

CALIX, INC  
Form 10-Q  
July 31, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 28, 2014

OR

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

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

Commission File Number: 001-34674

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

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|   |   |
|---|---|
| Delaware<br>(State or Other Jurisdiction of<br>Incorporation or Organization)                     | 68-0438710<br>(I.R.S. Employer<br>Identification No.) |
| 1035 N. McDowell Blvd., Petaluma, CA 94954<br>(Address of Principal Executive Offices) (Zip Code) |   |
| (707) 766-3000<br>(Registrant's Telephone Number, Including Area Code)                            |   |

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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:  No:

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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:  No:

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

Large Accelerated Filer  Accelerated Filer

Non-accelerated filer  (Do not check if a smaller reporting Company) Smaller Reporting Company

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

As of July 21, 2014, there were 50,914,092 shares of the Registrant's common stock, par value \$0.025 outstanding.



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## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements (Unaudited)

CALIX, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

|  | June 28,<br>2014<br>(Unaudited) | December 31,<br>2013<br>(See Note 1) |
|--|---------------------------------|--------------------------------------|
| <b>ASSETS</b>  |                                 |                                      |
| Current assets:  |                                 |                                      |
| Cash and cash equivalents  | \$32,543                        | \$82,747                             |
| Marketable securities  | 46,439                          | —                                    |
| Restricted cash  | 295                             | 295                                  |
| Accounts receivable, net   | 47,330                          | 43,520                               |
| Inventory  | 45,888                          | 51,071                               |
| Deferred cost of revenue   | 15,957                          | 21,076                               |
| Prepaid expenses and other current assets  | 5,038                           | 5,757                                |
| Total current assets   | 193,490                         | 204,466                              |
| Property and equipment, net  | 17,289                          | 17,473                               |
| Goodwill   | 116,175                         | 116,175                              |
| Intangible assets, net   | 34,460                          | 43,740                               |
| Other assets   | 1,503                           | 1,745                                |
| Total assets   | \$362,917                       | \$383,599                            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                 |                                      |
| Current liabilities:   |                                 |                                      |
| Accounts payable   | \$12,850                        | \$23,163                             |
| Accrued liabilities  | 34,689                          | 32,075                               |
| Deferred revenue   | 26,346                          | 34,862                               |
| Total current liabilities  | 73,885                          | 90,100                               |
| Long-term portion of deferred revenue  | 18,640                          | 18,431                               |
| Other long-term liabilities  | 958                             | 1,145                                |
| Total liabilities  | 93,483                          | 109,676                              |
| 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 June 28, 2014 and December 31, 2013  | —                               | —                                    |
| Common stock, \$0.025 par value; 100,000,000 shares authorized; 50,910,446 shares and 50,224,952 shares issued and outstanding as of June 28, 2014 and December 31, 2013, respectively | 1,273                           | 1,256                                |
| Additional paid-in capital   | 791,756                         | 782,253                              |
| Accumulated other comprehensive income   | 159                             | 190                                  |
| Accumulated deficit  | (523,754)                       | (509,776)                            |
| Total stockholders' equity   | 269,434                         | 273,923                              |
| Total liabilities and stockholders' equity   | \$362,917                       | \$383,599                            |

See accompanying notes to condensed consolidated financial statements.



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CALIX, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands, except per share data)

(Unaudited)

|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 28,<br>2014   | June 29,<br>2013 | June 28,<br>2014 | June 29,<br>2013 |
| Revenue  | \$98,005           | \$94,439         | \$183,825        | \$184,987        |
| Cost of revenue:   |                    |                  |                  |                  |
| Products and services <sup>(1)</sup>   | 51,575             | 49,846           | 98,381           | 97,191           |
| Amortization of intangible assets  | 2,088              | 2,088            | 4,176            | 4,176            |
| Total cost of revenue  | 53,663             | 51,934           | 102,557          | 101,367          |
| Gross profit   | 44,342             | 42,505           | 81,268           | 83,620           |
| Operating expenses:  |                    |                  |                  |                  |
| Research and development <sup>(1)</sup>  | 19,544             | 20,035           | 39,174           | 40,206           |
| Sales and marketing <sup>(1)</sup>   | 18,455             | 17,079           | 35,845           | 32,880           |
| General and administrative <sup>(1)</sup>  | 7,681              | 7,684            | 14,932           | 15,815           |
| Amortization of intangible assets  | 2,552              | 2,552            | 5,104            | 5,104            |
| Total operating expenses   | 48,232             | 47,350           | 95,055           | 94,005           |
| Loss from operations   | (3,890)            | (4,845)          | (13,787)         | (10,385)         |
| Interest and other income (expense), net:  |                    |                  |                  |                  |
| Interest income  | 30                 | 1                | 34               | 2                |
| Interest expense   | (58)               | (42)             | (115)            | (70)             |
| Other income (expense), net  | 70                 | (43)             | 103              | (322)            |
| Loss before provision for income taxes   | (3,848)            | (4,929)          | (13,765)         | (10,775)         |
| Provision for income taxes   | 103                | 224              | 213              | 581              |
| Net loss   | \$(3,951)          | \$(5,153)        | \$(13,978)       | \$(11,356)       |
| Net loss per common share:   |                    |                  |                  |                  |
| Basic and diluted  | \$(0.08)           | \$(0.10)         | \$(0.28)         | \$(0.23)         |
| Weighted-average number of shares used to<br>compute net loss per common share:          |                    |                  |                  |                  |
| Basic and diluted  | 50,573             | 49,153           | 50,425           | 49,034           |
| Other comprehensive (loss) income, net of tax:   |                    |                  |                  |                  |
| Unrealized gains (losses) on available-for-sale<br>marketable securities adjustment, net | (25)               | —                | (25)             | —                |
| Foreign currency translation adjustment, net   | (17)               | 30               | (6)              | 12               |
| Total other comprehensive (loss) income  | (42)               | 30               | (31)             | 12               |
| Comprehensive loss   | \$(3,993)          | \$(5,123)        | \$(14,009)       | \$(11,344)       |

<sup>(1)</sup> Includes stock-based compensation as follows:

|                            |         |         |         |         |
|----------------------------|---------|---------|---------|---------|
| Cost of revenue            | \$354   | \$377   | \$708   | \$728   |
| Research and development   | 1,306   | 1,300   | 2,486   | 2,486   |
| Sales and marketing        | 1,462   | 1,464   | 2,830   | 2,743   |
| General and administrative | 1,282   | 2,134   | 2,282   | 4,037   |
|                            | \$4,404 | \$5,275 | \$8,306 | \$9,994 |

See accompanying notes to condensed consolidated financial statements.





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CALIX, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Six Months Ended |                  |
|---|------------------|------------------|
|   | June 28,<br>2014 | June 29,<br>2013 |
| Operating activities:   |                  |                  |
| Net loss  | \$(13,978 )      | \$(11,356 )      |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: |                  |                  |
| Depreciation and amortization   | 4,522            | 5,363            |
| Loss on retirement of property and equipment  | —                | 560              |
| Amortization of intangible assets   | 9,280            | 9,280            |
| Amortization of premiums related to available-for-sale securities                         | 108              | —                |
| Stock-based compensation  | 8,306            | 9,994            |
| Changes in operating assets and liabilities:  |                  |                  |
| Accounts receivable, net  | (3,809 )         | (3,207 )         |
| Inventory   | 5,183            | 5,880            |
| Deferred cost of revenue  | 5,119            | (7,991 )         |
| Prepaid expenses and other assets   | 960              | (2,009 )         |
| Accounts payable  | (10,313 )        | (90 )            |
| Accrued liabilities   | 2,601            | 464              |
| Deferred revenue  | (8,307 )         | 16,001           |
| Other long-term liabilities   | (188 )           | 311              |
| Net cash (used in) provided by operating activities                                       | (516 )           | 23,200           |
| Investing activities:   |                  |                  |
| Purchase of marketable securities   | (46,572 )        | —                |
| Purchase of property and equipment  | (4,328 )         | (3,265 )         |
| Net cash used in investing activities   | (50,900 )        | (3,265 )         |
| Financing activities:   |                  |                  |
| Proceeds from exercise of stock options   | 139              | 288              |
| Proceeds from employee stock purchase plan  | 2,453            | 2,464            |
| Taxes paid for awards vested under equity incentive plans                                 | (1,377 )         | (312 )           |
| Net cash (used in) provided by financing activities                                       | 1,215            | 2,440            |
| Effect of exchange rate changes on cash and cash equivalents                              | (3 )             | 9                |
| Net (decrease) increase in cash and cash equivalents                                      | (50,204 )        | 22,384           |
| Cash and cash equivalents at beginning of period  | 82,747           | 46,995           |
| Cash and cash equivalents at end of period  | \$32,543         | \$69,379         |
| Non-cash investing activities:  |                  |                  |
| Property and equipment acquired using credits from Ericsson Inc.                          | \$—              | \$125            |

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. The Company is 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. The Company enables 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. The Company focuses 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. The Company develops and sells carrier-class hardware and software products, which the Company refers 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, 2013 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, 2013, included in the Company's Form 10-K.

The Company's fiscal year begins on January 1st and ends on December 31st. Quarterly periods are based on a 4-4-5 fiscal calendar with the first, second and third fiscal quarters ending on the 13th Saturday of each fiscal period. As a result, the Company had one fewer day in the six months ended June 28, 2014 than in the six months ended June 29, 2013, and the same number of days in the three months ended June 28, 2014 as in the three months ended June 29, 2013. 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, 2013. Our significant accounting policies did not change during the six months ended June 28, 2014.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which provides guidance for revenue recognition. ASU 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. Additionally, it supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts, and creates new Subtopic 340-40, Other Assets and Deferred Costs-Contracts with Customers. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under the previous guidance. These may include identifying

performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard will be effective for the Company in the first quarter of fiscal 2017. Early adoption is not permitted. The Company is currently assessing the potential impact on its financial statements from adopting this new guidance.

In July 2013, the FASB issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"), which provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward exists. Under the new standard update, the Company's unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. The accounting standard update became effective for the Company in the first quarter of 2014. As the Company's disclosures

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already conform to the required presentation, adoption of this standard did not impact the financial position or results of operations of the Company.

### 3. Cash, Cash Equivalents and Marketable Securities

The Company has invested its excess cash primarily in money market funds and highly liquid corporate debt instruments. The Company considers all investments with maturities of three months or less when purchased to be cash equivalents. Marketable securities represent highly liquid debt instruments with maturities greater than 90 days at date of purchase. Marketable securities with maturities greater than one year are classified as current because management considers all marketable securities to be available for current operations.

The Company's investments have been classified and accounted for as available-for-sale. Such investments are recorded at fair value and unrealized holding gains and losses are reported as a separate component of accumulated other comprehensive income in stockholders' equity until realized. Realized gains and losses on sales of marketable securities, if any, are reclassified from accumulated other comprehensive income to results of operations as other income (expense). The Company, to date, has not determined that any of the unrealized losses on its investments are considered to be other-than-temporary. The Company reviews its investment portfolio to determine if any security is other-than-temporarily impaired, which would require the Company to record an impairment charge in the period any such determination is made. In making this judgment, the Company evaluates, among other things, the duration and extent to which the fair value of a security is less than its cost; the financial condition of the issuer and any changes thereto; and the Company's intent and ability to sell, or whether the Company will more likely than not be required to sell, the security before recovery of its amortized cost basis. The Company has evaluated its investments as of June 28, 2014 and has determined that no investments with unrealized losses are other-than-temporarily impaired. No investments have been in a continuous loss position greater than one year

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

|  | June 28,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
| Cash and cash equivalents:                             |                  |                      |
| Cash   | \$17,377         | \$62,905             |
| Money market funds                                     | 15,166           | 19,842               |
| Total cash and cash equivalents                        | 32,543           | 82,747               |
| Marketable securities:                                 |                  |                      |
| Corporate debt securities                              | 41,048           | —                    |
| Commercial paper                                       | 5,391            | —                    |
| Total marketable securities                            | 46,439           | —                    |
| Total cash, cash equivalents and marketable securities | \$78,982         | \$82,747             |

The carrying amounts of our money market funds approximate their fair values due to their nature, duration and short maturities.

As of June 28, 2014, the amortized cost and fair value of marketable securities were as follows (in thousands):

|                             | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
|-----------------------------|-------------------|------------------------------|-------------------------------|------------|
| Corporate debt securities   | \$41,073          | \$1                          | \$(26 )                       | \$41,048   |
| Commercial paper            | 5,391             | —                            | \$—                           | 5,391      |
| Total marketable securities | \$46,464          | \$1                          | \$(26 )                       | \$46,439   |

As of June 28, 2014, there are no available-for-sale securities that have been in a continuous unrealized loss position in excess of twelve months.

As of June 28, 2014, the amortized cost and fair value of marketable securities by contractual maturity were as follows (in thousands):

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|                             | Amortized Cost | Fair Value |
|-----------------------------|----------------|------------|
| Due in 1 year or less       | \$23,744       | \$23,734   |
| Due in 1-2 years            | \$22,720       | \$22,705   |
| Total marketable securities | \$46,464       | \$46,439   |

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## 4. Fair Value Measurements

In accordance with Accounting Standard Codification ("ASC") 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 following table sets forth the Company's financial assets measured at fair value on a recurring basis as of June 28, 2014 and December 31, 2013, based on the three-tier fair value hierarchy (in thousands):

| As of June 28, 2014       | Level 1  | Level 2  | Total    |
|---------------------------|----------|----------|----------|
| Money market funds        | \$15,166 | \$—      | \$15,166 |
| Corporate debt securities | —        | 41,048   | 41,048   |
| Commercial paper          | —        | 5,391    | 5,391    |
| Total                     | \$15,166 | \$46,439 | \$61,605 |

| As of December 31, 2013   | Level 1  | Level 2 | Total    |
|---------------------------|----------|---------|----------|
| Money market funds        | \$19,842 | \$—     | \$19,842 |
| Corporate debt securities | —        | —       | —        |
| Commercial paper          | —        | —       | —        |
| Total                     | \$19,842 | \$—     | \$19,842 |

The fair values of money market funds classified as Level 1 were derived from quoted market prices as active markets for these instruments exist. The fair values of corporate debt securities and commercial paper classified as Level 2 were derived from quoted market prices for similar instruments indexed to prevailing market yield rates. The Company has no level 3 financial assets. The Company did not have any transfers between Level 1 and Level 2 of the fair value hierarchy during the six months ended June 28, 2014 and June 29, 2013.

## 5. Goodwill and Intangible Assets

## Goodwill

Goodwill was recorded as a result of the Company's acquisitions of Occam Networks, Inc. ("Occam") in February 2011 and Optical Solutions, Inc. ("OSI") in February 2006. This goodwill is not deductible for tax purposes, and there have been no adjustments to goodwill since the acquisition dates.

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 at 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. Management assessed qualitative factors to determine whether it was more likely than not (that is, a likelihood of more than 50 percent) that the fair value of the Company was less than its carrying amount, including goodwill, as of June 28, 2014. In assessing the qualitative factors, management considered the impact of these key factors: macro-economic conditions, industry and market environment, overall financial performance of the Company, cash flow from operating activities, market capitalization and stock price. Management concluded that the fair value of the Company was more likely than not greater than its carrying amount as of June 28, 2014. As such, it was not necessary to perform the two-step goodwill impairment test at the time.

Based on the above assessment, the Company concluded that there was no impairment to the carrying value of the Company's goodwill as of June 28, 2014.

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## Intangible Assets

Intangible assets are carried at cost, less accumulated amortization. The details of intangible assets as of June 28, 2014 and December 31, 2013 are disclosed in the following table (in thousands):

|   | June 28, 2014         |                          |          | December 31, 2013     |                          |          |
|---|-----------------------|--------------------------|----------|-----------------------|--------------------------|----------|
|   | Gross Carrying Amount | Accumulated Amortization | Net      | Gross Carrying Amount | Accumulated Amortization | Net      |
| Core developed technology                   | \$68,964              | \$(51,515)               | \$17,449 | \$68,964              | \$(47,339)               | \$21,625 |
| Customer relationships                      | 54,740                | (37,729)                 | 17,011   | 54,740                | (32,625)                 | 22,115   |
| Total intangible assets, excluding goodwill | \$123,704             | \$(89,244)               | \$34,460 | \$123,704             | \$(79,964)               | \$43,740 |

Amortization expense was \$4.6 million for the three months ended June 28, 2014 and June 29, 2013. Amortization expense was \$9.3 million for the six months ended June 28, 2014 and June 29, 2013.

As of June 28, 2014, expected future amortization expense for the fiscal years indicated is as follows (in thousands):

| Period            | Expected Amortization Expense |
|-------------------|-------------------------------|
| Remainder of 2014 | \$9,280                       |
| 2015              | 18,561                        |
| 2016              | 5,805                         |
| 2017              | 814                           |
| Total             | \$34,460                      |

## 6. Balance Sheet Details

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

|                                 | June 28, 2014 | December 31, 2013 |
|---------------------------------|---------------|-------------------|
| Accounts receivable             | \$48,382      | \$44,642          |
| Allowance for doubtful accounts | (390)         | (358)             |
| Product return reserve          | (662)         | (764)             |
| Accounts receivable, net        | \$47,330      | \$43,520          |

Inventory consisted of the following (in thousands):

|                 | June 28, 2014 | December 31, 2013 |
|-----------------|---------------|-------------------|
| Raw materials   | \$5,486       | \$6,591           |
| Finished goods  | 40,402        | 44,480            |
| Total inventory | \$45,888      | \$51,071          |

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

|   | June 28, 2014 | December 31, 2013 |
|---|---------------|-------------------|
| Test equipment                            | \$37,544      | \$36,932          |
| Computer equipment and software           | 28,860        | 27,280            |
| Furniture and fixtures                    | 1,642         | 1,614             |
| Leasehold improvements                    | 7,346         | 7,077             |
| Total                                     | 75,392        | 72,903            |
| Accumulated depreciation and amortization | (58,103)      | (55,430)          |
| Property and equipment, net               | \$17,289      | \$17,473          |





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Accrued liabilities consisted of the following (in thousands):

|   | June 28,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| Accrued warranty  | \$10,638         | \$10,856             |
| Accrued compensation and related benefits                       | 14,506           | 13,127               |
| Accrued professional and consulting fees                        | 2,441            | 1,634                |
| Accrued excess and obsolete inventory at contract manufacturers | 541              | 756                  |
| Accrued customer rebates  | 880              | 712                  |
| Accrued business travel expenses                                | 755              | 540                  |
| Sales and use tax payable                                       | 756              | 521                  |
| Income taxes payable  | 477              | 368                  |
| Accrued other   | 3,695            | 3,561                |
| Total accrued liabilities                                       | \$34,689         | \$32,075             |

Deferred revenue consisted of the following (in thousands):

|                                    | June 28,<br>2014 | December 31,<br>2013 |
|------------------------------------|------------------|----------------------|
| Product and services - current     | \$23,453         | \$32,051             |
| Extended warranty - current        | 2,893            | 2,811                |
| Extended warranty - non-current    | 18,556           | 18,335               |
| Product and services - non-current | 84               | 96                   |
| Total deferred revenue             | \$44,986         | \$53,293             |

Deferred cost of revenue consisted entirely of products and services.

## 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, 2013 are disclosed in our Annual Report on Form 10-K, and have not changed materially during the six months ended June 28, 2014 except for the following agreements entered into during 2014.

On March 4, 2014, the Company entered into a new commercial lease for a facility in Santa Barbara, California. The lease is set to commence on July 1, 2014 and expire on June 30, 2019. The total minimum future payment commitment under this lease is \$1.0 million. In connection with this lease, the Company received an incentive consisting of \$0.4 million that can be used for leasehold improvements, which will be amortized over the shorter of the lease term or estimated useful life of the assets.

On March 20, 2014, the Company entered into a new commercial lease for a facility in Richardson, Texas. This lease is set to commence on August 1, 2014 and expire on January 31, 2022. The total minimum future payment commitment under this lease is \$1.5 million. In connection with this lease, the Company received an incentive consisting of \$0.4 million that can be used for leasehold improvements, which will be amortized over the shorter of the lease term or estimated useful life of the assets.

### 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 |                  | Six Months Ended |                  |
|--------------------|------------------|------------------|------------------|
| June 28,<br>2014   | June 29,<br>2013 | June 28,<br>2014 | June 29,<br>2013 |
|                    |                  |                  |                  |

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|                                     |          |          |          |          |
|-------------------------------------|----------|----------|----------|----------|
| Balance at beginning of period      | \$10,827 | \$11,985 | \$10,856 | \$11,762 |
| Warranty charged to cost of revenue | 1,053    | 1,615    | 1,962    | 2,782    |
| Utilization of warranty             | (1,242 ) | (1,277 ) | (2,180 ) | (2,221 ) |
| Balance at end of period            | \$10,638 | \$12,323 | \$10,638 | \$12,323 |

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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 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 (the “amended Steinhardt complaint”). The amended Steinhardt complaint named Occam (which has since been merged into Calix) and the members of the Occam board of directors as defendants. The amended Steinhardt complaint did not name Calix as a defendant.

The amended Steinhardt complaint sought injunctive relief rescinding the merger transaction and an 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 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. The certified class is a non-opt-out class consisting of all owners of Occam common stock whose shares were converted to shares of Calix on the date of the merger transaction, with the exception of the defendants in the Delaware action and their affiliates. 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.

Fact discovery in the case closed on April 30, 2013. On June 11, 2013, the plaintiffs filed their Second Amended Class Action Complaint for Breach of Fiduciary Duty (“Second Amended Complaint”). The Second Amended Complaint adds Occam's former CFO as a defendant, and alleges that each of the defendants breached their fiduciary duties by failing to attempt to obtain the best purchase price for Occam and 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 filed with the SEC on November 2, 2010.

On July 17, 2013, attorneys representing all of the defendants named in the Second Amended Complaint filed Defendants' Opening Brief in Support of Their Motion for Summary Judgment, arguing that all defendants are entitled to summary judgment on all counts of the Second Amended Complaint. Plaintiffs' answering brief to the motion for summary judgment was filed on September 3, 2013, and defendants' reply brief was filed on October 4, 2013. A hearing on the motion for summary judgment was held on December 6, 2013.

On April 8, 2014, the Court of Chancery of the State of Delaware issued an Opinion granting in part and denying in part the Defendants' Motion for Summary Judgment. The court granted summary judgment in favor of those defendants who served solely as directors of Occam with respect to all claims alleging improper actions in connection with the Occam sale process. The ruling also granted summary judgment on all claims as to Occam, the corporate entity. The court left in place process-based claims against Occam's former CEO and CFO, and also declined to grant summary judgment on separate claims that the director and officer defendants breached their fiduciary duties by issuing a proxy statement for Occam's stockholder vote that allegedly contained misleading disclosures and had material omissions.

On June 12, 2014 the plaintiffs filed a Motion to Compel Production of Documents by Defendants and Jefferies & Company, Inc. and For Sanctions Against Defendants. This motion seeks additional documents from defendants and from Jefferies, Occam's former advisor, and requests that the court impose severe sanctions, up to and including a finding of liability against defendants. Defendants reject the suggestion that any additional documents should be produced and vigorously oppose the imposition of any sanctions.

The Company continues to believe that the allegations in the Second Amended Complaint are without merit and intends to continue to vigorously contest the action as it moves forward toward trial. However, there can be no assurance that the defendants 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 and officers 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 may ultimately result in the payment of indemnification amounts by the Company. The plaintiffs have not communicated any specific demand for damages. At this time, the Company is unable to quantify its indemnification risk, and an adverse result at trial could have a material adverse effect on the Company's business, operating results or financial condition. The trial is scheduled for February 16, 2015.

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.

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## 8. 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 |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | June 28,<br>2014   | June 29,<br>2013 | June 28,<br>2014 | June 29,<br>2013 |
| Numerator:                                    |                    |                  |                  |                  |
| Net loss                                      | \$ (3,951 )        | \$ (5,153 )      | \$ (13,978 )     | \$ (11,356 )     |
| Denominator:                                  |                    |                  |                  |                  |
| Weighted-average common shares outstanding    | 50,573             | 49,153           | 50,425           | 49,034           |
| Basic and diluted net loss per common share   | \$ (0.08 )         | \$ (0.10 )       | \$ (0.28 )       | \$ (0.23 )       |
| Potentially dilutive shares, weighted average | 5,262              | 5,526            | 5,011            | 5,251            |

For all periods presented, unvested restricted stock awards are included in the calculation of weighted-average common shares outstanding because such shares are participating securities; however, the impact was immaterial.

## 9. Stockholders' Equity

## Equity Incentive Plans

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 20, 2014. The Company also maintains a 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. To date, awards granted under the Plans consist of stock options, restricted stock units ("RSUs"), restricted stock awards ("RSAs"), and performance restricted stock units ("PRSUs").

## Stock Options

During the three months ended June 28, 2014, the Company did not grant stock options. During the six months ended June 28, 2014, the Company granted 551,000 stock options at a weighted-average grant date fair value of \$4.43 per share. During the three months ended June 28, 2014, 23,916 stock options were exercised at a weighted-average exercise price of \$4.94 per share. During the six months ended June 28, 2014, 28,811 stock options were exercised at a weighted-average exercise price of \$4.83 per share. As of June 28, 2014, unrecognized stock-based compensation expense of \$6.8 million related to stock options, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 2.5 years.

## Restricted Stock Units

During the three months ended June 28, 2014, 663,696 RSUs were granted with a weighted-average grant date fair value of \$8.77 per share. During the six months ended June 28, 2014, 679,396 RSUs were granted with a weighted-average grant date fair value of \$8.76 per share. During the three months ended June 28, 2014, 223,615 RSUs vested, net of shares withheld at the then-current value equivalent to the employees' minimum statutory obligation for applicable income and other employment taxes, and were converted to an equivalent number of shares of common stock. Taxes withheld from employees of \$0.7 million were remitted to the relevant taxing authorities during the three months ended June 28, 2014. During the six months ended June 28, 2014, 225,751 RSUs vested, net of shares withheld at the then-current value equivalent to the employees' minimum statutory obligation for applicable income and other employment taxes, and were converted to an equivalent number of shares of common stock. Taxes withheld from employees of \$0.7 million were remitted to the relevant taxing authorities during the six months ended June 28, 2014. As of June 28, 2014, unrecognized stock-based compensation expense of \$12.1 million related to RSUs, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 2.3 years.

## Performance Restricted Stock Units

In 2012, the Company commenced granting PRSUs to its executives with two-year and three-year performance periods. 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 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 the first day of the applicable performance period. 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, which may equal from zero percent (0%) to two hundred percent (200%) of the target award.

During the three months ended June 28, 2014, no PRSUs were granted. During the six months ended June 28, 2014, the Company granted 144,000 PRSUs with a weighted-average grant date fair value of \$8.00 per unit. During the three months ended June 28, 2014, 4,681 PRSUs, net of shares withheld at the then-current value equivalent to the employees' minimum statutory obligation for applicable income and other employment taxes, were converted to an equivalent number of shares of common stock. Taxes withheld from employees of \$23

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thousand were remitted to the relevant taxing authorities during the three months ended June 28, 2014. During the six months ended June 28, 2014, 94,249 PRSUs, net of shares withheld at the then-current value equivalent to the employees' minimum statutory obligation for applicable income and other employment taxes, were converted to an equivalent number of shares of common stock. Taxes withheld from employees of \$0.5 million were remitted to the relevant taxing authorities during the six months ended June 28, 2014. As of June 28, 2014, unrecognized stock-based compensation expense of \$1.9 million related to PRSUs, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 1.4 years.

Restricted Stock Awards

During the three and six months ended June 28, 2014, no RSAs were granted. Upon the vesting of RSAs during the three and six months ended June 28, 2014, taxes withheld from employees of \$0.1 million were remitted to the relevant taxing authorities. As of June 28, 2014, unrecognized stock-based compensation expense of \$1.6 million related to RSAs, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 1.1 years.

Employee Stock Purchase Plan

The Company's Amended and Restated Employee Stock Purchase Plan ("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. In addition, no participant may purchase more than 2,000 shares of common stock in each offering period.

The offering periods under the ESPP are six-month periods commencing on June 1 and December 1 of each year. 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. As of June 28, 2014, there were 2,220,221 shares available for issuance under the ESPP.

During the three and six months ended June 28, 2014, 353,594 shares were purchased under the ESPP. As of June 28, 2014, unrecognized stock-based compensation expense of \$0.6 million related to the ESPP was expected to be recognized over a remaining service period of 5 months.

Stock-Based Compensation Expense

In accordance with ASC Topic 718, Compensation - Stock Compensation, ("ASC Topic 718"), stock-based compensation expense associated with stock options, RSUs, PRSUs, RSAs, and purchase rights under the ESPP is measured at the grant date based on the fair value of the award, and is recognized, net of forfeitures, as expense over the remaining requisite service period on a straight-line basis.

The Company values RSUs and RSAs at the closing market price of the Company's common stock on the date of grant.

The fair value of PRSUs with a market condition is estimated on the date of award, using a Monte Carlo simulation model to estimate the TSR of the Company's stock in relation to the peer group over each performance period.

Compensation cost on PRSUs with a market condition is not adjusted for subsequent changes in the Company's stock performance or the level of ultimate vesting.

The Company estimates the fair value of stock options at the grant date using the Black-Scholes option-pricing model. This model requires the use of the following assumptions:

(i) Expected volatility of the Company's common stock - Starting in the fourth quarter of 2012, the Company computes its expected volatility assumption based on a blended volatility (50% historical volatility and 50% implied volatility from traded options on the Company's common stock). The selection of a blended volatility assumption was based upon the Company's assessment that a blended volatility is more representative of the Company's future stock price trend as it weighs the historical volatility with the future implied volatility. Prior to the fourth quarter of 2012, due to the lack of a sufficient history of the Company's stock prices, the Company's computation of expected volatility was based on the Company's peer group in the industry in which the Company does business.

(ii) Expected life of the option award - Represents the weighted-average period that the stock options are expected to remain outstanding. The Company's computation of expected life utilizes the simplified method in accordance with Staff Accounting Bulletin No. 110 ("SAB 110") due to the lack of sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The mid-point between the vesting date and the expiration



date is used as the expected term under this method.

(iii) Expected dividend yield - Assumption is based on the Company's history of not paying dividends and no future expectations of dividend payouts.

(iv) Risk-free interest rate - Based on the U.S. Treasury yield curve in effect at the time of grant with maturities approximating the grant's expected life.

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The following table summarizes the weighted-average assumptions used in estimating the grant-date fair value of stock options in the periods indicated:

|                         | Three Months Ended |                  | Six Months Ended |                  |
|-------------------------|--------------------|------------------|------------------|------------------|
|                         | June 28,<br>2014   | June 29,<br>2013 | June 28,<br>2014 | June 29,<br>2013 |
| Expected volatility     | N/A                | N/A              | 54%              | 62%              |
| Expected life (years)   | N/A                | N/A              | 6.15             | 6.05             |
| Expected dividend yield | N/A                | N/A              | —                | —                |
| Risk-free interest rate | N/A                | N/A              | 1.91%            | 1.12%            |

**Modification of Stock Awards**

In February 2013, the Company entered into a Transition and Separation Agreement ("Agreement") with Roger Weingarth, the Company's former Executive Vice President and Chief Operating Officer. Under the Agreement, Mr. Weingarth transitioned to the role of advisor to the Chief Executive Officer of the Company effective as of April 1, 2013, and terminated his employment with the Company on March 31, 2014 ("Termination Date"). Upon his termination, the Agreement provided for, among other things, the acceleration of the vesting of his unvested stock options, RSAs and RSUs held by him as of the Termination Date.

In accordance with ASC Topic 718, total fair value of the accelerated stock awards after the modification was \$0.6 million, which was recognized on a straight-line basis over the remaining service period through the Termination Date. During the three and six months ended June 28, 2014, \$0.1 million of the total fair value has been recognized in general and administrative expenses.

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## 10. Accumulated Other Comprehensive Income

The table below summarizes the changes in accumulated other comprehensive income by component for the periods indicated (in thousands).

|   | Three Months Ended<br>June 28, 2014  |   |       | June 29, 2013   |   |       |
|---|--|---|-------|---|---|-------|
|   | Unrealized<br>Gains<br>(Losses) on<br>Available-for-Sale<br>Marketable<br>Securities | Foreign<br>Currency<br>Translation<br>Adjustments | Total | Unrealized<br>Gains<br>(Losses)<br>on<br>Available-for-Sale<br>Marketable<br>Securities | Foreign<br>Currency<br>Translation<br>Adjustments | Total |
| Balance at beginning of period  | \$—  | \$ 201  | \$201 | \$—   | \$ 114  | \$114 |
| Other comprehensive (loss) income before reclassifications                      | (25  | ) (17   | ) (42 | ) —   | 30  | 30    |
| Reclassification of realized gains and losses on sales of marketable securities | —  | —   | —     | —   | —   | —     |
| Total other comprehensive (loss) income   | (25  | ) (17   | ) (42 | ) —   | 30  | 30    |
| Balance at end of period  | \$(25  | ) \$ 184  | \$159 | \$—   | \$ 144  | \$144 |

|   | Six Months Ended<br>June 28, 2014  |   |       | June 29, 2013   |   |       |
|---|--|---|-------|---|---|-------|
|   | Unrealized<br>Gains<br>(Losses) on<br>Available-for-Sale<br>Marketable<br>Securities | Foreign<br>Currency<br>Translation<br>Adjustments | Total | Unrealized<br>Gains<br>(Losses)<br>on<br>Available-for-Sale<br>Marketable<br>Securities | Foreign<br>Currency<br>Translation<br>Adjustments | Total |
| Balance at beginning of period  | \$—  | \$ 190  | \$190 | \$—   | \$ 132  | \$132 |
| Other comprehensive (loss) income before reclassifications                      | (25  | ) (6  | ) (31 | ) —   | 12  | 12    |
| Reclassification of realized gains and losses on sales of marketable securities | —  | —   | —     | —   | —   | —     |
| Total other comprehensive (loss) income   | (25  | ) (6  | ) (31 | ) —   | 12  | 12    |
| Balance at end of period  | \$(25  | ) \$ 184  | \$159 | \$—   | \$ 144  | \$144 |

Realized gains and losses on sales of available-for-sale marketable securities, if any, are reclassified from accumulated other comprehensive income to "Other income (expense)" in our Condensed Statements of Comprehensive Loss.

## 11. Credit Facility

The Company had a revolving credit facility ("Prior Credit Facility") of \$30.0 million with Silicon Valley Bank based upon a percentage of eligible accounts receivable, which matured on June 30, 2013. After the Prior Credit Facility matured on June 30, 2013, the Company cash collateralized any outstanding letters of credit with Silicon Valley Bank. As of June 28, 2014, the Company had \$0.3 million cash restricted for collateralizing the outstanding letters of credit with Silicon Valley Bank.

On July 29, 2013, the Company entered into a credit agreement with Bank of America, N.A. The credit agreement is structured such that other financial institutions can at a later time become party to the credit agreement through an

amendment via a syndication process (collectively, together with Bank of America, N.A., the "Lenders"). The credit agreement provides for a revolving facility in the aggregate principal amount of up to \$50.0 million, which includes a \$20.0 million sublimit for the issuance of letters of credit and a \$10.0 million sublimit for a swingline facility. Subject to customary conditions, up to \$25.0 million of the revolving facility may be converted to a term loan facility at any time prior to the maturity of the revolving facility. The revolving facility matures on July 29, 2016, but may be extended up to two times (each extension for an additional one-year period) upon mutual agreement of the Company and the Lenders. The credit facility is secured by substantially all of our assets, including our intellectual property. Proceeds of the credit facility may be used for general corporate purposes and permitted acquisitions. Loans under the credit facility bear interest at an annual rate equal to the base rate plus 0.75% to 1.25% or LIBOR plus 2.00% to 2.50% based on a leverage ratio of consolidated funded indebtedness to consolidated Adjusted EBITDA (customarily defined). Interest on the

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revolving facility is due quarterly, and any outstanding interest and principal is due on the maturity date of the revolving facility. The Company is required to repay principal on a term loan in twenty equal quarterly payments from the date the Company enters into a term loan, and all outstanding principal and accrued interest is due on the revolving facility maturity date. Swingline loans must be repaid on the earlier of (i) ten business days after a loan is made and (ii) the revolving facility maturity date. The Company is also required to pay commitment fees of 0.25% per year on any unused portions of this facility.

The credit facility includes affirmative and negative covenants applicable to the Company that are typical for credit facilities of this type. Furthermore, the credit agreement requires us to maintain certain financial covenants, including a maximum consolidated leverage ratio, and a minimum consolidated liquidity ratio of cash, cash equivalents and accounts receivable to consolidated funded indebtedness. As of June 28, 2014, the Company was in compliance with these requirements.

The credit facility also includes customary events of default, the occurrence and continuation of which would provide the Lenders with the right to demand immediate repayment of any principal and unpaid interest under the credit facility, and to exercise remedies against us and the collateral securing the loans under the credit facility.

As of June 28, 2014, the Company had no outstanding letters of credit or borrowings under the credit facility.

The Company incurred \$0.3 million of debt issuance costs that were directly attributable to the issuance of this credit facility. These costs will be amortized over three years starting from the effective date of the credit facility. As of June 28, 2014 and December 31, 2013, the unamortized debt issuance costs of \$0.2 million were included within "Other assets" in our Condensed Consolidated Balance Sheets.

## 12. Income Taxes

The following table presents the provision for income taxes from continuing operations and the effective tax rates for the periods indicated (in thousands, except percentages):

|                            | Three Months Ended |                  | Six Months Ended |                  |      |    |      |    |
|----------------------------|--------------------|------------------|------------------|------------------|------|----|------|----|
|                            | June 28,<br>2014   | June 29,<br>2013 | June 28,<br>2014 | June 29,<br>2013 |      |    |      |    |
| Provision for income taxes | \$103              | \$224            | \$213            | \$581            |      |    |      |    |
| Effective tax rate         | (2.7               | )%               | (4.5             | )%               | (1.5 | )% | (5.4 | )% |

The Company has incurred operating losses since inception and, as such, has not received a tax benefit for these losses. The income tax provision for the first six months of 2014 and 2013 primarily consisted of federal alternative minimum tax and state and foreign income taxes. The effective tax rates differ from the U.S. federal statutory rate of 34.0% due primarily to the tax affected change in the valuation allowance against the Company's deferred tax assets. ASC Topic 740, Income Taxes, ("ASC Topic 740"), 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 its net deferred tax assets, with the exception of certain foreign deferred tax assets, as the Company does not believe that realization of those assets is more likely than not.

As of June 28, 2014 and December 31, 2013, the Company had unrecognized tax benefits of \$14.4 million, none of which would affect the Company's effective tax rate if recognized.

## 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.

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### 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 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 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.

We market our access systems and software to CSPs globally through our direct sales force as well as a growing number of resellers. At the end of the second quarter of 2014, over 18 million ports of our Unified Access portfolio have been deployed at a growing number of CSPs worldwide, whose networks serve over 100 million subscriber lines in total. Our customers include many of the world's largest communications providers. In addition, we have enabled over 1,000 customers who have deployed gigabit passive optical network, Active Ethernet and point-to-point Ethernet fiber access networks.

Our revenue was \$98.0 million and \$183.8 million for the three and six months ended June 28, 2014, respectively, compared to \$94.4 million and \$185.0 million for the three and six months ended June 29, 2013, respectively. During the second quarter of 2014, we experienced results in line with our expectations. Continued 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, large CSPs and customers in international markets. For the three and six months ended June 28, 2014, we had a net loss of \$4.0 million and \$14.0 million, respectively. Our net loss was \$5.2 million and \$11.4 million for the three and six months ended June 29, 2013, respectively. Since our inception we have incurred significant losses and, as of June 28, 2014, we had an accumulated deficit of \$523.8 million.

Revenue fluctuations result from many factors, including but not limited to: increases or decreases in customer orders for our products and services, large customer purchase agreements with delayed revenue recognition, varying budget cycles 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 typically purchase more products during our second and third fiscal quarters. Finally, in our fourth fiscal quarter, customer purchases can increase as they are attempting to spend the rest of their budget for the year. As of June 28, 2014, our deferred revenue of \$45.0 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 require installation services, as well as extended warranty services contracts that are recognized ratably over the period during which the services are to be performed. 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 and services delivered to our customers, customers and geographies, changes in the cost of our inventory and inventory write-downs. 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 and services 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 expenses due to changes in the Company's performance, timing of research and development expenses including prototype builds and intermittent outsourced development projects.

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.

#### Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with U.S. 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



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December 31, 2013. During the six months ended June 28, 2014, there have been no significant changes in our critical accounting policies and estimates.

## Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which provides guidance for revenue recognition. ASU 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. Additionally, it supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts, and creates new Subtopic 340-40, Other Assets and Deferred Costs-Contracts with Customers. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under the previous guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard will be effective for the Company in the first quarter of fiscal 2017. Early adoption is not permitted. The Company is currently assessing the potential impact on its financial statements from adopting this new guidance.

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"), which provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward exists, with the purpose of reducing diversity in practice. Under the new standard update, with certain exceptions, the Company's unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. The accounting standard update became effective for the Company in the first quarter of 2014. As the Company's disclosures already conform to the required presentation, adoption of this standard does not impact the financial position or results of operations of the Company.

## Results of Operations

## Comparison of the Three and Six Months Ended June 28, 2014 and June 29, 2013

## Revenue

The following table sets forth our revenue (in thousands, except percentages):

|         | Three Months Ended |                  |                           | Six Months Ended          |                  |                  |                           |                           |
|---------|--------------------|------------------|---------------------------|---------------------------|------------------|------------------|---------------------------|---------------------------|
|         | June 28,<br>2014   | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent | June 28,<br>2014 | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent |
| Revenue | \$98,005           | \$94,439         | \$3,566                   | 4                         | 183,825          | 184,987          | \$(1,162)                 | (1)%                      |

Our revenue increased to \$98.0 million for the three months ended June 28, 2014, from \$94.4 million for the three months ended June 29, 2013. During the second quarter of 2014, we experienced stronger bookings and shipments across all territories due to increased customer demand. This additional demand offset timing differences in revenue recognition from BBS contracts. The first half of fiscal 2014 compared to first half of 2013 was flat, due to strength in 2014's second quarter offsetting a first quarter that was lower than the same period in the prior year.

Our revenue is principally derived in the United States. During the three and six months ended June 28, 2014, revenue generated in the United States represented approximately 87% of our total revenue. International revenue was \$12.6 million for the second quarter and \$23.2 million for the first half of fiscal 2014 compared to \$12.1 million and \$24.8 million for the same periods in 2013. We expect international and overall revenue to grow as we expand our international markets as we add new customers.

We had one 10% customer again this quarter.



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## Cost of Revenue and Gross Profit

The following table sets forth our cost of revenue (in thousands, except percentages):

|                                   | Three Months Ended |                  |                           |                           | Six Months Ended |                  |                           |                           |  |
|-----------------------------------|--------------------|------------------|---------------------------|---------------------------|------------------|------------------|---------------------------|---------------------------|--|
|                                   | June 28,<br>2014   | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent | June 28,<br>2014 | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent |  |
| Cost of revenue:                  |                    |                  |                           |                           |                  |                  |                           |                           |  |
| Products and services             | \$51,575           | \$49,846         | \$1,729                   | 3 %                       | \$98,381         | \$97,191         | \$1,190                   | 1 %                       |  |
| Amortization of intangible assets | 2,088              | 2,088            | —                         | — %                       | 4,176            | 4,176            | —                         | — %                       |  |
| Total cost of revenue             | \$53,663           | \$51,934         | \$1,729                   | 3 %                       | \$102,557        | \$101,367        | \$1,190                   | 1 %                       |  |
| Gross profit                      | \$44,342           | \$42,505         | \$1,837                   | 4 %                       | \$81,268         | \$83,620         | \$(2,352)                 | (3) %                     |  |
| Gross margin                      | 45 %               | 45 %             |                           |                           | 44 %             | 45 %             |                           |                           |  |

The increase in cost of revenue of \$1.7 million and \$1.2 million during the three and six months ended June 28, 2014 compared with the corresponding period of fiscal 2013 was primarily due to an increase in products and services cost as well as inventory reserves taken in 2014. The amortization of intangible assets remained at the same level.

Including amortization of intangible assets, gross margin increased to 45% during the three months ended June 28, 2014 from 44% during the corresponding period of fiscal 2013, primarily due to a combination of product and customer mix. This increase in gross margin during the three months ended June 28, 2014 compared with the corresponding period of fiscal 2013 was partially offset by an increase in inventory reserves in the same period in 2014. The decrease in gross margin during the six months ended June 28, 2014 was primarily related to decreased revenue and to the impact of inventory reserves taken during 2014. The amortization of intangible assets remained at the same level.

## Operating Expenses

## Research and Development Expenses

The following table sets forth our research and development expenses (in thousands, except percentages):

|                          | Three Months Ended |                  |                           |                           | Six Months Ended |                  |                           |                           |
|--------------------------|--------------------|------------------|---------------------------|---------------------------|------------------|------------------|---------------------------|---------------------------|
|                          | June 28,<br>2014   | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent | June 28,<br>2014 | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent |
| Research and development | \$19,544           | \$20,035         | \$(491)                   | (2) %                     | \$39,174         | \$40,206         | \$(1,032)                 | (3) %                     |
| Percent of total revenue | 20 %               | 21 %             |                           |                           | 21 %             | 22 %             |                           |                           |

The decrease in research and development expenses of \$0.5 million and \$1.0 million during the three and six months ended June 28, 2014 compared with the corresponding period of fiscal 2013 was primarily due to a decrease in consulting expenses of \$0.7 million for both periods, with the current quarter being offset by increased compensation and employee benefits expenses of \$0.2 million.

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. We expect to continue to incur research and development expenses in connection with our new and existing products and our expansion into international markets.

## Sales and Marketing Expenses

The following table sets forth our sales and marketing expenses (in thousands, except percentages):

|                     | Three Months Ended |                  |                           |                           | Six Months Ended |                  |                           |                           |
|---------------------|--------------------|------------------|---------------------------|---------------------------|------------------|------------------|---------------------------|---------------------------|
|                     | June 28,<br>2014   | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent | June 28,<br>2014 | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent |
| Sales and marketing | \$18,455           | \$17,079         | \$1,376                   | 8 %                       | \$35,845         | \$32,880         | \$2,965                   | 9 %                       |



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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 (in thousands, except percentages):

|                            | Three Months Ended |                  |                           | Six Months Ended          |                  |                  |                           |                           |
|----------------------------|--------------------|------------------|---------------------------|---------------------------|------------------|------------------|---------------------------|---------------------------|
|                            | June 28,<br>2014   | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent | June 28,<br>2014 | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent |
| General and administrative | \$7,681            | \$7,684          | \$(3 )                    | — %                       | \$14,932         | \$15,815         | \$(883 )                  | (6 )%                     |
| Percent of total revenue   | 8                  | % 8              | %                         |                           | 8                | % 9              | %                         |                           |

During the three months ended June 28, 2014, the decrease in non-cash compensation of \$0.8 million was offset by an increase of \$0.7 million in consulting expenses compared to the same period in 2013. Similarly, the decrease in general and administrative expenses during the six months ended June 28, 2014 compared with the corresponding periods of fiscal 2013 was mostly due to a \$1.8 million decrease in stock-based compensation primarily due to executive equity awards that completed vesting in 2013. This decrease in stock-based compensation was offset by increases in professional expenses of \$0.8 million and of \$0.5 million in new facility expenses in Texas and California.

## Provision for Income Taxes

The following table sets forth our provision for income taxes (in thousands, except percentages):

|                            | Three Months Ended |                  |                           | Six Months Ended          |                  |                  |                           |                           |
|----------------------------|--------------------|------------------|---------------------------|---------------------------|------------------|------------------|---------------------------|---------------------------|
|                            | June 28,<br>2014   | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent | June 28,<br>2014 | June 29,<br>2013 | Variance<br>in<br>Dollars | Variance<br>in<br>Percent |
| Provision for income taxes | \$103              | \$224            | \$(121 )                  | (54 )%                    | \$213            | \$581            | \$(368 )                  | (63 )%                    |
| Effective tax rate         | (2.7 )%            | (4.5 )%          |                           |                           | (1.5 )%          | (5.4 )%          |                           |                           |

The Company has significant accumulated net operating losses which are subject to a full valuation allowance and, as such, has not received a benefit for these losses.

The income tax provision for the first six months of 2014 consisted primarily of state and foreign income taxes. The Company continues to carryforward the alternative minimum tax net operating loss acquired from Occam Networks, of approximately \$5.1 million as of June 28, 2014, which will be used to offset future alternative minimum tax taxable income. The income tax provision for the first six months of 2013 primarily consisted of federal and state alternative minimum tax and state and foreign income taxes. The effective tax rates differ from the U.S. federal statutory rate of 34.0% due primarily to the tax affected change in the valuation allowance against our deferred tax assets.

ASC Topic 740 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 our net deferred tax assets, with the exception of certain foreign deferred tax assets, as we do not believe that realization of those assets is more likely than not.

As of June 28, 2014 and December 31, 2013, the Company had unrecognized tax benefits of \$14.4 million, none of which would affect the Company's effective tax rate if recognized.

## Liquidity and Capital Resources

We have funded our operations and investing activities primarily through cash generated from operations and the 2010 initial public offering of our common stock. At June 28, 2014, we had cash, cash equivalents and marketable securities of \$79.0 million, which consisted of deposits held at banks, money market mutual funds held at major financial institutions and highly liquid debt instruments.

## Operating Activities

Net cash used in operations of \$0.5 million in the six months ended June 28, 2014 consisted of net loss of \$14.0 million and \$8.7 million of cash flow decreases reflected in the net change in assets and liabilities, partially offset by \$22.2 million of non-cash charges. The net decrease from assets and liabilities primarily consisted of a \$10.3 million decrease in accounts payable due to payments to our manufacturers, a \$3.8 million increase in accounts receivable and a \$3.2 million net decrease in deferred revenue and deferred cost of revenue due to RUS-funded contracts recognized in the first quarter and BBS contracts recognized in the second quarter, partially offset by a \$5.2 million decrease in inventories primarily due to the absorption of the in-transit inventory in our books in December 2013, a \$2.6 million decrease in accrued liabilities and a \$1.0 million decrease in prepaid expenses and other current assets. Non-cash charges primarily consisted of \$9.3 million of amortization of intangible assets, \$8.3 million of stock-based compensation and \$4.5 million of depreciation and amortization.

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Net cash provided by operations of \$23.2 million in the six months ended June 29, 2013 consisted of a net loss of \$11.4 million more than offset by \$25.2 million of non-cash charges and \$9.4 million of cash flow increases reflected in the net change in assets and liabilities. Non-cash charges primarily consisted of \$10.0 million of stock-based compensation, \$9.3 million of amortization of intangible assets, \$5.3 million of depreciation and amortization and a \$0.6 million loss on retirement of property and equipment. The net increase from assets and liabilities primarily consisted of an \$8.0 million net increase in deferred revenue and deferred cost of revenue as a result of increased shipments relating to certain RUS-funded contracts, a \$5.9 million decrease in inventories due to improved inventory management and a \$0.8 million increase in accrued liabilities and other long-term liabilities, partially offset by a \$3.2 million increase in accounts receivable and a \$2.0 million increase in prepaids and other current assets.

Investing Activities

Our investing activities used \$50.9 million in the six months ended June 28, 2014, which consisted of \$46.6 million in purchases of marketable securities, which provide higher yields than money market funds, and \$4.3 million in capital expenditures for leasehold improvement, test equipment, computer equipment and software.

Our investing activities used \$3.3 million in the six months ended June 29, 2013, which consisted of capital expenditures for test equipment, computer equipment and software.

Financing Activities

Our financing activities provided \$1.2 million in the six months ended June 28, 2014, which consisted of \$2.6 million in proceeds from the issuance of stock under the ESPP and from stock option exercises, partially offset by \$1.4 million in stock withheld for employee payroll taxes due upon the vesting of awards under equity incentive plans.

Our financing activities provided \$2.5 million in the six months ended June 29, 2013, which consisted of \$2.8 million in proceeds from the issuance of stock under the ESPP and from stock option exercises, partially offset by \$0.3 million in stock withheld for employee payroll taxes due upon the vesting of awards under equity incentive plans.

Working Capital and Capital Expenditure Needs

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. 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 have a credit facility with an aggregate principal amount of up to \$50.0 million. The credit facility matures in July 2016, but may be extended up to two times (each extension for an additional one-year period) upon mutual agreement with the Lenders. Proceeds of the credit facility may be used for general corporate purposes and permitted acquisitions. As of June 28, 2014, there was \$50.0 million available for borrowing under this credit facility.

As of June 28, 2014, we had restricted cash of \$0.3 million to collateralize outstanding letters of credit with Silicon Valley Bank.

We believe based on our current operating plan, our existing cash, cash equivalents and amounts available under our credit facility 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 are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013, and have not changed materially during the six months ended June 28, 2014 except for the following agreements entered into during 2014.

On March 4, 2014, we entered into a new commercial lease for our facility in Santa Barbara, California. The lease is set to commence on July 1, 2014 and expire on June 30, 2019. The total minimum future payment commitment under

this lease is \$1.0 million. In connection with this lease, we received an incentive consisting of \$0.4 million that can be used for leasehold improvements.

On March 20, 2014 we entered into a new commercial lease for our facility in Richardson, Texas. This lease is set to commence on August 1, 2014 and expire on January 31, 2022. The total minimum future payment commitment under this lease is \$1.5 million. In connection with this lease, we received an incentive consisting of \$0.4 million that can be used for leasehold improvements.

#### Off-Balance Sheet Arrangements

As of June 28, 2014 and December 31, 2013, we did not have any off-balance sheet arrangements.



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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 June 28, 2014, we had cash, cash equivalents and marketable securities of \$79.0 million and restricted cash of \$0.3 million, which were held primarily in cash, money market funds and highly liquid debt instruments. Due to the nature of these money market funds and debt instruments, we believe that we do not have any material exposure to changes in the fair value of our cash equivalents and marketable securities 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 borrowings, if any, under our credit facility, which allows us to borrow up to a maximum amount of \$50.0 million. Borrowings under this credit facility will accrue interest at a variable rate based upon the applicable base rate or LIBOR plus a margin depending on the Company's leverage ratio of consolidated funded indebtedness to consolidated Adjusted EBITDA (customarily defined). We have not borrowed any funds under the credit facility.

Foreign Currency Exchange Risk

In our view, our primary foreign currency exposures are economic, translation and transaction.

Economic Exposure

The direct effect of foreign currency fluctuations on our sales and expenses have not been material because they are primarily denominated in U.S. dollars. However, we are indirectly exposed to changes in foreign currency exchange rates to the extent of our use of foreign contract manufacturers whom we pay in U.S. dollars. Changes in the local currency rates of these vendors in relation to the U.S. dollar could cause an increase in the price of products that we purchase. Additionally, if the U.S. dollar strengthens relative to other currencies, such strengthening could have an indirect effect on our sales to the extent it raises the cost of our products to non-U.S. customers and thereby reduces demand. A weaker U.S. dollar could have the opposite effect. The precise indirect effect of currency fluctuations is difficult to measure or predict because our sales are influenced by many factors in addition to the impact of such currency fluctuations.

Translation Exposure

Our sales contracts are primarily denominated in U.S. dollars and, therefore, the majority of our revenues are not subject to foreign currency risk. We are directly exposed to changes in foreign exchange rates to the extent such changes affect our expenses related to our foreign assets and liabilities with our subsidiary in China and the United Kingdom, whose functional currencies are the Chinese Renminbi ("RMB") and British pound sterling, respectively. Our operating expenses are incurred primarily in the United States, with a small portion of expenses incurred in China associated with our research and development operations that are maintained there, and in the United Kingdom where our sales and services office is located. Our operating expenses are generally denominated in the functional currencies of our subsidiaries in which the operations are located. For the six months ended June 28, 2014, approximately 91% of our operating expenses were U.S.-dollar denominated, 4% of our expenses were denominated in British pound and 5% in Chinese RMB. If the U.S. dollar had appreciated or depreciated by 10%, relative to the British pound and the Chinese RMB, our operating expenses for the first three months of 2014 would have decreased or increased by \$0.4 million, or 1%. We do not currently enter into forward exchange contracts to hedge exposure denominated in foreign currencies or any derivative financial instruments. In the future, we may consider entering into hedging transactions to help mitigate our foreign currency exchange risk.

Foreign exchange rate fluctuations may also adversely impact our financial position as the assets and liabilities of our foreign operations are translated into U.S. dollars in preparing our Condensed Consolidated Balance Sheets. The effect of foreign exchange rate fluctuations on our consolidated financial position for the six months ended June 28, 2014 was a net translation gain of approximately \$6 thousand. This gain is recognized as an adjustment to stockholders' equity through accumulated other comprehensive income.

Transaction Exposure

We have certain assets and liabilities, primarily receivables and accounts payable (including inter-company transactions) that are denominated in currencies other than the relevant entity's functional currency. In certain circumstances, changes in the functional currency value of these assets and liabilities create fluctuations in our

reported consolidated financial position, cash flows and results of operations. Transaction gains and losses on these foreign currency denominated assets and liabilities are recognized each period within other income (expense), net in our Condensed Consolidated Statements of Comprehensive Loss. During the six months ended June 28, 2014, the net loss we recognized related to these foreign exchange assets and liabilities was approximately \$8 thousand.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on their evaluation as of June 28, 2014, 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) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level.

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Limitations on the Effectiveness of Controls

Our disclosure controls and procedures provide our Chief Executive Officer and Chief Financial Officer reasonable assurance 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, 2013, as filed with the Securities and Exchange Commission on February 20, 2014. 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 currently 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, which make it difficult to predict our future revenue and plan our expenses appropriately.

We 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. 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 that which occurred in the fourth quarter of 2013. 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 maintain positive cash flows in the future.

We have experienced net losses in each year of our existence. For the years ended December 31, 2013, December 31, 2012, and December 31, 2011, we incurred net losses of \$17.3 million, \$28.3 million, and \$52.6 million, respectively. As of December 31, 2013, we had an accumulated deficit of \$509.8 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 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 other factors that we cannot anticipate. If we are unable to generate positive operating income and maintain positive cash flows 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, we may experience delays in recognizing revenue under applicable revenue-recognition rules, particularly from government-funded contracts, such as those funded by U.S. Department of Agriculture's Rural Utility Service ("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;

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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 defects 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;
- the attraction and retention of qualified employees and key management 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, upgrade and maintain their access networks. 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 canceled. 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 reductions in their budgets, delays in their purchasing cycles, access to external capital, e.g., government grants and loan programs or the capital markets, and seasonality and delays in capital allocation decisions. For example, we experienced lower than expected sales in the fourth quarter of 2013 because we believe our CSP customers had spent more than usual in the first three quarters of 2013 and they did not have enough in their budgets left in the fourth quarter to make significant purchases.

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 CSP or other providers, and changes in CSP 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 period 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 U.S. customers are Independent Operating Companies ("IOCs"), which have revenues that are particularly dependent upon interstate and intrastate access charges, and federal and state subsidies. The Federal Communications Commission ("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 to finance capital spending. Changes to these programs could reduce the ability of IOCs to access capital and thus reduce our revenue opportunities.

Many of our customers were awarded grants or loans under government stimulus programs such as the Broadband Stimulus programs under the American Recovery and Reinvestment Act of 2009 ("ARRA") and have purchased and will continue to purchase products from us or other suppliers while such programs and funding remain in place. However, customers may substantially curtail future purchases of products as ARRA funding winds down or because all purchases have been completed. The timetable for completion of funded projects varies between the two agencies administering the awards. Projects funded under the Broadband Technology Opportunities Program, which is administered by the National Telecommunications and Information Administration, were required to be completed by September 30, 2013

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and no government funds will be distributed for work undertaken after that date. Projects funded under the Broadband Initiatives Program, which is administered by the RUS, must be completed by June 30, 2015.

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., Arris Group, Inc., Ciena Corporation, Cisco Systems, Inc., Huawei Technologies Co., Ltd. and ZTE Corporation, among others.

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 ongoing ability to successfully integrate acquired product lines and customer bases into our business;
- our ability to gain customer acceptance of our products; and
- our ability to market and sell our products.

The broadband access equipment market has undergone consolidation in recent years, as participants 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 our acquisitions of Occam in February 2011 and of Ericsson's fiber access assets in November 2012, ADTRAN's acquisition of Nokia Siemens' broadband access line business in May 2012, and Cisco's acquisition of ClearAccess in May 2012. We expect this trend to continue as companies attempt to strengthen or maintain their market 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. Many of our competitors have broader product lines and can offer bundled solutions, which may appeal to certain customers. Our competitors may also 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. Some of our competitors may offer substantial discounts or rebates to win new customers or to retain existing 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, 2013, 2012 and 2011, our research and development expenses were \$79.3 million, or 21% of our revenue, \$66.7 million, or 20% of our revenue, and \$67.7 million, or 20% of our revenue, respectively. 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.

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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 of new products. In addition, demand for new products is dependent on the success of our customers in deploying and selling advanced 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, 2013, 2012 and 2011, CenturyLink accounted for 26%, 21% and 20%, respectively, of our revenue.

However, we cannot anticipate the level of CenturyLink's purchases in the future.

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 and among the Incumbent Local Exchange Carrier ("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 ("MSOs") and selected international CSPs. 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 via 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 terms of sale, 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 CSPs, including cable 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 larger CSPs, who have lengthy equipment qualification and sales cycles, without any assurance of generating sales. In particular, sales to these larger 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.

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We are exposed to the credit risks of our customers, and if we have inadequately assessed their creditworthiness we may have more exposure to accounts receivable risk than we anticipate. 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 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.

We perform credit evaluations of our customers' financial condition. However, our evaluation of the creditworthiness of customers may not be accurate if they do not provide us with timely and accurate financial information, or if their situations change after we evaluate 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 inability to reduce and control product costs;
  - changes in component pricing, changes in contract manufacturer rates, 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 goals 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 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 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.

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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 ("OEM") or original design manufacturer ("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 of and currently manufactures 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.

If we fail to forecast our manufacturing requirements accurately or fail to properly 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 their storage costs. Historically, we have reimbursed our primary contract manufacturers 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 incur payments to our contract manufacturers 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 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 developed and deployed. As we expand into adjacent markets and increase our international footprint, we are likely to encounter additional standards. 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 maintain Operations System Modification for Intelligent Network Elements ("OSMINE") certification for our products will affect our ongoing ability to continue 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.

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As the market for our products evolves, changing customer requirements may adversely affect the valuation of our inventory.

Customer demand for our products can change rapidly in response to market and technology developments. Demand can not only be affected by customer- or market-specific issues but also by broader economic and/or geopolitical factors. We may, from time to time, adjust inventory valuations downward in response to our assessment of demand from our customers for specific products or product lines.

We may be unable to successfully expand our international operations. In addition, we may be subject to a variety of international 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;
- liability or damage to our reputation resulting from corruption or unethical business practices in some countries;
- fluctuation in currency exchange rates;
- longer collection periods and difficulties in collecting accounts receivable;
- 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, terrorist attacks or acts of war; and
- restrictions on the repatriation of earnings.

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 appropriate resellers may reduce our sales and thus harm our business.

We engage some value added resellers ("VARs"), who provide sales and support services for our products. In particular, the non-exclusive reseller agreement entered into with Ericsson in 2012 has provided 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 recruit and train 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 of doing so, are likely to increase as we expand sales outside of North America.

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.

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 June 28, 2014, we held 90 U.S. patents and had 38 pending U.S. patent applications. One of the U.S. patents is also covered by granted international patents 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

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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 is 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 non-practicing entities, 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 to suit from these entities.

We have received in the past and expect that in the future we may receive 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 certain 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 defects 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 defects, bugs or security vulnerabilities. Some defects 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 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 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.

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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 generally 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.

Our failure or the failure of our contract manufacturers to comply with applicable environmental and other legal regulations could adversely impact our results of operations.

The manufacture, assembly and testing of our products may require the use of hazardous materials that are subject to environmental, health and safety regulations, or materials subject to international laws restricting the use of conflict minerals. Our failure or the failure of our contract manufacturers to comply with any of these applicable requirements could result in regulatory penalties, legal claims or disruption of production. In addition, our failure or the failure of our contract manufacturers to properly manage the use, transportation, emission, discharge, storage, recycling or disposal of hazardous materials could subject us to increased costs or liabilities. Existing and future environmental regulations and other legal requirements may restrict our use of certain materials to manufacture, assemble and test products. Any of these consequences could adversely impact our results of operations by increasing our expenses and/or requiring us to alter our manufacturing processes.

Regulatory and physical impacts of climate change and other natural events may affect our customers and our contract manufacturers, resulting in adverse effects on our operating results.

As emissions of greenhouse gases continue to alter the composition of the atmosphere, affecting large-scale weather patterns and the global climate, any new regulation of greenhouse gas emissions may result in additional costs to our customers and our contract manufacturers. In addition, the physical impacts of climate change and other natural events, including changes in weather patterns, drought, rising ocean and temperature levels, earthquakes and tsunamis may impact our customers, suppliers, contract manufacturers, and our operations. These potential physical effects may adversely affect our revenues, costs, production and delivery schedules, and cause harm to our results of operations and financial condition.

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 November 2, 2012, we acquired Ericsson's fiber access assets. 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 of intangible assets or impairment of 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.

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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 product development, 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 Connect America Fund capital incentive payments, which are intended to subsidize broadband and telecommunications services in areas that are expensive to serve. In early October 2011, the then-chairman of the FCC outlined a plan to transform the Universal Service Fund, an \$8 billion fund that is paid for by telephone customers in the U.S. and was 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. In late 2013, the new FCC chairman shared plans to review the implementation of this program. Changes to these programs could change the 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 U.S. 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.

Many jurisdictions, including international governments and regulators, are also evaluating, implementing and enforcing regulations relating to cyber security, privacy and data protection, which can affect the market and requirements for networking and communications equipment. 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.

Privacy concerns relating to our products and services could affect our business practices, damage our reputation and deter customers from purchasing our products and services.

Government and regulatory authorities in the U.S. and around the world have implemented and are continuing to implement laws and regulations concerning data protection. The interpretation and application of these data protection laws and regulations are often uncertain and in flux, and it is possible that they may be interpreted and applied in a manner that is inconsistent with our data practices. Complying with these various laws could cause us to incur

substantial costs or require us to change our business practices in a manner adverse to our business. Concerns about, or regulatory actions involving our practices with regard to the collection, use, disclosure, or security of customer information or other privacy related matters, even if unfounded, could damage our reputation and adversely affect operating results. While we strive to comply with all applicable data protection laws and regulations, the failure or perceived failure to comply may result in inquiries and other proceedings or actions against us by government entities or others, or could cause us to lose customers, which could potentially have an adverse effect on our business.

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

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our products or changes in export and import regulations or duties 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, duties 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, profitably or at all, 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 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 are required to comply with Section 404 of the Sarbanes-Oxley Act ("SOX"), 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 internally and externally report our operating results.

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We have applied multiple layers of security to control access to 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 apply best practice policies and 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.

Although our systems have been designed around industry-standard architectures to reduce downtime in the event of outages or catastrophic occurrences, they remain vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunication failures, terrorist attacks, cyber-attacks, viruses, denial-of-service attacks, human error, hardware or software defects or malfunctions, and similar events or disruptions. Some of our systems are not fully redundant, and our disaster recovery planning is not sufficient for all eventualities. Our systems are also subject to break-ins, sabotage, and intentional acts of vandalism. Despite any precautions we may take, the occurrence of a natural disaster, a decision by any of our third-party hosting providers to close a facility we use without adequate notice for financial or other reasons, or other unanticipated problems at our hosting facilities could cause system interruptions and delays, and result in loss of critical data and lengthy interruptions in our services.

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, 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 SOX and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), as well as rules implemented by the SEC, and the New York Stock Exchange ("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 SOX and Dodd-Frank 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 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 the "Risk Factors" section of this report, 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;
- failures by us to meet securities analysts' estimates;
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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.

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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 several 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 our management and board of directors.

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 or 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 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 and marketable securities 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 raise 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 stockholders' 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 under certain circumstances. 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 six months ended June 28, 2014.

ITEM 3. Defaults Upon Senior Securities

None.

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ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

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## ITEM 6. Exhibits

| Exhibit<br>Number | Description  |
|-------------------|--|
| 3.1               | Amended and Restated Certificate of Incorporation of Calix, Inc. (filed as Exhibit 3.3 to Amendment No. 7 to Calix's Registration Statement on Form S-1 filed with the SEC on March 23, 2010 (File No. 333-163252) and incorporated by reference herein).                    |
| 3.2               | Amended and Restated Bylaws of Calix, Inc. (filed as Exhibit 3.5 to Amendment No. 7 to Calix's Registration Statement on Form S-1 filed with the SEC on March 23, 2010 (File No. 333-163252) and incorporated by reference herein).  |
| 10.1              | Transition and Separation Agreement, by and between Calix, Inc. and Michael Ashby, dated February 11, 2014 (filed as Exhibit 10.16 to Calix's Annual Report on Form 10-K filed with the SEC on February 20, 2014 (File No. 001-34674) and incorporated by reference herein). |
| 10.2              | Calix, Inc. Non-Employee Director Cash Compensation Policy, effective January 31, 2014 (filed as Exhibit 10.21 to Calix's Annual Report on Form 10-K filed with the SEC on February 20, 2014 (File No. 001-34674) and incorporated by reference herein).                     |
| 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           | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase Document   |

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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)

Date: July 31, 2014

By: /s/ Carl Russo  
Carl Russo  
Chief Executive Officer  
(Principal Executive Officer)

Date: July 31, 2014

By: /s/ William J. Atkins  
William J. Atkins  
Chief Financial Officer  
(Principal Financial Officer)