RIVERSTONE NETWORKS INC
Form 10-Q
July 17, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended June 2, 2001

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

Commission File Number 0-32269

RIVERSTONE NETWORKS, INC.
(Exact name of registrant as specified in its charter)

Delaware	95-4596178
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification no.)

5200 Great America Parkway, Santa Clara, CA 95054
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (408) 878-6500

Indicate by check mark 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 - X NO -

As of July 16, 2001 there were 107,490,205 shares of the Registrant's common stock outstanding.

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RIVERSTONE NETWORKS, INC.

PART 1. FINANCIAL INFORMATION

ITEM 1. Financial Statements

Riverstone Networks Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

J

Assets	
Current Assets:	
Cash and cash equivalents	$
Cash due from parent	
Short-term investments	
Accounts receivable, net	
Inventories, net	
Prepaid expenses and other current assets	
Total current assets	
Property and equipment, net	
Goodwill and other long-term assets, net	
Total assets	$
Liabilities and Stockholders' Equity	
Current Liabilities:	
Accounts payable	$
Deferred revenue	
Accrued expenses	
Total current liabilities	
Commitments and contingencies	
Stockholders' equity:	
Common Stock	
Additional paid in capital	
Accumulated deficit	
Unearned stock-based compensation	
Accumulated other comprehensive income	
Total stockholders' equity	
Total liabilities and stockholders' equity	$

See accompanying notes to the unaudited condensed consolidated financial statements.

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Riverstone Networks Inc.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except share and per share amounts)
(Unaudited)

Net revenues	$
Cost of revenues	
Stock-based compensation	
Total cost of revenues	
Gross profit	
Operating expenses	
Research and development	
Sales and marketing	
General and administrative	
Stock-based compensation	
Total operating expenses	
Operating loss	
Interest (income)/expense, net	
Net loss	$
Net loss per share	
Basic and diluted	$
Weighted average number of shares outstanding:	
Basic and diluted	
Pro forma net loss per share:	
Basic and diluted	$
Pro forma weighted average number of shares outstanding:	
Basic and diluted	

See accompanying notes to the unaudited condensed consolidated financial statements.

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Riverstone Networks Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

Cash flows from operating activities:
Net loss
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation and amortization
Provision for losses on accounts receivable

Stock-based compensation
Changes in assets and liabilities:
Accounts receivable
Inventories
Prepaid expenses and other assets
Accrued expenses and accounts payable
Deferred revenue
Net cash used in operating activities
Cash flows from investing activities:
Capital expenditures
Purchases of short-term investments
Net cash used in investing activities
Cash flows from financing activities:
Principal payments on note payable
Net transfers from Cabletron
Net cash provided by financing activities
Net increase/(decrease) in cash and cash equivalents
Cash and cash equivalents at the beginning of period
Cash and cash equivalents at the end of period
Other cash flow information
Cash paid for interest
Non-cash investing and financing activities:
Unrealized gain on short-term investments

See accompanying notes to the unaudited condensed consolidated financial statements.

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

Note (1) Business Operations

On February 10, 2000, Cabletron Systems, Inc. ("Cabletron") announced its plan to create an independent publicly-traded company, Riverstone Networks, Inc. ("Riverstone" or the "Company"), comprised of Cabletron's Internet infrastructure solutions business for Internet service providers and other service providers. After completion of Riverstone's initial public offering on February 16, 2001, Cabletron owned 92,088,235 shares of common stock, representing approximately 86% of Riverstone's outstanding common stock.

On June 3, 2000, Cabletron, Riverstone and certain related parties entered into a Transformation Agreement, and Cabletron and Riverstone entered into a Contribution Agreement. In accordance with the Transformation Agreement, Cabletron transferred to Riverstone the Cabletron-owned assets and liabilities which related to the Riverstone business on August 28, 2000 (the "Contribution

Date"). Zeitnet was also contributed to and then merged into Riverstone. The accompanying financial statements for the three months ended June 3, 2000 reflect the historical basis of the Cabletron-owned assets and liabilities, which were transferred at the Contribution Date.

Cabletron has announced that it received a private letter ruling from the Internal Revenue Service indicating that the distribution of Cabletron's shares of Riverstone common stock to Cabletron's stockholders will be tax-free to Cabletron and its stockholders. The private letter ruling is subject to compliance with representations made by Cabletron to the Internal Revenue Service. Cabletron will not be able to rely on the ruling if any of the representations or assumptions on which the ruling is based are, or become, incorrect or untrue in any material respect. On July 10, 2001, Cabletron announced that it expects to complete the distribution on August 6, 2001 to its stockholders of record on July 27, 2001. Cabletron is not obligated to complete the distribution, and there can be no assurance that the distribution will occur. In addition, Cabletron announced its intention to contribute, prior to the planned distribution, certain strategic investments to Riverstone and invest an additional $120 million cash in exchange for approximately 7.1 million shares of Riverstone common stock.

Note (2) Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared by Riverstone pursuant to the rules and regulations of the Securities and Exchange Commission and include the accounts of Riverstone and its wholly-owned subsidiaries. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted pursuant to such rules and regulations. While in the opinion of the Company, the unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the financial position at June 2, 2001 and the operating results and cash flows for the three months ended June 3, 2000 and June 2, 2001, these financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and notes for the year ended March 3, 2001 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission. The condensed consolidated balance sheet at March 3, 2001 has been derived from audited financial statements as of that date.

The consolidated financial statements as of June 3, 2000 have been prepared using Cabletron's historical basis in the assets and liabilities and the historical results of operations of Riverstone.

The consolidated financial statements include allocations of certain Cabletron expenses, including centralized legal, accounting, treasury, real estate, information technology, distribution, customer service, advertising, sales, marketing, engineering and other Cabletron corporate services and infrastructure costs. All of the allocations and estimates in the financial statements are based upon assumptions that the Company's and Cabletron's management believe to be

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reasonable reflections of the cost of services provided or benefit received by Riverstone. However, these financial statements do not necessarily indicate the financial position or results of operations that would have occurred if the Company were a stand-alone entity.

Cash, Cash Equivalents and Short-Term Investments

The Company considers all highly liquid investments with original maturity dates of 90 days or less at the date of acquisition to be cash equivalents. Cash equivalents and short-term investments consist of money market funds, commercial paper, government securities, and corporate securities. To date all short-term investments have been classified as available-for-sale and are carried at fair value. Any unrealized gains or losses are reported as a separate component of stockholders' equity when significant. Premiums and discounts are amortized over the period from acquisition to maturity and are included in investment income, along with interest and dividends.

Inventories

Inventories are stated at the lower of cost or market. Costs are determined at standard cost, which approximates the first-in, first-out (FIFO) method.

Inventories consist of (in thousands):

	June 2, 2001	Mar 2
Raw materials	$ 2,867	$
Finished goods	5,829	
Consignment	4,879	
	$ 13,575	$

Revenue Recognition

The Company generally recognizes revenue upon shipment of products provided there are no uncertainties regarding customer acceptance, persuasive evidence of an arrangement exists, the sales price is fixed and determinable and collectibility is deemed probable. If uncertainties exist, revenue is recognized when such uncertainties are resolved. Revenues from service and maintenance contracts are deferred and recognized ratably over the period the services are performed, typically twelve months or less. When the Company provides a combination of products and services to a customer, revenue is allocated based on the relative fair values. Estimated costs to repair or replace products that may be returned under warranty are accrued at the time of shipment. The Company's warranty period typically extends twelve months from the date of shipment.

Lease Financing. The Company enters into transactions in which customers receive financing for the purchase of Company equipment from third party leasing organizations, who in turn remit payment to the Company. In certain transactions, the Company has guaranteed a portion of the customer's lease payments to be made to the lessor. Substantially all of the Company's customer leasing transactions involve capital leases. When the Company provides a financing guarantee, it records revenue at the time of shipment, subject to a sales reserve. The Company bases the amount of the reserve on a percentage of the guaranteed lease payments, based on specific customer analysis supplemented with industry experience. Accordingly, the Company has deferred revenue subject to this reserve that will be recognized by the end of the respective lease terms if all lease payments are made by end users.

Cabletron maintains investments in private debt and equity securities of certain companies accounted for under the cost method. These investments have been made during the past two years in order to establish investment relationships with companies in markets that Cabletron believes are consistent with its longer-term strategic direction. During the quarters ended June 2, 2001 and June 3, 2000 sales to companies in which Cabletron maintains such investments represented 40% and 18% or net revenues, respectively.

Customer Concentration

During the quarter ended June 2, 2001, one customer individually accounted for more than 10% of net revenues, compared with three customers individually accounting for more than 10% in the same period a year ago.

Segment Reporting

Financial Accounting Standards Board Statement No.131, Disclosures about Segments of an Enterprise and Related Information ("SFAS 131") establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker in making decisions how to allocate resources and assess performance. To date, the chief operating decision maker has viewed the Company`s operations as principally one segment, an Internet infrastructure solutions business for Internet service providers and other service providers. Revenues based on product shipment destination from unaffiliated customers by geographic region are as follows:

	Thr
	June 2001
Sales to unaffiliated customers (trade):	
United States	$ 26,
China	5,
Japan	4,
United Kingdom	2,
Other	4,
Total trade sales	43,
Sales to related parties	
Total sales	$ 44,

Substantially all of the Company's assets are located in the United States.

Historical Net Loss Per Share

Basic net loss per common share and diluted net loss per common share

are presented in conformity with Statement of Financial Accounting Standards No.128, Earnings Per Share ("SFAS 128") for all periods presented. In accordance with SFAS 128, basic net loss per common share has been calculated using the weighted-average number of shares of common stock outstanding during the period, which consists of Cabletron's 100 shares of common ownership for the quarter ended June 3, 2000 and 107,490,205 shares of common stock for the quarter ended June 2, 2001. For both periods, Riverstone has excluded all outstanding stock options as well as stock purchase rights held by private investors from the calculation of diluted net loss per common share because such securities are anti-dilutive for that period.

Pro Forma Basic and Diluted Net Loss per Share

The Series A Convertible Preferred Stock automatically converted into common stock at the 1:1 conversion rate upon the closing of the Company's initial public offering. The pro forma basic and diluted net loss per share information included in the accompanying statements of operations for the quarter ended June 3, 2000 reflects the impact on pro forma basic and diluted net loss per share of such conversion as of the beginning of the period using the if-converted method. For quarters ended June 2, 2001 and June 3, 2000, Riverstone has excluded all outstanding stock options as well as stock purchase rights held by private investors from the calculation of diluted net loss per common share because such securities are anti-dilutive for that period.

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The reconciliation of the numerators and denominators of the pro forma basic and diluted loss per share computation for the Company's reported net loss is as follows:

	Q June 20
Numerator:	
Net loss..	$ (
Denominator	
Common stock...	107,49
Assumed conversion of preferred stock..............................	
Weighted average number of diluted shares outstanding..................	107,49
Basic and diluted loss per share...	$

Recently Issued Accounting Standards

On March 4, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended ("SFAS 133"). SFAS 133 established accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Under this standard, the Company recognizes all derivative instruments as either assets or liabilities in its consolidated balance sheets and measures those instruments at fair value. Changes in the fair values of derivatives are reported in the Company's results of operations or other comprehensive income or loss depending on the use of the derivative and whether it qualifies for hedge accounting. The key criterion for hedge accounting is that the hedging relationship must be highly effective in achieving offsetting changes in those fair values or cash flows that are attributable to the hedged risk, both at inception of the hedge and on an ongoing basis.

The Company, as a result of its global operating and financial activities, is exposed to changes in foreign currency exchange rates, which may adversely affect its results of operations and financial position. Under its services agreement with Cabletron, Cabletron manages the Company's strategy to minimize foreign currency exchange risk. This strategy includes the use of foreign currency forward and option contracts. The Company has not designated these instruments as hedges under SFAS 133. The fair value of the instruments is insignificant to the consolidated financial statements as of June 2, 2001.

Note (3) Contingencies

We have granted options to purchase shares of our common stock under our 2000 equity incentive plan to our employees and employees of Cabletron and its affiliates and to our advisors and consultants. As a result of the nature of the persons who received these options and the vesting provisions of these options, we may have violated the California state securities laws because we did not qualify options granted prior to February 22, 2001 under California state securities laws. Because these option grants were not qualified under California state securities laws, persons residing in California who received these options may have a claim against us. Accordingly, we currently intend to offer to repurchase outstanding options to purchase shares of our common stock granted under our 2000 equity incentive plan prior to February 22, 2001 to persons who resided in California at the time of grant.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements and related notes appearing elsewhere in this Form 10-Q. The discussion below contains forward-looking statements that involve risks and uncertainties, including statements relating to anticipated costs and expenses, mix of revenues and plans for introducing new products or services. Our actual results could differ materially from the results discussed in these forward-looking statements.

The following information should be read in conjunction with the Company's Annual Report on Form 10-K filed on June 1, 2001 with the Securities and Exchange Commission and "Risk Factors That May Affect Future Results and Market Price of Stock" included herein.

Overview

We are a leading provider of Internet infrastructure equipment to service providers in the metropolitan area network. The metropolitan area network, or MAN, encompasses service providers, the Internet infrastructure connecting these service providers with their customers and the Internet backbone. Our routers contain bandwidth management and provisioning, accounting and billing, quality of service and content delivery capabilities that enable service providers to deliver advanced applications and differentiated services to their customers. The majority of our revenue comes from sales of our RS router family.

Our industry has experienced erosion of average selling prices. We anticipate that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, which may reduce our gross margins or revenues. We expect our quarterly gross margins to fluctuate with changes in our product mix. Most of our sales within the United States have been through direct sales channels. We intend to add and maintain a limited number of strategic distribution relationships, including with key original equipment manufactures, or OEMs, who may offer products or distribution channels that complement ours. International sales are made through a combination of direct and indirect sale efforts. We initiated sales and marketing efforts internationally during fiscal 2001, focusing initially on Europe and Asia. As part of this effort, we have negotiated separate reseller agreements with various distributors and network integrators in Europe and Asia.

Revenue Recognition. We generally recognize revenue upon shipment of products, provided that there is no uncertainty of customer acceptance, there is a contract or a purchase order, the sales price is fixed and determinable and we believe collectibility is probable. If uncertainties exist, revenue is recognized when these uncertainties are resolved. Revenues from service and maintenance contracts are deferred and recognized ratably over the period the services are performed, typically twelve months or less. We accrue estimated warranty costs and sales returns and allowances at the time of shipment based on contractual rights and historical experience. We do not sell our RapidOS operating system software on a stand-alone basis.

Cost of Revenues. Cost of revenues include costs of raw materials, direct labor, manufacturing overhead and amounts paid to third-party contract manufacturers, and other costs related to warranty and contractual obligations and customer service and support.

Research and Development. Research and development expenses consist primarily of salaries and related personnel expenses, consultants and outside service provider fees, non-recurring engineering charges and prototype costs related to the development, testing and enhancement of our ASICs and software, and the depreciation of property and equipment related to these activities. Our research and development efforts can require significant expenditures, the timing of which can cause quarterly variability in our expenses. We believe continued investment in product enhancements and new product development are critical to attain our strategic objectives, and we expect research and development expenses to continue to increase in absolute dollars.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing, sales and customer support functions, and trade shows, advertising and

promotional expenses. We intend to expand our worldwide direct and indirect sales organizations substantially by hiring additional sales personnel and establishing additional sales offices. We plan to initiate additional marketing programs to support our existing and new products and to build brand awareness of the Riverstone name. We believe that continued investment in sales and marketing is critical to our success and expect these expenses to increase in absolute dollars in the future.

General and Administrative. General and administrative expenses consist primarily of employee compensation and related expenses, professional and contractor fees, finance, legal, facilities, human resources and provisions for doubtful accounts. Included in general and administrative expenses are expenses for services provided by Cabletron under our services agreement with them. Before the effective date of the services agreement, March 1, 2000, Cabletron allocated to us general and administrative expenses that it incurred on our behalf, based on headcount and revenue. We expect general and administrative expenses to increase slightly in absolute dollars over the next year as we complete the build-out of our own administrative infrastructure.

Additional Option and Warrant Obligation. When Cabletron completes its planned distribution of its Riverstone stock, we will be obligated to issue additional options and warrants to acquire shares of our common stock to some holders of Cabletron stock options and the strategic investors at the time of the distribution.

Stock-based compensation. We have recorded approximately $11.1 million of unearned stock-based compensation primarily related to stock option grants to employees based on the excess of the determined fair market value over the exercise price at date of grant. This compensation expense is being recognized over the options vesting period of four years are amortized on a straight-line basis and we expect to recognize stock-based compensation expenses of $2.7 million, $2.7 million, $2.7 million and $1.6 million during our fiscal years 2002, 2003, 2004 and 2005.

Basis of Presentation

Our fiscal year 2001 condensed consolidated financial statements have been taken from the consolidated financial statements of Cabletron using historical results of operations and historical basis of the assets and liabilities attributable to our operations. The consolidated financial statements for fiscal 2001 and 2002 include allocations to us of Cabletron corporate expenses, including legal, accounting, treasury, real estate, information technology, distribution, customer services, sales, marketing, engineering and other corporate services and infrastructure costs. All of the allocations and estimates in our financial statements are based upon assumptions that our management and Cabletron's management believe to be reasonable reflections of the cost of services provided or the benefit received by us.

The financial information presented in this Form 10-Q is not indicative of our financial position, results of operations or cash flows in the future, nor is it necessarily indicative of what our financial position, results of operations or cash flows would have been had we been a separate, stand-alone company for the periods presented. The financial information presented in this Form 10-Q does not reflect the changes that will occur in our funding and operations when Cabletron completes its planned distribution of its Riverstone common stock.

Results of Operations

The following table sets forth for the period indicated certain financial data as a percentage of net revenues:

	June 2 2001
Net revenues	100%
Cost of revenues	43
Stock based compensation	-

Total cost of revenues	43
Gross profit	57
Operating expenses:	
Research and development	30

Sales and marketing	30
General and administrative	11
Stock-based compensation	1
Total operating expenses	72
Operating loss	(15)
Interest expense/(income)	(5)
Net loss	(10)

Three months Ended June 2, 2001 and June 3, 2000

Net Revenues. Net revenues were $44.2 million for the three months ended June 2, 2001 and $15.8 million for the three months ended June 3, 2000, representing an increase of $28.4 million or 180% from first quarter of fiscal year 2001 to first quarter of fiscal year 2002. The increase in net revenues was primarily due to the addition of new customers both in the United States and internationally.

Cost of Revenues. Cost of revenues for the three months ended June 2, 2001 were $19.1 million with a gross margin of 56.7%, compared to cost of revenues of $7.3 million for the three months ended June 2, 2001 and a gross margin of 53.9%. The increase in cost of revenues is primarily related to the increase in sales volume. We expect cost of revenues to continue to increase as net revenues increase. The improvement in gross margin is primarily attributable to economies of scale achieved from increased sales levels.

Research and Development. Research and development expenses excluding stock-based compensation were $13.3 million for the three months ended June 2, 2001, an increase of $3.1 million over the comparable quarter of fiscal year 2001. The increase was due primarily to increases in headcount and related costs to support the Company's product development efforts. Research and development expenses as a percentage of net revenues were 30% and 65% of net revenues in the first fiscal quarter of 2002 and 2001, respectively.

Sales and Marketing. Sales and marketing expenses excluding stock-based compensation were $13.1 million for the three months ended June 2, 2001, an increase of $5.8 million over the comparable quarter in fiscal year 2001. The increase in sales and marketing expenses resulted primarily from the addition of sales and marketing personnel to support increased sales and marketing activities. Sales and marketing expenses as a percentage of net revenues were 30% and 46% of net revenues in the first fiscal quarter of 2002 and 2001, respectively.

General and Administrative. General and administrative expenses excluding stock-based compensation were $5.0 million for the three months ended June 2, 2001, an increase of $1.8 million over the comparable quarter in fiscal year

2001. The increase was primarily due to the addition of personnel to support the increase in revenue and general corporate expenses consistent with the increased scale of operations. General and administrative expenses as a percentage of net revenues were 11% and 21% in the first fiscal quarter of 2002 and 2001, respectively.

Stock-based Compensation. We recorded total deferred compensation of $11.1 million during the fiscal year ended March 3, 2001, related to stock option grants to employees and an employee change in status, of which approximately $685,000 was expensed during the first quarter of fiscal year 2002. This expense was classified as cost of revenues or operating expense depending upon the classification of the respective employee. During the three months ended June 3, 2000 we recorded approximately $263,000 of compensation expense related to options to purchase an aggregate of 2,658,550 shares of our common stock granted to certain employees of Cabletron, including Piyush Patel, Cabletron president and CEO and a director of Riverstone, Eric Jaeger, Cabletron's executive vice president and a director of Riverstone and David Kirkpatrick, Cabletron's chief financial officer and chief operating officer.

Interest Income, Net. Interest income primarily consists of income on available-for-sale investments. Interest income was $2.3 million for the quarter ended June 2, 2001. For the quarter ended June 3, 2000, we earned no interest income. The increase in interest income is a direct result of increased cash and investment balances, resulting from the Company' initial public offering in February 2001.

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Liquidity and Capital Resources

Prior to our initial public offering, Cabletron administered our cash. We transferred cash receipts related to our business to Cabletron periodically, and Cabletron provided funds to cover our disbursements. On June 2, 2001 we reported cash of $10.5 million in our intercompany cash account compared with $31.2 million on March 3, 2001. Cabletron administers this intercompany account, as provided by our services agreement with them. We completed our initial public offering on February 16, 2001 and realized net proceeds of $108.8 million. At completion of our initial public offering, we also received $46.6 million from the exercise of stock purchase rights by strategic investors. At June 2, 2001, we had cash and cash equivalents of $59.8 million and short-term investments of $105.8 million compared with $136.8 million cash and cash equivalents and short-term investments of $21.5 million at March 3, 2001. These cash and short-term investment accounts are managed by us. Cash equivalents consisted of government and non-government debt securities and money market funds with original maturities of less than three months. Short-term investments was comprised of U.S debt securities and commercial paper with original maturities greater than three months.

Net cash used in operating activities for the three months ended June 2, 2001 and June 3, 2000 was $12.0 million and $2.7 million, respectively. Cash used by operating activities in these periods was primarily attributable to general operating expenses, and increases in inventories and other working capital items.

Investing activities consisted of $5.7 million of capital expenditures and $84.1 million in purchase of short-term investments for the three months ended June 2, 2001. For the three months ended June 3, 2000 investing activities consisted of $5.7 million capital expenditures. Capital expenditures during both periods include production equipment, research and development equipment, computers, enterprise resource planning software applications and facility-related improvements.

Cash provided by financing activities consisted of net transfers from Cabletron under our cash administration arrangements with them of $4.1 million and $64.0 for the three months ended June 2, 2001 and June 3, 2000, respectively.

Our future capital requirements will depend on a number of factors, including the timing and rate of the expansion of our business. We anticipate a substantial increase in our capital expenditures to support growth in operations and infrastructure. However, our underlying assumed levels of revenues and expenses may prove to be inaccurate. We may need to raise additional funds through public or private financing or other arrangements to:

- support more rapid expansion of our business than we anticipate;
- develop and introduce new or enhanced products or services;
- respond to competitive pressures;
- invest in or acquire businesses or technologies; or
- respond to unanticipated requirements or developments.

Financing may not be available to us, if needed, on favorable terms or at all. If we raise additional funds through the issuance of equity securities, dilution to existing stockholders may result. If sufficient funds are not available, we may be unable to introduce new products and services, expand our sales force and service organization or compete effectively in our markets, any of which could materially harm our business, financial condition and results of operations.

We believe that our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for working capital and capital expenditures over the next 12 months.

Risk Factors That May Affect Future Results and Market Price of Stock

Risks Related to Riverstone

We have a general history of losses and there can be no assurance that we will operate profitably in the future.

We have not yet achieved profitability, and we cannot be certain that we will realize sufficient revenue to achieve profitability in the future. Portions of our historical financial data is based on Cabletron's financial statements. During fiscal 2000 and 2001, we incurred net losses of $37.4 million and $65.8 million, respectively. During the first quarter of fiscal

2002, our net loss amounted to $4.7 million. We anticipate incurring significant and increasing sales and marketing, product development and general and administrative expenses, requiring us to realize significantly higher revenue to achieve and sustain profitability.

Our exclusive focus on sales to service provider customers subjects us to risks that may be greater than those for providers with a more diverse customer base.

Our customers consist of Internet, content and metropolitan area service providers whose businesses depend on the continuing demand for differentiated services by their customers. If this demand does not continue or the Internet does not continue to expand as a widespread communications medium and commercial marketplace, the demand for our products could decline. Our exposure to this risk is greater than other vendors who sell to a more diversified customer base. We believe that there are risks arising from doing business with service providers in these markets that may not be faced by our competitors in their relationships with corporate and other customers, including:

- any failure of a service provider's service to its customers that it attributes to our products, whether or not our products actually failed, which could lead to substantial negative publicity and undermine our efforts to increase our sales;

- the low level of brand loyalty demonstrated by service providers, which may cause them to switch to another supplier that provides, or that they believe provides, superior performance or cost-effectiveness;

- the introduction, or the planned introduction, of new products and product enhancements, which could cause service providers to cancel, reduce or delay existing orders; and

- service providers that are heavily dependent upon financing, particularly from the high yield debt market, to build out their infrastructure, who may decrease their infrastructure purchases if interest rates increase or if credit availability in these markets decreases.

The occurrence of one or more of these events is likely to harm our operating results.

Our quarterly revenue and operating results are likely to fluctuate, particularly as we expand and if, as expected, our expenses rise, which could cause us to miss quarterly revenue targets and result in a decline in our stock price.

We base our operating expenses on anticipated revenue trends. A high percentage of our expenses remain relatively fixed despite changes in revenue, including marketing, research and development and general administrative expenses and expenses for employee compensation other than sales commissions. This means that any failure to achieve anticipated revenues could cause our quarterly operating results to fall below the expectations of public market analysts or investors, which could cause the price of our common stock to fall. As we expand, we expect our expenses to rise significantly, which increases the magnitude of this risk.

Our quarterly revenue and operating results may vary significantly in the future due to a number of factors, including:

- fluctuations in demand for our products and services;

- unexpected product returns or the cancellation or rescheduling of significant orders;

- our ability to develop, introduce, ship and support new products and product enhancements and manage product transitions;

- the timing and amount of non-cash stock based compensation charges;

- our ability and our suppliers' ability to attain and maintain production volumes and quality levels for our products; and

- the mix of products sold and the mix of distribution channels through which they are sold.

Due to these factors, we believe that you should not rely on period-to-period comparisons of our operating results as an indicator of our future performance.

We generally do not have binding commitments from our customers and if significant customers cancel, reduce or delay a large purchase, our revenues may decline and the price of our stock may fall.

Historically, a limited number of customers have accounted for a significant portion of our revenue. For fiscal year 2001, Telseon accounted for over 10% of our net revenue and during the first quarter of fiscal year 2002, Intellispace accounted for over 10% of our net revenue. Customers making large purchases from us are likely to vary over time, due to changes in our product cycles, customer needs, competition or economic circumstances. Although our largest customers may vary from period to period, we anticipate that our operating results for any given period will continue to depend significantly on large orders from a small number of customers. We do not have binding commitments from any of our customers other than Tellabs. The commitments of Tellabs are subject to conditions, which may not be satisfied. If any of our large customers cancel, reduce or delay purchases, our revenue and profitability would be harmed because of our dependence on large customers.

Because the purchase of our products often represents a significant decision on the part of potential customers, we may expend significant resources on potential customers without achieving actual sales.

Purchases of our products often represent a significant strategic decision and capital investment by our customers related to their communications infrastructure and typically involve significant internal procedures involving the evaluation, testing, implementation and acceptance of new technologies. This evaluation process frequently results in a lengthy sales process, often ranging from one month to longer than a year, and purchases of our products are subject to a number of significant risks, including customer budgetary constraints and internal acceptance reviews. During this time we may incur substantial sales and marketing expenses and expend significant management effort. The length of the sales cycle, and the magnitude of our investment in the sales process, is more substantial for our service provider customers than it would typically be with corporate customers. If sales forecasts from a specific customer for a particular quarter are not realized in that quarter, we may be unable to compensate for the shortfall, which could harm our operating results.

We may be unable to expand our sales and direct and indirect distribution channels, which may hinder our ability to target multiple levels of a prospective customer's organization and increase sales and revenues.

Our products and services require a sophisticated sales and marketing effort targeted at several levels within a prospective customer's organization. Unless we expand our sales force and maintain high levels of marketing activity, we will be unable to increase revenues. Although we plan to continue to hire additional sales personnel, competition for qualified sales personnel is intense, and we may be unable to hire the sales personnel we require.

Our sales and distribution strategy relies on value-added resellers, original equipment manufacturers, or OEMs, our direct and indirect international sales efforts and our ability to package our products into a complete network infrastructure solution by working with other technology vendors. We rely on Tellabs and Terayon to act as OEMs of our products for sale to cable operators on a non-exclusive basis, and we expect to establish additional OEM relationships. If we are unable to establish new value-added reseller or OEM relationships, or if Tellabs or Terayon or our other OEMs and valued-added resellers are unsuccessful in distributing our products, our sales could suffer. Additionally, our agreement with Tellabs provides that Tellabs may terminate the agreement upon a change of control of us to specified parties. Because we are not a vertically integrated network infrastructure provider, if we fail to maintain existing technology vendor relationships or to establish new ones, we will be unable to satisfy our customers' need for complete, fully-integrated solutions and our business could suffer.

Many of our customers rely on us to supply or arrange and support financing for our products, which subjects us to credit and market risks.

Many of our customers do not have or do not wish to commit the financial resources required to purchase our products without financing, and these customers expect us to provide or arrange and support their financing. Many of these financing arrangements expose us to our customers' credit risk and in the past we have experienced customer defaults. If customers default on their financing payments in the future, our recognition of revenue from those customers will be harmed. Due to recent public market volatility, a number of our current or prospective customers may be unable to raise funding through the issuance of their equity securities or otherwise in a timely fashion. This difficulty could result in an increased need for

financing provided either by us or with our assistance and an increased risk of customer default. In the past, we have benefited from Cabletron's resources and credit in arranging financing for our customers. As a result of our separation from Cabletron, we will be a much smaller, stand-alone company, which could impair our ability to provide or arrange and support customer financing. If third party financing were to become less available due to credit market factors, our ability to arrange third party financing for our customers could be significantly limited, potentially resulting in reduced revenues.

We purchase several key components for our products from single or limited sources and could lose sales if these sources fail to fulfill our needs.

We purchase several key components used in the manufacture of our products from single or limited sources and are dependent upon supply from these sources to meet our needs. We have worked with NEC and Lucent to develop several of our key proprietary application specific integrated circuits, or ASICs. These proprietary ASICs are very complex, and NEC is and Lucent is our sole source supplier for the specific types of ASICs that it supplies to us. We do not have a long-term fixed price or minimum volume agreement with either of these suppliers. Should we encounter problems with NEC or Lucent, we would not be able to develop an alternate source in a timely manner, which could hurt our ability to deliver our switch routers and web switches.

We also purchase other critical components from single or limited sources. We are likely to encounter shortages and delays in obtaining these or other components in the future which could materially harm our ability to meet customer orders.

Recently, California has been experiencing a shortage of electric power supply that has resulted in intermittent loss of power in the form of rolling blackouts. While we have not encountered any shortages or delay in obtaining key components as a result of this energy situation, continued or extended blackouts could adversely affect our suppliers' ability to produce and deliver key components on a timely basis.

We base our purchasing decisions on a forecast of anticipated orders of our products, and if we miscalculate our needs or are not able to obtain necessary components, we could be harmed.

We use a forward-looking forecast of anticipated product orders to determine our material requirements, and if customer orders do not match forecasts, we may have excess or inadequate inventory of materials and components. In the past, we have experienced shortages of some components, resulting in delays in filling orders. For example, recent high demand in the cellular phone industry for Tantalum capacitors, a component required to manufacture our products, has led to shortages and price increases for these capacitors. We have also experienced delays in the prototyping of our ASICs during initial product development, which in turn has led to delays in product introductions. If we cannot obtain necessary components, we may not be able to meet customer orders and our business and results of operations could suffer.

We depend on a single contract manufacturer for substantially all of our manufacturing requirements, and a failure by this contract manufacturer would impair our ability to deliver products.

We outsource all of our manufacturing to one company, Flextronics International, Ltd., which manufactures our products in San Jose, California. If the demand for our products grows, we will need to increase our material purchases and our contract manufacturing capacity with Flextronics or add additional contract manufacturers. Our existing and future contract manufacturers may not meet our future requirements. We have experienced a delay in product shipments from our contract manufacturer in the past, which in turn delayed product shipments to our customers. We may in the future experience similar and other problems, such as insufficient quantity of product, which could materially harm our business and operating results. While Flextronics has not experienced any power failures to date as a result of the recent California energy shortage that have prevented its ability to manufacture our products, continued or extended blackouts could adversely affect Flextronics' ability to manufacture our products and meet scheduled delivery needs. The inability of our contract manufacturer to provide us with adequate supplies of high-quality products or the loss of our contract manufacturer would cause a delay in our ability to fulfill orders while we obtain a replacement manufacturer and would have a material adverse effect on our business, operating results and financial condition.

Substantially all of our revenues come from sales of our RS router family, making us dependent on widespread market acceptance of these products.

Substantially all of our revenues result from sales of our RS router family. Continuing market acceptance of our products is critical to our future success, and we are more dependent on the market acceptance of our individual product family than competitors with broader product offerings. Factors that may affect the market acceptance of our products include:

- adoption of advanced routing and switching products and technologies;
- the performance, price and total cost of ownership of our products;
- the availability and price of competing products and technologies;
- brand recognition of the Riverstone name; and
- the success and development of our sales and marketing organizations and resellers.

If we fail to achieve market acceptance for our router family, our revenues may be harmed.

The market for network equipment is subject to rapid technological change and if we fail to accurately predict and respond to market developments or demands, we will be unable to compete successfully.

The market for network equipment is characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Our future performance will depend on our successful development and introduction and the market acceptance of new and enhanced products that address customer requirements in a cost-effective manner. We may be unsuccessful in completing the development or introduction of these product enhancements or new products on a timely basis or at all. The failure of these enhancements or new products to operate as expected could delay or prevent future sales. Developments in routers and routing software could also significantly reduce demand for our product. Alternative technologies and customer requirements could achieve widespread market acceptance and displace the technologies, protocols and service requirements on which our product lines are based. Our technological approach may not achieve broad market acceptance, and other technologies or devices may supplant our approach.

If we and the third parties providing services for us are unable to deliver the high level of customer service and support demanded by our customers, we may lose customers and our operating results will suffer.

Our customers demand a high level of customer service and support. Historically, our customer service and support functions have been provided by a combination of Cabletron's services organization, which is now a part of Enterasys, and our internal product support group. We rely on Digital Equipment (India) to provide initial call support services. We may be unable to manage effectively those third parties who provide support services for us and they may provide inadequate levels of customer support.

Our products are very complex and undetected defects may increase our costs and harm our reputation with our customers.

Networking products are extremely complex and must operate successfully with equally complex products of other vendors. These products frequently contain undetected software or hardware errors when first introduced or as new upgrades are released. Additionally, the pressures we face to be the first to market new products, increases the possibility that we will offer products in which we or our customers later discover errors. We have experienced new product and product upgrade errors in the past and expect similar problems in the future. These problems could result in our incurring significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems and our stock price to fall.

We have limited ability to engage in acquisitions and other strategic transactions using our equity because of the federal income tax requirements for a tax-free distribution.

For the distribution of our stock by Cabletron to qualify as tax-free to Cabletron and its stockholders, Cabletron must own at least 80% of the voting power of our voting stock and 80% of each class of nonvoting stock at the time of the distribution. In light of our initial public offering and the issuance of shares of our common stock to the strategic investors pursuant to purchase rights relating to our common stock, we are limited in our ability to issue additional equity as additional equity issuances could reduce Cabletron's ownership below this 80% threshold. For any distribution of our stock by Cabletron to qualify as tax-free to Cabletron, there must not be a change in ownership of 50% or greater in either the voting power or value of either our stock or Cabletron's stock that is considered to be part of a plan or series of transactions related to the distribution. If there is a direct or indirect acquisition of our or Cabletron's stock by one or more persons during the four-year period beginning two years before and ending two years after the distribution, it will be presumed to be part of a plan or series of related transactions related to Cabletron's intended distribution of our stock. Unless this presumption is successfully rebutted, the distribution will be taxable to Cabletron.

We have entered into a tax sharing agreement with Cabletron, Aprisma, Enterasys and GNTS. This agreement requires us to indemnify Cabletron, Aprisma, Enterasys and GNTS if the distribution by Cabletron of its Riverstone shares does not qualify as tax-free due to actions we take or that otherwise relate to us, including any change of ownership of us. The process for determining whether a change of ownership has occurred under the tax rules is complex. If we do not carefully monitor our compliance with these rules, we might inadvertently cause a change of ownership to occur, triggering our obligation to indemnify Cabletron and the other parties to the tax sharing agreement. Our obligation to indemnify these parties if a change of ownership causes the distribution not to be tax-free could discourage or prevent a third party from making a proposal to acquire us.

For the reasons described above, our ability to use our stock for acquisitions and other similar strategic transactions or for compensation for employees and others is restricted. Many of our competitors use their equity to complete acquisitions, to expand their product offerings and speed the development of new technology and to attract and retain employees and other key personnel, giving them a potentially significant competitive advantage over us.

We jointly own with Enterasys some of our intellectual property, and our business could be harmed if Enterasys uses this intellectual property to compete with us.

In the transformation agreement among Cabletron, Enterasys, Aprisma, GNTS and us and the related contribution agreements, Cabletron contributed to us and to Enterasys, Aprisma and GNTS intellectual property related to the products to be sold by us and by the other subsidiaries or used in our or the relevant subsidiary's business. Intellectual property that relates to a family of ASICs used in both our switch router product family and Enterasys' Smart Switch Router product family was assigned jointly to us and to Enterasys. Enterasys is primarily a provider of local area network products for the enterprise market. There are no contractual provisions that prohibit Enterasys from developing products that are competitive with our products, including products based upon the jointly assigned intellectual property. If Enterasys is acquired by one of our competitors, there are no contractual provisions that would prohibit the combined company from developing products competitive with our products.

Our limited ability to protect our intellectual property may hinder our ability to compete.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure of confidential information to protect our intellectual property rights. We cannot assure you that any patents that we hold will protect our intellectual property or will not be challenged by third parties. Other parties may also independently develop similar or competing products that do not infringe our patents. Although we attempt to protect our intellectual property rights, we may be unable to prevent the misappropriation of our intellectual property, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States.

We may be subject to claims that our intellectual property infringes upon the proprietary rights of others, and a successful claim could harm our ability to sell and develop our products.

If other parties claim that our products infringe upon their intellectual property we would be forced to defend ourselves or our customers, manufacturers or suppliers against those claims. We could incur substantial costs to prosecute or defend those claims. A successful claim of infringement against us and our failure or inability to develop non-infringing technology or license the infringed technology on acceptable terms and on a timely basis could harm our business, results of operations and financial condition.

We have recently begun to expand our international sales effort, and marketing and distributing our products outside of the United States may require increased expenses and greater exposure to risks that we may not be able to successfully address.

Our growth strategy depends in part on the expansion of our international sales and operations. International sales, which were negligible in fiscal 1999, increased to 23% of our revenue in fiscal 2000 and 32% in fiscal 2001. During the first fiscal quarter 2002, our international sales were 38%. The international market for our products is less mature than the market in the United States, and our strategy of selling to service providers that operate in the metropolitan area network may be unsuccessful on an international basis. Operating internationally exposes us to risks such as longer accounts receivable collection cycles, difficulties in staffing and managing operations across disparate geographic areas and tariffs, export controls and other trade barriers. We conduct our international sales in either U.S. dollars or local currencies and a change in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. We are also subject to fluctuations in exchange rates between the U.S. dollar and the particular local currency. We may determine to engage in hedging transactions to minimize the risk of fluctuations and if we are not successful in managing hedging transactions, we could incur losses.

If we fail to address the strain on our resources caused by our growth or if we are unable to attract and retain qualified personnel, we may not be able to achieve our objectives and our business could be harmed.

We have experienced a period of rapid growth and expansion, which has placed, and continues to place, a significant strain on our management, operational and financial resources. From February 28, 1999 to June 2, 2001, the number of our employees increased from 163 to 486 and is expected to continue to increase. Our management team has only been recently formed and has had limited experience managing rapidly growing companies. Some members of our management team have joined us only recently. Our success depends to a significant degree upon the continued contributions of our key management, engineering, sales and marketing, customer support and manufacturing personnel, many of whom would be difficult to replace. In particular, we believe that our future success is highly dependent on Romulus Pereira, our president and chief executive officer.

We believe our future success also depends on our ability to attract and retain highly skilled managerial, engineering, sales and marketing, finance, customer support and manufacturing personnel. Competition for these personnel is intense, especially in the San Francisco bay area, and we have had difficulty hiring employees in the timeframe we desire, particularly software and hardware engineers. We may be unsuccessful in attracting and retaining personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel in the future or delays in hiring required 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.

We rely on independent service providers to supply our back-office functions, and if they fail to deliver adequate services, our business will suffer.

We rely on service providers to supply us with many of our operational and back-office functions, including human resources applications, enterprise resource management applications and customer relationship management applications. Although these functions are critical to our business, we neither own the software that performs these functions nor, in some cases, the hardware on which these programs and our data reside. If there is a significant degradation or failure in service, we may be unable to quickly and cost-effectively transition to other service providers or provide the necessary functionality ourselves and our business could be disrupted.

Risks Related to Our Industry

Intense competition in the market for network equipment could prevent us from increasing revenue and sustaining profitability.

The market for network equipment is very competitive and has historically been dominated by Cisco Systems. Other principal competitors include established companies such as Extreme Networks, Foundry Networks, Juniper Networks, Lucent, Nortel Networks and Siemens. We also experience competition from a number of other smaller public and private companies. These competitors may have developed or could in the future develop new technologies that compete with our products or even make our products obsolete. Consolidation in our industry is occurring and is likely to continue. Future acquisitions by, and mergers among, our competitors and potential competitors could expand their product offerings and accelerate their development of new technologies, providing them with a competitive advantage.

Many of our competitors have significantly more established customer support and professional services organizations

and substantially greater financial resources than we do. Many of our competitors also have much greater name recognition and have a more extensive customer base and broader customer relationships and product offerings than we do. These companies can rely on their customer bases and broader product offerings and adopt aggressive pricing policies to gain market share. We expect that competitive pressures may result in price reductions, reduced margins and loss of market share, which would materially harm our business, results of operations and financial condition.

We expect the average selling prices of our products to decrease rapidly, which may reduce our gross margins or revenue.

Our industry has experienced rapid erosion of average selling prices. We anticipate that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, increased sales discounts, new product introductions by us or our competitors and increasing availability of relatively inexpensive standard microprocessors that can perform some of our products' functionality. If we are unable to achieve sufficient cost reductions and increases in sales volumes, this decline in average selling prices will reduce our revenue and gross margins.

If our products do not comply with complex governmental regulations and evolving industry standards, our products may not be widely accepted, which may prevent us from sustaining our revenues or achieving profitability.

The market for network equipment products is characterized by the need to support industry standards as different standards emerge, evolve and achieve acceptance. To be competitive, we must continually introduce new products and product enhancements that meet these emerging standards. We have had to delay the introduction of new products to comply with third party standards testing. We may be unable to address compatibility and interoperability issues that arise from technological changes and evolving industry standards. In the United States, our products must comply with various governmental regulations and industry regulations and standards, including those defined by the Federal Communications Commission, Underwriters Laboratories and Networking Equipment Building Standards, or NEBS. Internationally, products that we develop may be required to comply with standards or obtain certifications established by telecommunications authorities in various countries and with recommendations of the International Telecommunications Union. If we do not comply with existing or evolving industry standards or fail to obtain timely domestic or foreign regulatory approvals or certificates, we will be unable to sell our products where these standards or regulations apply, which may prevent us from sustaining our revenues or achieving profitability.

Risks Related to Our Separation from Cabletron

Although Cabletron has received a tax ruling from the Internal Revenue Service relating to the distribution of our common stock, Cabletron is not obligated to complete its distribution of our common stock, and Cabletron may continue to control many aspects of our business and the liquidity of our stock may be limited.

Cabletron has announced that it received a private letter ruling from the Internal Revenue Service indicating that the distribution of Cabletron's shares of Riverstone common stock to Cabletron's stockholders will be tax-free to Cabletron and its stockholders. The private letter ruling is subject to compliance with representations made by Cabletron to the Internal Revenue Service. Cabletron will not be able to rely on the ruling if any of the representations or assumptions on which the ruling is based are, or become, incorrect or untrue in any material respect. On July 10, 2001, Cabletron announced that it expects to complete the distribution on August 6, 2001 to its stockholders of record on July 27, 2001. Cabletron is not obligated to complete the distribution, and there can be no assurance that the distribution will occur.

If the distribution is delayed or not completed, Cabletron would continue to control many aspects of our business and the liquidity of our shares will be constrained unless and until Cabletron elects to sell some portion of its equity ownership in us. Our agreements with Cabletron do not prevent Cabletron from selling its Riverstone common stock. The sale or potential sale by Cabletron of Riverstone common stock, even of relatively small amounts, could result in a lower trading price of our stock. Also, if Cabletron does not distribute its shares, we may face significant difficulty hiring and retaining key personnel, many of whom are attracted by the potential of operating our business as a fully independent entity.

Cabletron owns approximately 86% of our outstanding common stock. As long as Cabletron owns a majority of our outstanding common stock, subject to its independent director obligation described below, Cabletron will continue to be able to elect our entire board of directors and to remove any director without calling a special meeting. Cabletron has agreed that for so long as it owns any of our stock, it will vote its shares to elect to our board of directors the number of independent directors required to comply with the Nasdaq National Market listing rules. Due to Cabletron's voting control, before Cabletron's distribution or other disposition of our common stock, our investors will be unable to affect the outcome of any stockholder vote and Cabletron will control all matters affecting us, including:

- through its control of the composition of our board of directors, the determination of our business direction and policies, including the appointment and removal of officers;
- the allocation of business opportunities that may be suitable for us and Cabletron and its affiliates;
- any determinations relating to mergers or other business combinations;
- our acquisition or disposition of assets;
- our financing;
- changes to the agreements providing for our separation from Cabletron;
- the payment of dividends on our common stock; and
- determinations for our tax returns.

Conflicts of interest may arise between Cabletron and us in a number of areas relating to our past and ongoing relationships, including:

- labor, tax, employee benefit, indemnification and matters arising from our separation from Cabletron;
- employee retention and recruiting;
- sales or distributions by Cabletron of all or any portion of its ownership interest in us;
- the nature, quality and pricing of services Cabletron has agreed to provide us; and
- business opportunities that may be attractive to Cabletron or one of Cabletron's affiliates, such as Enterasys, and us.

We may not be able to resolve any potential conflicts, and even if we do, the resolution may be less favorable than if we were dealing with an unaffiliated party. There are no contractual agreements restricting Cabletron or its affiliates, including Enterasys with whom we share important technologies, from competing with us. Enterasys is a provider of local area network products that are primarily sold to large corporations or institutions, but is not restricted from selling network products to service provider customers. In our certificate of incorporation we have renounced any interest in business opportunities that are presented to Cabletron, its subsidiaries other than us, or our officers or directors who are employees of Cabletron or its subsidiaries other than us at the time the opportunity is presented.

When Cabletron distributes the shares of our common stock that it owns to its stockholders, we will issue options and warrants to purchase shares of our common stock to holders of Cabletron options and warrants, which will dilute our existing stockholders.

When Cabletron distributes to its stockholders the Riverstone shares that it owns, we will grant options to acquire shares of our common stock under our 2000 equity incentive plan to those persons holding Cabletron compensatory stock options. We are obligated under our agreement with Cabletron to ensure that sufficient shares are available under our 2000 equity incentive plan to make these supplemental option grants. Similarly, Cabletron has issued warrants to purchase shares of its common stock to the strategic investors. We have agreed with Cabletron that upon any distribution by Cabletron of shares of our common stock to its stockholders, we will issue warrants to the strategic investors to purchase shares of our common stock. The strategic investors will receive warrants to purchase the number of shares of our common stock that they would have received from Cabletron in the distribution, had they exercised their Cabletron warrants before the distribution.

As of March 3, 2001, there were 188,511,262 shares of Cabletron's capital stock outstanding, options outstanding to purchase 11,767,580 shares of Cabletron common stock, and the strategic investors held warrants to purchase 450,000 shares of Cabletron common stock. Unvested Cabletron options held by Riverstone employees as of the time of the distribution would terminate because these employees would no longer be employed by a subsidiary of Cabletron as of the time of the distribution. Cabletron's board of directors has voted to accelerate, as of the time of the distribution, the vesting of Cabletron options held by Riverstone employees which would vest by February 28, 2002. Not including portions of Cabletron options held by Riverstone employees which vest after February 28, 2002, as of March 3, 2001, there were options outstanding to purchase 11,022,102 shares of Cabletron common stock. Assuming no change in these amounts from March 3, 2001 through the date of the distribution and that as of the date of the distribution Cabletron owns 92,088,235 shares of our common stock, we would be required to:

- grant options to purchase approximately 5,384,400 shares of our common stock to holders of Cabletron stock options; and

- issue warrants to the strategic investors to purchase approximately 219,300 shares of our common stock for warrants to purchase shares of Cabletron common stock.

Our existing stockholders will suffer dilution upon the exercise of the supplemental options and warrants that we issue. There are no restrictions on the number of options to purchase Cabletron common stock that Cabletron may issue before its distribution of our stock, and we cannot control the number of supplemental options that we will be required to grant. Consequently, we are unable to predict the extent of the dilution that our existing stockholders will experience when Cabletron distributes the shares of our common stock that it owns.

Our historical financial information may not be representative of our results as a separate company.

Our consolidated financial statements are based on the consolidated financial statements of Cabletron, using the historical results of operations and historical bases of the assets and liabilities of the Cabletron router and switch business contributed to us. The historical financial information we have included in this Report on Form 10-Q does not necessarily reflect what our financial position, results of operations and cash flows would have been had we been a separate, stand-alone entity during the periods presented. Cabletron did not account for us as a separate, stand-alone entity before June 3, 2000. Our costs and expenses include allocations from Cabletron for centralized corporate services and infrastructure costs, including:

- customer service;
- sales;
- information technology;
- distribution;
- legal and accounting;
- real estate; and
- treasury.

These allocations have been determined on bases that we and Cabletron consider to be reasonable reflections of the utilization of services provided to or the benefit received by us. The historical financial information is not necessarily indicative of what our results of operations, financial position and cash flows will be in the future. We have not made adjustments to our historical financial information to reflect many significant changes that will occur in our cost structure, funding and operations due to our separation from Cabletron, including increased costs from reduced economies of scale, increased marketing expenses related to building a company brand identity separate from Cabletron and the increased costs of being a publicly traded, stand-alone company.

We use Cabletron's operational and administrative infrastructure and Cabletron provides us with numerous administrative services, and our ability to operate our business may suffer if we do not successfully develop our own

infrastructure or if Cabletron elects not to provide these services to us.

Under a services agreement, we use Cabletron's administrative infrastructure and Cabletron provides us centralized corporate functions, including legal, accounting, payroll and other services. Cabletron may not provide these services at the same level as when we were part of Cabletron, and we may be unable to obtain the same benefits. These services arrangements generally have a term of less than two years following the date of our separation from Cabletron. With sixty days prior written notice, Cabletron may terminate the services agreement for any or all of the services provided under the agreement. After the expiration of these various arrangements, we may be unable to replace these services in a timely manner or on terms and conditions, including cost, as favorable as those received from Cabletron.

Many of Cabletron's infrastructure systems used by us are proprietary to Cabletron and are very complex. These systems have been modified, and are being further modified, to enable us to separately track items related to our business. These modifications, however, may result in unexpected system failures or the loss or corruption of data. Any failure or significant downtime in Cabletron's or our own information systems or termination of our ability to use these systems before we have developed our own systems could harm our business. To successfully implement and operate our own systems and transition data from Cabletron's systems, we must be able to attract and retain a significant number of highly skilled employees.

Our arrangements with Cabletron were made in the context of a parent-subsidiary relationship and were established in the overall context of our separation from Cabletron. The prices charged to us may be lower than the prices that we may be required to pay third parties for similar services or the costs of similar services if we undertake them ourselves.

We cannot rely on Cabletron to fund our future capital requirements, and financing from other sources may not be available on favorable terms or at all.

In the past, our capital needs have been satisfied by Cabletron. However, following our separation, Cabletron is under no obligation to provide funds to finance our working capital or other cash requirements or to support customer financing. Financing or financial support from other sources, if needed, may not be available on favorable terms or at all.

We believe our capital requirements will vary greatly from quarter to quarter. Capital expenditures, fluctuations in our operating results, financing activities, acquisitions, investments and inventory and receivables management may contribute to these fluctuations. We believe that the proceeds from our initial public offering, and our future cash flow from operations, will be sufficient to satisfy our working capital, capital expenditure and research and development requirements for at least the next twelve months. However, we may require or choose to obtain additional debt or equity financing to finance acquisitions or other investments in our business. Future equity financings may be dilutive to the existing holders of our common stock. Future debt financings could involve restrictive covenants. We will likely not be able to obtain debt financing with interest rates and other terms as favorable as those that Cabletron could obtain.

The plaintiffs in Cabletron's outstanding class action suit might seek to add us to this litigation or seek payment of any related damages.

Since December 1997, Cabletron has been party to an outstanding class action suit alleging that during the period of March 3, 1997 through December 2, 1997, Cabletron released false and misleading information about its operations and that Cabletron's accounting practices resulted in the disclosure of materially misleading financial results. The plaintiffs' complaint does not specify the amount of damages, but if the plaintiffs prevail Cabletron could be required to pay substantial damages. The plaintiffs in this matter might seek to involve us in this litigation or, if they prevail in this litigation, might seek to recover damages from us, particularly if Cabletron has insufficient assets.

Conflicts of interest may arise because our directors and executive officers have ownership interests in Cabletron, and our directors hold equity interests in Aprisma, Enterasys and GNTS.

Many of our directors and executive officers have a substantial amount of their personal financial portfolios in Cabletron common stock and options to purchase Cabletron common stock. Our directors also hold options to purchase stock of Aprisma, Enterasys and GNTS. Piyush Patel and Eric Jaeger serve on our board of directors and are both executive officers of Cabletron. Mr. Patel is also a board member of Cabletron. These factors could create, or appear to create, potential conflicts of interest when directors and officers are faced with decisions that could have different implications for

Cabletron, its affiliates, such as Aprisma, Enterasys and GNTS, or us.

We could incur significant tax liability if the distribution does not qualify for tax-free treatment, which could require us to pay Cabletron a substantial amount of money.

In addition to our liability under the tax sharing agreement with Cabletron, Aprisma, GNTS and Enterasys, under United Stated Federal income tax laws, we would be jointly and severally liable for the Federal income taxes of Cabletron resulting from the distribution being taxable. This means that even if we do not have to indemnify Cabletron under the tax sharing agreement because we did not take any specific action to cause the distribution to fail as a tax-free event, we may still be liable for any part of, including the whole amount of, these liabilities and expenses if Cabletron fails to pay them.

Risks Related to Our Stock

Substantial sales of our common stock may result from Cabletron's proposed distribution of our shares of common stock that it owns, which could cause our stock price to decline.

On July 10, 2001, Cabletron announced that it anticipated to complete the distribution of our common stock that it holds on August 6, 2001 to its stockholders of record on July 27, 2001. Substantially all of these shares will be eligible for immediate resale in the public market once distributed. Significant amounts of common stock may be sold in the open market in anticipation of, or following, this distribution, or by Cabletron if the distribution does not occur. Additionally, a portion of Cabletron's common stock is held by index funds tied to the Standard & Poor's 500 Index or other stock indices. If we are not in these indices at the time of Cabletron's distribution of our common stock but Cabletron is, these index funds will be required to sell our stock. There may not be a sufficient number of buyers in the market at that time. Any sales of substantial amounts of common stock in the public market, or the perception that sales might occur, whether related to this distribution or not, could harm the market price of our common stock.

Our stock price has been and may continue to be volatile, which could result in substantial losses for individual stockholders.

The stock markets in general, and the markets for high technology stocks in particular, have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. For example, during the first quarter of calendar year 2001, the Nasdaq Composite Index had a closing low of 1820.57, representing 36.3% less than the closing high of 2859.15 for the same period. The market price of our common stock has been volatile and we expect that it will continue to be volatile. In addition, before Cabletron distributes its Riverstone shares, relatively small trades of our stock will have a disproportionate effect on our stock price. Accordingly, purchasers of shares of our common stock may not be able to resell those shares at or above the price paid, which could result in a substantial loss.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, government and non-government debt securities and money market funds. In general, money market funds are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate.

Under our services agreement with Cabletron, Cabletron provides us with a centralized treasury function. As part of this function, Cabletron administers our intercompany cash account. This account represents an amount, which may be adjusted periodically for our receivables collected and payables paid and for other appropriate credits and debits, which is payable on demand by Cabletron to us in cash. The amount of cash we can demand from Cabletron is not affected by any profit or loss Cabletron may realize from its cash management activities, except that Cabletron does credit interest income to us based on our weighted average cash balance at the same rate as Cabletron earns on average on its holdings of cash, cash equivalents and other short-term investments. As of June 2, 2001, our cash account with Cabletron totaled $10.5 million. Based upon Cabletron's reported cash reserves, we do not believe that there is any material risk that Cabletron would fail to pay us upon demand.

Foreign Currency Exchange Risk

Under our services agreement with Cabletron, Cabletron manages our treasury risk management strategy. Cabletron's strategy has been to use foreign exchange forward and option contracts to hedge some balance sheet exposures and intercompany balances against future movements in foreign exchange rates. Gains and losses on the forward and option contracts are largely offset by gains and losses on the underlying exposure and consequently a sudden or significant change in foreign exchange rates would not have a material impact on future net income or cash flows. Cabletron performed a sensitivity analysis as of March 3, 2001, which resulted in immaterial fair value movements based on hypothetical exchange rate movements. Consistent with that analysis, our foreign currency exchange risk, as it relates to fair value, is immaterial. We are evaluating our exchange rate risk management strategy. We do not now or in the future intend to use derivative financial instruments for trading purposes.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

A consolidated class action lawsuit raising claims against Cabletron and some officers and directors of Cabletron was filed in the United States district court for the district of New Hampshire and, following transfer, is pending in the district of Rhode Island. The complaint alleges that Cabletron and several of its officers and directors made materially false and misleading information about Cabletron's operations and acted in violation of Section 10(b) of and Rule 10b-5 under the Securities Exchange Act of 1934 during the period between March 3, 1997 and December 2, 1997. The complaint also alleges that Cabletron's accounting practices resulted in the disclosure of materially misleading financial results during the same period. More specifically, the complaint challenged Cabletron's revenue recognition policies, accounting for product returns, and the validity of some sales. The complaint does not specify the amount of damages sought on behalf of the class. Cabletron and other defendants moved to dismiss the complaint and, by order dated December 23, 1998, the district court expressed its intention to grant Cabletron's motion to dismiss unless the plaintiffs amended their complaint. In a ruling dated May 23, 2001, the district court dismissed this complaint with prejudice. The plaintiffs have appealed this ruling to the First Circuit Court of Appeals. If the plaintiffs were to prevail on appeal, and ultimately prevail on the merits of the case, Cabletron could be required to pay substantial damages.

We have not assumed any liabilities from Cabletron for this litigation. We have not been named as a defendant in this litigation and none of our officers or directors is named as a defendant to this litigation. However, the plaintiffs might attempt to involve us in this litigation or might seek to have us pay damages if Cabletron has insufficient assets to cover any resulting damages. Any involvement in this litigation could be protracted and may result in a diversion of management and other resources. The payment of substantial legal costs or damages, or the diversion of our management and other resources, could have a material adverse effect on our business, financial condition or results of operations.

We have granted options to purchase shares of our common stock under our 2000 equity incentive plan to our employees and employees of Cabletron and its affiliates and to our advisors and consultants. As a result of the nature of the persons who received these options and the vesting provisions of these options, we may have violated the California state securities laws because we did not qualify options granted prior to February 22, 2001 under California state securities laws. Because these option grants were not qualified under California state securities laws, persons residing in California who received these options may have a claim against us. Accordingly, we currently intend to offer to repurchase outstanding options to purchase shares of our common stock granted under our 2000 equity incentive plan prior to February 22, 2001 to persons who resided in California at the time of grant.

We are not aware of any legal proceedings against us that, individually or in the aggregate, would have a material adverse effect on our business, operating results or financial condition. We may in the future be party to litigation arising in the course of our business, including claims that we allegedly infringe third-party trademarks and other intellectual property rights. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Item 2. Changes in Securities and Use of Proceeds

On February 16, 2001, in connection with the initial public offering of our common stock, $0.01 par value, a Registration Statement on Form S-1 (No. 333- 45958) was declared effective by the Securities and Exchange Commission registering 11,500,000 shares for an aggregate estimated maximum offering price of $161,000,000. We expect to use the net proceeds of the offering for working capital and for other general corporate purposes. We will use our working capital to fund our operating expenses including our increased research and development costs and the expansion of our sales and marketing force. We may use a portion of the net proceeds to acquire complementary products, technologies or businesses. However, we have no commitments or agreements for any specific acquisitions and are not in negotiations for any acquisition transactions.

Until the use of the net proceeds from our initial public offering as described above, we plan to invest the net proceeds in short-term, investment grade, interest bearing obligations.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

On July 10, 2001, Cabletron and Riverstone entered into an agreement pursuant to which, upon the closing of the transactions contemplated by the agreement, Cabletron will transfer to Riverstone $120 million cash and certain strategic investments in exchange for 7,117,757 shares of Riverstone's common stock. The transfers contemplated by the agreement are expected to close on or about July 20, 2001.

Riverstone has agreed to release Cabletron from its obligation to indemnify Riverstone for amounts paid or expenses incurred in connection with Riverstone's rescission offer in exchange for $1.5 million.

On July 13, 2001, the Riverstone board of directors approved the adoption of a stockholder rights plan. Under the plan, one right will be issued for each share of the Company's common stock outstanding on July 26, 2001. Stock issued after that date will be issued with an attached right. Each right would initially represent the right, under certain circumstances, to purchase 1/1000 of a share of a new series of preferred stock of the Company at an exercise price of $115 per share.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

None.

(b) Reports on Form 8-K.

None.

SIGNATURES

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

RIVERSTONE NETWORKS, INC.

July 16, 2001	By: /s/ Romulus Pereira
Date	Romulus Pereira President, Chief Executive Officer and Director

Signature	Titles	Dat
/s/ Romulus Pereira Romulus Pereira	President, Chief Executive Officer and Director (principal executive officer)	July 16
/s/ Robert Stanton Robert Stanton	Executive Vice President of Finance and Chief Financial Officer (principal financial and accounting officer)	July 16