INFINERA CORP
Form 424B4
October 31, 2007
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Filed Pursuant to Rule 424(b)(4)
Registration No. 333-146686

10,000,000 Shares

Infinera Corporation

Common Stock

Infinera is offering 5,000,000 of the shares to be sold in the offering. The selling stockholders identified in this prospectus are offering an additional 5,000,000 shares. Infinera will not receive any of the proceeds from the sale of the shares being sold by the selling stockholders.

The common stock is listed on the Nasdaq Global Market under the symbol INFN. The last reported sale price of the common stock on October 30, 2007 was $22.65 per share.

See Risk Factors on page 10 to read about factors you should consider before buying shares of our common stock.

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

	Per Share	Total
Initial price to public	$ 22.000	$ 220,000,000
Underwriting discount	$ 1.045	$ 10,450,000
Proceeds, before expenses, to Infinera	$ 20.955	$ 104,775,000
Proceeds, before expenses, to selling stockholders	$ 20.955	$ 104,775,000

To the extent that the underwriters sell more than 10,000,000 shares of common stock, the underwriters have the option to purchase up to an additional 1,500,000 shares from Infinera at the public offering price less the underwriting discount.

The underwriters expect to deliver the shares against payment in New York, New York on November 5, 2007.

Goldman, Sachs & Co.

Lehman Brothers

Morgan Stanley

JPMorgan

Thomas Weisel Partners LLC

Jefferies & Company

Prospectus dated October 30, 2007.

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No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell only the shares offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date.

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PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the following summary together with the more detailed information appearing in this prospectus, including our financial statements and notes, and our risk factors beginning on page 10, before deciding whether to purchase shares of our common stock. Unless the context otherwise requires, we use the terms Infinera, the company, we, us and our in this prospectus to refer to Infinera Corporation and its subsidiaries.

INFINERA CORPORATION

Overview

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

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

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

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

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

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

We began commercial shipment of our DTN System in November 2004. In the third quarter of 2005, we believe we achieved, and have since maintained through the fourth quarter of 2006, the largest market share of 10 Gbps long-haul ports shipped worldwide. According to Ovum RHK, a third party industry analyst, we achieved the number one position, with a 27% market share, of the North American multi-reach dense wavelength division multiplexing, or DWDM, market based on our invoiced shipments and our competitors revenues, as reported by Ovum RHK, for the trailing four quarters through the second quarter of 2007. In addition, according to Ovum RHK, we achieved a 12% market share, or the number four position, of the international multi-reach DWDM market for the same period. As of September 29, 2007, we have sold our DTN System for deployment in the optical networks of 38 customers worldwide, including Internet2, Interoute, Level 3 Communications and Qwest Communications. We do not have long-term purchase commitments with our customers. To date, a few of our customers have accounted for a significant percentage of our revenue. In 2006 and in the first two quarters of 2007, Level 3 and Broadwing Corporation, which Level 3 acquired in January 2007, together accounted for approximately 75% and 55% of our revenue, respectively.

Industry Background

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

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

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

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

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

The Infinera Solution and Strategy

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

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

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

Penetrate adjacent markets. We intend to increase our addressable market by adding functionality to our DTN System, by developing new products, including products for government, research and educational institutions, MSOs and internet content provider markets, and by creating the service and support infrastructure needed to address these markets;

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

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

Risks Associated With Our Business

Our business is subject to numerous risks, as discussed more fully in the section titled Risk Factors immediately following this prospectus summary. We incurred net losses of $66.5 million in 2004, $64.8 million in 2005, $89.9 million in 2006 and $45.9 million in the six months ended June 30, 2007. As of June 30, 2007, our accumulated deficit was $360.0 million. Our management determined, subsequent to their issuance, that our financial statements should be restated. In connection with the audit of our financial statements for 2005 and 2006, our management and our independent registered public accounting firm reported to our board of directors a material weakness for each year in the design and operation of our internal control over financial reporting. We believe we have remediated the material weakness identified in 2005 related to our inventory valuation process by implementing additional procedures and controls, hiring additional accounting personnel and increasing management review and oversight. We have developed a remediation plan to address the material weakness identified in 2006 related to non-routine manual accounting and reporting processes involving our revenue process in 2006 and net loss per common share computations in 2002 through 2006, but we cannot assure you that we will be able to remediate this material weakness.

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Recent Developments

On October 23, 2007, we announced results for the quarter ended September 29, 2007. Revenue was $62.2 million, and net loss was $5.5 million.

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 29, 2007	September 30, 2006	September 29, 2007
	(Unaudited)		(Unaudited)	
Revenue:				
Ratable product and related support and services	$ 6,118	$ 62,130	$ 12,825	$ 162,488
Product	1,578	25	1,578	7,275
Total revenue	7,696	62,155	14,403	169,763
Cost of revenue(1):				
Cost of ratable product and related support and services	7,967	37,620	17,940	109,992
Lower of cost or market adjustment	4,172	3,184	12,154	6,470
Cost of product	311	18	311	3,869
Total cost of revenue	12,450	40,822	30,405	120,331
Gross profit (loss)	(4,754)	21,333	(16,002)	49,432
Operating expenses(1):				
Sales and marketing	4,914	7,995	11,777	22,032
Research and development	14,034	14,621	27,752	44,758
General and administrative	3,960	7,069	7,624	17,984
Amortization of intangible assets	19	37	19	111
Total operating expenses	22,927	29,722	47,172	84,885
Loss from operations	(27,681)	(8,389)	(63,174)	(35,453)
Other income (expense), net:				
Interest income	849	2,459	1,644	3,373
Interest expense	(1,152)	(67)	(3,541)	(2,249)
Other gain (loss), net	(589)	533	139	(16,982)
Total other income (expense), net	(892)	2,925	(1,758)	(15,858)
Loss before provision of income taxes	(28,573)	(5,464)	(64,932)	(51,311)
Provision for income taxes	23	62	53	124
Net loss	$ (28,596)	$ (5,526)	$ (64,985)	$ (51,435)
Net loss per common share, basic and diluted	$ (4.42)	$ (0.07)	$ (11.40)	$ (1.34)
Weighted average shares used in computing basic and diluted net loss per common share	6,465	84,017	5,701	38,419

(1) The following table summarizes the effects of stock-based compensation related to employees, non-recourse notes and non-employees for the three and nine months ended September 30, 2006 and September 29, 2007 (unaudited).

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 29, 2007	September 30, 2006	September 29, 2007
Cost of revenue	$ 12	$ 143	$ 16	$ 254
Research and development	226	1,113	284	2,436
Sales and marketing	119	689	147	1,122
General and administrative	138	1,129	178	2,032
	495	3,074	625	5,844
Cost of revenue - amortization from balance sheet*		89		129
Total stock-based compensation expense	$ 495	$ 3,163	$ 625	$ 5,973

* Stock-based compensation expense deferred to inventory and deferred inventory costs in prior periods and recognized in the current period.

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	December 31, 2006	September 29, 2007 (Unaudited)
	(in thousands)	
Balance Sheet Data:		
Cash, cash equivalents and short-term investments	$ 29,572	$ 174,826
Working capital	2,218	154,256
Total assets	230,466	406,569
Current and long-term debt	28,382	
Total stockholders equity (deficit)	(306,321)	188,226

Total ratable revenue increased from $6.1 million in the three months ended September 30, 2006 to $62.1 million in the corresponding period in 2007. The increase reflected an increase in invoiced shipments of bundled products from $40.4 million in the three months ended September 30, 2006 to $80.3 million in the corresponding period in 2007. The increase in invoiced shipments of bundled products was due to increased purchases of our DTN System by existing customers and the addition of new customers. In the nine months ended September 29, 2007, we recorded $208.7 million of invoiced shipments of bundled products, recognized $169.8 million of revenue and added $46.2 million to the deferred revenue balance. We added 23 new customers between September 30, 2006 and September 29, 2007 for a total of 38 customers as of September 29, 2007. We had two customers that exceeded 10% of our revenue on a GAAP basis for the three months ended September 29, 2007, reflecting continued diversification in our customer base. In the quarter ended September 29, 2007, Level 3 accounted for 47% of our revenue on a GAAP basis.

In the third quarter of 2006, we recognized $4.4 million of deferred revenue from prior periods and $1.7 million from invoiced shipments of bundled products in the period. In the third quarter of 2007, we recognized $54.8 million of deferred revenue from prior periods and $7.3 million from current period invoiced shipments of bundled products. As of September 29, 2007, deferred revenue was $157.2 million, of which $60.1 million, $43.8 million, $29.8 million, $14.6 million and $8.9 million will be recognized in the fourth quarter of 2007, the first, second and third quarters of 2008 and future periods, respectively.

We have experienced significant revenue growth over the last two years and expect to see continued revenue growth into the future but at somewhat lower growth rates. Revenue growth will be directly impacted by underlying growth in invoiced shipments. Although we expect growth in invoiced shipments to continue on a year-over-year basis, the quarter-over-quarter growth may be impacted by several factors including the timing of large product deployments, acquisitions of new customers and general market conditions. Therefore, the quarter-over-quarter revenue growth could be somewhat volatile and growth may not always occur in a linear manner. In addition, the rate at which we recognize revenue will be directly impacted by our ability to establish vendor specific objective evidence, or VSOE, or fair value for training and software warranty or product support services. See the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates for a description of our revenue recognition policy.

We expect our gross margins to be volatile in the short-term, likely declining in the three months ending December 29, 2007 versus the three months ended September 29, 2007, and to improve in the long-term as deferred revenue is recognized and as average selling prices and product mix improve due to new and existing customers purchasing higher margin network components to increase the capacity of their installed DTN Systems. Gross margins improved from the three months ended September 30, 2006 to the corresponding period in 2007 due to the impact of the recognition of $24.0 million of deferred gross margin related to invoiced shipments in prior periods. In addition, there was a significant improvement in gross margins on current period invoiced shipments reflecting improved

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pricing and cost structures. Although we continued to sell common equipment at low or negative margins, we experienced a reduction of $1.0 million in lower of cost or market, or LCM, adjustments in the current period compared to the third quarter of 2006, primarily due to a continued decline in component pricing. We also recorded a favorable change in estimate to our warranty reserve of $1.9 million primarily due to improved expected future failure rates. Both of these changes, which we do not expect to occur consistently on a going forward basis, along with an improved customer mix and improved product mix, caused our gross margin during the quarter ended September 29, 2007 to improve versus prior periods.

In the next twelve months, capital expenditures are expected to be approximately $20 million, primarily for product development and manufacturing expansion and upgrades.

Corporate Information

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

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

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THE OFFERING

Common stock offered by Infinera	5,000,000 shares
Common stock offered by the selling stockholders	5,000,000 shares
Common stock to be outstanding after this offering	90,357,657 shares
Common stock offered by Infinera as a percentage of common stock to be outstanding after this offering	5.5%
Use of proceeds	We intend to use the net proceeds from this offering for working capital and other general corporate purposes. We may also use a portion of the net proceeds to acquire other businesses, products or technologies. We do not, however, have agreements or commitments for any specific acquisitions at this time. We will not receive any proceeds from the shares sold by the selling stockholders. See the section titled Use of Proceeds.
Dividend policy	Currently, we do not anticipate paying cash dividends.
Risk factors	You should read the Risk Factors section of this prospectus for a discussion of factors that you should consider carefully before deciding whether to invest in shares of our common stock.
NASDAQ Global Market symbol	INFN

The number of shares of our common stock to be outstanding following this offering is based on 85,357,657 shares of our common stock outstanding as of June 30, 2007, but excludes:

- 11,633,856 shares of common stock issuable upon exercise of options outstanding as of June 30, 2007 at a weighted average exercise price of $5.46 per share;
- 498,131 shares of common stock issuable upon the lapsing of restrictions associated with awards of the restricted stock units outstanding as of June 30, 2007;
- 1,332,680 shares of common stock issuable upon the exercise of warrants outstanding as of June 30, 2007, at a weighted average exercise price of $5.36 per share;
- 9,622,255 shares of common stock reserved under our 2007 Equity Incentive Plan; and
- 1,812,500 shares of common stock reserved for issuance under our 2007 Employee Stock Purchase Plan.

Unless otherwise indicated, this prospectus reflects and assumes no exercise by the underwriters of their option to purchase up to an additional 1,500,000 shares.

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SUMMARY CONSOLIDATED FINANCIAL DATA

The following tables summarize our consolidated financial data. We have derived the statements of operations data for the years ended December 31, 2004, 2005 and 2006 from our audited consolidated financial statements appearing elsewhere in this prospectus. The statement of operations data for the six months ended June 30, 2006 and 2007 and the balance sheet data as of June 30, 2007 are derived from our unaudited consolidated financial statements that are included in this prospectus. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the information set forth therein. The results for any interim period are not necessarily indicative of the results that may be expected for a full year. Additionally, our historical results are not indicative of the results that should be expected in the future. You should read this summary consolidated financial data in conjunction with the sections titled Selected Consolidated Financial Data and Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes, all included elsewhere in this prospectus.

	Years Ended December 31,			Six Months Ended June 30,	
	2004	2005	2006	2006	2007
				(Unaudited)	
	(In thousands, except per share data)				
Statements of Operations Data:					
Revenue:					
Ratable product and related support and services	$	$ 4,127	$ 52,978	$ 6,707	$ 100,358
Product	599		5,258		7,250
Total revenue	599	4,127	58,236	6,707	107,608
Cost of revenue:					
Cost of ratable product and related support and services		17,759	48,072	9,973	72,372
Lower of cost or market adjustment	1,587	9,696	21,693	7,982	3,286
Cost of product	5,653		1,660		3,851
Total cost of revenue	7,240	27,455	71,425	17,955	79,509
Gross profit (loss)	(6,641)	(23,328)	(13,189)	(11,248)	28,099
Operating expenses:					
Sales and marketing	8,294	11,053	20,682	6,863	14,037
Research and development	46,306	24,986	38,967	13,718	30,137
General and administrative	2,888	4,328	12,650	3,664	10,915
Amortization of intangible assets			56		74
Total operating expenses	57,488	40,367	72,355	24,245	55,163
Loss from operations	(64,129)	(63,695)	(85,544)	(35,493)	(27,064)
Other income (expense), net	(2,351)	(2,256)	(4,319)	(866)	(18,783)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(66,480)	(65,951)	(89,863)	(36,359)	(45,847)
Provision for income taxes		12	72	30	62
Loss before cumulative effect of change in accounting principle	(66,480)	(65,963)	(89,935)	(36,389)	(45,909)
Cumulative effect of change in accounting principle		(1,137)			
Net loss	$ (66,480)	$ (64,826)	$ (89,935)	$ (36,389)	$ (45,909)

Net loss per common share, basic and diluted	$ (17.94)	$ (14.08)	$ (14.90)	$ (6.84)	$ (2.94)
Weighted average number of shares used in computing basic and diluted net loss per common share	3,705	4,605	6,036	5,320	15,620

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	As of June 30, 2007	
	Actual	As Adjusted
	(In thousands, unaudited)	
Balance Sheet Data:		
Cash, cash equivalents and short-term investments	$ 198,115	$ 302,140
Working capital	172,258	276,283
Total assets	394,853	498,878
Current and long-term debt	4,500	4,500
Total stockholders equity	190,147	294,172

The as adjusted column in the balance sheet data table above reflects our sale of 5,000,000 shares of common stock in this offering, at the public offering price of $22.00 per share, and after deducting the underwriting discount and estimated offering expenses payable by us and the application of our net proceeds from this offering.

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RISK FACTORS

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

Risk Related to Our Business

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

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

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

We have not achieved profitability. We experienced a net loss of $89.9 million for the year ended December 31, 2006 and $45.9 million for the six months ended June 30, 2007. As of June 30, 2007, our accumulated deficit was $360.0 million. We expect to continue to incur substantial losses, and we may not become profitable in the foreseeable future, if ever. We expect to continue to make significant expenditures related to the development of our business, including expenditures to hire additional personnel related to the sales, marketing and development of our DTN System and to maintain and expand our manufacturing facilities and research and development operations. In addition, as a newly public company, we have and will continue to incur significant legal, accounting and other expenses that we did not incur as a private company. We will have to generate and sustain significant increased revenue and product gross margins to achieve profitability. Accordingly, we may not be able to achieve or maintain profitability and we may continue to incur significant losses in the future.

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

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

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

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

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reductions in customers budgets for optical communications purchases and delays in their purchasing cycles;

order cancellations or reductions or delays in delivery schedules by our customers;

timeliness of our customers payments for their purchases;

the timing of recognizing revenue in any given quarter as a result of software revenue recognition requirements and any changes in U.S. generally accepted accounting principles or new interpretations of existing accounting rules;

our ability to establish vendor specific objective evidence, or VSOE, in order to be able to recognize revenue once the four revenue recognition criteria have been met, rather than over the period represented by the longest undelivered service period;

readiness of customer sites for installation of our DTN System;

the timing of product releases or upgrades by us or by our competitors;

availability of third party suppliers to provide contract engineering and installation services for us;

any significant changes in the competitive dynamics of our market, including any new entrants, technological advances or substantial discounting of products;

our ability to control costs, including our operating expenses and the costs of components we purchase; and

general economic conditions in domestic and international markets.

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

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

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

the mix in any period of higher and lower margin products and services;

price discounts negotiated by our customers;

sales volume from each customer during the period;

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

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

charges for excess or obsolete inventory;

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

our ability to reduce manufacturing costs;

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

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- increased price competition, including competition from low-cost producers in China; and
- increased warranty or repair costs.

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

Aggressive business tactics by our competitors may harm our business.

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

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

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

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

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

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

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

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

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

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

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

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Further, many of our customers are large communications service providers that have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers have and may continue to seek advantageous pricing and other commercial terms and may require us to develop additional features in the products we sell to them. We have and may continue to be required to reduce the average selling price, or increase the average cost, of our DTN System in response to these pressures or competitive pricing pressures. To maintain acceptable operating results, we will need to develop and introduce new products and product enhancements on a timely basis and continue to reduce our costs.

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

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

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

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

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

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

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

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

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hire additional sales personnel and develop and manage new sales channels through resellers, distributors and systems integrators. If we do not succeed in our efforts to sell to these target markets and customers, the size of our total addressable market will be limited. This, in turn, would harm our ability to grow our customer base and revenue.

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

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

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

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

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

Any claim of infringement from a third party, even those without merit, could cause us to incur substantial costs defending against such claims, and could distract our management from running our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering our DTN System. In addition, we might be required to seek a

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

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

On April 11, 2007, we, Level 3 and Cheetah filed a joint motion with the court, agreeing to the following: (1) to stay all proceedings in the lawsuit pending a determination by the U.S. Patent and Trademark Office as to whether it will reexamine U.S. Patent Nos. 6,795,605 and 7,142,347; and (2) if the U.S. Patent and Trademark Office decides to reexamine either U.S. Patent No. 6,795,605 or 7,142,347, to stay all proceedings in the lawsuit pending final resolution of the reexamination(s) by the U.S. Patent and Trademark Office. On April 12, 2007, the court granted the motion staying all proceedings in the lawsuit. On June 26, 2007, the U.S. Patent and Trademark Office ordered reexamination of U.S. Patent No. 6,795,605. On August 1, 2007, the U.S. Patent and Trademark Office ordered reexamination of U.S. Patent No. 7,142,347. As a result, all proceedings in this lawsuit are stayed until the final resolution of these reexaminations. We do not know when the U.S. Patent and Trademark Office reexamination process will be completed. In the event that Cheetah is successful in obtaining a judgment requiring us to pay damages or obtains an injunction preventing the sale of our DTN System, our business could be harmed.

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

We are required to generate forecasts of future demands for our DTN System several months prior to the scheduled delivery to our prospective customers, which requires us to make significant investments before we know if corresponding revenue will be recognized. If we overestimate demand for our DTN System and increase our inventory in anticipation of customer orders that do not materialize, we will have excess inventory, we will face a risk of obsolescence and significant inventory write-downs and our capital infrastructure will be depreciated across fewer units raising our per unit costs. If we underestimate demand for our DTN System, we will have inadequate inventory, which could slow down or interrupt the manufacturing of our DTN System and result in delays in shipments

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and our ability to recognize revenue. In addition, we may be unable to meet our supply commitments to customers which could result in a breach of our customer agreements and require us to pay damages. Lead times for materials and components, including application-specific integrated circuits, that we need to order for the manufacturing of our DTN System vary significantly and depend on factors such as the specific supplier, contract terms and demand for each component at a given time.

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

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

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

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

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

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

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

delays in collecting accounts receivable;

payment of damages for performance failures;

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- reduced orders from existing customers; and
- declining interest from potential customers.

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

From time to time, we encounter interruptions or delays in the activation of our DTN System at a customers site. These interruptions or delays may result from product performance problems or from issues with installation and activation, some of which are outside our control. If we experience significant interruptions or delays that we cannot promptly resolve, confidence in our DTN System could be undermined, which could cause us to lose customers and fail to add new customers.

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

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

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

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

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

Since our DTN System is based on complex technology, we may experience unanticipated delays in developing, improving, manufacturing or deploying it. Any modification to our PIC and to our

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DTN System entails similar development risks. At any given time, various enhancements to our DTN System are in the development phase and are not yet ready for commercial manufacturing or deployment. The maturing process from laboratory prototype to customer trials, and subsequently to general availability, involves a number of steps, including:

- completion of product development;
- the qualification and multiple sourcing of critical components;
- validation of manufacturing methods and processes;
- extensive quality assurance and reliability testing, and staffing of testing infrastructure;
- validation of software; and
- establishment of systems integration and systems test validation requirements.

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

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

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

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

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

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

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

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

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

Based on an evaluation performed by our management, with the participation of our Chief Executive Officer, or CEO, and our Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures and in light of the unremediated material weakness in our internal controls over our non-routine manual accounting and reporting processes, our CEO and CFO have concluded that, as of September 29, 2007, our disclosure controls and procedures were not effective. To address this material weakness, we have completed additional review and re-performance procedures in relation to non-routine manual accounting and reporting processes as part of our financial close procedures.

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

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

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

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

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

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

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

Because the purchase of our equipment involves substantial cost, most of our customers wait to purchase our equipment until they are ready to deploy it in their network. As a result, it is difficult for us to accurately predict the timing of future purchases by our customers. In addition, product purchases are frequently subject to budget constraints, multiple approvals and unplanned administrative,

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processing and other delays. If sales expected from customers for a particular quarter are not realized in that quarter or at all, our revenue will be negatively impacted.

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

We market, sell and service our DTN System globally. In 2005, 2006 and the six months ended June 30, 2007, we derived approximately 36%, 14% and 19%, respectively, of our revenue from customers outside of the United States. We have sales and support personnel in numerous countries worldwide. In addition, we have a large group of software development personnel located in Bangalore, India. We expect that significant management attention and financial resources will be required for our international activities over the foreseeable future as we enter new international markets. In some countries, our success will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements for international sales of our DTN System could impact our ability to maintain or increase international market demand for our DTN System.

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

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

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

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

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

Our future success will depend on our ability to have sufficient volumes of our DTN System manufactured in a cost-effective and quality-controlled manner. We have engaged third parties to manufacture certain elements of our DTN System and are in the process of qualifying non-U.S.

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contract manufacturing sites. There are a number of risks associated with our dependence on contract manufacturers, including:

- reduced control over delivery schedules, particularly for international contract manufacturing sites;
- reliance on the quality assurance procedures of third parties;
- potential uncertainty regarding manufacturing yields and costs;
- potential lack of adequate capacity during periods of excess demand;
- potential uncertainty related to the use of international contract manufacturing sites;
- limited warranties on components supplied to us;
- potential misappropriation of our intellectual property; and
- potential manufacturing disruptions.

Any of these risks could impair our ability to fulfill orders. Our contract manufacturers may not be able to meet the delivery requirements of our customers, which could decrease customer satisfaction and harm our DTN System sales. We do not have long-term contracts or arrangements with our contract manufacturers that will guarantee product availability, or the continuation of particular pricing or payment terms. If our contract manufacturers are unable or unwilling to continue manufacturing our DTN System in required volumes or our relationship with any of our contract manufacturers is discontinued for any reason, we would be required to identify and qualify alternative manufacturers, which could cause us to be unable to meet our supply requirements to our customers and result in the breach of our customer agreements. Qualifying a new contract manufacturer and commencing volume production is expensive and time-consuming and if we are required to change or qualify a new contract manufacturer, we would likely lose sales revenue and damage our existing customer relationships.

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

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

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

Acquisitions also involve numerous risks, including:

problems integrating the acquired operations, technologies or products with our own;

diversion of management s attention from our core business;

assumption of unknown liabilities;

adverse effects on existing business relationships with suppliers and customers;

increased accounting compliance risk;

risks associated with entering new markets; and

potential loss of key employees.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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Risks Related to this Offering and Ownership of Our Common Stock

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

The trading prices of the securities of technology companies have been highly volatile. Further, our common stock has a limited trading history. From our initial public offering in June 2007 through September 29, 2007, our stock price fluctuated from a low of $16.00 to a high of $30.00. Factors affecting the trading price of our common stock include:

- variations in our operating results;
- announcements of technological innovations, new services or service enhancements, strategic alliances or agreements by us or by our competitors;
- the gain or loss of customers;
- recruitment or departure of key personnel;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- market conditions in our industry, the industries of our customers and the economy as a whole; and
- adoption or modification of regulations, policies, procedures or programs applicable to our business.

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

A significant portion of our outstanding common stock will soon be released from restrictions on resale and may be sold in the public market in the near future. Future sales of shares by existing stockholders, including sales pursuant to this offering, could cause our stock price to decline.

If our existing stockholders, particularly our directors, their affiliated venture capital funds and our executive officers, sell substantial amounts of our common stock in the public market, or are perceived by the public market as intending to sell, the trading price of our common stock could decline significantly. Based on shares outstanding as of June 30, 2007, upon completion of this offering we will have 90,357,657 shares of common stock outstanding, assuming no exercise of the underwriters option to purchase additional shares. Of these shares, 26,100,000 shares, consisting of the 10,000,000 shares being sold in this offering and the 16,100,000 shares sold in our initial public offering, will be freely tradable without restriction in the public market immediately following the closing of this offering.

The remaining 64,257,657 shares, or 71.1% of our outstanding shares after this offering, are currently subject to market standoff agreements entered into by our stockholders with us or contractual lock-up agreements entered into by our stockholders with the underwriters in connection with our initial public offering and will become freely tradeable in the public market on December 4, 2007, subject to extension as described below, except for shares of common stock held by directors, executive officers and our other affiliates which will be subject to volume limitations under Rule 144 of the Securities Act and, in certain cases, various vesting arrangements. Of these shares, 9,571,202 shares, or 10.6% of our outstanding shares after this offering, are subject to additional contractual lock-up agreements entered into by our executive officers, directors and the selling stockholders with the underwriters for

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this offering and will not be able to be sold in the public market until 90 days after the date of this prospectus, subject to extension or reduction as described below. Goldman, Sachs & Co. currently does not anticipate shortening or waiving any of the lock-up agreements, other than releasing the selling stockholders and us to sell shares in this offering, and allowing sales under pre-existing Rule 10b5-1 trading plans, and does not have any pre-established conditions for such modifications or waivers. Goldman, Sachs & Co. may, however, release for sale in the public market all or any portion of the shares subject to the lock-up agreements.

The contractual lock-up period described above for lock-up agreements entered into in connection with our initial public offering will be automatically extended under the following circumstances: if during the 17 days prior to December 3, 2007, we issue an earnings release or announce material news or a material event or, if we announce that we will release earnings results during the 15-day period following December 3, 2007. The restrictions described above will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the announcement of the material news or material event.

The contractual lock-up period described above for lock-up agreements entered into in connection with this offering may be extended or reduced if we issue an earnings release or announce material news or a material event within 15 days before or after the expiration date of the initial lock-up period. If during the 15 days prior to the expiration date of the initial lock-up period we issue an earnings release or announce material news or a material event, the applicable contractual lock-up period will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the announcement of the material news or material event. Prior to the expiration date of the initial lock-up period, if we announce that we will release earnings results during the 15-day period following the last day of the initial lock-up period, the lock-up restrictions on resale will expire on the day 15 days prior to the scheduled earnings release so long as we issue a press release and file an accompanying current report on Form 8-K announcing the early release date at least three days before the early release date. If we do not publicly announce the early release date by such time, the lock-up restrictions will instead continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release. The scheduled expiration of the lock-up period for this offering is 90 days after the date of this prospectus. In no event will the lock-up period expire prior to January 16, 2008. We intend to release our earnings for the quarter and year ended December 31, 2007 on January 31, 2008 and we intend to file the requisite Form 8-K on or before January 10, 2008, which would cause the aforementioned lock-up to expire on January 16, 2008.

Some of our existing stockholders have contractual demand or piggyback rights to require us to register with the SEC up to 57,753,659 shares of our common stock, including 168,952 shares issuable upon exercise of warrants, after the shares being sold in this offering. These registration rights have been waived with respect to this offering. If we register these shares of common stock in connection with this offering or otherwise, the stockholders would be able to sell those shares freely in the public market.

We have also registered 24,035,738 shares of our common stock that we have issued or may issue under our equity plans. These shares can be freely sold in the public market upon issuance, subject to vesting restrictions, the market standoff agreements and the lock-up agreements described above.

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

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If no or few securities or industry analysts cover our company, the trading price for our stock would be negatively impacted. If one or more of the analysts who covers us downgrades our stock or publishes misleading or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price or trading volume to decline.

Insiders have substantial control over us and will be able to influence corporate matters and delay or prevent a third party from acquiring control over us.

Upon completion of this offering, our directors and executive officers and their affiliates will beneficially own, in the aggregate, approximately 12.1% of our outstanding common stock, assuming no exercise of the underwriters option to purchase additional shares. As a result, these stockholders will be able to exercise influence over all matters requiring stockholder approval, including the election of directors and approval of corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit your ability to influence corporate matters and delay or prevent a third party from acquiring control over us. For information regarding the ownership of our outstanding stock by our executive officers and directors and their affiliates, please see the section titled Principal Stockholders.

If you purchase shares of common stock sold in this offering, you will experience substantial dilution as a result of this offering and future equity issuances.

The public offering price per share in this offering is substantially higher than the pro forma net tangible book value per share of our common stock outstanding prior to this offering. As a result, investors purchasing common stock in this offering will experience immediate substantial dilution of $18.74 a share. In addition, we have issued options to acquire common stock at prices below the public offering price. To the extent outstanding options are ultimately exercised, there will be further dilution to investors in this offering. This dilution is due in large part to the fact that our earlier investors paid substantially less than the public offering price when they purchased their shares of common stock. In addition, if the underwriters exercise their option to purchase additional shares, if outstanding warrants to purchase our common stock are exercised, or if we issue additional equity securities, you will experience additional dilution.

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

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

- authorize the issuance of blank check convertible preferred stock that could be issued by our board of directors to thwart a takeover attempt;

- establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;

- require that directors only be removed from office for cause and only upon a supermajority stockholder vote;

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- provide that vacancies on the board of directors, including newly-created directorships, may be filled only by a majority vote of directors then in office rather than by stockholders;

- prevent stockholders from calling special meetings; and

- prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders.

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

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

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FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 contains certain safe harbor provisions regarding forward-looking statements. This prospectus includes forward-looking statements that relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. All statements contained in this prospectus other than statements of historical facts, including statements regarding our future operating results and financial position, our business strategy and plans and our objectives for future operations, are forward-looking statements. The words anticipate, architected, believe, continue, could, designed, en estimate, expect, intend, likely, may, plan, target, will, or would and similar expressions are intended to identify forwa statements.

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

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

All forward-looking statements involve risks, assumptions and uncertainties. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, operating results, business strategy, short-term and long-term business operations and objectives, and financial needs. The occurrence of the events described, and the achievement of the expected results, depend on many events, some or all of which are not predictable or within our control. Actual results may differ materially from expected results. See the section titled Risk Factors and elsewhere in this prospectus for a more complete discussion of these risks, assumptions and uncertainties and for other risks and uncertainties. These risks, assumptions and uncertainties are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors also could harm our results. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this prospectus might not occur. We undertake no obligation, and specifically decline any obligation, to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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USE OF PROCEEDS

We estimate that our net proceeds from the sale of the common stock that we are offering will be approximately $104.0 million, based on the public offering price of $22.00 per share, and after deducting the underwriting discount and estimated offering expenses payable by us. If the underwriters option to purchase additional shares in this offering is exercised in full we estimate that our net proceeds will be approximately $135.5 million, based on the same assumptions and estimates. We will not receive any proceeds from the sale of shares of common stock by the selling stockholders.

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

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

PRICE RANGE OF COMMON STOCK

Our common stock has traded on the Nasdaq Global Market under the symbol INFN since it began trading on June 7, 2007. Our initial public offering was priced at $13.00 per share on June 6, 2007. The following table sets forth, for the time periods indicated, the high and low sales prices of our common stock as reported on the Nasdaq Global Market.

	High	Low
Second Quarter 2007 (from June 7, 2007)	$ 30.00	$ 16.00
Third Quarter 2007	$ 25.98	$ 16.52
Fourth Quarter 2007 (through October 30, 2007)	$ 27.12	$ 20.20

On October 30, 2007, the last reported sale price of our common stock on the Nasdaq Global Market was $22.65.

DIVIDEND POLICY

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

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CAPITALIZATION

The following table presents our cash, cash equivalents and short-term investments and capitalization as of June 30, 2007:

- on an actual basis; and
- on an as adjusted basis reflecting the receipt of the estimated net proceeds from the sale of 5,000,000 shares of common stock offered by us in this offering, at the public offering price of $22.00 per share, and after deducting the underwriting discount and estimated offering expenses payable by us.

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

	As of June 30, 2007	
	Actual	As Adjusted
	(Unaudited) (In thousands)	
Cash, cash equivalents and short-term investments	$ 198,115	$ 302,140
Current and long-term debt	$ 4,500	$ 4,500
Preferred stock, $0.001 par value: 25,000 shares authorized, no shares issued and outstanding actual; 25,000 shares authorized, no shares issued and outstanding as adjusted		
Common stock, $0.001 par value: 500,000 shares authorized, 85,358 shares issued and outstanding actual; 500,000 shares authorized, 90,358 shares issued and outstanding as adjusted	85	90
Additional paid-in capital	550,188	654,208
Accumulated other comprehensive loss	(129)	(129)
Accumulated deficit	(359,997)	(359,997)
Total stockholders equity (deficit)	190,147	294,172
Total capitalization	$ 194,647	$ 298,672

This table excludes the following shares:

- 11,633,856 shares of common stock issuable upon exercise of stock options outstanding as of June 30, 2007 at a weighted average exercise price of $5.46 per share;
- 498,131 shares of common stock issuable upon the lapsing of restrictions associated with awards of restricted stock units outstanding as of June 30, 2007;
- 1,332,680 shares of common stock issuable upon the exercise of warrants outstanding as of June 30, 2007 at a weighted average exercise price of $5.36 per share; and

- 9,622,255 shares of common stock reserved for future issuance under our 2007 Equity Incentive Plan; and

- 1,812,500 shares of common stock reserved for future issuance under our 2007 Employee Stock Purchase Plan.

This table includes the following shares:

- 1,550,345 shares of restricted common stock issued upon the early exercise of stock options at a weighted average exercise price of $1.77 per share that are classified as outstanding for financial reporting purposes, except in the calculation of earnings per share.

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

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DILUTION

Our net tangible book value as of June 30, 2007 was $190.1 million, or approximately $2.23 per share. Net tangible book value per share represents the amount of stockholders equity divided by 85,357,657 shares of common stock outstanding.

Net tangible book value dilution per share to new investors represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the net tangible book value per share of common stock immediately after the closing of this offering. After giving effect to our sale of 5,000,000 shares of common stock in this offering at the public offering price of $22.00 per share, and after deducting the underwriting discount and estimated offering expenses, our as adjusted net tangible book value as of June 30, 2007 would have been $294.2 million, or $3.26 per share. This represents an immediate increase in net tangible book value of $1.03 per share to existing stockholders and an immediate dilution in net tangible book value of $18.74 per share to purchasers of common stock in the offering, as illustrated in the following table:

Public offering price per share		$ 22.00
Net tangible book value per share as of June 30, 2007	$ 2.23	
Increase in as adjusted net tangible book value per share attributable to new investors	1.03	
As adjusted net tangible book value per share after the offering		3.26
Dilution per share to new investors		$ 18.74

If the underwriters exercise their option to purchase additional shares of our common stock in full in this offering, the as adjusted net tangible book value per share after the offering would be $3.54 per share, the increase in the as adjusted net tangible book value per share to existing stockholders would be $1.31 per share and the dilution to new investors purchasing shares in this offering would be $18.46 per share.

If all of our outstanding stock options, restricted stock units, or RSUs, and warrants were exercised and the underwriters do not exercise their option to purchase additional shares of our common stock in full in this offering, as adjusted net tangible book value per share after the offering would be $3.51 per share, the increase in the as adjusted net tangible book value per share to existing stockholders would be $1.28 per share and the dilution to new investors purchasing shares in this offering would be $18.49 per share.

As of June 30, 2007, there were options outstanding to purchase a total of 11,633,856 shares of common stock at a weighted average exercise price of $5.46 per share, and there were RSUs to purchase a total of 498,131 shares of common stock at zero cost. As of June 30, 2007 there were warrants outstanding to purchase 1,332,680 shares of common stock with a weighted average exercise price of $5.36 per share. If all of these options, RSUs and warrants were exercised and the shares subject to the RSUs delivered, our existing stockholders, including the holders of these options, warrants and RSUs, would own 95.2% of the total number of shares of our common stock outstanding upon the closing of this offering and our new investors would own 4.8% of the total number of shares of our common stock upon the closing of this offering.

As of June 30, 2007, there were 1,550,345 shares of restricted common stock issued upon the early exercise of stock options at a weighted average exercise price of $1.77 per share that are classified as outstanding for financial reporting purposes, except in the calculation of net loss per common share. For a description of our equity plans, please see the section titled Management Equity Benefit Plans.

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SELECTED CONSOLIDATED FINANCIAL DATA

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

We derived the statements of operations and cash flow data for the years ended December 31, 2004, 2005 and 2006 and the balance sheet data as of December 31, 2005 and 2006 from our audited consolidated financial statements and related notes, which are included elsewhere in this prospectus. We derived the statements of operations and cash flow data for the years ended December 31, 2002 and 2003 and the balance sheet data as of December 31, 2002, 2003 and 2004 from our audited consolidated financial statements and related notes which are not included in this prospectus. The statement of operations and cash flow data for the six months ended June 30, 2006 and 2007 and the balance sheet data as of June 30, 2007 are derived from our unaudited consolidated financial statements that are included in this prospectus. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the information set forth therein. The results for any interim period are not necessarily indicative of the results that may be expected for a full year. Additionally, our historical results are not necessarily indicative of the results that should be expected in the future.

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	Years Ended December 31,					Six Months Ended June 30,	
	2002	2003	2004	2005	2006	2006	2007
						(Unaudited)	
	(in thousands, except per share data)						
Statements of Operations Data:							
Revenue:							
Ratable product and related support and services	$	$	$	$ 4,127	$ 52,978	$ 6,707	$ 100,358
Product			599		5,258		7,250
Total revenue			599	4,127	58,236	6,707	107,608
Cost of revenue:							
Cost of ratable product and related support and services				17,759	48,072	9,973	72,372
Lower of cost or market adjustment			1,587	9,696	21,693	7,982	3,286
Cost of product			5,653		1,660		3,851
Total cost of revenue			7,240	27,455	71,425	17,955	79,509
Gross profit (loss)			(6,641)	(23,328)	(13,189)	(11,248)	28,099
Operating expenses:							
Sales and marketing	895	1,680	8,294	11,053	20,682	6,863	14,037
Research and development	26,759	41,951	46,306	24,986	38,967	13,718	30,137
General and administrative	4,938	4,587	2,888	4,328	12,650	3,664	10,915
Amortization of intangible assets					56		74
Total operating expenses	32,592	48,218	57,488	40,367	72,355	24,245	55,163
Loss from operations	(32,592)	(48,218)	(64,129)	(63,695)	(85,544)	(35,493)	(27,064)
Other income (expense), net	(1,470)	(2,013)	(2,351)	(2,256)	(4,319)	(866)	(18,783)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(34,062)	(50,231)	(66,480)	(65,951)	(89,863)	(36,359)	(45,847)
Provision for income taxes				12	72	30	62
Loss before cumulative effect of change in accounting principle	(34,062)	(50,231)	(66,480)	(65,963)	(89,935)	(36,389)	(45,909)
Cumulative effect of change in accounting principle				(1,137)			
Net loss	$ (34,062)	$ (50,231)	$ (66,480)	$ (64,826)	$ (89,935)	$ (36,389)	$ (45,909)
Net loss per common share, basic and diluted	$ (21.27)	$ (19.61)	$ (17.94)	$ (14.08)	$ (14.90)	$ (6.84)	$ (2.94)
Weighted average number of shares used in computing basic and diluted net loss per common share	1,602	2,561	3,705	4,605	6,036	5,320	15,620

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	As of December 31,					As of June 30,
	2002	2003	2004	2005	2006	2007 (Unaudited)
	(In thousands)					
Balance Sheet Data:						
Cash, cash equivalents and short-term investments	$ 49,997	$ 54,244	$ 40,017	$ 37,112	$ 29,572	$ 198,115
Working capital	40,956	43,976	37,665	29,579	2,218	172,258
Total assets	69,849	75,441	69,514	100,912	230,466	394,853
Current and long-term debt	16,638	10,256	6,359	23,773	28,382	4,500
Convertible preferred stock	91,870	151,865	207,315	247,147	320,550	
Common and additional paid-in-capital	1,628	2,095	2,979	3,529	7,920	550,273
Stockholders deficit	(41,725)	(91,200)	(156,471)	(220,710)	(306,321)	(359,997)

	Years Ended December 31,					Six Months Ended June 30,
	2002	2003	2004	2005	2006	2007 (Unaudited)
	(In thousands)					
Cash Flow Data:						
Cash provided by (used in) operating activities	$ (31,527)	$ (43,727)	$ (62,222)	$ (56,449)	$ (67,775)	$ 6,208
Cash provided by (used in) investing activities	(59,001)	(4,892)	9,283	29,451	(18,069)	(6,186)
Cash provided by financing activities	38,611	53,573	51,608	58,059	78,780	168,463

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

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

We began commercial shipment of our DTN System in November 2004. As of September 29, 2007, we had sold our DTN System for deployment in the optical networks of 38 customers worldwide, including telecommunications carriers, cable operators, Internet service providers and others. Our goal is to be a leading provider of optical communications systems to communications service providers. Our revenue growth will depend on the continued acceptance of our DTN System, growth of communications traffic and the proliferation of next-generation bandwidth-intensive services, which are expected to drive the need for increased levels of bandwidth. Our ability to increase revenue and achieve profitability will be directly affected by the level of acceptance of our products in the long-haul and metro markets and by our ability to cost-effectively develop and sell innovative products that leverage our technology advantages.

In June 2007, we completed our initial public offering, or IPO, of common stock in which we sold and issued 16.1 million shares of our common stock, including 2.1 million shares sold by us pursuant to the underwriters full exercise of their option to purchase additional shares, at an issue price of $13.00 per share. We raised a total of $209.3 million in gross proceeds from the IPO, or $190.2 million in net proceeds after deducting underwriting discounts and commissions and other offering costs.

Since our inception, we have incurred significant losses, and as of June 30, 2007 we had an accumulated deficit of $360.0 million. We have not achieved profitability on a quarterly or annual basis, and we expect to continue to incur substantial losses. Our ability to become profitable will be affected by any additional expenses that we incur to expand our manufacturing capacity, sales, marketing, development and general and administrative capabilities in order to grow our business. The largest component of our expenses is personnel costs. Personnel costs consist of salaries, benefits and incentive compensation for our employees, including commissions for sales personnel and stock-based compensation for all employees.

We primarily sell our products through our direct sales force, with a small proportion sold indirectly through resellers. We derived 85% and 98% of our revenue from direct sales to customers in 2005 and 2006, respectively, and 98% in each of the six months ended June 30, 2006 and 2007. We expect to continue generating a significant majority of our revenue from direct sales in the future.

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

We have experienced significant revenue growth over the last two years and expect to see continued revenue growth into the future but at somewhat lower growth rates. Revenue growth will be directly impacted by underlying growth in invoiced shipments. Although we expect growth in invoiced shipments to continue on a year-over-year basis, the quarter-over-quarter growth may be impacted by several factors including the timing of large product deployments, acquisitions of new customers and general market conditions. Therefore, quarter-over-quarter revenue growth could be somewhat volatile and growth may not always occur in a linear manner. In addition, the rate at which we recognize revenue will be directly impacted by our ability to establish vendor specific objective evidence, or VSOE, or fair value for training and software warranty or product support services.

As described below, we had $64.3 million of deferred margin on our balance sheet at June 30, 2007. This, when combined with the fact that we expect to see continual improvements in gross margin on invoiced shipments should result in an overall improvement in gross margins going forward. However, it is difficult to predict when the improvements in invoiced shipment gross margins will be recognized in the Consolidated Statement of Operations and how these margins will be impacted by a lower of cost or market adjustment, or LCM, adjustments when common equipment is sold at a loss.

We will continue to make significant investments in the business with operating expenses expected to average over 35% of invoiced shipments in future periods.

Overview of Consolidated Financial Data

Revenue

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

The following table illustrates our revenue for the specified periods:

Revenue (In thousands)	Three Months Ended 2005 (Unaudited) Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended Dec. 31, 2005	Three Months Ended 2006 (Unaudited) Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended Dec. 31, 2006	Three Months Ended 2007 (Unaudited) Mar. 31	Jun. 30
Ratable revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 6,118	$ 40,153	$ 52,978	$ 45,947	$ 54,411
Product revenue								1,578	3,680	5,258	3,245	4,005
Total revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 7,696	$ 43,833	$ 58,236	$ 49,192	$ 58,416

Ratable Revenue. Substantially all of our sales arrangements consist of product sales bundled with training and product support. Product support services consist of software warranty, updates and unspecified upgrades and product support. To date, we have not established VSOE of fair value for

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training and software warranty or product support services. All revenue for these bundled products is deferred and recognized ratably over the longest undelivered service period. In order to establish VSOE, we must have a history of selling our training and product support services separately at a consistent price. Once we have a sufficiently consistent transactional history to establish VSOE for training, software warranty and product support services, we will be able to recognize revenue up front for new customer orders once all of the following have occurred: (1) we have entered into a legally binding arrangement with a customer; (2) delivery and acceptance have occurred, which is when product title and risk of loss has transferred to the customer; (3) customer payment is deemed fixed or determinable; and (4) collectibility is reasonably assured. Revenue for then existing customer orders will continue to be recognized over the applicable revenue recognition period.

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

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

The ratable revenue that is recognized in each quarter includes a ratable portion recognized from deferred revenue of prior invoiced shipments of bundled products together with a ratable portion of each new invoiced shipment of bundled products in that quarter. Invoiced shipments of bundled products represent sales of our DTN System and services delivered and accepted by the customer for which payment will be made in accordance with normal payment terms, but for which VSOE has not been established. Shipments of bundled products are invoiced when all products ordered on a purchase order have been shipped and the relevant customer acceptance criteria have been satisfied. Customer acceptance periods averaged approximately 19 days both in the fourth quarter of 2006 and the second quarter of 2007. The customer acceptance period for the first quarter of 2007 was 17.8 days. Invoiced shipments of bundled products are amortized and recognized as revenue over the longest undelivered service period in each customer contract.

Product Revenue. Revenue for products that does not require significant customization, and with respect to which any software is considered incidental, is recognized under Staff Accounting Bulletin No. 104, *Revenue Recognition*, SAB 104. Under SAB 104, revenue is recognized only when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the fee is fixed or determinable and collectibility is reasonably assured. Additionally, a small portion of our sales arrangement consist of product sales not bundled with product support services and therefore recognized upfront in accordance with Statement of Position No. 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition,*

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with Respect to Certain Transaction when all of the following have occurred: (1) we have entered into a legally binding arrangement with a customer; (2) delivery has occurred, which is when product title and risk of loss have transferred to the customer; (3) customer payment is deemed fixed or determinable; and (4) collectibility is reasonably assured. Revenue is recognized net of cash discounts. Revenue related to these arrangements is included in product revenue in the accompanying consolidated statements of operations.

Deferred Revenue

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

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

	Three Months Ended 2005				Year Ended Dec. 31,	Three Months Ended 2006				Year Ended Dec. 31,	Three Months Ended 2007	
Deferred Revenue (In thousands)	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2005**	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2006**	**Mar. 31**	**Jun. 30**
	(Unaudited)					**(Unaudited)**					**(Unaudited)**	
Beginning balance	$	$ 2,577	$ 4,020	$ 17,020	$	$ 23,200	$ 34,349	$ 49,977	$ 84,284	$ 23,200	$ 110,953	$ 128,420
Invoiced shipments of bundled products	2,998	2,046	14,126	8,157	27,327	13,802	19,682	40,425	66,822	140,731	63,414	64,946
Ratable revenue	(421)	(603)	(1,126)	(1,977)	(4,127)	(2,653)	(4,054)	(6,118)	(40,153)	(52,978)	(45,947)	(54,411)
Ending balance	$ 2,577	$ 4,020	$ 17,020	$ 23,200	$ 23,200	$ 34,349	$ 49,977	$ 84,284	$ 110,953	$ 110,953	$ 128,420	$ 138,955

In 2005, we recorded $27.3 million of invoiced shipments of bundled products, recognized $4.1 million of revenue and added $23.2 million to the deferred revenue balance. In 2006, we recorded $140.7 million of invoiced shipments of bundled products, recognized $53.0 million of revenue and added $87.8 million to the deferred revenue balance. In the six months ended June 30, 2007, we recorded $128.4 million of invoiced shipments of bundled products, recognized $100.4 million of revenue and added $28.0 million to the deferred revenue balance.

The growth in invoiced shipments from 2006 to 2007 is due primarily to increased shipments to existing customers and the addition of a significant number of new customers. The growth in revenue reflects this increase in invoiced shipments and a shortening of the average revenue recognition period for ratable revenue due to the amendment of historical contracts as discussed above and the negotiation of shorter warranty periods in new contracts.

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Cost of Revenue

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

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

Cost of Revenue (In thousands)	Three Months Ended 2005 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended Dec. 31, 2005	Three Months Ended 2006 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended Dec. 31, 2006	Three Months Ended 2007 Mar. 31	Jun. 30
	(Unaudited)					(Unaudited)					(Unaudited)	
Cost of ratable revenue	$ 2,276	$ 7,032	$ 5,092	$ 3,359	$ 17,759	$ 5,485	$ 4,488	$ 7,967	$ 30,132	$ 48,072	$ 34,843	$ 37,529
Lower of cost or market adjustment	104	1,438	3,604	4,550	9,696	4,325	3,657	4,172	9,539	21,693	1,067	2,219
Cost of product revenue								311	1,349	1,660	1,363	2,488
Total cost of revenue	$ 2,380	$ 8,470	$ 8,696	$ 7,909	$ 27,455	$ 9,810	$ 8,145	$ 12,450	$ 41,020	$ 71,425	$ 37,273	$ 42,236

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

Certain manufacturing costs are recognized in the period in which they are incurred or can be estimated, including period costs and losses associated with products which are sold or anticipated to be sold at a loss. The initial deployment of our DTN System at a customer involves the installation of common equipment, including a chassis, optical line amplifiers and related equipment. This common equipment is typically sold at low or negative gross margins. When we sell equipment at a loss, the losses are recognized in the period in which they are incurred or reasonably estimatable. We refer to this loss as a lower of cost or market, or LCM, adjustment. In the years ended December 31, 2005 and 2006 and in the six months ended June 30, 2007, our LCM adjustment was $9.7 million, $21.7 million and $3.3 million, respectively. In addition, we recorded inventory write-downs for excess and obsolete inventory in 2004, 2005 and 2006 of $2.2 million, $(0.7) million and $1.7 million, respectively, and in the six months ended June 30, 2007 of $2.5 million. The remainder of our cost of ratable revenue is recorded as deferred costs of invoiced shipments of bundled products and is recognized in the same period as the corresponding revenue.

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

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Deferred Inventory Cost

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

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

	Three Months Ended 2005				Year Ended Dec. 31,	Three Months Ended 2006				Year Ended Dec. 31,	Three Months Ended 2007	
Deferred Inventory Cost	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2005**	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2006**	**Mar. 31**	**Jun. 30**
(In thousands)		**(Unaudited)**					**(Unaudited)**				**(Unaudited)**	
Beginning balance	$	$ 2,090	$ 3,527	$ 11,637	$	$ 16,687	$ 26,548	$ 35,038	$ 55,612	$ 16,687	$ 67,253	$ 73,458
Deferred cost of invoiced shipments of bundled products	2,365	1,872	8,954	6,428	19,619	11,880	11,298	24,442	38,986	86,606	33,164	32,800
Amortization to cost of ratable revenue	(275)	(435)	(844)	(1,378)	(2,932)	(2,019)	(2,808)	(3,868)	(27,345)	(36,040)	(26,959)	(31,552)
Ending balance	$ 2,090	$ 3,527	$ 11,637	$ 16,687	$ 16,687	$ 26,548	$ 35,038	$ 55,612	$ 67,253	$ 67,253	$ 73,458	$ 74,706

Gross Margin

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

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

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

	Three Months Ended 2005				Year Ended Dec. 31,	Three Months Ended 2006				Year Ended Dec. 31,	Three Months Ended 2007	
Gross Margin	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2005**	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2006**	**Mar. 31**	**Jun. 30**
(In thousands)		**(Unaudited)**					**(Unaudited)**				**(Unaudited)**	
Total revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 7,696	$ 43,833	$ 58,236	$ 49,192	$ 58,416
Cost of revenue	2,380	8,470	8,696	7,909	27,455	9,810	8,145	12,450	41,020	71,425	37,273	42,236

Gross profit (loss)	$ (1,959)	$ (7,867)	$ (7,570)	$ (5,932)	$ (23,328)	$ (7,157)	$ (4,091)	$ (4,754)	$ 2,813	$ (13,189)	$ 11,919	$ 16,180
Gross margin	(465)%	(1,305)%	(672)%	(300)%	(565)%	(270)%	(101)%	(62)%	6%	(23)%	24%	28%

The improved gross margin for the six months ended June 30, 2007 compared to the corresponding period of 2006 reflects the impact of the recognition of $26.3 million of deferred gross

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

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

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

We expect our gross margins to continue to improve in the future as deferred revenue is recognized and as average selling prices and product mix improve due to new and existing customers purchasing higher margin network components to increase the capacity of their installed DTN Systems. As of December 31, 2006, deferred revenue was $111.0 million and deferred inventory cost was $67.3 million. As of June 30, 2007, deferred revenue was $139.0 million and deferred inventory cost was $74.7 million.

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

	Deferred Balance as of June 30, 2007	For the Three Months Ended 2007		For the Three Months Ended March 29, 2008	Future Periods
		Sept. 29	Dec. 29		
Revenue	$ 138,955	$ 54,732	$ 40,349	$ 24,235	$ 19,639
Cost of Inventory	74,707	30,811	21,659	12,669	9,568
Gross Profit	$ 64,248	$ 23,921	$ 18,690	$ 11,566	$ 10,071

Operating Expenses

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

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

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

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

Other Income (expense), net

Other income (expense), net includes interest expense on short- and long-term debt, interest income on our cash balances, and losses or gains on conversion of foreign currency transactions into U.S. dollars. In 2005, 2006 and the six months ended June 30, 2007, other income (expense), net, also included adjustments to record our convertible preferred stock warrants at fair value as required by Staff Position 150-5, *Issuer s Accounting under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable*, or FSP 150-5, as described below. In the six months ended June 30, 2007, other income (expense), net also included a gain of $2.0 million related to the sale of assets acquired during the period under an asset purchase agreement as described in Note 4 of Notes to Consolidated Financial Statements.

Critical Accounting Policies and Estimates

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

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

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Revenue Recognition

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

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

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

Occasionally, we sell our networking products to customers who do not purchase training or product support services as part of the arrangement. Revenue related to these arrangements is generally recognized as product revenue when delivery of the product has occurred, assuming all other revenue recognition criteria have been met. Once product delivery has taken place, there are no remaining undelivered elements in these arrangements.

Contracts and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery and transfer of title. Revenue is recognized only when title and risk of loss passes to customers. In instances where acceptance of the product is specified by the customer, revenue is deferred until all acceptance criteria have been met. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. Payment terms to customers generally range from net 30 to 120 days from invoice. In the event payment terms are provided that differ from our standard business practices, the fees are deemed to not be fixed or determinable and, therefore, revenue is deferred until the fees become fixed or determinable, which we believe is when they are legally due and payable. We assess the ability to collect from our customers based primarily on the creditworthiness of the customer and past payment history of the customer.

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

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Stock-Based Compensation

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

During the period from January 1, 2006 through June 6, 2007, we granted stock options with exercise prices as follows:

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