INFINERA CORP
Form 10-Q
October 31, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 27, 2008

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ________ to ________

Commission file number: 001-33486

Infinera Corporation

(Exact name of registrant as specified in its charter)

Delaware	**77-0560433**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

169 Java Drive

Sunnyvale, CA 94089

(Address of principal executive offices, including zip code)

(408) 572-5200

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x Smaller reporting company ¨

(Do not check if a smaller reporting company)

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

As of October 24, 2008, 93,818,228 shares of the registrant s Common Stock, $0.001 par value, were issued and outstanding.

Table of Contents

INFINERA CORPORATION

QUARTERLY REPORT ON FORM 10-Q

FOR THE FISCAL QUARTER ENDED SEPTEMBER 27, 2008

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements***

INFINERA CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par values)

(Unaudited)

	September 27, 2008	December 29, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 169,439	$ 91,209
Short-term investments	78,551	181,168
Short-term restricted cash	840	743
Accounts receivable	48,571	39,216
Other receivables	250	1,127
Inventory	58,620	58,579
Deferred inventory costs	6,505	78,362
Prepaid expenses and other current assets	7,016	3,941
Total current assets	369,792	454,345
Property, plant and equipment, net	42,860	36,973
Intangible assets	1,342	1,541
Deferred inventory costs, non-current	2,787	3,260
Long-term investments	73,803	30,116
Long-term restricted cash	1,959	2,594
Other non-current assets	2,297	359
Total assets	$ 494,840	$ 529,188
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 24,834	$ 17,504
Accrued expenses	10,160	9,497
Accrued compensation and related benefits	9,078	17,749
Accrued warranty	5,814	4,974
Deferred revenue	25,444	167,031
Total current liabilities	75,330	216,755
Accrued warranty, non-current	4,862	5,018
Deferred revenue, non-current	7,012	7,406
Long-term exercised unvested options	318	825
Other long-term liabilities	3,747	4,610
Commitments and contingencies (Note 10)		
Stockholders equity:		
Preferred stock, $0.001 par value Authorized shares 25,000 and no shares issued and outstanding		
	94	92

Common stock, $0.001 par value Authorized shares 500,000 as of September 27, 2008 and December 29, 2007, respectively Issued and outstanding shares 93,773 as of September 27, 2008 and 91,580 as of December 29, 2007, respectively		
Additional paid-in capital	695,158	663,870
Accumulated other comprehensive income (loss)	(7,631)	78
Accumulated deficit	(284,050)	(369,466)
Total stockholders equity	403,571	294,574
Total liabilities and stockholders equity	$ 494,840	$ 529,188

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

INFINERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Revenue:				
Product	$ 76,130	$ 25	$ 226,763	$ 7,275
Ratable product and related support and services	39,495	62,130	181,462	162,488
Services	4,881		11,643	
Total revenue	120,506	62,155	419,868	169,763
Cost of revenue:				
Cost of product	45,139	18	131,928	3,869
Cost of ratable product and related support and services	18,537	40,804	86,537	116,462
Cost of service	2,592		5,814	
Total cost of revenue	66,268	40,822	224,279	120,331
Gross profit	54,238	21,333	195,589	49,432
Operating expenses:				
Sales and marketing	11,171	7,995	32,277	22,032
Research and development	21,092	14,621	57,172	44,758
General and administrative	8,713	7,069	25,632	17,984
Amortization of intangible assets	37	37	111	111
Total operating expenses	41,013	29,722	115,192	84,885
Income (loss) from operations	13,225	(8,389)	80,397	(35,453)
Other income (expense), net:				
Interest income	1,675	2,459	7,236	3,373
Interest expense		(67)	(3)	(2,249)
Other gain (loss)	37	533	1,213	(16,982)
Total other income (expense), net	1,712	2,925	8,446	(15,858)
Income (loss) before provision for income taxes	14,937	(5,464)	88,843	(51,311)
Provision for income taxes		62	3,427	124
Net income (loss)	$ 14,937	$ (5,526)	$ 85,416	$ (51,435)
Net income (loss) per common share:				
Basic	$ 0.16	$ (0.07)	$ 0.93	$ (1.34)
Diluted	$ 0.15	$ (0.07)	$ 0.88	$ (1.34)
Weighted average shares used in computing net income (loss) per common share:				
Basic	92,888	84,017	92,087	38,419

Diluted	97,208	84,017	97,061	38,419

The accompanying notes are an integral part of these condensed consolidated financial statements.

4

Table of Contents

INFINERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	September 27, 2008	September 29, 2007
Cash Flows from Operating Activities:		
Net income (loss)	$ 85,416	$ (51,435)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	8,877	7,150
Amortization of debt discount		282
Accretion of investment discount	(881)	
Asset impairment charges		393
Stock-based compensation expense	17,843	5,973
Excess tax benefit from stock option transactions	(2,588)	
Tax benefit from stock option transactions	2,588	
Revaluation of warrant liabilities		19,761
Gain on disposal of assets	(1,006)	(2,409)
Other loss (gain)	7	(73)
Changes in assets and liabilities:		
Accounts receivable	(8,478)	1,147
Inventory	(701)	3,215
Prepaid expenses and other current assets	(3,142)	(1,234)
Deferred inventory costs	71,626	(12,764)
Other non-current assets	(1,964)	(1,266)
Accounts payable	7,777	(14,692)
Accrued liabilities and other expenses	(8,723)	(2,694)
Deferred revenue	(141,981)	46,197
Accrued warranty	684	6,653
Net cash provided by operating activities	25,354	4,204
Cash Flows from Investing Activities:		
Purchase of available-for-sale investments	(172,875)	(111,294)
Proceeds from sale of investments	103,190	12,000
Proceeds from maturities of investments and restricted cash	122,899	
Proceeds from disposal of assets	1,080	2,781
Purchase of property and equipment	(15,152)	(11,710)
Net cash provided by (used in) investing activities	39,142	(108,223)
Cash Flows from Financing Activities:		
Principal payments on loan obligation		(35,401)
Proceeds from loans		7,119
Proceeds from initial public offering, net of issuance costs		190,078
Proceeds from issuance of common stock	11,242	2,097
Excess tax benefit from stock option transactions	2,588	
Proceeds from exercise of warrants		45
Repurchase of common stock	(30)	(50)
Net cash provided by financing activities	13,800	163,888

Effect of exchange rate changes	(66)	70
Net change in cash and cash equivalents	78,230	59,939
Cash and cash equivalents at beginning of period	91,209	28,884
Cash and cash equivalents at end of period	$ 169,439	$ 88,823
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 3	$ 2,473
Cash paid for income taxes	$ 858	$ 62

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

INFINERA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business

Infinera Corporation (Infinera or the Company), headquartered in Sunnyvale, California, was founded in December 2000 and incorporated in the State of Delaware. Infinera has developed a digital optical networking system (DTN System) and began commercial shipment of its DTN System in November 2004. Infinera s DTN System is unique in its use of a breakthrough semiconductor technology: the photonic integrated circuit (PIC). Infinera s DTN System and PIC technology are designed to provide optical networks with simpler and more flexible engineering and operations, faster time-to-service, and the ability to rapidly deliver differentiated services without reengineering their optical infrastructure.

In June 2007, the Company completed its initial public offering (IPO) of common stock in which it sold and issued 16.1 million shares of its common stock, including 2.1 million shares sold pursuant to the underwriters full exercise of their over-allotment option, at an issue price of $13.00 per share. The Company raised a total of $209.3 million in gross proceeds from its IPO, or $190.1 million in net proceeds after deducting underwriting discounts and commissions of $14.7 million and other offering costs of $4.5 million. Upon the closing of the IPO, all shares of convertible preferred stock outstanding automatically converted into 59.4 million shares of common stock.

In November 2007, the Company completed its follow-on offering of common stock in which it sold and issued 5.0 million shares of its common stock, at an issue price of $22.00 per share. The Company raised a total of $110.0 million in gross proceeds, or approximately $104.0 million in net proceeds after deducting underwriting discounts of $5.2 million and other offering costs of approximately $0.8 million. Additionally, 5.0 million shares were sold by existing stockholders of the Company at a price of $22.00 per share. The Company did not receive any of the proceeds from the shares sold by the selling stockholders.

2. Basis of Presentation

Basis of Financial Statements

The Company prepared its interim condensed consolidated financial statements that accompany these notes in conformity with U.S. generally accepted accounting principles (GAAP), consistent in all material respects with those applied in the Company s annual report on Form 10-K for the year ended December 29, 2007. The condensed consolidated balance sheet as of December 29, 2007 has been derived from the audited consolidated financial statements included in the company s Annual Report on Form 10-K for the year ended December 29, 2007. The interim financial information is unaudited, but reflects all normal adjustments that are, in management s opinion, necessary to provide a fair statement of results for the interim periods presented. This interim information should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s annual report on Form 10-K. The Company reclassified certain amounts reported in previous periods to conform to the current presentation.

Use of Estimates

The condensed consolidated financial statements are prepared in accordance with GAAP. These accounting principles require the Company to make certain estimates, assumptions and judgments that can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Significant estimates, assumptions and judgments made by management include revenue recognition, warranty reserve, cash, cash equivalents and short and long-term investments, inventory valuation, stock based compensation and accounting for income taxes. Management believes that the estimates and judgments upon which the Company relies are reasonable based upon information available to it at the time that these estimates and judgments are made. To the extent there are material differences between these estimates and actual results, the Company s condensed consolidated financial statements will be affected.

3. Accounting Changes

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS No. 159, a company may elect to use fair value to measure eligible items at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Eligible items include, but are not limited to, accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees, issued debt and firm commitments. If elected, SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company did not elect to use fair value to measure its eligible items.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods of those fiscal years. In February 2008, the FASB released a FASB Staff Position (FSP FAS 157-2 *Effective Date of FASB Statement No. 157*) which delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. In October 2008, the FASB released a FASB Staff Position (*FSP FAS 157-3 Determining the fair value of a financial asset when the market for that asset is not active*) which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The adoption of SFAS No. 157 for financial assets and liabilities had no impact on the Company s condensed consolidated financial position, results of operations or cash flows. See Note 5 Investments and Fair Value Measurements.

Commencing in June 2007, the Company elected to use the simplified method to estimate the expected term as permitted by U.S. Securities and Exchange Commission (SEC) Staff Accounting Bulletin 107 (SAB 107) due to the unknown effect on option holder behavior of the increased liquidity of the underlying options following the Company s IPO. In December 2007, the SEC released Staff Accounting Bulletin No. 110 (SAB 110). SAB 110 amends SAB 107 to allow for the continued use, under certain circumstances, of the simplified method in developing an estimate of the expected term of plain vanilla stock options accounted for under SFAS 123(R). As a result, the Company will continue to use the simplified method until it has sufficient historical data to provide a reasonable basis to estimate the expected term.

4. Summary of Significant Accounting Policies

The Company believes the following critical accounting policies reflect its more significant judgments and estimates used in the preparation of its condensed consolidated financial statements.

Revenue Recognition

The Company s networking products are generally integrated with software that is more than incidental to the functionality of the equipment. Accordingly, the Company accounts for revenue 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, with Respect to Certain Transactions*. The Company recognizes product revenue when all of the following have occurred: (1) it has 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) collectability is reasonably assured. Revenue is recognized net of cash discounts.

Substantially all of the Company s product sales are sold in combination with support services comprised of either software warranty or software subscription services. In addition, the Company periodically sells training and installation and deployment services with its product sales. Software warranty provides customers with maintenance releases and patches during the warranty support period. Software subscription includes software warranty support and in addition, provides customers with rights to receive unspecified software product upgrades released during the support period. Training services include the right to a specified number of training classes over the term of the arrangement. Installation and deployment services may include customer site assessments, equipment installation and testing.

Product revenue consists of products that are sold without services or bundled products that are sold with services for which VSOE of fair value has already been established and therefore, is recognized upfront under the residual method 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, with Respect to Certain Transaction*. The Company uses the residual method to recognize revenue when a sales agreement includes one or more elements to be delivered at a future date and vendor specific objective evidence (VSOE) of fair value of all undelivered elements exists. VSOE of fair value for software warranty, software subscription, training and installation and deployment services is determined by reference to the price the customer will be required to pay when these services are sold separately.

Prior to the first quarter of 2008, the Company had not established VSOE of fair value for its support services, and therefore recognized all revenue for transactions bundled with these services ratably over the longest support period which ranges from one to five years. Revenue related to these arrangements is included in ratable product and related support and services revenue. The Company determined that it had established VSOE of fair value for software subscription in the first quarter and for training and installation and deployment services in the second quarter of 2008. For arrangements with multiple elements which include product and software subscription services and or training and installation and deployment services, the Company allocates revenue to the

Table of Contents

undelivered elements using the residual method based on VSOE of fair value for each such element and the remainder is recognized as product revenue. However, when these transactions also include undelivered services for which VSOE of fair value has not been established, revenue is deferred and recognized ratably over the longest remaining support period. Upon completion of the services for which VSOE of fair value has not been established, the difference between the VSOE of fair value for the remaining related service periods and the remaining unrecognized portion of the arrangement fee is recognized as ratable product and related support and services revenue.

Services revenue includes software subscription services, training, installation and deployment services and extended hardware warranty services. Revenue from software subscription and extended hardware warranty contracts is deferred and is recognized ratably over the contractual support period, which is generally one year. A majority of the Company s customers have exercised the option to purchase software subscription services on an ongoing basis. Revenue related to training and installation and deployment services is recognized as the services are completed.

Contracts and customer purchase orders are generally used to determine the existence of an arrangement. In addition, 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 pass to customers. In instances where acceptance of the product is specified by the customer, revenue is deferred until all such customer-specific acceptance criteria have been met. The Company assesses 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 the Company s standard business practices, the fees are deemed to not be fixed or determinable and, therefore, revenue is not recognized until the fees become fixed or determinable which the Company believes is when they are legally due and payable. The Company assesses the ability to collect from its customers based primarily on the creditworthiness and past payment history of the customer.

For sales to resellers, the same revenue recognition criteria apply. It is the Company s practice to identify an end user prior to shipment to a reseller. The Company does not offer rights of return or price protection to its resellers.

Shipping charges billed to customers are included in product revenue and in ratable product and related support and services revenue.

Stock-Based Compensation

Under SFAS 123(R), the Company estimated the fair value of the stock options granted and rights to acquire stock using the Black-Scholes option pricing formula and a single option award approach. For new-hire grants, options typically vest with respect to 25% of the shares one year after the option s vesting commencement date and the remainder ratably on a monthly basis over three years, commencing one year after the vesting commencement date. For annual refresh grants, options typically vest ratably on a monthly basis over five years after the vesting commencement date. The Company makes a number of estimates and assumptions related to SFAS 123(R) including forfeiture rate, expected life and volatility. The Company utilized its historical data as an estimate of the expected forfeiture rate and it recognized compensation costs only for those equity awards expected to vest. The effect of adjusting the forfeiture rate for all expense amortization is recognized in the period the forfeiture estimate is changed. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from the Company s estimates, such amounts will be recorded as an adjustment in the period estimates are revised. Actual results may differ substantially from these estimates.

The expected term of options granted represents the period of time that options granted are expected to be outstanding, which incorporates the contractual terms, grant vesting schedules and terms and expected employee and director behaviors. Commencing in June 2007, the Company elected to use the simplified method to estimate the expected term as permitted by SEC Staff Accounting Bulletin 107 (SAB 107) due to the unknown effect on option holder behavior of increased liquidity of the underlying options following the Company s IPO. In December 2007, the SEC released Staff Accounting Bulletin No. 110 (SAB 110). SAB 110 amends SAB 107 to allow for the continued use, under certain circumstances, of the simplified method in developing an estimate of the expected term of plain vanilla stock options accounted for under SFAS 123(R). As a result, the Company will continue to use the simplified method until it has sufficient historical data to provide a reasonable basis to estimate the expected term.

Table of Contents

Expected volatility of the stock is based on the Company s peer group in the industry in which the Company does business because the Company does not have sufficient historical volatility data for its own common stock. In the future, as the Company gains historical data for volatility in its own stock and more data on the actual term employees hold their options, the expected volatility and expected term may change, which could substantially change the grant-date fair value of future awards of stock options and ultimately the expense the Company records.

During the three and nine months ended September 27, 2008, the Company granted options to employees and directors to purchase an aggregate of 35,000 and 2.4 million shares of common stock at weighted average exercise prices of $8.31and $12.84 per share, respectively. These options have exercise prices equal to the closing market value of the Company s common stock on the dates these options were granted. The Company s current practice is to grant options to senior directors and above, and restricted stock units (RSUs) to all employees except for executive officers.

The weighted average estimated values of employee stock option grants and rights granted under the 2000 Stock Plan and the 2007 Equity Incentive Plan, as well as the weighted average assumptions used in calculating these values during the three and nine months ended September 27, 2008 and September 29, 2007 were based on estimates at the date of grant as follows:

	Three Months Ended		Nine Months Ended	
Employee and Director Stock Options	**September 27, 2008**	**September 29, 2007**	**September 27, 2008**	**September 29, 2007**
Volatility	71%	79% - 81%	65% - 74%	62% - 84%
Risk-free interest rate	3.47%	4.7%	3.07% - 3.53%	4.5% - 4.9%
Expected Life	6.1 years	6.1 - 6.3 years	5.3 - 6.3 years	4.3 - 6.3 years
Estimated fair value	$5.34 - $5.55	$13.67 - $17.04	$5.34 - $9.44	$2.12 - $17.04

Concurrent with the IPO in June 2007, the Company established the 2007 Employee Stock Purchase Plan (ESPP). This plan provides for consecutive six-month offering periods, except for the first such offering period which commenced on June 7, 2007 and ended on February 15, 2008. The Black-Scholes option pricing model is used to estimate the fair value of rights to acquire stock granted under the ESPP. Compensation cost related to the ESPP under FAS123(R) was approximately $1.0 million and $2.0 million for the three and nine months ended September 27, 2008 and the fair value of the ESPP shares were estimated at the date of grant using the following assumptions:

	Three Months Ended		Nine Months Ended	
Employee Stock Purchase Plan	**September 27, 2008**	**September 29, 2007**	**September 27, 2008**	**September 29, 2007**
Volatility	55%	49%	55% - 65%	49%
Risk-free interest rate	1.92%	4.97%	1.92% - 2.12%	4.97%
Expected life	0.5 years	0.7 years	0.5 years	0.7 years
Estimated fair value	$3.51	$4.17	$3.51 - $4.42	$4.17

The Company began issuing RSUs in the second quarter of 2007 pursuant to the Company s 2007 Equity Incentive Plan. An RSU is a right to receive a share of the Company s common stock when the unit vests, subject to continuing service with the Company on each vesting date. During the three and nine months ended September 27, 2008, the Company granted RSUs to employees to purchase an aggregate of 0.2 million shares and 1.7 million shares, respectively, of common stock at no cost, vesting annually over four or five years. The Company accounted for the fair value of the RSUs using the closing market price of the Company s common stock on the date of grant.

Table of Contents

The following table summarizes the effects of stock-based compensation related to employee and director awards, employee non-recourse notes and non-employee awards on the Company s condensed consolidated balance sheets and statements of operations for the three and nine months ended September 27, 2008 and September 29, 2007, respectively (in thousands):

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Stock-based compensation effects in inventory				
Beginning balance	$ 1,758	$ 2,429	$ 2,215	$ 81
Stock-based compensation expense added to inventory	794	158	2,187	2,621
Stock-based compensation expense released from inventory to cost of revenue	(971)	(19)	(2,594)	(26)
Stock-based compensation expense released from inventory to deferred inventory costs	(26)	(307)	(253)	(415)
Closing balance	$ 1,555	$ 2,261	$ 1,555	$ 2,261
Stock-based compensation effects in deferred inventory cost				
Beginning balance	$ 428	$ 98	$ 947	$ 23
Stock-based compensation expense added from inventory	26	307	253	415
Stock-based compensation expense recognized released from inventory to cost of revenue	(209)	(70)	(955)	(103)
Closing balance	$ 245	$ 335	$ 245	$ 335
Stock-based compensation effects in income (loss) before provision for income taxes				
Cost of revenue	$ 299	$ 143	$ 778	$ 254
Research and development	1,870	1,113	4,722	2,436
Sales and marketing	1,250	689	3,264	1,122
General and administration	1,956	1,129	5,530	2,032
	5,375	3,074	14,294	5,844
Cost of revenue - amortization from balance sheet*	1,180	89	3,549	129
Total stock-based compensation expense	$ 6,555	$ 3,163	$ 17,843	$ 5,973

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

Inventory Valuation

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

Inventory that is obsolete or in excess of the Company s forecasted demand or is anticipated to be sold at a loss is written down to its estimated net realizable value based on historical usage and expected demand. The Company s forecasted demand is an estimate that requires significant judgment. To the extent there are material differences between the estimated forecasted demand and actual demand and the Company cannot effectively respond to these changes, the Company s condensed consolidated financial statements may be materially affected.

The Company recorded inventory write-downs for excess and obsolete inventory in the three and nine months ended September 27, 2008 of $0.9 million and $4.5 million, respectively, and in the three and nine months ended September 29, 2007 of $1.7 million and $4.2 million, respectively. In addition, the Company recorded total inventory write-downs for lower of cost or market (LCM) adjustments in the three and nine months ended September 27, 2008 of $3.0 million and $3.5 million, respectively, and in the three and nine months ended September 29, 2007 of $3.2 million and $6.5 million, respectively. These write-downs for excess and obsolete inventory and LCM adjustments were reflected as cost of product and cost of ratable product and related support and services.

In valuing its deferred inventory costs, the Company considered the valuation of inventory using the guidance of Accounting Research Bulletin 43 *Restatement and Revision of Accounting Research Bulletins* (ARB 43). In particular, the Company considered ARB 43, Chapter 4, Statement 5 and whether the utility of the products delivered or expected to be delivered at less than cost, primarily comprised of common equipment, had declined. The Company concluded that, in the instances where the utility of the products delivered or expected to be delivered were less than cost, it was appropriate to value the deferred inventory costs and

10

Table of Contents

inventory costs at cost or market, whichever is lower, thereby recognizing the cost of the reduction in utility in the period in which the reduction occurred or can be reasonably estimated. The Company has, therefore, recorded inventory write-downs as necessary in each period in order to reflect common equipment inventory at the lower of cost or market. In addition, the Company considered the guidance provided in ARB 43, Chapter 4, Statement 10 relating to losses on firm purchase commitments related to inventory items. Given that the expected selling price of common equipment in the future remains below cost, the Company has also recorded losses on these firm purchase commitments in the period in which the commitment is made. When the inventory parts related to these firm purchase commitments are received, that inventory is recorded at the purchase price less the accrual for the loss on the purchase commitment.

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

Warranty Reserve

The Company warrants that its products will operate substantially in conformity with product specifications. Upon delivery of the Company s products, the Company provides for the estimated cost to repair or replace products or the related components that may be returned under warranty. The Company s hardware warranty periods range from 1 to 5 years from date of acceptance for hardware and 90 days to 60 months for software warranty. The hardware warranty reserve is based on actual historical returns experience and the impact of the returns rate on future estimated returns. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Cash, Cash Equivalents and Short-term and Long-term Investments

The Company considers all liquid instruments with an original maturity at the date of purchase of 90 days or less to be cash equivalents. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

The Company considers all debt instruments with remaining time to maturity of one year or less to be short-term investments. At September 27, 2008 and December 29, 2007, cash equivalents and short and long-term investments consisted primarily of money market funds, commercial paper, corporate bonds, U.S. agency notes, U.S. treasuries and adjustable rate securities. The Company s cash equivalents and short and long-term investments are classified as available-for-sale in accordance with the provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

All cash, cash equivalents and short and long-term investments are stated at fair market value with unrealized gains and losses reported in accumulated comprehensive loss as a separate component of stockholders equity. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, both of which are included in interest income. Gains are recognized when realized in the Company s condensed consolidated statements of operations. Losses are recognized as realized or when the Company has determined that an other-than-temporary decline in fair value has occurred. Gains and losses are determined using the specific identification method.

In accordance with SFAS No. 115, it is the Company s policy to review its marketable debt securities classified as short or long-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. The Company s policy includes, but is not limited to, reviewing the length of time and extent to which the market value has been less than amortized cost, the financial condition and near-term prospects of the issuer, and its intent and ability to retain its investment in the issuer for a sufficient period of time to allow for recovery in market value. If the Company believes that an other-than-temporary decline exists in one of its marketable debt securities, its policy is to write down these debt investments to the market value and record the related write-down as an investment loss on its condensed consolidated statements of operations. No other-than-temporary impairment charges were recorded for the three and nine months ended September 27, 2008 and September 29, 2007. See Note 5 to the Condensed Consolidated Financial Statements for further information regarding unrealized losses recorded as of September 27, 2008.

Accounting for Income Taxes

As part of the process of preparing the Company s condensed consolidated financial statements, the Company is required to estimate its taxes in each of the jurisdictions in which it operates. The Company estimates actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets and liabilities, which are included in the Company s condensed consolidated balance sheets. In general, deferred tax assets represent future tax benefits to be received when certain expenses previously recognized in the Company s condensed consolidated statements of operations become deductible expenses under applicable income tax laws or loss or credit carry-forwards are utilized. Accordingly, realization of the Company s deferred tax assets is dependent on future taxable income within the respective jurisdictions against which these deductions, losses and credits can be utilized within the applicable future periods.

Table of Contents

The Company must assess the likelihood that some portion or all of its deferred tax assets will be recovered from future taxable income within the respective jurisdictions, and to the extent the Company believes that recovery does not meet the more-likely-than-not standard, it must establish a valuation allowance. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management judgment is required in determining the Company s provision for income taxes, its deferred tax assets and liabilities and any valuation allowance recorded against its net deferred tax assets. At September 27, 2008 and December 29, 2007, certain of the Company s deferred tax assets were fully reserved with a valuation allowance because, based on the available evidence, the Company believed at that time it was more likely than not that it would not be able to utilize those deferred tax assets in the future. The Company intends to maintain valuation allowances until sufficient evidence exists to support the reversal of the valuation allowances. The Company makes estimates and judgments about its future taxable income, by jurisdiction, based on assumptions that are consistent with its plans and estimates. Should the actual amounts differ from the Company s estimates, the amount of its valuation allowance could be materially impacted.

5. Investments and Fair Value Measurements

Available-for-sale Investments

The following is a summary of available-for-sale investments as of September 27, 2008 and December 29, 2007 (in thousands):

	September 27, 2008				December 29, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Money market funds	$ 80,762	$	$	$ 80,762	$ 35,857	$	$	$ 35,857
Commercial paper	36,928			36,928	74,352	12	(8)	74,356
Corporate bonds	24,453		(332)	24,121	49,796	47	(29)	49,814
U.S. agency notes	10,000		(16)	9,984	21,945	6	(5)	21,946
U.S. treasuries	72,491	84		72,575				
Adjustable rate securities	75,650		(6,818)	68,832	96,150			96,150
Total available-for-sale investments	$ 300,284	$ 84	$ (7,166)	$ 293,202	$ 278,100	$ 65	$ (42)	$ 278,123

The longest time that individual securities included in available-for-sale investments have been in a continuous unrealized loss position, is seven months.

The following is a summary of the carrying values and balance sheet classification as of September 27, 2008 and December 29, 2007 (in thousands):

	September 27, 2008	December 29, 2007
Available-for sale investments	$ 293,202	$ 278,123
Cash in banks	28,591	24,370
Restricted cash	2,799	3,337
Total	$ 324,592	$ 305,830
Reported as:		
Cash and cash equivalents	$ 169,439	$ 91,209
Short-term investments	78,551	181,168
Short-term restricted cash	840	743
Long-term investments	73,803	30,116

Long-term restricted cash		1,959		2,594
Total	$	324,592	$	305,830

As of September 27, 2008, the Company held approximately $68.8 million at fair value of municipal note investments with an auction reset feature (adjustable rate securities) whose underlying assets are generally student loans which are substantially backed by the federal government under the Federal Family Education Loan Programs (FFELP) and are currently rated AAA by a rating agency. In February 2008, auctions began to fail for these securities and each auction since then has failed. The Company has since been unable to liquidate the securities. Based on the overall failure rate of these auctions, the frequency of the failures, and the underlying maturities of the securities, which range from 22 years to 39 years, the Company has classified these investments as

Table of Contents

long-term assets on the balance sheet. These investments were valued at fair value as of September 27, 2008, and the Company recorded an unrealized loss of $6.8 million under Accumulated Other Comprehensive Income (Loss) in the accompanying condensed consolidated balance sheets under Stockholders Equity as of September 27, 2008 related to these adjustable rate securities.

Fair Value Measurement

SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS No. 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level I) observable inputs such as quoted prices in active markets; (Level II) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level III) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures its investments and marketable securities at fair value. The majority of the Company s cash and investment instruments are classified within Level I or Level II of the fair value hierarchy because they are valued using quoted market prices, market prices for similar securities, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets includes the Company s money market funds and U.S. treasuries. Such instruments are generally classified within Level I of the fair value hierarchy. The types of instruments valued based on other observable inputs includes the Company s U.S. government agency notes, corporate bonds and commercial paper. Such instruments are classified within Level II of the fair value hierarchy. The types of instruments valued based on unobservable inputs in which there is little or no market data and the unobservable inputs are significant to the fair value measurement includes the Company s adjustable rate securities, or ARS. As of December 29, 2007, these securities were valued at par value based on successful market auction data and were classified within Level II of the fair value hierarchy. However, as a result of auction failures related to these securities, these market inputs were not available as of September 27, 2008. A discounted cash flow model has therefore been used to determine the estimated fair value of the Company s investment in ARS as of September 27, 2008. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, discount rates and timing and amounts of cash flows, including assumptions about the expected holding periods of these securities. Such instruments are generally classified as Level III of the fair value hierarchy.

In accordance with SFAS 157, the following table represents the Company s fair value hierarchy for its marketable securities measured at fair value as of September 27, 2008 (in thousands):

	September 27, 2008			
	Level I	Level II	Level III	Total
Money market funds	$ 80,762	$	$	$ 80,762
Commercial paper		36,928		36,928
Corporate bonds		24,121		24,121
U.S. agency notes		9,984		9,984
U.S. treasuries	72,575			72,575
Adjustable rate securities			68,832	68,832
Total available-for-sale investments	$ 153,337	$ 71,033	$ 68,832	$ 293,202

Unrealized losses associated with Level III financial instruments were classified as Accumulated Other Comprehensive Income (Loss) in the accompanying condensed consolidated balance sheets under Stockholders Equity. Unrealized losses associated with Level III financial instruments were approximately $6.8 million as of September 27, 2008.

Table of Contents

The following table summarizes the change in balance sheet carrying value associated with Level III financial instruments carried at fair value during the three and nine months ended September 27, 2008 (in thousands):

	Three Months Ended September 27, 2008					
	June 29, 2008	Payment, Purchases (Sales), Net	Transfers In (Out), Net	Gains (Losses) Realized	Gains (Losses) Unrealized	September 27, 2008
Adjustable Rate Securities	$ 70,862	$	$	$	$ (2,030)	$ 68,832

	Nine Months Ended September 27, 2008					
	December 29, 2007	Payment, Purchases (Sales), Net	Transfers In (Out), Net	Gains (Losses) Realized	Gains (Losses) Unrealized	September 27, 2008
Adjustable Rate Securities	$	$ (20,500)	$ 96,150	$	$ (6,818)	$ 68,832

As a result of several states Attorney General s actions, during August 2008, several large financial institutions/broker dealers announced programs to purchase adjustable rate securities from their clients at par value. On October 24, 2008, the Company entered into a contract with one of its broker dealers to sell back $65.7 million of adjustable rate securities at par value at anytime during a two-year period beginning June 30, 2010 through July 2, 2012. These adjustable rate securities are recorded at fair value of $60.0 million with an unrealized loss of $5.7 million as of September 27, 2008 in the accompanying condensed consolidated balance sheets.

This contract represents a put option which will be valued at fair value, reflecting the Company s right to recover par value for these adjustable rate securities discounted for any underlying credit risk associated with the broker dealer and the timing of the cash flows. The difference between the fair value of this put option and any unrealized loss on these adjustable rate securities will be recorded in the Company s condensed consolidated statements of operations for the quarter ended December 27, 2008. The put option and the adjustable rate securities will be revalued to fair market value on a quarterly basis until the sale of these securities has been completed.

6. Balance Sheet Components

Restricted Cash

As of September 27, 2008, the Company had short-term restricted cash of $0.8 million and long-term restricted cash of $2.0 million. As of December 29, 2007, the Company had short-term restricted cash of $0.7 million and long-term restricted cash of $2.6 million. The Company s restricted cash balances are comprised of certificates of deposit, of which the majority are not FDIC insured. These amounts primarily collateralize the Company s issuances of stand-by and commercial letters of credit.

Inventory

Inventory is comprised of the following (in thousands):

	September 27, 2008	December 29, 2007
Raw materials	$ 10,045	$ 10,475
Work in process	35,772	35,110
Finished goods	12,803	12,994
Total inventory	$ 58,620	$ 58,579

Included in finished goods inventory at September 27, 2008 and December 29, 2007 were $5.5 million and $1.5 million, respectively, of inventory at customer locations for which product acceptance had not occurred.

Table of Contents

Property, plant and Equipment, Net

Property, plant and equipment, net, is comprised of the following (in thousands):

	September 27, 2008	December 29, 2007
Computer hardware	$ 5,353	$ 4,267
Computer software	3,635	3,111
Laboratory and manufacturing equipment	61,867	50,897
Furniture and fixtures	604	805
Leasehold improvements	13,949	12,438
	$ 85,408	$ 71,518
Less accumulated depreciation and amortization	(42,548)	(34,545)
Property, plant end equipment, net	$ 42,860	$ 36,973

Depreciation for the three and nine months ended September 27, 2008 was $3.4 million and $8.9 million, respectively, and depreciation for the three and nine months ended September 29, 2007 was $2.7 million and $6.7 million, respectively.

Intangible Assets

Other intangible assets, net are comprised of the following (in thousands):

	September 27, 2008			December 29, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Patents & developed technology	$ 1,628	$ (454)	$ 1,174	$ 1,628	$ (317)	$ 1,311
Assembled workforce and other	370	(202)	168	370	(140)	230
Total intangible assets	$ 1,998	$ (656)	$ 1,342	$ 1,998	$ (457)	$ 1,541

Accrued Expenses

Accrued expenses are comprised of the following (in thousands):

	September 27, 2008	December 29, 2007
Loss contingency related to purchase commitments	$ 1,399	$ 1,880
Customer prepay liability	449	1,109
Tax payable	2,389	855
Other accrued expenses	5,923	5,653
Total accrued expenses	$ 10,160	$ 9,497

7. Comprehensive Income (Loss)

Comprehensive income (loss) consists of other comprehensive income (loss) and net income (loss). Other comprehensive income (loss) includes certain changes in equity that are excluded from net income (loss). Specifically, cumulative foreign currency translation adjustments and unrealized holding gains (losses) on available-for-sale investments are included in accumulated other comprehensive income (loss) in the condensed consolidated balance sheets.

The components of accumulated other comprehensive income (loss) are as follows (in thousands):

	September 27, 2008	December 29, 2007
Accumulated net unrealized gain (loss) on foreign currency translation adjustment	$ (549)	$ 55
Net unrealized holding gain (loss) on available-for-sale investments	(7,082)	23
Total accumulated other comprehensive income (loss)	$ (7,631)	$ 78

The following table reconciles net income (loss) to comprehensive income (loss) for the three and nine month periods ended September 27, 2008 and September 29, 2007 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Net income (loss)	$ 14,937	$ (5,526)	$ 85,416	$ (51,435)
Other comprehensive income (loss)	(2,496)	79	(7,709)	102
Total comprehensive income (loss)	$ 12,441	$ (5,447)	$ 77,707	$ (51,333)

8. Basic and Diluted Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of vested common shares outstanding during the period. Diluted net income (loss) per common share was computed using net income (loss) and the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the assumed exercise of outstanding stock options, assumed vesting of outstanding restricted stock units, assumed exercise of outstanding warrants, and assumed issuance of stock under the stock purchase plan using the treasury stock method.

The following table sets forth the computation of net income (loss) per common share (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Numerator - Basic and Diluted				
Net income (loss)	$ 14,937	$ (5,526)	$ 85,416	$ (51,435)
Denominator				
Basic weighted average common shares outstanding	92,888	84,017	92,087	38,419
Effect of dilutive securities:				
Employee equity plans	3,955		4,559	
Warrants to purchase common stock	365		415	
Diluted weighted average common shares outstanding	97,208	84,017	97,061	38,419

Net income (loss) per common share - basic	$	0.16	$	(0.07)	$	0.93	$	(1.34)
Net income (loss) per common share - dilutive	$	0.15	$	(0.07)	$	0.88	$	(1.34)

For the three months ended September 27, 2008 and September 29, 2007, the Company excluded 6.0 million shares and 0.1 million shares of outstanding stock options from the calculation of diluted earnings per common share, respectively, because the exercise prices of these stock options were greater than the average market value of the common stock shares. These options could be included in the calculation in the future if the average market value of the common stock shares increases and is greater than the exercise price of these options.

Table of Contents

9. Deferred Revenue and Deferred Inventory Costs

Deferred revenue and deferred inventory costs consist of the following (in thousands):

	September 27, 2008	December 29, 2007
Deferred product and ratable product and related support and services, current	$ 19,036	$ 167,031
Deferred service revenue, current	6,408	
Deferred revenue - current	25,444	167,031
Deferred product and ratable product and related support and services, non-current	7,012	7,406
Deferred revenue - non-current	7,012	7,406
Total deferred revenue	$ 32,456	$ 174,437
Deferred inventory costs, current	$ 6,505	$ 78,362
Deferred inventory costs, non-current	2,787	3,260
Total deferred inventory costs	$ 9,292	$ 81,622

Deferred ratable product and related support and services revenue primarily consists of revenue on transactions where VSOE of fair value of support and other services has not been established and, therefore, the entire arrangement is being recognized ratably over the longest bundled support or service period.

10. Commitment and Contingencies

Purchase Commitments

The Company has purchase agreements with its major production suppliers where the Company is committed to purchase certain parts. As of September 27, 2008 and December 29, 2007, these non-cancelable purchase commitments were $22.1 million and $33.7 million, respectively. The contractual obligation table below excludes the Company s FIN48 liabilities because it cannot reliably estimate such liability obligations.

The following is a summary of the Company s contractual obligations as of September 27, 2008 (in thousands):

		Payments Due by Period			
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Purchase obligations	$ 22,142	$ 22,142	$	$	$
Operating leases	12,739	4,240	6,433	2,066	
Total contractual obligations	$ 34,881	$ 26,382	$ 6,433	$ 2,066	$

Legal Matters

On April 11, 2007, the Company, Level 3 and Cheetah Omni LLC (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 and August 1, 2007, the U.S. Patent and Trademark Office ordered reexamination of U.S. Patents 6,795,605 and 7,142,347, respectively. As a result, all proceedings in this lawsuit are stayed until the final resolution of these reexaminations.

On March 14, 2007, the Company submitted requests to the U.S. Patent and Trademark Office for inter parts reexamination of U.S. Patent Nos. 6,795,605 and 7,142,347 asking the U.S. Patent and Trademark Office to reexamine the patents based on prior art in order to invalidate the patents or limit the scope of each patent s claims. On March 21, 2007, the Company and Level 3 filed a motion with the court to stay all proceedings in the lawsuit pending the reexamination of U.S. Patent Nos. 6,795,605 and 7,142,347.

Table of Contents

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, the Company and Level 3 filed responses to Cheetah s third amended complaint denying all infringement claims, and the Company and Level 3 asserted counterclaims against Cheetah asserting that the claims of the patents are invalid and that the DTN System does not infringe the patents.

On May 9, 2006, the Company and Level 3 were sued by Cheetah in the U.S. District Court for the Eastern District of Texas 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 the Company s DTN System and to recover all damages caused by the alleged willful infringement including any and all compensatory damages available by law, such as actual and punitive damages, attorneys fees, associated interest and Cheetah s costs incurred in the lawsuit. Cheetah s complaint does not request a specific dollar amount for these compensatory damages. The Company is contractually obligated to indemnify Level 3 for damages suffered by Level 3 to the extent its product is found to infringe, and it has assumed the defense of this matter. On July 20, 2006, the Company and Level 3 filed an amended response denying all infringement claims under patent No. 6,795,605 and asserting that the claims of the patent are invalid and that the DTN System does not infringe the patent. On November 28, 2006, Cheetah filed a second amended complaint and added patent No. 7,142,347 to the lawsuit. On December 18, 2006, the Company and Level 3 filed responses to Cheetah s second amended complaint denying all infringement claims under patent No. 7,142,347 and the Company and Level 3 asserted counterclaims against Cheetah asserting that the claims are invalid and that the DTN System does not infringe the patents.

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

11. Employee Equity Incentive Plans

The following table summarizes the Company s stock award activity and related information for the nine months ended September 27, 2008 (in thousands, except per share data):

	Share Available for Grant [1]	Awards and Options Outstanding	Weighted-Average Exercise Price Per Share	Aggregate Intrinsic Value [2]
Balance at December 29, 2007	10,198	11,742	$ 5.98	$ 97,808
Additional options and RSUs authorized [3]	4,579		$	
Options granted	(2,429)	2,429	$ 12.84	
RSUs granted	(1,672)	1,672	$	
Options exercised		(1,339)	$ 2.19	$ 13,486
RSUs released		(79)	$	$ 662
Options canceled	691	(691)	$ 7.96	
RSUs canceled	79	(79)	$	
Balance at September 27, 2008	11,446	13,655	$ 6.81	$ 65,648

(1) Shares available for grant under the 2000 plan and 2007 plan, as applicable. The Company does not intend to grant any additional options or other awards under the 2000 Plan.

(2) The aggregate intrinsic value of unexercised options and unvested RSUs is calculated as the difference between the exercise price of the underlying equity awards and the closing price of the Company s common stock at as of September 27, 2008. The aggregate intrinsic value of options which have been exercised is calculated as the difference between the fair market value of the common stock at the date of exercise and the exercise price of the underlying stock option awards.

(3) Pursuant to the evergreen provision of the Company s 2007 Equity Incentive Plan, the number of shares reserved for issuance under the Company s 2007 Equity Incentive Plan was increased by 4.6 million shares in the first quarter of 2008 as approved by the Board of Directors.

Table of Contents