failure to obtain financing when and as required could force us to curtail our operations, which would harm our business.

We do not currently intend to pay dividends on our common stock and, consequently, our stockholder's ability to achieve a return on their investment will depend on appreciation in the price of our common stock.

We do not currently intend to pay any cash dividends on our common stock for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. Additionally, the terms of our credit facility restrict our ability to pay dividends. Therefore, our stockholders are not likely to receive any dividends on our common stock for the foreseeable future.

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

There were no unregistered sales, or purchases made by or on behalf of us or by any affiliated purchaser, of our equity securities during the nine months ended September 29, 2012.

ITEM 3. Defaults Upon Senior Securities.

None.

ITEM 4. Mine Safety Disclosures.

Not applicable.

ITEM 5. Other Information.

None.

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ITEM 6. Exhibits.

Exhibit Number	Description
10.1	Asset Purchase Agreement between Ericsson Inc. and Calix, Inc., dated August 20, 2012.
10.2*	Calix, Inc. Non-Employee Director Cash Compensation Policy, effective January 1, 2012.
31.1	Certification of Chief Executive Officer of Calix, Inc. Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer of Calix, Inc. Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer of Calix, Inc. Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS **	XBRL Instance Document
101.SCH **	XBRL Taxonomy Extension Schema Document
101.CAL **	Taxonomy Extension Calculation Linkbase Document
101.DEF **	Taxonomy Extension Definition Linkbase Document
101.LAB **	XBRL Taxonomy Extension Label Linkbase Document
101.PRE **	XBRL Taxonomy Extension Presentation Linkbase Document

* Indicates management compensatory plan, contract or arrangement.

** In accordance with Rule 406T of Regulation S-T, the XBRL information is furnished and not filed herewith, is not a part of a registration statement or Prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURES

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

	CALIX, INC. (Registrant)
Dated: November 1, 2012	By: /s/ Carl Russo Carl Russo Chief Executive Officer (Principal Executive Officer)
Dated: November 1, 2012	By: /s/ Michael Ashby Michael Ashby Chief Financial Officer (Principal Financial Officer)