INFINERA CORP
Form S-1/A
April 27, 2007
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As filed with the Securities and Exchange Commission on April 27, 2007

Registration No. 333-140876

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 3

to

FORM S-1

REGISTRATION STATEMENT

Under

The Securities Act of 1933

INFINERA CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	**3661**	**77-0560433**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

169 Java Drive

Sunnyvale, CA 94089

(408) 572-5200

(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

Jagdeep Singh

President and Chief Executive Officer

Infinera Corporation

169 Java Drive

Sunnyvale, CA 94089

(408) 572-5200

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Commission acting pursuant to said Section 8(a) may determine.

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The information in this preliminary prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell nor does it seek an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion. Dated April 27, 2007.

Shares

Infinera Corporation

Common Stock

This is an initial public offering of shares of common stock of Infinera Corporation. All of the shares of common stock are being sold by Infinera Corporation.

Prior to this offering, there has been no public market for our common stock. It is currently estimated that the initial public offering price per share will be between $ and $. Application has been made for the quotation of the common stock on the NASDAQ Global Market under the symbol INFN.

See Risk Factors on page 8 to read about factors you should consider before buying shares of our common stock.

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

	Per Share	Total
Initial public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to Infinera	$	$

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

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

Goldman, Sachs & Co.

Citi

JPMorgan

Lehman Brothers

Thomas Weisel Partners LLC

Prospectus dated , 2007.

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PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the following summary together with the more detailed information appearing in this prospectus, including our financial statements and notes, and our risk factors beginning on page 8, before deciding whether to purchase shares of our common stock. Unless the context otherwise requires, we use the terms Infinera, the company, we, us and our in this prospectus to refer to Infinera Corporation and its subsidiaries.

INFINERA CORPORATION

Overview

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

We believe that photonic integrated circuits can change optical communications networks in a fashion similar to the integrated circuit s impact on electronics beginning in the 1950 s. Our DTN System is designed to serve as the key element for long-haul and metro optical transport networks of U.S. and international communications service providers. Our DTN System currently competes in the wavelength division multiplexing segment of the nearly $12 billion global optical communications equipment market.

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

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

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

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

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We began commercial shipment of our DTN System in November 2004. In the third quarter of 2005, we believe we achieved, and have since maintained through the fourth quarter of 2006, the largest market share of 10 Gbps long-haul ports shipped worldwide. As of March 31, 2007, we have sold our DTN System for deployment in the optical networks of 28 customers worldwide, including Internet2, Interoute, Level 3 Communications and Qwest Communications. We do not have long-term purchase commitments with our customers. To date, a few of our customers have accounted for a significant percentage of our revenue. In 2006, Level 3 and Broadwing Corporation, which Level 3 acquired in January 2007, together accounted for approximately 60% of our revenue.

Industry Background

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

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

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

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

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

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The Infinera Solution and Strategy

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

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

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

- *Penetrate adjacent markets.* We intend to increase our addressable market by adding functionality to our DTN System, by developing new products, including products specifically designed for metro applications, and by creating the service and support infrastructure needed to address these markets;

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

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

Risks Associated With Our Business

Our business is subject to numerous risks, as discussed more fully in the section titled Risk Factors immediately following this prospectus summary. We incurred net losses of $66.5 million in 2004, $64.8 million in 2005 and $89.9 million in 2006. As of December 31, 2006, our accumulated deficit was $314.1 million. Our management determined, subsequent to their issuance, that our financial statements should be restated. These restatements are further described in Note 1 of Notes to Consolidated Financial Statements included elsewhere in this prospectus. In connection with the audit of our financial statements for 2005 and 2006, our management and our independent registered public accounting firm reported to our board of directors a material weakness for each year in the design and operation of our internal control over financial reporting. We believe we have remediated the material weakness identified in 2005 related to our inventory valuation process by implementing additional procedures and controls, hiring additional accounting personnel and increasing management review and oversight. We have developed a remediation plan to address the material weakness identified in 2006 related to non-routine manual accounting and reporting processes involving our revenue process in 2006 and net loss per common share computations in 2002 through 2006, but we cannot assure you that we will be able to remediate this material weakness.

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Corporate Information

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

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

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THE OFFERING

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

The number of shares of our common stock to be outstanding following this offering is based on 68,481,069 shares of our common stock outstanding as of December 31, 2006, but excludes:

- 7,872,264 shares of common stock issuable upon exercise of options outstanding as of December 31, 2006 at a weighted average exercise price of $1.77 per share;
- 1,332,682 shares of common stock issuable upon the exercise of warrants outstanding as of December 31, 2006, at a weighted average exercise price of $5.41 per share; and
- 17,482,974 shares of common stock reserved for future issuance under our stock-based compensation plans, consisting of 2,070,474 shares of common stock reserved for issuance under our 2000 Stock Plan, 13,600,000 shares of common stock reserved for issuance under our 2007 Equity Incentive Plan and 1,812,500 shares of common stock reserved for issuance under our 2007 Employee Stock Purchase Plan. The 2007 Equity Incentive Plan and the 2007 Employee Stock Purchase Plan will become effective on the date of this offering.

Unless otherwise indicated, this prospectus reflects and assumes the following:

- a 1-for-4 reverse stock split of our common stock and convertible preferred stock to be effected prior to the closing of this offering;

the conversion of all outstanding shares of our convertible preferred stock immediately prior to the closing of this offering;

the filing of our amended and restated certificate of incorporation and the adoption of our amended and restated bylaws immediately prior to the closing of this offering; and

no exercise by the underwriters of their option to purchase up to an additional shares to cover over-allotments.

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SUMMARY CONSOLIDATED FINANCIAL DATA

The following tables summarize our consolidated financial data. We have derived the statements of operations data for the years ended December 31, 2004, 2005 and 2006 and balance sheet data as of December 31, 2006 from our audited consolidated financial statements appearing elsewhere in this prospectus. Our historical results are not indicative of the results that should be expected in the future. You should read this summary consolidated financial data in conjunction with the sections titled Selected Consolidated Financial Data and Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes, all included elsewhere in this prospectus.

	Years Ended December 31,		
	2004	2005 (Restated)	2006 (Restated)
	(In thousands, except per share data)		
Statements of Operations Data:			
Revenue:			
Ratable product and related support and services	$	$ 4,127	$ 52,978
Product	599		5,258
Total revenue	599	4,127	58,236
Cost of revenue:			
Cost of ratable product and related support and services		27,455	69,765
Cost of product	7,240		1,660
Total cost of revenue	7,240	27,455	71,425
Gross loss	(6,641)	(23,328)	(13,189)
Operating expenses:			
Sales and marketing	8,294	11,053	20,682
Research and development	46,306	24,986	38,967
General and administrative	2,888	4,328	12,650
Amortization of intangible assets			56
Total operating expenses	57,488	40,367	72,355
Loss from operations	(64,129)	(63,695)	(85,544)
Other income (expense), net	(2,351)	(2,256)	(4,319)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(66,480)	(65,951)	(89,863)
Provision for income taxes		12	72
Loss before cumulative effect of change in accounting principle	(66,480)	(65,963)	(89,935)
Cumulative effect of change in accounting principle		(1,137)	
Net loss	$ (66,480)	$ (64,826)	$ (89,935)
Net loss per common share, basic and diluted (restated)	$ (17.94)	$ (14.08)	$ (14.90)

Weighted average number of shares used in computing basic and diluted net loss per common share (restated)	3,705	4,605	6,036
Pro forma net loss per common share, basic and diluted (unaudited)			$ (1.49)
Weighted average number of shares used in computing pro forma basic and diluted net loss per common share (unaudited)			60,389

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	As of December 31, 2006		
	Actual (Restated)	Pro Forma (Restated)	Pro Forma As Adjusted
	(In thousands, unaudited)		
Balance Sheet Data:			
Cash, cash equivalents and short-term investments	$ 29,572	$ 29,572	
Working capital	2,218	7,627	
Total assets	230,466	230,466	
Preferred stock warrant liability	5,409		
Current and long-term debt	28,382	28,382	
Convertible preferred stock	320,550		
Total stockholders equity (deficit)	(306,321)	19,638	

The pro forma column in the balance sheet data table above reflects (i) the conversion of all outstanding shares of our convertible preferred stock into an aggregate of 59,427,604 shares of common stock immediately prior to the closing of the offering and (ii) the reclassification of the preferred stock warrant liability to common stock immediately prior to the closing of this offering.

The pro forma as adjusted column in the balance sheet data table above reflects (i) the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of the offering, (ii) the reclassification of the preferred stock warrant liability to common stock immediately prior to the closing of the offering, and (iii) our sale of shares of common stock in this offering, at an assumed initial public offering price of $ per share, which is the midpoint of the price range listed on the cover page of this prospectus, and after deducting the estimated underwriting discount and estimated offering expenses payable by us and the application of our net proceeds from this offering.

The pro forma as adjusted information discussed above is illustrative only and will adjust based on the actual initial public offering price and other terms of this offering determined at pricing.

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RISK FACTORS

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

Risk Related to Our Business

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

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

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

We have not achieved profitability. We experienced a net loss of $89.9 million for the year ended December 31, 2006. As of December 31, 2006, our accumulated deficit was $314.1 million. We expect to continue to incur substantial losses, and we may not become profitable in the foreseeable future, if ever. We expect to continue to make significant expenditures related to the development of our business, including expenditures to hire additional personnel related to the sales, marketing and development of our DTN System and to maintain and expand our manufacturing facilities and research and development operations. In addition, as a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. We will have to generate and sustain significant increased revenue and product gross margins to achieve profitability. Accordingly, we may not be able to achieve or maintain profitability and we may continue to incur significant losses in the future.

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

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

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

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

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- reductions in customers budgets for optical communications purchases and delays in their purchasing cycles;
- order cancellations or reductions or delays in delivery schedules by our customers;
- timeliness of our customers payments for their purchases;
- the timing of recognizing revenue in any given quarter as a result of software revenue recognition requirements and any changes in U.S. generally accepted accounting principles or new interpretations of existing accounting rules;
- our ability to establish vendor specific objective evidence, or VSOE, in order to be able to recognize revenue once the four revenue recognition criteria have been met, rather than over the period represented by the longest undelivered service period;
- readiness of customer sites for installation of our DTN System;
- the timing of product releases or upgrades by us or by our competitors;
- availability of third party suppliers to provide contract engineering and installation services for us;
- any significant changes in the competitive dynamics of our market, including any new entrants, technological advances or substantial discounting of products;
- our ability to control costs, including our operating expenses and the costs of components we purchase; and
- general economic conditions in domestic and international markets.

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

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

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

- the mix in any period of higher and lower margin products and services;
- price discounts negotiated by our customers;

sales volume from each customer during the period;

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

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

charges for excess or obsolete inventory;

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

our ability to reduce manufacturing costs;

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

increased price competition, including competition from low-cost producers in China; and

increased warranty or repair costs.

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

Aggressive business tactics by our competitors may harm our business.

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

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

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

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

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

Many of our competitors have substantially greater name recognition and technical, financial and marketing resources, greater manufacturing capacity and better established relationships with

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

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

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

A relatively small number of customers account for a large percentage of our net revenue. In particular, for the year ended December 31, 2006, Level 3 Communications, or Level 3, and Broadwing, which Level 3 acquired in January 2007, together accounted for approximately 60% of our revenue. We expect Level 3 to continue to represent a large percentage of our revenue for the foreseeable future. Our business will be harmed if we do not generate as much revenue as we expect from our key customers, particularly from Level 3, if we experience a loss of Level 3 or of any of our other key customers or if we suffer a substantial reduction in orders from these customers. Our ability to continue to generate revenue from our key customers will depend on our ability to introduce new products that are desirable to these customers at competitive prices, and we may not be successful doing so. Because, in most cases, our sales are made to these customers pursuant to standard purchase orders rather than long-term purchase commitments, orders may be cancelled or reduced readily. In the event of a cancellation or reduction of an order, we may not have enough time to reduce operating expenses to minimize the effect of the lost revenue on our business. Our operating results will continue to depend on our ability to sell our DTN System to Level 3 and other large customers.

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

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

Further, many of our customers are large communications service providers that have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers

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have and may continue to seek advantageous pricing and other commercial terms and may require us to develop additional features in the products we sell to them. We have and may continue to be required to reduce the average selling price, or increase the average cost, of our DTN System in response to these pressures or competitive pricing pressures. To maintain acceptable operating results, we will need to develop and introduce new products and product enhancements on a timely basis and continue to reduce our costs.

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

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

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

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

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

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

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

We believe that, in order to grow our revenue and business and to build a large and diverse customer base, we must successfully sell our DTN System in metro and international markets and ultimately to U.S. regional bell operating companies, international postal, telephone and telegraph companies, cable multiple system operators and U.S. competitive local exchange carriers. We have limited experience selling our DTN System internationally and to U.S. regional bell operating companies, international postal, telephone and telegraph companies, cable multiple system operators and U.S. competitive local exchange carriers. To succeed in these sales efforts, we believe we must hire additional sales personnel and develop and manage new sales channels through resellers, distributors and systems integrators. If we do not succeed in our efforts to sell to these target markets and customers, the size of our total addressable market will be limited. This, in turn, would harm our ability to grow our customer base and revenue.

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

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

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

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

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

Any claim of infringement from a third party, even those without merit, could cause us to incur substantial costs defending against such claims, and could distract our management from running our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering our DTN System. In addition, we might be required to seek a license for the use of such intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we may be required to develop non-infringing technology, which would require significant effort and expense and may ultimately not be successful. Any of these

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events could harm our business, financial condition and operating results. Competitors and other third parties have and may continue to assert infringement claims against our customers and sales partners. Any of these claims would require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims, because we generally indemnify our customers and sales partners from claims of infringement of proprietary rights of third parties. If any of these claims succeed, we may be forced to pay damages on behalf of our customers or sales partners, which could have an adverse effect on our business, financial condition and operating results.

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

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

We are required to generate forecasts of future demands for our DTN System several months prior to the scheduled delivery to our prospective customers, which requires us to make significant investments before we know if corresponding revenue will be recognized. If we overestimate demand for our DTN System and increase our inventory in anticipation of customer orders that do not materialize, we will have excess inventory, we will face a risk of obsolescence and significant inventory write-downs and our capital infrastructure will be depreciated across fewer units raising our per unit costs. If we underestimate demand for our DTN System, we will have inadequate inventory, which could slow down or interrupt the manufacturing of our DTN System and result in delays in shipments and our ability to recognize revenue. In addition, we may be unable to meet our supply commitments to customers which could result in a breach of our customer agreements and require us to pay damages. Lead times for materials and components, including application-specific integrated circuits, that we need to order for the manufacturing of our DTN System vary significantly and depend on factors such as the specific supplier, contract terms and demand for each component at a given time.

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

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

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

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

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

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

- delays in our ability to recognize revenue;
- costs associated with fixing software or hardware defects or replacing products;
- high service and warranty expenses;
- delays in shipments;
- high inventory excess and obsolescence expense;
- high levels of product returns;
- diversion of our engineering personnel from our product development efforts;
- delays in collecting accounts receivable;
- payment of damages for performance failures;
- reduced orders from existing customers; and
- declining interest from potential customers.

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

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

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

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

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

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

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

Since our DTN System is based on complex technology, we may experience unanticipated delays in developing, improving, manufacturing or deploying it. Any modification to our PIC and to our DTN System entails similar development risks. At any given time, various enhancements to our DTN System are in the development phase and are not yet ready for commercial manufacturing or deployment. The maturing process from laboratory prototype to customer trials, and subsequently to general availability, involves a number of steps, including:

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

establishment of systems integration and systems test validation requirements.

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

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

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

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

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

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

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

In 2007, subsequent to the initial filing of the registration statement, of which this prospectus is a part, our management identified a material weakness related to non-routine manual accounting and reporting processes. Management s review of these transactions and disclosures were not sufficient to

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

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

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

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

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

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

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

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

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

Because the purchase of our equipment involves substantial cost, most of our customers wait to purchase our equipment until they are ready to deploy it in their network. As a result, it is difficult for us to accurately predict the timing of future purchases by our customers. In addition, product purchases are frequently subject to budget constraints, multiple approvals and unplanned administrative, processing and other delays. If sales expected from customers for a particular quarter are not realized in that quarter or at all, our revenue will be negatively impacted.

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

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

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

- greater difficulty in collecting accounts receivable and longer collection periods;

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

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

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

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

Our future success will depend on our ability to have sufficient volumes of our DTN System manufactured in a cost-effective and quality-controlled manner. We have engaged third parties to manufacture certain elements of our DTN System. There are a number of risks associated with our dependence on contract manufacturers, including:

- reduced control over delivery schedules;
- reliance on the quality assurance procedures of third parties;

- potential uncertainty regarding manufacturing yields and costs;
- potential lack of adequate capacity during periods of excess demand;
- limited warranties on components supplied to us;
- potential misappropriation of our intellectual property; and
- potential manufacturing disruptions.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Acquisitions also involve numerous risks, including:

- problems integrating the acquired operations, technologies or products with our own;
- diversion of management s attention from our core business;
- assumption of unknown liabilities;
- adverse effects on existing business relationships with suppliers and customers;
- increased accounting compliance risk;
- risks associated with entering new markets; and
- potential loss of key employees.

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

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

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

Risks Related to this Offering and Ownership of Our Common Stock

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

The trading prices of the securities of technology companies have been highly volatile. Further, our common stock has no prior trading history. Factors affecting the trading price of our common stock will include:

- variations in our operating results;
- announcements of technological innovations, new services or service enhancements, strategic alliances or agreements by us or by our competitors;
- the gain or loss of customers;

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- recruitment or departure of key personnel;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- market conditions in our industry, the industries of our customers and the economy as a whole; and
- adoption or modification of regulations, policies, procedures or programs applicable to our business.

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

Our securities have no prior market and our stock price may decline after the offering.

Prior to this offering, there has been no public market for shares of our common stock. Although we have applied to have our common stock quoted on the NASDAQ Global Market, an active public trading market for our common stock may not develop or, if it develops, may not be maintained after this offering. Our company and the representatives of the underwriters will negotiate to determine the initial public offering price. The initial public offering price may be higher than the trading price of our common stock following this offering. As a result, you could lose all or part of your investment.

Future sales of shares by existing stockholders could cause our stock price to decline.

If our existing stockholders sell, or indicate an intention to sell, substantial amounts of our common stock in the public market after the 180-day contractual lock-up, which period may be extended in certain limited circumstances, and other legal restrictions on resale discussed in this prospectus lapse, the trading price of our common stock could decline below the initial public offering price. Based on shares outstanding as of December 31, 2006, upon completion of this offering, we will have outstanding shares of common stock, assuming no exercise of the underwriters over-allotment option. Of these shares, only the shares of common stock sold in this offering will be freely tradable, without restriction, in the public market. The managing underwriters may, in their sole discretion, permit our officers, directors, employees and current stockholders who are subject to the contractual lock-up to sell shares prior to the expiration of the lock-up agreements.

After the lock-up agreements pertaining to this offering expire 180 days from the date of this prospectus, which period may be extended in certain limited circumstances, up to an additional 64,441,825 shares will be eligible for sale in the public market, 29,943,715 of which are held by directors, executive officers and other affiliates and will be subject to volume limitations under Rule 144 under the Securities Act of 1933, as amended, or the Securities Act, and various vesting agreements. In addition, as of December 31, 2006, the 1,332,682 shares subject to outstanding warrants, the 7,872,264 shares that are subject to outstanding options and the 2,070,474 shares reserved for future issuance under our 2000 Stock Plan, and the 13,600,000 shares of common stock to be reserved for issuance under our 2007 Equity Incentive Plan and 1,812,500 shares of common stock to be reserved for issuance under our 2007 Employee Stock Purchase Plan upon the effective date of this offering, will become eligible for sale in the public market to the extent permitted by the provisions of various

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vesting agreements, the lock-up agreements and Rules 144 and 701 under the Securities Act. If these additional shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline.

Some of our existing stockholders have contractual demand or piggyback rights to require us to register with the SEC up to 62,427,604 shares of our common stock. If we register these shares of common stock, the stockholders would be able to sell those shares freely in the public market. All of these shares are subject to lock-up agreements restricting their sale for 180 days after the date of this prospectus, which period may be extended in certain limited circumstances.

After this offering, we intend to register approximately 25,355,238 shares of our common stock that we have issued or may issue under our equity plans. Once we register these shares, they can be freely sold in the public market upon issuance, subject to the lock-up agreements, if applicable, described above.

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

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. We do not currently have and may never obtain research coverage by securities and industry analysts. If no or few securities or industry analysts commence coverage of our company, the trading price for our stock would be negatively impacted. In the event we obtain securities or industry analyst coverage, if one or more of the analysts who covers us downgrades our stock or publishes misleading or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price or trading volume to decline.

Insiders will continue to have substantial control over us after this offering, which may limit our stockholders ability to influence corporate matters and delay or prevent a third party from acquiring control over us.

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

As a new investor, you will experience substantial dilution as a result of this offering and future equity issuances.

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

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of common stock. In addition, if the underwriters exercise their over-allotment option, if outstanding warrants to purchase our common stock are exercised, or if we issue additional equity securities, you will experience additional dilution.

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

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

- authorize the issuance of blank check convertible preferred stock that could be issued by our board of directors to thwart a takeover attempt;
- establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;
- require that directors only be removed from office for cause and only upon a supermajority stockholder vote;
- provide that vacancies on the board of directors, including newly-created directorships, may be filled only by a majority vote of directors then in office rather than by stockholders;
- prevent stockholders from calling special meetings; and
- prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders.

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

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

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FORWARD-LOOKING STATEMENTS

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

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

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

All forward-looking statements involve risks, assumptions and uncertainties. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, operating results, business strategy, short-term and long-term business operations and objectives, and financial needs.

The occurrence of the events described, and the achievement of the expected results, depend on many events, some or all of which are not predictable or within our control. Actual results may differ materially from expected results. See the section titled Risk Factors and elsewhere in this prospectus for a more complete discussion of these risks, assumptions and uncertainties and for other risks and uncertainties. These risks, assumptions and uncertainties are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors also could harm our results. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this prospectus might not occur. We undertake no obligation, and specifically decline any obligation, to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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USE OF PROCEEDS

We estimate that our net proceeds from the sale of the common stock that we are offering will be approximately $, assuming an initial public offering price of $ per share, which is the midpoint of the range listed on the cover page of this prospectus, and after deducting the estimated underwriting discount and estimated offering expenses payable by us. If the underwriters over-allotment option to purchase additional shares in this offering is exercised in full we estimate that our net proceeds will be approximately $.

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

In addition, we may choose to repay our credit facilities, including:

- up to $6.2 million outstanding as of December 31, 2006 under our credit facility with Silicon Valley Bank and Gold Hill Ventures Lending 03, L.P. dated December 29, 2004 that has a maturity date of June 1, 2008 and had a weighted-average interest rate of 16.7% in 2006;

- up to $9.5 million outstanding as of December 31, 2006 under our credit facility with Silicon Valley Bank dated December 29, 2004 that has a maturity date of September 27, 2007 and had a weighted-average interest rate of 10.1% in 2006; and

- up to $7.8 million outstanding as of December 31, 2006 under our credit facility with United Commercial Bank dated June 21, 2005 that has a maturity date of October 31, 2009 and had an interest rate of 8.3% in 2006.

However, we do not have agreements or commitments for any specific repayments related to these credit facilities at this time.

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

DIVIDEND POLICY

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

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CAPITALIZATION

The following table presents our cash, cash equivalents and short-term investments and capitalization as of December 31, 2006:

- on an actual basis;
- on a pro forma basis after giving effect to (i) the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of the offering and (ii) the reclassification of the preferred stock warrant liability to common stock immediately prior to the closing of this offering; and
- on a pro forma as adjusted basis reflecting (i) the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of this offering and the reclassification of the convertible preferred stock warrant liabilities to common stock and additional paid-in-capital and (ii) the receipt of the estimated net proceeds from the sale of shares of common stock offered by us at an assumed initial public offering price of $ per share, which is the midpoint of the range listed on the cover page of this prospectus, and after deducting the estimated underwriting discount and estimated offering expenses and the filing of our amended and restated certificate of incorporation immediately prior to the closing of this offering.

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

	As of December 31, 2006		
	Actual (Restated)	Pro Forma (Restated)	Pro Forma As Adjusted
		(In thousands)	
Cash, cash equivalents and short-term investments	$ 29,572	$ 29,572	
Preferred stock warrant liability	$ 5,409	$	$
Current and long-term debt	28,382	28,382	
Convertible preferred stock, $0.001 par value: 62,000 authorized and issuable in series, 58,806 shares issued and outstanding, actual; no shares authorized, no shares issued and outstanding, pro forma; no shares authorized, no shares issued and outstanding, pro forma as adjusted	320,550		
Stockholders equity (deficit):			
Convertible preferred stock, $0.001 par value: no shares authorized, issued and outstanding, actual; 25,000 shares authorized, no shares issued and outstanding, pro forma; 25,000 shares authorized, no shares issued and outstanding, pro forma as adjusted			
Common stock, $0.001 par value: 79,500 shares authorized, 9,054 shares issued and outstanding actual; 79,500 shares authorized; 68,481 shares issued and outstanding pro forma; 79,500 shares authorized, 68,481 shares issued and outstanding pro forma as adjusted	9	68	
Additional paid-in capital	7,911	333,811	
Accumulated other comprehensive loss	(153)	(153)	
Accumulated deficit	(314,088)	(314,088)	
Total stockholders equity (deficit)	(306,321)	19,638	
Total capitalization	$ 48,020	$ 48,020	$

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All share numbers reflect a 1-for-4 reverse stock split of our common stock and convertible preferred stock to be effected prior to the closing of this offering.

This table excludes the following shares:

- 7,872,264 shares of common stock issuable upon exercise of stock options outstanding as of December 31, 2006 at a weighted average exercise price of $1.77 per share;

- 1,332,682 shares of common stock issuable upon the exercise of warrants outstanding as of December 31, 2006 at a weighted average exercise price of $5.41 per share; and

- 17,482,974 shares of common stock reserved for future issuance under our stock-based compensation plans, consisting of 2,070,474 shares of common stock reserved for issuance under our 2000 Stock Plan, 13,600,000 shares of common stock reserved for issuance under our 2007 Equity Incentive Plan and 1,812,500 shares of common stock reserved for issuance under our 2007 Employee Stock Purchase Plan. The 2007 Equity Incentive Plan and the 2007 Employee Stock Purchase Plan will become effective on the date of this offering.

This table includes the following shares:

- 1,513,043 shares of restricted common stock issued upon the early exercise of stock options at a weighted average exercise price of $1.26 per share that are classified as outstanding for financial reporting purposes, except in the calculation of earnings per share.

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

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DILUTION

Our pro forma net tangible book value as of December 31, 2006 was $19.6 million, or approximately $0.29 per share. Net tangible book value per share represents the amount of stockholders equity divided by 68,481,069 shares of common stock outstanding after giving effect to the conversion of all outstanding shares of convertible preferred stock into shares of common stock upon the closing of this offering.

Net tangible book value dilution per share to new investors represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the net tangible book value per share of common stock immediately after the closing of this offering. After giving effect to our sale of shares of common stock in this offering at an assumed initial public offering price of $ per share, which is the midpoint of the range on the cover of the prospectus, and after deducting the estimated underwriting discount and estimated offering expenses, our net tangible book value as of December 31, 2006 would have been $ million, or $ per share. This represents an immediate increase in net tangible book value of $ per share to existing stockholders and an immediate dilution in net tangible book value of $ per share to purchasers of common stock in the offering, as illustrated in the following table:

Assumed initial public offering price per share		$
Pro forma net tangible book value per share as of December 31, 2006	$ 0.29	
Increase in pro forma as adjusted net tangible book value per share attributable to new investors		
Pro forma as adjusted net tangible book value per share after the offering		
Dilution per share to new investors		$

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

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

If all of our outstanding stock options and warrants were exercised and the underwriters exercise their option to purchase additional shares of our common stock in full in this offering, the pro forma as adjusted net tangible book value per share after the offering would be $ per share, the decrease in pro forma net tangible book value per share to existing stockholders would be $ per share and the dilution to new investors purchasing shares in this offering would be $ per share.

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The following table presents on a pro forma basis as of December 31, 2006, after giving effect to the conversion of all outstanding shares of convertible preferred stock into common stock immediately prior to the closing of this offering, the differences between the existing stockholders and the purchasers of shares in the offering with respect to the number of shares purchased from us, the total consideration paid and the average price paid per share:

	Shares Purchased		Total Consideration		Average Price Per
	Number	Percent	Amount	Percent	Share
	(in thousands, except percentages and per share data)				
Existing stockholders	68,481	%	$	%	$
New stockholders					
Totals		100.0%		100.0%	

As of December 31, 2006, there were options outstanding to purchase a total of 7,872,264 shares of common stock at a weighted average exercise price of $1.77 per share. As of December 31, 2006 there were warrants outstanding to purchase 1,332,682 shares of common stock with a weighted average exercise price of $5.41 per share. The above discussion and table assumes no exercise of stock options or warrants outstanding as of December 31, 2006. If all of these options and warrants were exercised, our existing stockholders, including the holders of these options and warrants, would own % of the total number of shares of our common stock outstanding upon the closing of this offering and our new investors would own % of the total number of shares of our common stock upon the closing of this offering.

As of December 31, 2006, there were 1,513,043 shares of restricted common stock issued upon the early exercise of stock options at a weighted average exercise price of $1.26 per share that are classified as outstanding for financial reporting purposes, except in the calculation of net loss per common share. For a description of our equity plans, please see the section titled Management Equity Benefit Plans.

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SELECTED CONSOLIDATED FINANCIAL DATA

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

We derived the statements of operations data for the years ended December 31, 2004, 2005 and 2006 and the balance sheet data as of December 31, 2005 and 2006 from our audited consolidated financial statements and related notes, which are included elsewhere in this prospectus. We derived the statements of operations and cash flow data for the years ended December 31, 2002 and 2003 and the balance sheet data as of December 31, 2002, 2003 and 2004 from our audited consolidated financial statements and related notes which are not included in this prospectus. Historical results for any prior period are not necessarily indicative of future results for any period.

The pro forma basic and diluted net loss per common share data in the statement of operations data for the year ended December 31, 2006 reflect the conversion of all of our outstanding shares of convertible preferred stock into 59,427,604 shares of common stock immediately prior to the closing of this offering.

	Years Ended December 31,				
	2002	2003	2004	2005 (Restated)	2006 (Restated)
	(In thousands, except per share data)				
Statements of Operations Data:					
Revenue:					
Ratable product and related support and services	$	$	$	$ 4,127	$ 52,978
Product			599		5,258
Total revenue			599	4,127	58,236
Cost of revenue:					
Cost of ratable product and related support and services				27,455	69,765
Cost of product			7,240		1,660
Total cost of revenue			7,240	27,455	71,425
Gross loss			(6,641)	(23,328)	(13,189)
Operating expenses:					
Sales and marketing	895	1,680	8,294	11,053	20,682
Research and development	26,759	41,951	46,306	24,986	38,967
General and administrative	4,938	4,587	2,888	4,328	12,650
Amortization of intangible assets					56
Total operating expenses	32,592	48,218	57,488	40,367	72,355
Loss from operations	(32,592)	(48,218)	(64,129)	(63,695)	(85,544)
Other income (expense), net	(1,470)	(2,013)	(2,351)	(2,256)	(4,319)
Loss before provision for income taxes and cumulative effect of change in accounting principle	(34,062)	(50,231)	(66,480)	(65,951)	(89,863)
Provision for income taxes				12	72
Loss before cumulative effect of change in accounting principle	(34,062)	(50,231)	(66,480)	(65,963)	(89,935)

Cumulative effect of change in accounting principle				(1,137)	
Net loss	$ (34,062)	$ (50,231)	$ (66,480)	$ (64,826)	$ (89,935)
Net loss per common share, basic and diluted (restated)	$ (21.27)	$ (19.61)	$ (17.94)	$ (14.08)	$ (14.90)
Weighted average number of shares used in computing basic and diluted net loss per common share (restated)	1,602	2,561	3,705	4,605	6,036
Pro forma net loss per common share, basic and diluted (unaudited)					$ (1.49)
Weighted average number of shares used in computing pro forma basic and diluted net loss per common share (restated) (unaudited)					60,389

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

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

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Management determined, subsequent to their issuance, that our financial statements for 2005 and 2006 should be restated to reduce revenue by $0.5 million for 2006 and increase interest expense by $0.2 million and $0.3 million for 2005 and 2006, respectively. This resulted in an understatement of our net loss by $0.2 million and $0.8 million for 2005 and 2006, respectively. Short-term deferred revenue was understated by $0.5 million as of December 31, 2006, other non-current assets was understated by $0.6 million and $0.3 million as of December 31, 2005 and 2006, respectively, and long-term debt was understated by $0.8 million as of December 31, 2005 and 2006, respectively. Net loss per share was understated by $0.04 and $0.14 per diluted share for 2005 and 2006, respectively. Pro forma net loss per share was understated by $0.02 per diluted share for 2006. In addition, management determined that our financial statements for 2002, 2003, 2004, 2005 and 2006 should be restated to correct the net loss per common share number for each period. This resulted in an understatement of the reported net loss per common share of $4.22 in 2002, $3.51 in 2003, $2.64 in 2004, $0.28 in 2005 and $0.22 in 2006.

This restatement is further described in Note 1 of Notes to Consolidated Financial Statements included elsewhere in this prospectus. The accompanying management s discussion and analysis of financial condition and results of operations gives effect to the restatement.

Overview

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

We began commercial shipment of our DTN System in November 2004. As of March 31, 2007, we had sold our DTN System for deployment in the optical networks of 28 customers worldwide. Our goal is to be a leading provider of optical communications systems to communications service providers. Our revenue growth will depend on the continued acceptance of our DTN System, growth of communications traffic and the proliferation of next-generation bandwidth-intensive services, which are expected to drive the need for increased levels of bandwidth. Our ability to increase revenue and achieve profitability will be directly affected by the level of acceptance of our products in the long-haul and metro markets and by our ability cost-effectively to develop and sell innovative products that leverage our technology advantage.

Since our inception, we have incurred significant losses, and as of December 31, 2006 we had an accumulated deficit of $314.1 million. We have not achieved profitability on a quarterly or annual basis, and we expect to continue to incur substantial losses. Our ability to become profitable will be affected

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by any additional expenses that we incur to expand our manufacturing capacity, sales, marketing, development and general and administrative capabilities in order to grow our business. The largest component of our expenses is personnel costs. Personnel costs consist of salaries, benefits and incentive compensation for our employees, including commissions for sales personnel and stock-based compensation for all employees. We expect that after this offering we will incur additional accounting and legal costs related to compliance with securities laws and other regulations, These costs include, but are not limited to, costs associated with compliance with the Sarbanes-Oxley Act of approximately $2.5 million and investor relations and additional insurance costs of approximately $1.5 million.

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

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

Overview of Consolidated Financial Data

Revenue

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

The following table illustrates our revenue for the specified periods:

Revenue	For The Three Months Ended 2005 Mar. 31	Jun. 30	Sept. 30	Dec. 31	Year Ended December 31, 2005	For the Three Months Ended 2006 Mar. 31	Jun. 30	Sept. 30	Dec. 31 (Restated)	Year Ended December 31, 2006 (Restated)
(In thousands)		**(Unaudited)**					**(Unaudited)**			
Ratable revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 6,118	$ 40,153	$ 52,978
Product revenue								1,578	3,680	5,258
Total revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 7,696	$ 43,833	$ 58,236

Ratable Revenue. Substantially all of our sales arrangements consist of product sales bundled with training and product support. Product support services consist of software warranty, updates and unspecified upgrades and product support. To date, we have not established vendor specific objective evidence, or VSOE, of fair value for training and software warranty or product support services. All revenue for these bundled products is deferred and recognized ratably over the longest undelivered service period. In order to establish VSOE, we must have a history of selling our training and product support services separately at a consistent price. Once we have a sufficiently consistent transactional history to establish VSOE for training, software warranty and product support services, we will be able to

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recognize revenue up front for new customer orders once all of the following have occurred: (1) we have entered into a legally binding arrangement with a customer; (2) delivery and acceptance have occurred, which is when product title and risk of loss has transferred to the customer; (3) customer payment is deemed fixed or determinable; and (4) collectibility is reasonably assured. Revenue for then existing customer orders will continue to be recognized over the applicable revenue recognition period.

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

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

The ratable revenue that is recognized in each quarter includes a ratable portion recognized from deferred revenue of prior invoiced shipments of bundled products together with a ratable portion of each new invoiced shipment of bundled products in that quarter. Invoiced shipments of bundled products represent sales of our DTN System and services delivered and accepted by the customer for which payment will be made in accordance with normal payment terms, but for which VSOE has not been established. Shipments of bundled products are invoiced when all products ordered on a purchase order have been shipped and the relevant customer acceptance criteria have been satisfied. Customer acceptance periods averaged 18.8 days in the fourth quarter of 2006. Invoiced shipments of bundled products are amortized and recognized as revenue over the longest undelivered service period in each customer contract.

Product Revenue. A small portion of our sales arrangements do not require significant customization and the software content is considered incidental to the product. Such product revenue is recognized upon shipment in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*, or SAB 104.

Deferred Revenue

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

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

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

In 2005, we recorded $27.3 million of invoiced shipments of bundled products, recognized $4.1 million of revenue and added $23.2 million to the deferred revenue balance. In 2006, we recorded $140.7 million of invoiced shipments of bundled products, recognized $53.0 million of revenue and added $87.8 million to the deferred revenue balance.

When a contract amendment shortens the service obligation period for a customer, all invoiced shipments of bundled products that have not previously been fully recognized for such customer are amortized over this shorter period resulting in increased recognition of revenue beginning on the amendment date. Of the $53.0 million of ratable revenue recognized in 2006, $40.2 million was recognized in the fourth quarter reflecting a combination of increased invoiced shipments of bundled products and the shortening of the contractual service obligation period described above.

Cost of Revenue

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

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

Cost of Revenue	For The Three Months Ended 2005				Year Ended December 31, 2005	For The Three Months Ended 2006				Year Ended December 31, 2006
	Mar. 31	Jun. 30	Sept. 30	Dec. 31		Mar. 31	Jun. 30	Sept. 30	Dec. 31	
(In thousands)	(Unaudited)					(Unaudited)				
Cost of ratable revenue	$ 2,380	$ 8,470	$ 8,696	$ 7,909	$ 27,455	$ 9,810	$ 8,145	$ 12,139	$ 39,671	$ 69,765
Cost of product revenue								311	1,349	1,660
Total cost of revenue	$ 2,380	$ 8,470	$ 8,696	$ 7,909	$ 27,455	$ 9,810	$ 8,145	$ 12,450	$ 41,020	$ 71,425

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

Certain manufacturing costs are recognized in the period in which they are incurred or can be estimated, including period costs and losses associated with products which are sold or anticipated to be sold at a loss. The initial deployment of our DTN System at a customer involves the installation of common equipment, including a chassis, optical line amplifiers and related equipment. This common equipment is typically sold at low or negative gross margins. When we sell equipment at a loss, the

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losses are recognized in the period in which they are incurred or reasonably estimatable. We refer to this loss as a lower of cost or market adjustment, or LCM adjustment. In the years ended December 31, 2005 and 2006, our LCM adjustment was $9.7 million and $21.6 million, respectively, and was recorded as part of cost of ratable revenue. The remainder of our cost of ratable revenue is recorded as deferred costs of invoiced shipments of bundled products and is recognized in the same period as the corresponding revenue.

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

Deferred Inventory Cost

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

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

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

Gross Margin

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

Our common equipment is typically sold at low margins or at a loss. Customers generally purchase additional common equipment to expand the reach of the DTN System and can increase the capacity of existing common equipment for the DTN System by purchasing our DLMs, TAMs or TOMs, that are typically sold at higher gross margins. These higher margin sales positively impact overall gross margin over the ratable revenue recognition period.

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

	For The Three Months Ended 2005				Year Ended December 31,	For The Three Months Ended 2006				Year Ended December 31,
Gross Margin	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2005**	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**2006**

(In thousands)	(Unaudited)						(Unaudited)		(Restated)	(Restated)
Total revenue	$ 421	$ 603	$ 1,126	$ 1,977	$ 4,127	$ 2,653	$ 4,054	$ 7,696	$ 43,833	$ 58,236
Cost of revenue	2,380	8,470	8,696	7,909	27,455	9,810	8,145	12,450	41,020	71,425
Gross profit (loss)	$ (1,959)	$ (7,867)	$ (7,570)	$ (5,932)	$ (23,328)	$ (7,157)	$ (4,091)	$ (4,754)	$ 2,813	$ (13,189)
Gross margin	-465%	-1,305%	-672%	-300%	-565%	-270%	-101%	-62%	6%	-23%

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

The contractual prices paid for our DTN System vary by customer. In addition, the quantity of DTN Systems purchased by each of our customers varies from quarter-to-quarter depending on our customers needs for optical transport equipment. To the extent that a customer with lower contractual prices purchases significant quantities of our DTN System that comprise a significant portion of the DTN Systems we sell within a quarter, our gross margin for such quarter and, to a lesser extent, the next three quarters if we continue to recognize revenue ratably over approximately a 1 year period, would be lower. In addition, substituting a new customer with a higher requirement for common equipment could result in an increased inventory write-down in a given quarter, which can have a significant impact on our gross margin in that quarter.

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

The table below, which only represents a portion of our results for the projected periods presented and may not be indicative of our future results, shows the expected future impact of the recognition of these deferred amounts on our Consolidated Statement of Operations:

	Deferred Balance as of December 31, 2006	For The Three Months Ended 2007 Mar. 31	Jun. 30	Sept. 30	Dec. 31	For The Year Ended December 31, 2007	Future Periods
Revenue	$ 110,953	$ 38,114	$ 31,484	$ 24,006	$ 9,516	$ 103,120	$ 7,833
Cost of Inventory	$ 67,253	$ 23,284	$ 20,004	$ 14,907	$ 5,758	$ 63,953	$ 3,300
Gross Profit	$ 43,700	$ 14,830	$ 11,480	$ 9,099	$ 3,758	$ 39,167	$ 4,533
Operating and Net Income	$ 43,700	$ 14,830	$ 11,480	$ 9,099	$ 3,758	$ 39,167	$ 4,533

The projected gross profit for the periods directly impact our operating and net income because there are no corresponding deferred operating costs.

Operating Expenses

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

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

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

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

Other Income (expense), net

Other income (expense), net includes interest expense on short- and long-term debt, interest income on our cash balances, and losses or gains on conversion of foreign currency transactions into U.S. dollars. In 2005 and 2006, other income (expense), net, also included an adjustment to record our convertible preferred stock warrants at fair value as required by Staff Position 150-5, *Issuer s Accounting under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable*, or FSP 150-5, as described below.

Critical Accounting Policies and Estimates

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

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

Revenue Recognition

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

Substantially all of our product sales have been sold in combination with training and product support services, which consist of software warranty and updates, and product support.

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

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

Contracts and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery and transfer of title. Revenue is recognized only when title and risk of loss passes to customers. In instances where acceptance of the product is specified by the customer, revenue is deferred until all acceptance criteria have been met. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. Payment terms to customers generally range from net 30 to 90 days from invoice. In the event payment terms are provided that differ from our standard business practices, the fees are deemed to not be fixed or determinable and, therefore, revenue is deferred until the fees become fixed or determinable, which we believe is when they are legally due and payable. We assess the ability to collect from our customers based primarily on the creditworthiness of the customer and past payment history of the customer.

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

Shipping charges billed to customers are included in product revenue and in ratable revenue. The related shipping costs are included in cost of product sales and cost of ratable revenue in our statements of operations.

Stock-Based Compensation

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

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During the period from January 1, 2006 through the date of filing this registration statement, we granted stock options with exercise prices as follows:

Stock Award Grant Dates	Number of Options Granted	Exercise Price Per Share	Valuation Prior to Grant Date	SFAS 123(R) Black-Scholes Option Fair Value
February 27, 2006	118,322	$ 1.32	$ 1.04	$0.80 - $0.92
April 5, 2006	128,311	1.32	1.04	0.80 - 0.92
August 8, 2006	3,229,735	2.00	2.00	1.16 - 1.36
August 29, 2006	193,750	2.00	2.00	1.16 - 1.36
September 7, 2006	999,766	2.00	2.00	1.16 - 1.36
January 3, 2007	224,999	4.04	4.04	2.29 - 2.68
January 4, 2007	683,287	4.04	4.04	2.29 - 2.68
February 7, 2007	75,000	7.68	7.68	4.35
February 12, 2007	103,075	7.68	7.68	4.35

We have increased the estimated fair value of our common stock from January 1, 2006 through the date of the filing of this registration statement based on, among other factors, contemporaneous valuations performed by our independent valuation specialists. If the Internal Revenue Service determines that certain of our stock options were granted at below the fair value of our common stock on the date of grant, the recipients of those stock option grants could be subject to an additional deferred compensation tax under Internal Revenue Code Section 409A and we could be liable for withholding obligations.

In the absence of a public trading market, our board of directors obtained contemporaneous valuations performed by independent valuation specialists in order to help the board determine the value of our common stock. The valuations performed by these independent valuation specialists utilized the enterprise value allocation method. As part of this enterprise value allocation method, the value of our common stock was measured on a per share basis utilizing a probability weighted scenario analysis. The common stock per share value was based on the probability weighted average of two possible future liquidity scenarios: (1) a scenario where an IPO is not completed, or a no IPO liquidity scenario, and (2) a scenario where an IPO is completed, or an IPO liquidity scenario.

In the no IPO liquidity scenario, the common stock per share value is based on the Black-Scholes option-pricing model and represents the current nominal value of the common stock plus its option value for potential future increases in our value until a liquidity event. The methodology used allocated the estimated aggregate value to each security. A value was first assigned to each series of convertible preferred stock and then the remaining equity securities were analyzed and the remaining enterprise value was apportioned to the remaining equity securities. The rights, preferences and privileges of each security were considered, including the liquidation and conversion rights, and the manner in which the value of each security affects the other securities.

In the no IPO liquidity scenario, a large proportion of our enterprise value is apportioned to our convertible preferred stock because the aggregate liquidation preference is approximately $325.2 million and each series of our convertible preferred stock participates with the common stock up to certain caps after the payment of the aggregate liquidation preference.

In the IPO liquidity scenario, options and warrants are valued based solely on the Black-Scholes option-pricing model. The aggregate value related to options and warrants are subtracted from the aggregate equity value for purposes of determining the convertible preferred stock and common stock values on an as-if converted, per share basis. After accounting for the value of the options and warrants, the remaining enterprise value is apportioned equally among the shares of common stock and each series of convertible preferred stock, which causes our common stock to have a higher relative value per share than under the no IPO liquidity scenario.

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Our board of directors also considered a number of factors, in addition to the valuations, to determine the estimated fair value of our common stock at each grant date, including:

- the shares of common stock underlying the options were and are illiquid securities in a private company that were not readily tradable at the time of grant and that there could be no assurance of such shares ever being readily tradable;
- the prices at which convertible preferred stock was issued and sold to outside investors in arm s-length transactions, and the rights, preferences and privileges of the convertible preferred stock relative to the common stock;
- important developments relating to achievement of our business objectives, including new product launches, customer wins and growth in our revenue and invoiced shipments;
- our stage of development and business strategy;
- the status of our efforts to build our management team;
- the status of our efforts to increase revenue and invoiced shipments while reducing losses, as well as our financial results;
- the likelihood of achieving a liquidity event for the shares of our common stock, such as an initial public offering or sale of the company, given prevailing market conditions and achievement of our business objectives;
- the state of the new issue market for similarly-situated technology companies; and
- the market prices of publicly-held technology companies with similar business models.

Our board of directors also considered the provisions of our Series A through G convertible preferred stock in determining the estimated fair value of our common stock at the time of each option grant, including the aggregate liquidation preference of the Series A through G convertible preferred stock of $325.2 million and the fact that in a sale of Infinera the Series A through G convertible preferred stock would participate with the common stock up to certain caps after the payment of the aggregate liquidation preference. As we approach our initial public offering, the per share value of our common stock moves closer to our enterprise value per share because the likelihood of a sale of Infinera where our convertible preferred stock receives a larger proportion of our enterprise value decreases.

The anticipated timing of a potential liquidity event, the estimated volatility, the discount rate, the discount for lack of marketability and the probability that we are able to complete an initial public offering of our common stock used by the independent valuation specialists in the determination of the common stock value per share are as set forth below for each of our valuation dates since December 31, 2005:

	Dec. 31, 2005(1)	June 30, 2006	Nov. 30, 2006	Jan. 15, 2007
Common Stock Value Per Share	$ 1.04(2)	$ 2.00	$ 4.04	$ 7.68

Time to Liquidity (in years)	N/A	1.4	1.0	0.5
Volatility	N/A	65%	60%	55%
DCF Discount Rate	18-20%	30%	25%	20%
Marketability Discount Rate	30%	25%	15%	5%
Probability of an IPO	N/A	15%	25%	75%

(1) The December 31, 2005 valuation was performed by a different valuation specialist than for the later valuations.

(2) For options granted in February and April 2006, our board of directors determined the fair value of our common stock to be $1.32 per share.

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As can be seen in the table above, the increase in the valuation of our common stock from December 2005 to January 2007 can be attributed to declines in the anticipated time to liquidity, the volatility rate, the discount rate and the marketability discount rate and an increase in the probability that we are able to complete an initial public offering of our common stock. The most significant driver of the increase in the fair value of our common stock from the stock option grants we made on January 3 and 4, 2007 to the grants we made on February 7 and 12, 2007 was the increase in the probability that we are able to complete an initial public offering of our common stock. The probability of an IPO increased significantly as our 2006 financial statement audit neared completion and as we prepared to file our initial registration statement on Form S-1 on February 26, 2007.

During 2006, we granted options to employees to purchase a total of 4,669,884 shares of common stock at exercise prices ranging from $1.32 to $2.00 per share. In 2007, we granted 1,086,361 shares of common stock at exercise prices ranging from $4.04 to $7.68.

Based upon an assumed initial public offering price of $ per share, which is the midpoint of the price range listed on the cover page of the prospectus, the aggregate intrinsic value of outstanding options vested and expected to vest as of December 31, 2006 was $, of which $ related to vested options and $ related to options expected to vest.

	As of December 31, 2006 (in thousands)	**Weighted Average Price**	**Assumed IPO Price**	**Excess of IPO Price**	**Aggregate Intrinsic Value of Options Expected to Vest (in thousands)**
Vested	2,466	$ 1.69	$	$	$
Expected to vest	5,028	1.81			$
Total vested & expected to vest	7,494				$
Not expected to vest	378				
	7,872				

On January 1, 2006, we adopted the provisions of the Financial Accounting Standards Board, or FASB, SFAS 123(R), *Share-Based Payments*, or SFAS 123(R). Under SFAS 123(R), stock-based compensation costs for employees is measured at the grant date, based on the estimated fair value of the award at that date, and is recognized as expense over the employee s requisite service period, which is generally over the vesting period, on a straight-line basis. We adopted the provisions of SFAS 123(R) using the prospective transition method. Under this transition method, non-vested option awards outstanding at January 1, 2006, continue to be accounted for under the minimum value method as stipulated by SFAS 123(R). All awards granted, modified or settled after the date of adoption are accounted for using the measurement, recognition and attribution provisions of SFAS 123(R).

We make a number of estimates and assumptions related to SFAS 123(R). The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as an adjustment in the period estimates are revised. Actual results may differ substantially from these estimates. In valuing share-based awards under SFAS 123(R), significant judgment is required in determining the expected volatility of our common stock and the expected term individuals will hold their share-based awards prior to exercising. Expected volatility of the stock is based on our peer group in the industry in which we do business because we do not have sufficient historical volatility data for our own stock. The expected term of options granted represents the period of time that options granted are expected to be outstanding and was calculated based on historical information. In the future, as we gain historical data for volatility in our own stock and more data on the actual term employees hold our options, expected volatility and expected term may change which could substantially change the grant-date fair value of future awards of stock options and ultimately the expense we record.

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The following table summarizes the effects of stock-based compensation for 2004, 2005 and 2006:

	Years Ended December 31,		
	2004	2005	2006
Cost of revenue	$	$	$ 151
Sales and marketing		36	198
Research and development	180	99	411
General and administrative	34	7	335
Total stock-based compensation effects in loss before taxes	$ 214	$ 142	$ 1,095

For 2006, the total compensation cost related to stock-based awards granted under SFAS 123(R) to employees and directors but not yet amortized was approximately $5.2 million, net of estimated forfeitures of $0.4 million. These costs will be amortized on a straight-line basis over a weighted-average period of approximately 1.1 years. Amortization for 2006 was approximately $0.9 million, net of estimated forfeitures.

The fair value of each option grant is estimated on the date of grant using the following weighted-average assumptions used for grants in 2004, 2005 and 2006:

	Years Ended December 31,		
	2004	2005	2006
Dividend			
Volatility	0%	0%	72% - 83%
Risk-free interest rate	3.00%	4.05%	4.57% - 5.08%
Weighted-average expected life	4 years	4 years	4.2 - 5.4 years
Weighted-average fair value of common stock	$ 0.15	$ 0.15	$0.81 - $1.35

We account for stock options granted to non-employees in accordance with Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction With Selling, Goods or Services,* or EITF No. 96-18, and related interpretations. We grant stock options to certain consultants and advisory board members for a fixed number of shares with an exercise price equal to the fair value of our common stock at the date of grant. Under EITF No. 96-18, compensation expense on non-employee stock options is calculated using the Black-Scholes option-pricing model and is recorded using the straight-line method over the vesting period, which approximates the service period.

Freestanding Preferred Stock Warrants

On June 29, 2005, the FASB issued FSP 150-5. This Staff Position affirms that such warrants are subject to the requirements in Statement 150, regardless of the timing of the redemption feature or the redemption price. Therefore, under Statement 150, the freestanding warrants that are related to our convertible preferred stock and common stock are liabilities that should be recorded at fair value. We previously accounted for freestanding warrants for the purchase of our convertible preferred stock and common stock under EITF Issue No. 96-18.

Effective July 1, 2005, we adopted FSP 150-5 and reclassified the fair value of the warrants from equity to liability and recorded a cumulative effect charge of approximately $1.1 million income. In addition, we recorded additional charges of approximately $0.2 million to reflect the increase in fair value between July 1, 2005 and December 31, 2005. In 2006, we recorded approximately $2.4 million of charges reflected as other loss, to reflect the increase in fair value between January 1, 2006 and December 31, 2006. The calculation of fair value requires the input of highly subjective assumptions and a change in our assumptions could materially affect the fair value estimates.

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We will continue to adjust the liabilities for changes in fair value until the earlier of the exercise of the warrants or the completion of a liquidation event, including the completion of this initial public offering, at which time the liabilities will be reclassified to stockholders equity (deficit).

We estimated the fair value of these warrants using the Black-Scholes model for change of control scenario and the Lattice model for a successful initial public offering scenario. We then used a probability weighted average of per-share values under the different scenarios to determine the fair value of these warrants at the respective balance sheet dates.

Both models require the input of highly subjective assumptions and a change in our assumptions could materially affect the fair value estimates.

The following table presents the pro forma effect of the adoption of FSP 150-5 on our results of operations for 2004 and 2005, if applied retroactively, assuming FSP 150-5 had been adopted in those years:

	December 31, 2004 (Restated)	December 31, 2005 (Restated)
	(In thousands, except per share data)	
Net loss, as reported	$ (66,480)	$ (64,826)
Add: Cumulative effect of change in accounting principle included in net loss		1,137
Change in fair value of warrants	1,029	(229)
Pro forma net loss	$ (65,451)	$ (66,192)
Pro forma loss per common share, basic and diluted	$ (17.67)	$ (14.37)
Shares used in computing basic and diluted net loss per common share	3,705	4,605

Inventories

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

Inventory that is obsolete or in excess of our forecasted demand or is anticipated to be sold at a loss is written down to its estimated net realizable value based on historical usage and expected demand. We recorded total inventory write-downs for LCM adjustments in 2004, 2005 and 2006 of $1.6 million, $9.7 million and $21.6 million, respectively. These adjustments related to our inventory and firm purchase commitments with suppliers and included the impact of expected losses on common equipment. In addition, we recorded inventory write-downs for excess and obsolete inventory in 2004, 2005 and 2006 of $2.2 million, $(0.7) million and $1.7 million, respectively. These write-downs were reflected as cost of product and cost of ratable product and related support and services.

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

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

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

Results of Operations

Revenue

The following table presents our revenue by type, geography and sales channel for 2004, 2005 and 2006:

	Years ended December 31,		
	2004	2005	2006 (Restated)
		(In thousands)	
Total revenue	$ 599	$ 4,127	$ 58,236
Total revenue by type			
Ratable product and related support and services	$	$ 4,127	$ 52,978
Product	599		5,258
% Revenue by type			
Ratable product and related support and services	0%	100%	91%
Product	100%	0%	9%
Total revenue by geography			
Domestic	$	$ 2,660	$ 49,901
International	599	1,467	8,335
% Revenue by geography			
Domestic	0%	64%	86%
International	100%	36%	14%
Total revenue by sales channel			
Direct	$	$ 3,488	$ 57,304
Indirect	599	639	932
% Revenue by sales channel			
Direct	0%	85%	98%
Indirect	100%	15%	2%

2005 Compared to 2006. Total ratable revenue increased from $4.1 million in 2005 to $53.0 million in 2006. This increase reflected an increase in invoiced shipments of bundled products from $27.3 million in 2005 to $140.7 million in 2006 and the shortening of the ratable revenue recognition period from an average period of 3.7 years in the third quarter of 2006 to 1.3 years in the fourth quarter of 2006. The increase in invoiced shipments of bundled products was due to increased purchases of our DTN System by existing customers and the addition of customers in the United States and Europe.

Although our international revenue grew on an absolute basis from 2005 to 2006, international revenue as a percentage of total revenue declined by 61% from 2005 to 2006 primarily due to a

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significant increase in revenue from an existing U.S. customer and the addition of a number of new U.S. customers during 2006.

In 2006, we recorded $5.3 million of product revenue related to the sale of 10 Gbps cards not for use in our DTN System. We do not expect to generate significant revenues from the sale of these products in the foreseeable future.

2004 Compared to 2005. Total revenue increased from $0.6 million in 2004 to $4.1 million in 2005. This increase was primarily due to the fact that we signed a master purchase agreement with Level 3 in April 2005 and commenced shipments of our DTN System to Level 3 shortly thereafter. In addition, we signed a number of contracts with other customers in the United States and Europe. Revenue in 2004 consisted of one product sale of evaluation equipment to a customer in Asia Pacific. The product was sold without warranty or support services and revenue was recognized upon shipment.

Cost of Revenue and Gross Margin

The following table presents our revenue, cost of revenue by revenue source, gross profit (loss) and gross margin for 2004, 2005 and 2006:

	Years Ended December 31,		
	2004	**2005**	**2006 (Restated)**
		(In thousands)	
Total revenue	$ 599	$ 4,127	$ 58,236
Cost of ratable product and related support and services		27,455	69,765
Cost of product	7,240		1,660
Gross loss	$ (6,641)	$ (23,328)	$ (13,189)
Gross margin	N/M%[1]	-565%	-23%

(1) N/M = Not Meaningful.

2005 Compared to 2006. Gross margins improved from 2005 to 2006 due to increased ratable revenue, increased ASPs and improved product mix as customers purchased higher margin products to increase their network capacity. In addition, in 2006 we experienced reduced per unit manufacturing costs primarily due to improved yields and increased production volume, offset by an increase in LCM adjustments and charges for excess and obsolete inventory of $11.9 million. Gross margins in 2005 were impacted primarily by negative manufacturing variances, comprised of lower yields and lower fixed cost absorption, due to low volume production. To the extent our production volume increases, we expect continued improvement in manufacturing and materials costs per unit.

2004 Compared to 2005. Cost of product revenue in 2004 is comprised of the cost of one evaluation equipment sale, excess and obsolete inventory, inventory reserves and manufacturing costs associated with the ramp up of production. Cost of ratable revenue in 2005 consisted of the amortization of deferred inventory costs and period costs including inventory reserves, LCM adjustments and increased costs related to the roll-out of our service organization.

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Research and Development Expenses

The following table presents our research and development expenses in absolute dollars and as a percent of total revenue for 2004, 2005 and 2006:

	Years Ended December 31,		
	2004	2005	2006