EXTREME NETWORKS INC
Form 10-Q
November 04, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

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Form 10-Q

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(Mark One)

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

For the quarterly period ended September 30, 2013

OR

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

For the transition period from to

Commission file number 000-25711

_____

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

_____

DELAWARE [State or other jurisdiction of incorporation or organization]	77-0430270 [I.R.S Employer Identification No.]
145 Rio Robles, San Jose, California [Address of principal executive office]	95134 [Zip Code]

Registrant's telephone number, including area code: (408) 579-2800

_____

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

The number of shares of the Registrant's Common Stock, $.001 par value, outstanding at October 21, 2013 was 94,472,100.

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CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	September 30, 2013	June 30, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$103,008	$95,803
Short-term investments	96,427	43,034
Accounts receivable, net of allowances of $1,088 at September 30, 2013 and $1,252 at June 30, 2013	39,297	47,642
Inventories	30,389	16,167
Deferred income taxes	408	386
Prepaid expenses and other current assets	11,712	5,749
Total current assets	281,241	208,781
Property and equipment, net	25,807	23,644
Marketable securities	—	66,776
Intangible assets, net	3,957	4,243
Other assets	7,965	7,980
Total assets	$318,970	$311,424
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$28,451	$27,163
Accrued compensation and benefits	12,957	13,503
Restructuring liabilities	572	1,466
Accrued warranty	3,440	3,296
Deferred revenue, net	32,080	33,184
Deferred distributors revenue, net of cost of sales to distributors	18,600	17,388
Other accrued liabilities	15,114	16,502
Total current liabilities	111,214	112,502
Deferred revenue, less current portion	8,156	8,270
Other long-term liabilities	6,582	1,507
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Convertible preferred stock, $.001 par value, issuable in series, 2,000,000 shares authorized; none issued	—	—
Common stock, $.001 par value, 750,000,000 shares authorized; 94,467,468 shares issued and outstanding at September 30, 2013 and 93,626,150 shares issued and outstanding at June 30, 2013	94	94
Additional paid-in-capital	824,705	821,331
Accumulated other comprehensive loss	(843)	(1,377)
Accumulated deficit	(630,938)	(630,903)
Total stockholders' equity	193,018	189,145
Total liabilities and stockholders' equity	$318,970	$311,424

See accompanying notes to condensed consolidated financial statements.

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EXTREME NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended	
	September 30, 2013	September 30, 2012
Net revenues:		
Product	$61,045	$61,119
Service	14,871	15,008
Total net revenues	75,916	76,127
Cost of revenues:		
Product	27,516	30,476
Service	4,693	5,676
Total cost of revenues	32,209	36,152
Gross profit:		
Product	33,529	30,643
Service	10,178	9,332
Total gross profit	43,707	39,975
Operating expenses:		
Research and development	9,937	10,566
Sales and marketing	22,694	22,027
General and administrative	6,934	5,357
Acquisition-related costs	3,695	—
Restructuring charge (credit), net of reversals	75	(10)
Gain on sale of facilities	—	(11,537)
Total operating expenses	43,335	26,403
Operating income	372	13,572
Interest income	275	269
Interest expense	—	(1)
Other expense, net	(255)	(348)
Income before income taxes	392	13,492
Provision for income taxes	427	577
Net (loss) income	$(35)	$12,915
Basic and diluted net income per share:		
Net income per share – basic	$—	$0.14
Net income per share – diluted	$—	$0.14
Shares used in per share calculation – basic	94,062	94,738
Shares used in per share calculation – diluted	94,062	95,499

See accompanying notes to condensed consolidated financial statements.

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EXTREME NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended	
	September 30, 2013	September 30, 2012
Net (loss) income:	$(35)	$12,915
Other comprehensive income, net of tax:		
Available for sale securities:		
Change in unrealized gains (losses) on available for sale securities	433	302
Reclassification of adjustment for realized net gains on available for sale securities included in net income	(148)	—
Net change in unrealized gains (losses) on available for sale securities	285	302
Change in net foreign currency translation adjustment	101	842
Other comprehensive income	386	1,144
Total comprehensive income	$351	$14,059

See accompanying notes to condensed consolidated financial statements.

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EXTREME NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended	
	September 30, 2013	September 30, 2012
Cash flows from operating activities:		
Net (loss) income	$(35)	$ 12,915
Adjustments to reconcile net income to net cash provided by operating activities:		
Decrease in accrued investment income	538	396
Depreciation and amortization	1,437	1,171
Amortization of intangible assets	286	438
Provision for doubtful accounts	(164)	(448)
Deferred income taxes	90	149
Stock-based compensation	1,575	2,168
Gain on disposition of long lived assets, net	—	(11,537)
Unrealized (loss) gain on foreign exchange transactions	(350)	371
Changes in operating assets and liabilities, net		
Accounts receivable	8,510	6,908
Inventories	(14,222)	3,856
Prepaid expenses and other assets	(2,073)	173
Accounts payable	1,288	(7,617)
Accrued compensation and benefits	(545)	(1,844)
Restructuring liabilities	(894)	—
Other current and long term liabilities	6,484	(47)
Net cash provided by operating activities	1,925	7,052
Cash flows from investing activities:		
Capital expenditures	(9,808)	(1,562)
Purchases of investments	—	(7,066)
Proceeds from maturities of investments and marketable securities	13,062	—
Proceeds from sales of facilities	—	42,659
Net cash provided by investing activities	3,254	34,031
Cash flows from financing activities:		
Proceeds from issuance of common stock	1,799	593
Net cash provided by financing activities	1,799	593
Foreign currency effect on cash	227	440
Net increase in cash and cash equivalents	7,205	42,116
Cash and cash equivalents at beginning of period	95,803	54,596
Cash and cash equivalents at end of period	$103,008	$ 96,712

See accompanying notes to the condensed consolidated financial statements.

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EXTREME NETWORKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The unaudited condensed consolidated financial statements of Extreme Networks, Inc. (referred to as the “Company” or “Extreme Networks”) included herein have been prepared under the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted under such rules and regulations. The condensed consolidated balance sheet at June 30, 2013 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2013.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme Networks at September 30, 2013. The results of operations for the three months ended September 30, 2013 are not necessarily indicative of the results that may be expected for fiscal 2014 or any future periods.

2. Summary of Significant Accounting Policies

Revenue Recognition

The Company's revenue is primarily derived from the sale of networking products, which are tangible products containing software and non-software components that function together to deliver the tangible product's essential functionality. In addition to tangible products, the Company's sales arrangements may include other deliverables such as standalone software licenses, or service offerings. For multiple deliverable arrangements, the Company recognizes revenue in accordance with the accounting standard for multiple deliverable revenue arrangements, which provides guidance on whether multiple deliverables exist, how deliverables in an arrangement should be separated, and how consideration should be allocated. Software revenue recognition guidance is applied to the sales of the Company's standalone software products, including software upgrades and software that is not essential to the functionality of the hardware with which it is sold.

Pursuant to the guidance of the accounting standard for multiple deliverable revenue arrangements, when the Company's sales arrangements contain multiple elements, such as products, software licenses, maintenance agreements, or professional services, the Company determines the standalone selling price for each element based on a selling price hierarchy. The application of the multiple deliverable revenue accounting standard does not change the units of accounting for the Company's multiple element arrangements. Under the selling price hierarchy, the selling price for each deliverable is based on the Company's vendor-specific objective evidence (“VSOE”), which is determined by a substantial majority of the Company's historical standalone sales transactions for a product or service falling within a narrow range. If VSOE is not available due to a lack of standalone sales transactions or lack of pricing within a narrow range, then third party evidence (“TPE”), as determined by the standalone pricing of competitive vendor products in similar markets, is used, if available. TPE typically is difficult to establish due to the proprietary differences of competitive products and difficulty in obtaining reliable competitive standalone pricing information. When neither VSOE nor TPE is available, the Company determines its best estimate of standalone selling price (“ESP”) for a product or service and does so by considering several factors including, but not limited to, the 12-month historical median sales price, sales channel, geography, gross margin objective, competitive product pricing, and product life cycle. In consideration of all relevant pricing factors, the Company applies management judgment to determine the Company's best estimate of selling price through consultation with and formal approval by the Company's management for all products and services for which neither VSOE nor TPE is available. Generally the standalone selling price of services is determined using VSOE and the standalone selling price of other deliverables is determined by using ESP. The Company regularly reviews VSOE, TPE and ESP for all of its products and services

and maintains internal controls over the establishment and updates of these estimates.

In accordance with the software revenue recognition accounting standard, the Company continues to recognize revenue for software using the residual method for its sale of standalone software products, including optional software upgrades and other software that is not essential to the functionality of the hardware with which it is sold. After allocation of the relative selling price to each element of the arrangement, the Company recognizes revenue in accordance with the Company's policies for product, software, and service revenue recognition.

3. Recently Issued Accounting Pronouncements

In July 2013, the FASB issued ASU No. 2013-11, Topic 740 - Income Taxes ("ASU 2013-11") which provides guidance to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

carryforward exists. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company intends to adopt this standard in the first quarter of fiscal 2015 and does not expect the adoption will have an impact on its consolidated financial statements.

4. Balance Sheet Accounts

Cash, Cash Equivalents, Short-Term Investments and Marketable Securities

Summary of Cash and Available-for-Sale Securities (in thousands)

	September 30, 2013	June 30, 2013
Cash	$34,854	$41,518
Cash equivalents	$68,154	$54,285
Short-term investments	96,427	43,034
Marketable securities	—	66,776
Total available-for-sale	$164,581	$164,095
Total cash and available for sale securities	$199,435	$205,613

Available-for-Sale Securities

The following is a summary of available-for-sale securities (in thousands):

	Amortized Cost	Fair Value	Unrealized Holding Gains	Unrealized Holding Losses
September 30, 2013				
Money market funds	$68,154	$68,154	$—	$—
U.S. corporate debt securities	96,262	96,427	165	—
	$164,416	$164,581	$165	$—
Classified as:				
Cash equivalents	$68,154	$68,154	$—	$—
Short-term investments	96,262	96,427	165	—
	$164,416	$164,581	$165	$—
June 30, 2013				
Money market funds	$54,285	$54,285	$—	$—
U.S. corporate debt securities	110,078	109,810	126	(394)
	$164,363	$164,095	$126	$(394)
Classified as:				
Cash equivalents	$54,285	$54,285	$—	$—
Short-term investments	42,994	43,034	44	(4)
Marketable securities	67,084	66,776	82	(390)
	$164,363	$164,095	$126	$(394)

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EXTREME NETWORKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The amortized cost and estimated fair value of available-for-sale investments in debt securities at September 30, 2013, by contractual maturity, were as follows (in thousands):

	Amortized Cost	Fair Value
Due in 1 year or less	$164,416	$164,581
Total investments in available for sale debt securities	$164,416	$164,581

The Company considers highly liquid investments with maturities of three months or less at the date of purchase to be cash equivalents. Investments with original maturities of greater than three months, but less than one year at the balance sheet date are classified as Short Term Investments. Investments with maturities of greater than one year at balance sheet date which the Company intends to hold for longer than one year are classified as Marketable Securities. Except for direct obligations of the United States government, securities issued by agencies of the United States government, and money market funds, the Company diversifies its investments by limiting its holdings with any individual issuer.

Investments include available-for-sale investment-grade debt securities that the Company carries at fair value. The Company accumulates unrealized gains and losses on the Company's available-for-sale debt securities, net of tax, in accumulated other comprehensive income (loss) in the stockholders' equity section of its balance sheets. Such an unrealized gain or loss does not reduce net income for the applicable accounting period. If the fair value of an available-for-sale debt instrument is less than its amortized cost basis, an other-than-temporary impairment is triggered in circumstances where (1) the Company intends to sell the instrument, (2) it is more likely than not that the Company will be required to sell the instrument before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the instrument (that is, a credit loss exists). If the Company intends to sell or it is more likely than not that the Company will be required to sell the available-for-sale debt instrument before recovery of its amortized cost basis, the Company recognizes an other-than-temporary impairment in earnings equal to the entire difference between the debt instruments' amortized cost basis and its fair value. For available-for-sale debt instruments that are considered other-than-temporarily impaired due to the existence of a credit loss, if the Company does not intend to sell and it is not more likely than not that the Company will be required to sell the instrument before recovery of its remaining amortized cost basis (amortized cost basis less any current-period credit loss), the Company separates the amount of the impairment into the amount that is credit related and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the debt instrument's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the debt instrument's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The Company determines the basis of the cost of a security sold or the amount reclassified out of accumulated other comprehensive income into earnings using the specific identification method. As of September 30, 2013, twenty-six out of fifty-three investment securities had unrealized losses. As of September 30, 2013, the Company intends to sell its investments in the near term. Therefore, for investments that were in an unrealized loss position as of September 30, 2013, the Company recorded an other than temporary impairment loss of $148,000 during the three months ended September 30, 2013, and the Company has classified all of its investments as short-term investments as of September 30, 2013 even though their stated maturity date may be greater than one year at the balance sheet date.

Inventories

Inventory is stated at the lower of cost or market. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. The Company reduces the carrying value of inventory to net realizable value based on excess and obsolete inventories which are primarily determined by age of inventory and future demand forecasts.

At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. Any written down or obsolete inventory subsequently sold has not had a material impact on gross profit for any of the periods disclosed.

Long-Lived Assets

Long-lived assets include property and equipment, intangible assets, and service inventory. Property and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets or asset groups may not be recoverable. If such facts and circumstances exist, the Company assesses the recoverability of these assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairments, if any, are based on the excess of the carrying amount over the fair value of those assets. The Company reduces the carrying value of service inventory to net realizable value based on excess and obsolete inventories which are primarily determined by age of inventory and future demand forecasts.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On September 11, 2012, the Company completed the sale of its corporate campus and accompanying 16 acres of land in Santa Clara, California for net cash proceeds of approximately $44.7 million and realized a gain of approximately $11.5 million.

Deferred Revenue, Net

Deferred revenue, net represents amounts for (i) deferred services revenue (support arrangements, professional services and training), and (ii) deferred product revenue net of the related cost of revenue when the revenue recognition criteria have not been met. The following table summarizes deferred revenue, net at September 30, 2013 and June 30, 2013, respectively (in thousands):

	September 30, 2013	June 30, 2013
Deferred services	$37,091	$38,003
Deferred product and other revenue	3,145	3,451
Total deferred revenue	40,236	41,454
Less: current portion	32,080	33,184
Non-current deferred revenue, net	$8,156	$8,270

The Company offers for sale to its customers renewable support arrangements, including extended warranty contracts, that range from one to five years. Deferred support revenue is included within deferred revenue, net within the Services category above. The change in the Company’s deferred support revenue balance in relation to these arrangements was as follows (in thousands):

	Three Months Ended	
	September 30, 2013	September 30, 2012
Balance beginning of period	$38,003	$37,461
New support arrangements	13,343	12,537
Recognition of support revenue	(14,255)	(14,337)
Balance end of period	37,091	35,661
Less: current portion	28,935	28,377
Non-current deferred revenue	$8,156	$7,284

Deferred Distributors Revenue, Net of Cost of Sales to Distributors

The Company records revenue from its distributors on a sell-through basis, recording deferred revenue and deferred cost of sales associated with all sales transactions to its distributors in “Deferred distributors revenue, net of cost of sales to distributors” in the liability section of its condensed consolidated balance sheet. When the Company ships products to its distributors, legal title to the products passes to its distributors, and a legally enforceable obligation is created for the distributors to pay on a current basis. Therefore, the Company records a trade receivable at the contractual discount to the list selling price and relieves inventory for the cost of goods shipped to the distributor. The amount shown as “Deferred distributors revenue, net of cost of sales to distributors” represents the deferred gross margin on sales to distributors based on contractual pricing. Distributors purchase products from the Company at a contractual discount based on geographic region and resell the Company's products at a very broad range of individually negotiated price points depending on competitive factors and other market conditions. A portion of the deferred revenue balance represents an amount of the distributors' original purchase price that will be remitted back to the distributors after resale transactions are reported to the Company. Therefore, the amount of gross margin the

Company will recognize in future periods from distributor sales will be less than the deferred amount recorded for the original sale to the distributor as a result of the price concessions negotiated at the time of sell-through. The wide range and variability of negotiated price credits granted to distributors do not allow the Company to accurately estimate the portion of the balance in the deferred revenue that will be credited to the distributors in the future. Therefore, the Company does not reduce deferred revenue by anticipated future price credits; instead, price credits are recorded against revenue and accounts receivable when incurred, which is generally at the time the distributor sells the product.

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EXTREME NETWORKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes deferred distributors revenue, net of cost of sales to distributors at September 30, 2013 and June 30, 2013, respectively (in thousands):

	September 30, 2013	June 30, 2013
Deferred distributors revenue	$23,961	$22,411
Deferred cost of sales to distributors	(5,361)	(5,023)
Deferred distributors revenue, net of cost of sales to distributors	$18,600	$17,388

Guarantees and Product Warranties

Upon issuance of a standard product warranty, the Company discloses and recognizes a liability for the obligation it assumes under the warranty. The following table summarizes the activity related to the Company's product warranty liability during the three months ended September 30, 2013 and 2012:

	Three Months Ended	
	September 30, 2013	September 30, 2012
Balance beginning of period	$3,296	$2,871
New warranties issued	1,304	1,561
Warranty expenditures	(1,160)	(1,461)
Balance end of period	$3,440	$2,971

The Company's standard hardware warranty period is typically 12 months from the date of shipment to end-users and 90 days for software. For certain access products, the Company offers a limited lifetime hardware warranty commencing on the date of shipment from the Company and ending five (5) years following the Company's announcement of the end of sale of such product. Upon shipment of products to its customers, the Company estimates expenses for the cost to repair or replace products that may be returned under warranty and accrues a liability in cost of product revenue for this amount. The determination of the Company's warranty requirements is based on actual historical experience with the product or product family, estimates of repair and replacement costs and any product warranty problems that are identified after shipment. The Company estimates and adjusts these accruals at each balance sheet date in accordance with changes in these factors.

In the normal course of business to facilitate sales of its products, the Company indemnifies its resellers and end-user customers with respect to certain matters. The Company has agreed to hold the customer harmless against losses arising from a breach of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material impact on its operating results or financial position.

Concentrations

The Company may be subject to concentration of credit risk as a result of certain financial instruments consisting principally of marketable investments and accounts receivable. The Company has placed its investments with high-credit quality issuers. The Company does not invest an amount exceeding 10% of its combined cash, cash equivalents, short-term investments and marketable securities in the securities of any one obligor or maker, except for obligations of the United States government, obligations of United States government agencies and money market accounts.

The following table sets forth major customers accounting for 10% or more of our net revenue:

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EXTREME NETWORKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Three Months Ended			
	September 30, 2013		September 30, 2012	
Westcon Group Inc.	18	%	15	%
Scansource, Inc.	14	%	12	%
Tech Data	*		10	%

* Less than 10% of revenue

5. Fair Value Measurements

The following table presents the Company's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis:

September 30, 2013	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets				
Investments:				
Money market funds	$68,154	$—	$—	$68,154
Corporate notes/bonds	—	96,427	—	96,427
Total	$68,154	$96,427	$—	$164,581
Liabilities				
Foreign currency forward contracts	$—	$(7)	$—	$(7)
Total	$—	$(7)	$—	$(7)

June 30, 2013	Level 1	Level 2	Level 3	Total
	(In thousands)			
Assets				
Investments:				
Money market funds	$54,285	$—	$—	$54,285
Corporate notes/bonds	—	109,810	—	109,810
Foreign currency forward contracts	—	21	—	21
Total	$54,285	$109,831	$—	$164,116

Level 2 investment valuations are based on inputs such as quoted market prices of similar instruments, dealer quotations or valuations provided by alternative pricing sources supported by observable inputs. These generally include U.S. government and sovereign obligations, most government agency securities, investment-grade corporate bonds, and state, municipal and provincial obligations. There were no transfers of assets or liabilities between Level 1 and Level 2 during the three months ended September 30, 2013 and 2012.

6. Share-based Compensation

Share-based compensation expense recognized in the condensed consolidated financial statements by line item caption is as follows (in thousands):

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Three Months Ended	
	September 30, 2013	September 30, 2012
Cost of product revenue	$102	$ 174
Cost of service revenue	40	159
Research and development	243	727
Sales and marketing	570	432
General and administrative	620	676
Total share-based compensation expense	$1,575	$ 2,168

During the three months ended September 30, 2013 and 2012, the Company did not capitalize any stock-based compensation expense in inventory, as the amounts were immaterial. The income tax benefit for share-based compensation expense was immaterial in the three months ended September 30, 2013 and 2012.

The weighted-average grant-date per share fair value of options granted during the three months ended September 30, 2013 and 2012 were $2.24 and $1.85, respectively. The weighted-average estimated per share fair value of shares purchased under the Company's 1999 Employee Stock Purchase Plan ("ESPP") during the three months ended September 30, 2013 and 2012 were $1.07 and $0.87, respectively.

The following table summarizes stock option activity under all plans for the three months ended September 30, 2013:

	Number of Shares (000's)	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000's)
Options outstanding at June 30, 2013	9,145	$3.66		
Granted	854	$4.18		
Exercised	(524)	$3.44		$410
Cancelled	(390)	$3.72		
Options outstanding at September 30, 2013	9,085	$3.72	4.77	$14,665
Exercisable at September 30, 2013	4,464	$3.21	3.21	$6,550
Vested and expected to vest at September 30, 2013	8,181	$4.58	4.58	$13,010

Stock Awards

Stock awards may be granted under the 2005 Plan on terms approved by the Board of Directors. Stock awards generally provide for the issuance of restricted stock which vests over a fixed period.

The following table summarizes stock award activity for the three months ended September 30, 2013:

	Number of Shares (000's)	Weighted-Average Grant-Date Fair Value	Aggregate Fair Market Value ($000's)
Non-vested stock outstanding at June 30, 2013	2,686	$3.09	
Granted	130	$4.18	
Vested	(249)	$4.12	$1,047
Cancelled	(137)	$3.53	
Non-vested stock outstanding at September 30, 2013	2,430	$3.01	

The fair value of each option award and share purchase option under the Company's ESPP is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the following table. The Company uses the Monte-Carlo simulation model to determine the fair value and the derived service period of performance-based option awards, with market conditions, on the date of the grant. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The expected term of ESPP represents the contractual life of the ESPP purchase period. The risk-free rate based upon the estimated life of the option and ESPP is based on the U.S.

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Treasury yield curve in effect at the time of grant. Expected volatility is based on both the implied volatilities from traded options on the Company's stock and historical volatility on the Company's stock.

	Stock Option Plan		Employee Stock Purchase Plan	
	Three Months Ended		Three Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Expected life	5 years	5 years	0.25 years	0.25 years
Risk-free interest rate	1.53 %	0.90 %	0.09 %	0.06 %
Volatility	64 %	66 %	32 %	69 %
Dividend yield	— %	— %	— %	— %

The Company is required to estimate the expected forfeiture rate and only recognize expense on a straight-line method for those shares expected to vest.

7. Common Stock Repurchases

On September 28, 2012, the Company's Board of Directors approved a share repurchase program for a maximum of $75 million which may be purchased over a three year period in the open market or in privately negotiated transactions. Since the inception of the program, 4.1 million shares have been repurchased and $60.5 million of the authorized amount is remaining. All repurchased shares will be retired and included in the Company's authorized but unissued shares. During the three months ended September 30, 2013, the Company did not repurchase any common stock.

8. Commitments and Contingencies

Purchase Commitments

The Company currently has arrangements with contract manufacturers and suppliers for the manufacture of its products. The arrangements allow them to procure long lead-time component inventory based upon a rolling production forecast provided by the Company. The Company is obligated to the purchase of long lead-time component inventory that its contract manufacturer procures in accordance with the forecast, unless the Company gives notice of order cancellation outside of applicable component lead-times. As of September 30, 2013, the Company had non-cancelable commitments to purchase approximately $80.0 million of such inventory.

Legal Proceedings

The Company may from time to time be party to litigation arising in the course of its business, including, without limitation, allegations relating to commercial transactions, business relationships or intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Litigation in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict.

In accordance with applicable accounting guidance, the Company records accruals for certain of its outstanding legal proceedings, investigations or claims when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. The Company evaluates, at least on a quarterly basis, developments in legal proceedings, investigations or claims that could affect the amount of any accrual, as well as any developments that would result in a loss contingency to become both probable and reasonably estimable. When a loss contingency is not both probable and reasonably estimable, the Company does not record a loss accrual. However, if the loss (or an additional loss in excess of any prior accrual) is at least a reasonable possibility and material, then the Company would disclose an estimate of the possible loss or range of loss, if such estimate can be made, or disclose that an estimate cannot be made. The assessment whether a loss is probable or a reasonable possibility, and whether the loss or a range of loss is estimable, involves a series of complex judgments about future events. Even if a loss is reasonably possible, the

Company may not be able to estimate a range of possible loss, particularly where (i) the damages sought are substantial or indeterminate, (ii) the proceedings are in the early stages, or (iii) the matters involve novel or unsettled legal theories or a large number of parties. In such cases, there is considerable uncertainty regarding the ultimate resolution of such matters, including the amount of any possible loss, fine or penalty. Accordingly, for current proceedings, the Company is currently unable to estimate any reasonably possible loss or range of possible loss. However, an adverse resolution of one or more of such matters could have a material adverse effect on the Company's results of operations in a particular quarter or fiscal year.

Intellectual Property Litigation

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Chrimar Systems

On October 31, 2011, Chrimar Systems, Inc. dba CMS Technologies, and Chrimar Holding Company filed suit against the Company, Cisco Systems, Inc., and Cisco Consumer Products LLC. Cisco-Linksys LLC, Hewlett-Packard Company, 3Com Corporation and Avaya, Inc. in the United States District Court for the District of Delaware, Civil Action No. 11-1050 (the "Delaware action"). The complaint alleges infringement of U.S. Patent No. 7,457,250. The Delaware action has been stayed pursuant to 28 USC Section 1659(a) pending final determination of the International Trade Commission action described below, based on the fact that the allegations in both cases relate to the same patent.

During the quarter ending March 31, 2013, venue for the Delaware action was transferred to the United States District Court for the District of Northern California.

On July 16, 2013, the parties entered into a confidential patent license and settlement agreement (“Agreement”). Pursuant to that Agreement, the Company paid $1.4 million on July 25, 2013 and Chrimar filed for dismissal of the Delaware Action with prejudice on July 29, 2013. All matters between the parties have now been resolved.

Relay IP Inc.

On May 3, 2013, Relay IP, Inc. filed suit against the Company in the United States District Court for the District of Delaware, Civil Action case number 13-775. The complaint alleges infringement based on the Company's testing of its own equipment and inducing its customers to infringe U.S. Patent No. 5,331,637 and seeks unspecified monetary damages. An answer was filed on July 15, 2013. Given the preliminary nature of the claims, it is premature to assess the likelihood of a particular outcome.

Indemnification Obligations

Subject to certain limitations, the Company may be obligated to indemnify its current and former directors, officers and employees. These obligations arise under the terms of its certificate of incorporation, its bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify, where applicable, generally means that the Company is required to pay or reimburse, and in certain circumstances the Company has paid or reimbursed, the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of these claims. The cost to defend the Company and the named individuals could have a material adverse effect on its consolidated financial position, results of operations and cash flows in the future. Recovery of such costs under its directors and officers insurance coverage is uncertain. As of September 30, 2013, the Company had no outstanding indemnification claims.

9. Income Taxes

The Company recorded an income tax provision of $0.4 million and $0.6 million for the three months ended September 30, 2013 and September 30, 2012, respectively.

The income tax provisions for the three months ended September 30, 2013 and 2012 consisted primarily of taxes on foreign income and U.S. state income taxes. The income tax provisions for both fiscal years were calculated based on the results of operations for the three months ended September 30, 2013 and 2012, and may not reflect the annual effective rate.

The Company has provided a full valuation allowance against all of its U.S. federal and state deferred tax assets, and no valuation allowance against any of its non-U.S. deferred tax assets. The valuation allowance is determined by assessing both negative and positive evidence to determine whether it is more likely than not that the deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. The Company's inconsistent earnings in recent periods, coupled with the Company's inability to forecast greater than one quarter in advance and the cyclical nature of its business represent sufficient negative evidence to require a full valuation allowance against its U.S. federal and state net deferred tax assets. This valuation allowance will be evaluated periodically and can be reversed partially or totally if business results and the economic environment have sufficiently improved to support

realization of the Company's deferred tax assets.

The Company had $10.9 million of unrecognized tax benefits as of September 30, 2013. The future impact of the unrecognized tax benefit of $10.9 million, if recognized, is as follows: approximately $0.3 million would impact the effective tax rate, and approximately $10.6 million would result in adjustments to deferred tax assets and corresponding adjustments to the valuation allowance. It is reasonably possible that the amount of unrealized tax benefit could decrease by approximately $0.1 million during the next twelve months due to the expiration of the statute of limitations in certain foreign jurisdictions.

Estimated interest and penalties related to the underpayment of income taxes are classified as a component of tax expense in the Condensed Consolidated Statements of Operations and were immaterial for both the three months ended September 30, 2013 and 2012. Accrued interest and penalties were $42,000 and $0.1 million as of September 30, 2013 and 2012, respectively.

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In general, the Company's U.S. federal income tax returns are subject to examination by tax authorities for fiscal years 2001 forward due to net operating losses and the Company's state income tax returns are subject to examination for fiscal years 2003 forward due to net operating losses.

10. Net Income Per Share

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period, less shares subject to repurchase, and excludes any dilutive effects of options, warrants and unvested restricted stock. Dilutive earnings per share is calculated by dividing net income by the weighted average number of common shares used in the basic earnings per share calculation plus the dilutive effect of shares subject to repurchase, options, warrants and unvested restricted stock. The following table presents the calculation of basic and diluted net income (loss) per share (in thousands, except per share data):

	Three Months Ended	
	September 30, 2013	September 30, 2012
Net (loss) income	$(35)	$ 12,915
Weighted-average shares used in per share calculation – basic	94,062	94,738
Incremental shares using the treasury stock method:		
Stock options	—	356
Restricted stock units	—	294
Employee Stock Purchase Plan	—	111
Weighted -average share used in per share calculation – diluted	94,062	95,499
Net income per share – basic	$0.00	$ 0.14
Net income per share – diluted	$0.00	$ 0.14

Potentially dilutive common shares from employee incentive plans are determined by applying the treasury stock method to the assumed exercise of outstanding stock options, the assumed vesting of outstanding restricted stock units, and the assumed issuance of common stock under the stock purchase plan. Weighted stock options outstanding with an exercise price higher than the Company's average stock price for the periods presented are excluded from the calculation of diluted net income per share since the effect of including them would have been anti-dilutive due to the net income position of the Company during the periods presented. For the three months ended September 30, 2013 and 2012, the Company excluded 6.8 million and 7.1 million outstanding weighted average stock options and awards, respectively, from the calculation of diluted earnings per common share because they would have been anti-dilutive.

11. Restructuring Charges

As part of the Company's on-going restructuring efforts, during the second quarter of fiscal year 2013, the Company initiated a plan to reduce its worldwide headcount by 13%, consolidate specific global administrative functions, and shift certain operating costs to lower cost regions, among other actions. Restructuring expense was $0.1 million in the three months ended September 30, 2013. Restructuring expense was not significant in the three months ended September 30, 2012.

The following table summarizes restructuring activities for the three months ended September 30, 2013:

	Termination Benefits (1)	Contract Termination	Other Cost	Total
Balance at June 30, 2013	$1,217	$—	$249	$1,466
Period charges	103	187	75	365
Period reversals	(283)	(7)	—	(290)

Period payments	(630)	(15)	(324)	(969)
Restructuring liabilities at September 30, 2013	$407	$165	$—	$572

(1) Termination benefits generally include severance, outplacement services and health insurance coverage.

12. Foreign Exchange Forward Contracts

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The Company uses derivative financial instruments to manage exposures to foreign currency. The Company's objective for holding derivatives is to use the most effective methods to minimize the impact of these exposures. The Company does not enter into derivatives for speculative or trading purposes. The Company records all derivatives on the balance sheet as Other Assets, Net at fair value. Changes in the fair value of derivatives are recognized in earnings as Other Income (Expense). The Company enters into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the foreign currency forecasted transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges. At September 30, 2013, these forward foreign currency contracts had a notional principal amount of $7.2 million and an immaterial unrealized loss on foreign exchange contracts. These contracts have maturities of less than 60 days. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities.

Foreign currency transaction gains and losses from operations were a $0.1 million loss for the three months ended September 30, 2013 and a $0.3 million loss for the three months ended September 30, 2012.

13. Disclosure about Segments of an Enterprise and Geographic Areas

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision makers with respect to the allocation of resources and performance.

The Company operates in one segment, the development and marketing of network infrastructure equipment. The Company conducts business globally and is managed geographically. Revenue is attributed to a geographical area based on the location of the customers. The Company operates in three geographical areas: Americas, which includes the United States, Canada, Mexico, Central America and South America; EMEA, which includes Europe, Russia, Middle East and Africa; and APAC which includes Asia Pacific, South Asia, and Australia.

The Company attributes revenues to geographic regions primarily based on the customer's ship-to location. Information regarding geographic areas is as follows (in thousands):

	Three Months Ended	
Net Revenues:	September 30, 2013	September 30, 2012
Americas:		
United States	$25,389	$ 25,204
Other	6,301	9,779
Total Americas	31,690	34,983
EMEA	30,842	28,519
APAC	13,384	12,625
Total net revenues	$75,916	$ 76,127

Substantially all of the Company's assets were attributable to North America operations at September 30, 2013 and June 30, 2013.

14. Subsequent Events

Acquisition of Enterasys Networks

On October 31, 2013, the Company consummated the previously announced acquisition from Enterprise Networks Holdings Inc., of all of the issued and outstanding capital stock of Enterasys Networks, Inc. ("Enterasys"), a privately held provider of wired and wireless network infrastructure and security solutions based in Salem, New Hampshire. The purchase price paid by the Company was $180 million in cash, consisting of cash on hand and borrowings under a

new credit facility. We have agreed to reimburse the sellers on a dollar-for-dollar basis for any cash remaining in Enterasys at the closing. The purchase price is subject to customary post-closing purchase price adjustments. The purchase of Enterasys has been accounted for as a business combination under the acquisition method. Enterasys is now a wholly-owned subsidiary of the Company and the results of operations of Enterasys (beginning with the closing date of the acquisition) and the estimated fair value of assets acquired will be included in the Company's consolidated financial statements beginning in the second quarter of fiscal 2014.

Senior Secured Credit Agreement

On October 31, 2013, the Company entered into a $125 million senior secured credit facilities agreement consisting of a $65 million term loan facility ("Term loan") and a revolving credit facility of $60 million ("Revolving facility"). Both facilities mature on October 31, 2018. The proceeds of the Term loan were used to pay a portion of the purchase price in the acquisition

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of all of the issued and outstanding capital stock of Enterasys. The company drew $35 million of the $60 million Revolving facility to pay fees and expenses incurred in connection with the acquisition and to provide ongoing working capital and for other general corporate purposes. Borrowings under the Term loan and Revolving facility bear interest, at the Company's election, at a rate per annum equal to an agreed to applicable margin plus (a) the prime rate in effect on such day or (b) Libor. The credit facility contains standard events of default and financial covenants, including those that require the Company to maintain certain leverage and quick and fixed charge coverage ratios.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This quarterly report on Form 10-Q, including the following sections, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including in particularly, our expectations regarding market demands, customer requirements and the general economic environment, and future results of operations, and other statements that include words such as "may" "expect" or "believe" . These forward-looking statements involve risks and uncertainties. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in the section entitled "Risk Factors" in this Report, our Quarterly Report on Form 10-Q for the first quarter of fiscal 2014, our Annual Report on Form 10-K for the fiscal year ended June 30, 2013, and other filings we have made with the Securities and Exchange Commission. These risk factors, include, but are not limited to: fluctuations in demand for our products and services; a highly competitive business environment for network switching equipment; our effectiveness in controlling expenses; the possibility that we might experience delays in the development or introduction of new technology and products; customer response to our new technology and products; the timing of any recovery in the global economy; risks related to pending or future litigation; a dependency on third parties for certain components and for the manufacturing of our products; and our ability to receive the anticipated benefits of the acquisition of Enterasys.

Business Overview

We are a leading provider of network infrastructure equipment and services for enterprises, data centers, and service providers. We were incorporated in California in May 1996 and reincorporated in Delaware in March 1999. Our corporate headquarters are located in San Jose, California. We develop and sell network infrastructure equipment to our enterprise, data center and telecommunications service provider customers.

We conduct our sales and marketing activities on a worldwide basis through a distribution channel utilizing distributors, resellers and our field sales organization. We primarily sell our products through an ecosystem of channel partners who combine our Ethernet products with their offerings to create compelling information technology solutions for end user customers. We utilize our field sales organization to support our channel partners and to sell direct to end-user customers, including some large global accounts. Our customers include businesses, hospitals, universities, hotels, telecommunications companies and government agencies around the world.

We outsource the majority of our manufacturing and supply chain management operations as part of our strategy to maintain global manufacturing capabilities and to reduce our costs. We conduct quality assurance, manufacturing engineering, document control and test development at engineering facilities in San Jose, California, Research Triangle Park, North Carolina, and Chennai, India. This approach enables us to reduce fixed costs and to quickly respond to changes in market demand.

The market for network infrastructure equipment is highly competitive and dominated by a few large companies. The current economic climate has further driven consolidation of vendors within the Ethernet networking market and with vendors from adjacent markets, including storage, security, wireless and voice applications. We believe that the underpinning technology for all of these adjacent markets is Ethernet. As a result, independent Ethernet switch vendors are being acquired or merged with larger, adjacent market vendors to enable them to deliver complete and broad solutions. As a result, we believe that, as an independent Ethernet switch vendor, we must provide products that, when combined with the products of our large strategic partners, create compelling solutions for end user customers. Our approach is to focus on the intelligence and automation layer that spans our hardware products and that facilitates end-to-end solutions, as opposed to positioning Extreme Networks as a low-cost-vendor with point products.

We believe that continued success in our marketplace is dependent upon a variety of factors that includes, but is not limited to, our ability to design, develop and distribute new and enhanced products employing leading-edge technology.

Results of Operations

During the first quarter of fiscal 2014, we achieved the following results:

- Net revenues of $75.9 million compared to net revenues of $76.1 million in the first quarter of fiscal 2013.

- Product revenues of $61.0 million compared to product revenues of $61.1 million in the first quarter of fiscal 2013.
- Service revenues of $14.9 million compared to service revenues of $15.0 million in the first quarter of fiscal 2013.
- Total gross margin of 58% of net revenues compared to total gross margin of 53% of net revenues in the first quarter of fiscal 2013.
- Operating income of $0.4 million compared to operating income of $13.6 million in the first quarter of fiscal 2013.

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- Net loss of $35,000 compared to net income of $12.9 million in the first quarter of fiscal 2013.
- Cash flow provided by operating activities of $1.9 million in the three months ended September 30, 2013 compared to cash flow provided by operating activities of $7.1 million in the three months ended September 30, 2012.
- Cash and cash equivalents, short-term investments and marketable securities decreased by $6.2 million to $199.4 million as of September 30, 2013 from $205.6 million as of June 30, 2013, primarily due to cash used by operating and investing activities.

We operate in three regions: Americas, which includes the United States, Canada, Mexico, Central America and South America; EMEA, which includes Europe, Russia, Middle East, and Africa; and APAC which includes Asia Pacific, South Asia, and Australia. The following table presents the total net revenue geographically for the three months ended September 30, 2013 and September 30, 2012, respectively (dollars in thousands):

Net Revenues	Three Months Ended September 30, 2013		September 30, 2012		$ Change	% Change
Americas:						
United States	$25,389		$25,204		$185	0.7 %
Other	6,301		9,779		(3,478)	(35.6)%
Total Americas	31,690		34,983		(3,293)	(9.4)%
Percentage of net revenue	42.0	%	46.0	%		
EMEA	30,842		28,519		2,323	8.1 %
Percentage of net revenue	40.6	%	37.5	%		
APAC	13,384		12,625		759	6.0 %
Percentage of net revenue	17.6	%	16.6	%		
Total net revenues	$75,916		$76,127		$(211)	(0.3)%

Net Revenues

The following table presents net product and service revenue for the three months ended September 30, 2013 and September 30, 2012, respectively (dollars in thousands):

	Three Months Ended September 30, 2013		September 30, 2012		$ Change	% Change
Net Revenues:						
Product	$61,045		$61,119		$(74)	(0.1)%
Percentage of net revenue	80.4	%	80.3	%		
Service	14,871		15,008		(137)	(0.9)%
Percentage of net revenue	19.6	%	19.7	%		
Total net revenues	$75,916		$76,127		$(211)	(0.3)%

Product revenue was flat in the first quarter of fiscal 2014 compared to the corresponding period of fiscal 2013. In the three months ending September 30, 2013, we experienced weaker than expected demand from our enterprise customers in the Americas region which was offset by increased demand from our public sector and strategic customers and distributors in the EMEA region.

Service revenue was flat in the first quarter of fiscal 2014 compared to the corresponding period of fiscal 2013.

Cost of Revenue and Gross Profit

The following table presents the gross profit on product and service revenue and the gross profit percentage of product and service revenue for the three months ended September 30, 2013 and 2012 (in thousands):

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	Three Months Ended							
	September 30, 2013		September 30, 2012		$ Change		% Change	
Gross profit:								
Product	$33,529		$30,643		$2,886		9.4	%
Percentage of product revenue	54.9	%	50.1	%				
Service	10,178		9,332		846		9.1	%
Percentage of service revenue	68.4	%	62.2	%				
Total gross profit	$43,707		$39,975		$3,732		9.3	%
Percentage of net revenue	57.6	%	52.5	%				

Cost of product revenue includes costs of materials, amounts paid to third-party contract manufacturers, costs related to warranty obligations, charges for excess and obsolete inventory, royalties under technology license agreements, and internal costs associated with manufacturing overhead, including management, manufacturing engineering, quality assurance, development of test plans, and document control. We outsource substantially all of our manufacturing and supply chain management operations, and we conduct quality assurance, manufacturing engineering, document control and distribution in San Jose, California, China, and Taiwan. Accordingly, a significant portion of our cost of product revenue consists of payments to our primary contract manufacturer located in Hsinchu, Taiwan. In addition, we OEM our wireless product line from Motorola.

Product gross margin increased to 54.9% from 50.1% in the first quarter of fiscal 2014 compared to the corresponding periods of fiscal 2013. The increase in product gross margin for the first quarter of fiscal 2014 was primarily due to favorable product mix and lower excess and obsolete inventory charges as compared to first quarter of fiscal 2013.

Our cost of service revenue consists primarily of labor, overhead, repair and freight costs and the cost of spares used in providing support under customer service contracts. Service gross margin increased to 68.4% from 62.2% in the first quarter of fiscal 2014. The increase in service gross margin was primarily due to lower labor costs from our cost reduction initiatives.

Operating Expenses

The following table presents operating expenses and operating income (in thousands, except percentages):

	Three Months Ended							
	September 30, 2013		September 30, 2012		$ Change		% Change	
Research and development	$9,937		$10,566		$(629	)	(6.0	)%
Sales and marketing	22,694		22,027		667		3.0	%
General and administrative	6,934		5,357		1,577		29.4	%
Acquisition-related costs	3,695		—		3,695		100.0	%
Restructuring charge, net of reversals	75		(10	)	85		850.0	%
Gain on sale of campus	—		(11,537	)	11,537		(100.0	)%
Total operating expenses	$43,335		$26,403		$16,932		64.1	%
Operating income	$372		$13,572		$(13,200	)	(97.3	)%

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The following table highlights our operating expenses and operating income as a percentage of net revenues:

	Three Months Ended	
	September 30, 2013	September 30, 2012
Research and development	13.1 %	13.9 %
Sales and marketing	29.9 %	28.9 %
General and administrative	9.1 %	7.0 %
Acquisition-related costs	4.9 %	— %
Restructuring charge, net of reversals	0.1 %	— %
Gain on sale of campus	— %	(15.2)%
Total operating expenses	57.1 %	34.6 %
Operating income	0.5 %	17.8 %

Research and Development Expenses

Research and development expenses consist primarily of salaries and related personnel expenses, consultant fees and prototype expenses related to the design, development, and testing of our products.

Research and development expenses decreased by $0.6 million, or 6.0% in the first quarter of fiscal 2014 compared to the corresponding period of fiscal 2013. The decrease in research and development expenses primarily resulted from lower personnel costs from our cost reduction initiatives.

Sales and Marketing Expenses

Sales and marketing expenses consist of salaries, commissions and related expenses for personnel engaged in marketing and sales functions, as well as trade shows and promotional expenses.

Sales and marketing expenses increased by $0.7 million, or 3.0% in the first quarter of fiscal 2014, compared to the corresponding periods of fiscal 2013. The increase in sales and marketing expenses was primarily due to increased spending on sales and marketing programs.

General and Administrative Expenses

General and administrative expenses increased by $1.6 million, or 29.4% in the first quarter of fiscal 2014, compared to the corresponding periods of fiscal 2013. The increase in general and administrative expenses during the three months ending September 30, 2013, compared to the corresponding period of fiscal 2013, was primarily due to higher rent and facilities expense of $0.9 million, higher bad debt expense, and higher travel costs in the first quarter of fiscal 2014. The Company completed the sale of its former corporate campus during first quarter of fiscal 2013.

Acquisition-related Costs

During the first quarter of fiscal 2014, we announced that we had entered into a stock purchase agreement with Enterprise Networks Holdings Inc. to acquire all of the issued and outstanding capital stock of Enterasys Networks Inc. We incurred $3.7 million of acquisition-related costs during the quarter ended September 30, 2013.

Restructuring Charge, Net of Reversals

Restructuring charges increased by $0.1 million in the first quarter of fiscal 2014 compared to the corresponding period of fiscal 2013. During the second quarter of fiscal 2013, we initiated a plan to reduce our worldwide headcount by 13%, consolidate specific global administrative functions, and shift certain operating costs to lower cost regions, among other actions. The Company has substantially expensed all of the costs associated with this initiative. As of September 30, 2013, we had restructuring liabilities of $0.6 million, which we anticipate paying by the end of fiscal 2015.

Gain on Campus Sale

During the first quarter of fiscal 2013, we completed the sale of our corporate campus and accompanying 16 acres of land in Santa Clara, California for net cash proceeds of approximately $44.7 million. We realized a gain of approximately $11.5 million in connection with this transaction.

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Other Expense, Net

Other expense, net decreased by $0.1 million in the first quarter of fiscal 2014, compared to the corresponding period of fiscal 2013. The change in other expense, net in the first quarter of fiscal 2014, as compared to the same period in fiscal 2013, was primarily due to gains from the revaluation of certain assets and liabilities denominated in foreign currencies into U.S. dollars offsetting other than temporary impairment loss of $148,000, recorded in the first quarter of fiscal 2014.

Provision for Income Taxes

We recorded an income tax provision of $0.4 million and $0.6 million for the three months ended September 30, 2013 and 2012, respectively. The income tax provision for the first quarter of fiscal 2014 consisted primarily of taxes on foreign income and U.S state income taxes. The income tax provision for the first quarter of fiscal 2013 consisted primarily of taxes on foreign income and U.S. state income taxes. The income tax provisions for both quarters were calculated based on the results of operations for the three months ended September 30, 2013 and 2012, and may not reflect the annual effective rate.

We have provided a full valuation allowance against all of our U.S. federal and state deferred tax assets, and no valuation allowance against any of our non-U.S. deferred tax assets. The valuation allowance is determined by assessing both negative and positive evidence to determine whether it is more likely than not that the deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. Our inconsistent earnings in recent periods, coupled with our inability to forecast greater than one quarter in advance and the cyclical nature of our business represent sufficient negative evidence to require a full valuation allowance against our U.S. federal and state net deferred tax assets. This valuation allowance will be evaluated periodically and can be reversed partially or totally if business results and the economic environment have sufficiently improved to support realization of our deferred tax assets.

Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements and the related notes included elsewhere in this report are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. On an ongoing basis, we evaluate our estimates and assumptions. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

As discussed in Part II, Item 7, “Management's Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the year ended June 30, 2013, we consider the following accounting policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements:

- Revenue Recognition
- Inventory Valuation
- Long Lived Assets
- Allowance for Doubtful Accounts
- Deferred Tax Valuation Allowance
- Accounting for Uncertainty in Income Taxes
- Share-Based Compensation
- Legal Contingencies
- Restructuring Costs

There have been no changes to our critical accounting policies since the filing of our last Annual Report on Form 10-K.

New Accounting Pronouncements

In July 2013, the FASB issued ASU No. 2013-11, Topic 740 - Income Taxes ("ASU 2013-11") which provides guidance to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The

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Company intends to adopt this standard in the first quarter of fiscal 2015 and does not expect the adoption will have an impact on its consolidated financial statements.

Liquidity and Capital Resources

The following summarizes information regarding our cash, investments, and working capital (in thousands):

	September 30, 2013	June 30, 2013
Cash and cash equivalent	$103,008	$95,803
Short-term investments	96,427	43,034
Marketable securities	—	66,776
Total cash and investments	$199,435	$205,613
Working capital	$170,027	$96,279

As of September 30, 2013, our principal sources of liquidity consisted of cash, cash equivalents and investments of $199.4 million and net accounts receivable of $39.3 million. As of September 30, 2013, we intend to sell our investments in the near term. We have classified all of our investments as short term investments as of September 30, 2013 even though the stated maturity date may be greater than one year at the balance sheet date. Historically, our principal uses of cash have consisted of the purchase of finished goods inventory from our contract manufacturers, payroll and other operating expenses related to the development, marketing of our products and purchases of property and equipment and repurchases of our common stock. We believe that our $199.4 million of cash and cash equivalents and investments at September 30, 2013 will be sufficient to fund our operating requirements, stock repurchase program, and restructuring expenses for at least the next 12 months as well as for partial payment of the purchase price for the Enterasys acquisition.

The Company has entered into a senior secured credit facility agreement of $125 million to partially pay the purchase price in the acquisition of Enterasys as well as to pay fees and expenses incurred in connection with the acquisition and to provide ongoing working capital and for other general corporate purposes.

Key Components of Cash Flows and Liquidity

A summary of the sources and uses of cash and cash equivalents is as follows (in thousands):

	Three Months Ended	
	September 30, 2013	September 30, 2012
Net cash provided by operating activities	$1,925	$7,052
Net cash provided by investing activities	$3,254	$34,031
Net cash provided by financing activities	$1,799	$593
Foreign currency effect on cash	$227	$440
Net increase in cash and cash equivalents	$7,205	$42,116

Net Cash Provided by Operating Activities

Cash flows from operations decreased by $5.1 million in the three months ending September 30, 2013 compared to the corresponding period of fiscal 2013, primarily due to the increase in inventory balance due to timing of inventory receipts to bring the inventory levels in line with the near term demand and an increase in accounts payable balance due to the timing of payments.

Net Cash Provided by Investing Activities

Cash flow provided by investing activities in the three months ending September 30, 2013 was $3.3 million, comprised of proceeds of $13.1 million from the maturities of investments, offset by $9.8 million used to purchase property and equipment.

Net Cash Provided by Financing Activities

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Cash flow provided by financing activities in the three months ending September 30, 2013 was $1.8 million, comprised of proceeds from the exercise of stock options and purchases of shares of our common stock under the ESPP, net of taxes paid on vested and released stock awards.

Contractual Obligations

The following summarizes our contractual obligations at September 30, 2013, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	Total	Less than 1 Year	1-3 years	3-5 years	More than 5 years
Contractual Obligations:					
Non-cancellable inventory purchase commitments	$79,964	$79,964	$—	$—	$—
Non-cancellable operating lease obligations	34,066	3,301	10,069	7,811	12,885
Other liabilities	3,896	390	775	700	2,031
Total contractual cash obligations	$117,926	$83,655	$10,844	$8,511	$14,916

Non-cancelable inventory purchase commitments represent the purchase of long lead-time component inventory that our contract manufacturers procure in accordance with our forecast. Inventory purchase commitments were $80.0 million as of September 30, 2013, an increase of $29.9 million from $50.1 million as of June 30, 2013. We expect to honor the inventory purchase commitments within the next 12 months.

Non-cancelable operating lease obligations represent base rents and operating expense obligations to landlords for facilities we occupy at various locations.

Other liabilities include the Company's commitments towards specific arrangements other than inventory.

The amounts in the table above exclude $0.3 million of income tax liabilities related to uncertain tax positions as we are unable to reasonably estimate the timing of settlement.

We did not have any material commitments for capital expenditures as of September 30, 2013.

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of September 30, 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity

The primary objective of our investment activities is to preserve principal while at the same time maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, other non-government debt securities and money market funds.

The valuation of our investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact its valuation include changes to credit ratings of the securities, discount rates and ongoing strength and quality of market credit and liquidity.

If the current market conditions deteriorate further, or the anticipated recovery in market values does not occur, we may be required to record impairment charges in future quarters.

The following table presents the amounts of our cash equivalents, short-term investments and marketable securities that are subject to market risk by range of expected maturity and weighted-average interest rates as of September 30, 2013. This table does not include money market funds because those funds are generally not subject to market risk.

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	Maturing in Three months or less	Three months to one year	Greater than one year	Total	Fair Value
	(In thousands)				
September 30, 2013					
Included in short-term investments	$10,123	$19,635	$66,669	$96,427	$96,427
Weighted average interest rate	0.44 %	0.67 %	0.77 %		

As of September 30, 2013, we intend to sell our investments in the near term. We have classified all of our investments as short term investments as of September 30, 2013 even though the stated maturity date may be greater than one year at the balance sheet date.

The following tables present hypothetical changes in fair value of the financial instruments held at September 30, 2013 that are sensitive to changes in interest rates:

Unrealized gain given a decrease in interest rate of X bps		Fair value as of	Unrealized loss given an increase in interest rate of X bps	
(100 bps)	(50 bps)	September 30, 2013	100 bps	50 bps
(In thousands)				
$1,287	$641	$164,581	$(1,266)	$(634)

Exchange Rate Sensitivity

Currently, substantially all of our sales and the majority of our expenses are denominated in United States dollars. While we conduct some sales transactions and incur certain operating expenses in foreign currencies and expect to continue to do so, we do not anticipate that foreign exchange gains or losses will be significant, in part because of our foreign exchange risk management process discussed below.

Foreign Exchange Forward Contracts

We record all derivatives on the balance sheet at fair value. Changes in the fair value of derivatives are recognized in earnings as Other Income (Expense), net. We enter into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the foreign currency forecasted transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges. At September 30, 2013, these forward foreign currency contracts had a notional principal amount of $7.2 million and an immaterial unrealized loss on foreign exchange contracts. These contracts have maturities of less than 60 days. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities.

Foreign currency transaction gains and losses from operations were a $0.1 million loss for the three months ended September 30, 2013 and a $0.3 million loss for the three months ended September 30, 2012.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 as amended, such as this Report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”), as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our CEO and CFO, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Report. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Report.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurances with respect to financial statement preparation. Further because of changes in conditions, the effectiveness of internal control may vary over time.

We assessed the effectiveness of our internal control over financial reporting as of the end of the period covered by this Report. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment using those criteria, we concluded that, as of the end of the period covered by this Report, our internal control over financial reporting is effective.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Our controls and procedures are designed to provide reasonable assurance that our control system's objective will be met and our CEO and CFO have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within Extreme Networks have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events. Projections of any evaluation of the effectiveness of controls in future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Notwithstanding these limitations, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. Our CEO and CFO have concluded that our disclosure controls and procedures are, in fact, effective at the “reasonable assurance” level.

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PART II. Other Information

Item 1. Legal Proceedings

For information regarding litigation matters that we deem significant, refer to Part I, Item 3, Legal Proceedings of our Annual Report on Form 10-K for the fiscal year ended June 30, 2013 and Note 8 to our Notes to Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report which are incorporated herein by reference.

Item 1A. Risk Factors

The following is a list of risks and uncertainties which may have a material and adverse effect on our business, financial condition or results of operations. The risks and uncertainties set out below are not the only risks and uncertainties we face, and some are endemic to the networking industry.

We cannot assure you that we will be profitable in the future because a number of factors could negatively affect our financial results.

We have a limited history of profitability and have reported losses in some of our prior fiscal years. In addition, in years when we reported profits, we were not profitable in each quarter during those years. We anticipate continuing to incur significant sales and marketing, product development and general and administrative expenses. Any delay in generating or recognizing revenue could result in a loss for a quarter or full year. Even if we are profitable, our operating results may fall below our expectations and those of our investors, which could cause the price of our stock to fall.

We may experience challenges or delays in generating or recognizing revenue for a number of reasons and our revenue and operating results have varied significantly in the past and may vary significantly in the future due to a number of factors, including, but not limited to, the following:

- we are dependent upon obtaining orders during a quarter and shipping those orders in the same quarter to achieve our revenue objectives;
- decreases in the prices of the products that we sell;
- the mix of products sold and the mix of distribution channels through which products are sold;
- acceptance provisions in customer contracts;
- our ability to deliver installation or inspection services by the end of the quarter;
- changes in general and/or specific economic conditions in the networking industry;
- seasonal fluctuations in demand for our products and services;
- a disproportionate percentage of our sales occurring in the last month of the quarter;
- our ability to ship products by the end of a quarter;
- reduced visibility into the implementation cycles for our products and our customers' spending plans;
- our ability to forecast demand for our products, which in the case of lower-than-expected sales, may result in excess or obsolete inventory in addition to non-cancelable purchase commitments for component parts;
- sales to the telecommunications service provider market, which represent a significant source of large product orders, are especially volatile and difficult to forecast;
- product returns or the cancellation or rescheduling of orders;
- announcements and new product introductions by our competitors;
- our ability to develop and support relationships with enterprise customers, service providers and other potential large customers;
- our ability to achieve targeted cost reductions;
- fluctuations in warranty or other service expenses actually incurred;
- our ability to obtain sufficient supplies of sole- or limited-source components for our products on a timely basis;
- increases in the price of the components that we purchase.

Due to the foregoing factors, period-to-period comparisons of our operating results should not be relied upon as an indicator of our future performance.

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We may fail to realize the anticipated benefits of the acquisition of Enterasys.

The success of the acquisition of Enterasys will depend on, among other things, our ability to combine the businesses of Extreme and Enterasys in a manner that does not materially disrupt existing relationships and that allows us to achieve anticipated operational synergies. We will face significant challenges in combining Enterasys's operations into our operations in a timely and efficient manner. The failure to integrate successfully and to manage successfully the challenges presented by the integration process may result in us not achieving the anticipated benefits of the acquisition.

We have made certain assumptions relating to the acquisition in our forecasts that may prove to be materially inaccurate.

We have made certain assumptions relating to the forecast level of cost savings, synergies and associated costs of the acquisition of Enterasys. Our assumptions relating to the forecast level of cost savings, synergies and associated costs of the acquisition may be inaccurate based on the information available to us, including as the result of the failure to realize the expected benefits of the acquisition, higher than expected transaction and integration costs, including our ability to service new debt, as well as general economic and business conditions that may adversely affect the combined company following the completion of the acquisition.

The combination of our business with the Enterasys business will require significant management attention, and we expect to incur significant costs because of integration challenges.

The combined company will be required to devote significant management attention and other resources to integrating the two businesses. We may not successfully complete the integration of our operations in a timely manner and may experience disruptions in relationships with customers, suppliers and employees as a result.

Through September 30, 2013, we have incurred transaction costs in connection with the Enterasys acquisition of approximately $3.7 million. We expect to incur additional costs integrating the companies’ operations, product offerings, and personnel, which cannot be estimated accurately at this time. Although we expect that the realization of efficiencies related to the integration of the business will offset incremental transaction, integration and restructuring costs over time, we cannot give any assurance that this net benefit will be achieved. If the total costs of the integration exceed the anticipated benefits of the acquisition, our results of operations could be adversely affected.

We may engage in future acquisitions that dilute the ownership interests of our stockholders, cause us to incur debt and assume contingent liabilities.

As part of our business strategy, we review acquisition and strategic investment prospects that we believe would complement our current product offerings, augment our market coverage or enhance our technical capabilities, or otherwise offer growth opportunities. In the event of any future acquisitions, we could:

- issue equity securities which would dilute current stockholders' percentage ownership;
- incur substantial debt;
- assume contingent liabilities; or
- expend significant cash.

These actions could have a material adverse effect on our operating results or the price of our common stock. Moreover, even if we do obtain benefits in the form of increased sales and earnings, these benefits may be recognized much later than the time when the expenses associated with an acquisition are incurred. This is particularly relevant in cases where it would be necessary to integrate new types of technology into our existing portfolio and new types of products may be targeted for potential customers with which we do not have pre-existing relationships. Acquisitions and investment activities also entail numerous risks, including:

- difficulties in the assimilation of acquired operations, technologies and/or products;
- unanticipated costs associated with the acquisition or investment transaction;

- the diversion of management's attention from other business concerns;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience;
- the potential loss of key employees of acquired organizations; and

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- substantial charges for the amortization of certain purchased intangible assets, deferred stock compensation or similar items.

Our credit facilities impose financial and operating restrictions on us.

Our debt instruments impose, and the terms of any future debt may impose, operating and other restrictions on us. These restrictions could affect, and in many respects limit or prohibit, among other items, our ability to:

- incur additional indebtedness;
- create liens;
- make investments;
- enter into transactions with affiliates;
- sell assets;
- guarantee indebtedness;
- declare or pay dividends or other distributions to stockholders;
- repurchase equity interests;
- change the nature of our business;
- enter into swap agreements;
- issue or sell capital stock of certain of our subsidiaries; and
- consolidate, merge, or transfer all or substantially all of our assets and the assets of our subsidiaries on a consolidated basis.

The agreements governing our credit facilities also require us to achieve and maintain compliance with specified financial ratios.

A breach of any of these restrictive covenants or the inability to comply with the required financial ratios could result in a default under our debt instruments. If any such default occurs, the lenders under our credit agreement may elect to declare all outstanding borrowings, together with accrued interest and other fees, to be immediately due and payable. The lenders under our credit agreement also have the right in these circumstances to terminate any commitments they have to provide further borrowings. If we are unable to repay outstanding borrowings when due, the lenders under our credit agreement will have the right to proceed against the collateral granted to them to secure the debt. If the debt under our credit agreement were to be accelerated, we cannot give assurance that this collateral would be sufficient to repay our debt.

If we fail to meet our payment or other obligations under our credit agreement, the lenders under such credit agreement could foreclose on, and acquire control of, substantially all of our assets.

Our credit agreement is jointly and severally guaranteed by us and certain of our subsidiaries. Borrowings under our credit facilities are secured by liens on substantially all our assets, including the capital stock of certain of our subsidiaries, and the assets of our subsidiaries that are loan party guarantors. If we are unable to repay outstanding borrowings when due, the lenders under our credit agreement will have the right to proceed against this pledged capital stock and take control of substantially all of our assets.

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

We currently purchase several key components used in the manufacture of our products from single or limited sources and are dependent upon supply from these sources to meet our needs. Certain components such as tantalum capacitors, SRAM, DRAM, and printed circuit boards, have been in the past, and may in the future be, in short supply. We have encountered, and are likely in the future to encounter, shortages and delays in obtaining these or other components, and this could have a material adverse effect on our ability to meet customer orders. Our principal sole-source components include:

- ASICs;
- Merchant silicon;
- microprocessors;

- programmable integrated circuits;

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- selected other integrated circuits;
- custom power supplies; and
- custom-tooled sheet metal.

Our principal limited-source components include:

- flash memory;
- DRAMs and SRAMs;
- printed circuit boards; and
- CAMs.

We use our forecast of expected demand to determine our material requirements. Lead times for materials and components we order vary significantly, and depend on factors such as the specific supplier, contract terms and demand for a component at a given time. If forecasts exceed orders, we may have excess and/or obsolete inventory, which could have a material adverse effect on our operating results and financial condition. If orders exceed forecasts, we may have inadequate supplies of certain materials and components, which could have a material adverse effect on our ability to meet customer delivery requirements and to recognize revenue.

Generally, we do not have agreements fixing long-term prices or minimum volume requirements from suppliers. From time to time we have experienced shortages and allocations of certain components, resulting in delays in filling orders. Qualifying new suppliers to compensate for such shortages may be time-consuming and costly, and may increase the likelihood of errors in design or production. In addition, during the development of our products, we have experienced delays in the prototyping of our chipsets, which in turn has led to delays in product introductions. Similar delays may occur in the future. Furthermore, the performance of the components as incorporated in our products may not meet the quality requirements of our customers.

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

The market for network switching solutions is intensely competitive and dominated primarily by Brocade Communications Systems, Inc., Cisco Systems Inc., Dell, Hewlett-Packard Company, Huawei, and Juniper Networks, Inc. Most of our competitors have longer operating histories, greater name recognition, larger customer bases, broader product lines and substantially greater financial, technical, sales, marketing and other resources. As a result, these competitors are able to devote greater resources to the development, promotion, sale and support of their products. In addition, they have larger distribution channels, stronger brand names, access to more customers, a larger installed customer base and a greater ability to make attractive offers to channel partners and customers than we do. For example, we have encountered, and expect to continue to encounter, many potential customers who are confident in and committed to the product offerings of our principal competitors. Accordingly, these potential customers may not consider or evaluate our products. When such potential customers have considered or evaluated our products, we have in the past lost, and expect in the future to lose, sales to some of these customers as large competitors have offered significant price discounts to secure these sales.

The pricing policies of our competitors impact the overall demand for our products and services. Some of our competitors are capable of operating at significant losses for extended periods of time, increasing pricing pressure on our products and services. If we do not maintain competitive pricing, the demand for our products and services, as well as our market share, may decline. From time to time, we may lower the prices of our products and services in response to competitive pressure. When this happens, if we are unable to reduce our component costs or improve operating efficiencies, our revenue and margins will be adversely affected.

We may not fully realize the anticipated positive impacts to future financial results from our restructuring efforts.

We have undertaken restructuring efforts within the last year to streamline operations and reduce operating expenses. Our ability to achieve the anticipated cost savings and other benefits from our restructuring efforts within expected time frames is subject to many estimates and assumptions, and may vary materially based on factors such as market conditions and the effect of our restructuring efforts on our work force. These estimates and assumptions are subject to

significant economic, competitive and other uncertainties, some of which are beyond our control. There can be no assurance that we will fully realize the anticipated positive impacts to future financial results from our current or future restructuring efforts. If our estimates and assumptions are incorrect or if other unforeseen events occur, we may not achieve the cost savings expected from such restructurings, and our business and results of operations could be adversely affected.

Industry consolidation may lead to stronger competition and may harm our operating results.

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There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. For example, some of our current and potential competitors for enterprise data center business have made acquisitions, or announced new strategic alliances, designed to position them with the ability to provide end-to-end technology solutions for the enterprise data center. Companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, operating results, and financial condition. Furthermore, particularly in the service provider market, rapid consolidation will lead to fewer customers, with the effect that loss of a major customer could have a material impact on results not anticipated in a customer marketplace composed of more numerous participants.

We intend to invest in engineering, sales, service, marketing and manufacturing on a long term basis, and delays or inability to attain the expected benefits may result in unfavorable operating results.

While we intend to focus on managing our costs and expenses, over the long term, we also intend to invest in personnel and other resources related to our engineering, sales, service, marketing and manufacturing functions as we focus on our foundational priorities, such as leadership in our core products and solutions and architectures for business transformation. We are likely to recognize the costs associated with these investments earlier than some of the anticipated benefits and the return on these investments may be lower, or may develop more slowly, than we expect. If we do not achieve the benefits anticipated from these investments, or if the achievement of these benefits is delayed, our operating results may be adversely affected.

We expect the average selling prices of our products to decrease, which may reduce gross margin and/or revenue.

The network equipment industry has traditionally experienced an erosion of average selling prices due to a number of factors, including competitive pricing pressures, promotional pricing and technological progress. We anticipate that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, excess inventories, increased sales discounts and new product introductions by us or our competitors. We may experience decreases in future operating results due to the erosion of our average selling prices. To maintain our gross margin, we must develop and introduce on a timely basis new products and product enhancements and continually reduce our product costs. Our failure to do so would likely cause our revenue and gross margin to decline.

Our success is dependent on our ability to continually introduce new products and features that achieve broad market acceptance.

The network equipment market is characterized by rapid technological progress, frequent new product introductions, changes in customer requirements and evolving industry standards. If we do not regularly introduce new products in this dynamic environment, our product lines will become obsolete. These new products must be compatible and inter-operate with products and architectures offered by other vendors. We have and may in the future experience delays in product development and releases, and such delays have and could in the future adversely affect our ability to compete and our operating results.

When we announce new products or product enhancements or end of sale existing products that have the potential to replace or shorten the life cycle of our existing products, customers may defer or cancel orders for our existing products. These actions could have a material adverse effect on our operating results by unexpectedly decreasing sales, increasing inventory levels of older products and exposing us to greater risk of product obsolescence.

Even if we introduce new switching products, alternative technologies could achieve widespread market acceptance and displace the Ethernet technology on which we have based our product architecture. For example, developments in routers and routing software could significantly reduce demand for our products. As a result, we may not be able to achieve widespread market acceptance of our current or future products.

The unfavorable economic environment has and may continue to negatively impact our business and operating results.

The challenges and uncertainty currently affecting global economic conditions may negatively impact our business and operating results in the following ways:

- customers may delay or cancel plans to purchase our products and services;

- customers may not be able to pay, or may delay payment of, the amounts that they owe us which may adversely affect our cash flow, the timing of our revenue recognition and the amount of revenue;
- increased pricing pressure may result from our competitors aggressively discounting their products;
- accurate budgeting and planning will be difficult due to low visibility into future sales;

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- forecasting customer demand will be more difficult, increasing the risk of either excess and obsolete inventory if our forecast is too high or insufficient inventory to meet customer demand if our forecast is too low; and
- our component suppliers and contract manufacturers have been negatively affected by the economy which may result in product delays and changes in pricing and service levels.

If global economic conditions do not show continued improvement, we believe that we could experience material adverse impacts to our business and operating results.

Claims of infringement by others may increase and the resolution of such claims may adversely affect our operating results.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patents, copyrights (including rights to “open source” software), and other intellectual property rights. Because of the existence of a large number of patents in the networking field, the secrecy of some pending patents and the issuance of new patents at a rapid pace, it is not possible to determine in advance if a product or component might infringe the patent rights of others. Because of the potential for courts awarding substantial damages and the lack of predictability of such awards, it is not uncommon for companies in our industry to settle even potentially unmeritorious claims for very substantial amounts. Further, the entities with whom we have or could have disputes or discussions include entities with extensive patent portfolios and substantial financial assets. These entities are actively engaged in programs to generate substantial revenue from their patent portfolios and are seeking or may seek significant payments or royalties from us and others in our industry.

Litigation resulting from claims that we are infringing the proprietary rights of others has resulted and could in the future result in substantial costs and a diversion of resources, and could have a material adverse effect on our business, financial condition and results of operations. We have received notices from entities alleging that we may be infringing their patents, and we are currently parties to patent litigation as described under Part I, Item 3, Legal Proceedings. Without regard to the merits of these or any other claims, an adverse court order or a settlement could require us, among other actions, to:

- stop selling our products that incorporate the challenged intellectual property;
- obtain a royalty bearing license to sell or use the relevant technology, and that license may not be available on reasonable terms or available at all;
- pay damages; or
- redesign those products that use the disputed technology.

In addition, our products include so-called “open source” software. Open source software is typically licensed for use at no initial charge, but imposes on the user of the open source software certain requirements to license to others both the open source software as well as modifications to the open source software. Our use of open source software subjects us to certain additional risks for the following reasons:

- open source license terms may be ambiguous and may result in unanticipated obligations regarding our products;
- open source software cannot be protected under trade secret law;
- suppliers of open-source software do not provide the warranty, support and liability protections typically provided by vendors who offer proprietary software; and
- it may be difficult for us to accurately determine the developers of the open source code and whether the acquired software infringes third-party intellectual property rights.

We believe that even if we do not infringe the rights of others, we will incur significant expenses in the future due to disputes or licensing negotiations, though the amounts cannot be determined. These expenses may be material or otherwise adversely affect our operating results.

Our operating results may be negatively affected by defending or pursuing claims or lawsuits.

We have and may in the future pursue or be subject to claims or lawsuits in the normal course of our business. In addition to the intellectual property lawsuits described above, we are currently parties to securities and contract litigation as described in Part I, Item 3. Legal Proceedings. Regardless of the result, litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a lawsuit in which we are a defendant could result in a court order against us or payments to other parties that would have an adverse effect on our business, results of operations, or financial

condition. Even if we are successful in prosecuting claims and lawsuits, we may not recover damages sufficient to cover our expenses incurred to manage, investigate and pursue the litigation. In addition,

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subject to certain limitations, we may be obligated to indemnify our current and former directors, officers and employees in certain lawsuits. We do not maintain insurance coverage which will cover all of our litigation costs and liabilities.

If we fail to protect our intellectual property, our business could suffer.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. However, we cannot ensure that the actions we have taken will adequately protect our intellectual property rights or that other parties will not independently develop similar or competing products that do not infringe on our patents. We generally enter into confidentiality or license agreements with our employees, consultants and corporate partners, and control access to and distribution of our intellectual property and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise misappropriate or use our products or technology, which would adversely affect our business.

When our products contain undetected errors, we may incur significant unexpected expenses and could lose sales.

Network products frequently contain undetected errors when new products or new versions or updates of existing products are released to the marketplace. In the past, we have experienced such errors in connection with new products and product updates. We have experienced component problems in prior years that caused us to incur higher than expected warranty, service costs and expenses, and other related operating expenses. In the future, we expect that, from time to time, such errors or component failures will be found in new or existing products after the commencement of commercial shipments. These problems may have a material adverse effect on our business by causing us to incur significant warranty, repair and replacement costs, diverting the attention of our engineering personnel from new product development efforts, delaying the recognition of revenue and causing significant customer relations problems. Further, if products are not accepted by customers due to such defects, and such returns exceed the amount we accrued for defective returns based on our historical experience, our operating results would be adversely affected.

Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. The occurrence of system errors, whether or not caused by our products, could result in the delay or loss of market acceptance of our products and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems would likely have a material adverse effect on our business, operating results and financial condition.

Our dependence on one manufacturer for our manufacturing requirements could harm our operating results.

We primarily rely on one manufacturing partner, Alpha Networks, Inc. headquartered in Hsinchu, Taiwan, to manufacture our products. We have experienced delays in product shipments from our manufacturing partner in the past, which in turn delayed product shipments to our customers. These or similar problems may arise in the future, such as delivery of products of inferior quality, delivery of insufficient quantity of products, or the interruption or discontinuance of operations of a manufacturer, any of which could have a material adverse effect on our business and operating results. In addition, any natural disaster or business interruption to our manufacturing partner could significantly disrupt our business. While we maintain strong relationships with our manufacturing partner, our agreements with this manufacturer are generally of limited duration and pricing, quality and volume commitments are negotiated on a recurring basis. The failure to maintain continuing agreements with our manufacturing partner could adversely affect our business. We intend to introduce new products and product enhancements, which will require that we rapidly achieve volume production by coordinating our efforts with those of our suppliers and contract manufacturer.

As part of our cost-reduction efforts, we will need to realize lower per unit product costs from our manufacturing partner by means of volume efficiencies and the utilization of manufacturing sites in lower-cost geographies. However, we cannot be certain when or if such price reductions will occur. The failure to obtain such price reductions would adversely affect our gross margins and operating results.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 Section 1502 (the “Dodd-Frank Act”) requires certain public companies to disclose whether certain minerals, commonly known as “conflict minerals,” are necessary to the functionality or production of a product manufactured by those companies and if those minerals originated in the Democratic Republic of the Congo (DRC) or an adjoining country. It may be possible that conflict

minerals may be part of the supply chain in the electronics industry and contained in our products. To comply with the Dodd-Frank Act, as determined by the U.S. Securities and Exchange Commission, we will be required to perform due diligence and disclose whether or not our products contain such minerals and from which countries and source (smelter)the minerals were obtained. The implementation of these requirements by government regulators and our partners and/or customers could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of certain components used in our products. In addition, we will incur additional costs to comply with the disclosure requirements for conflict minerals, including costs related to determining the source of any of the relevant minerals and metals used in our products. As a result, our business and financial results could be harmed.

Our dependence on an OEM for all of our wireless products could harm our operating results.

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We rely on Motorola to provide our wireless products. If we experience delays in product shipments from our OEM or if they experience delays from their suppliers, which in turn delays product shipments to our customers, our financial results could be negatively impacted. Problems such as delivery of products of inferior quality, delivery of insufficient quantity of products, or the interruption or discontinuance of operations of our OEM, may arise in the future, any of which could have a material adverse effect on our business and operating results.

We depend upon international sales for a significant portion of our revenue which imposes a number of risks on our business.

International sales constitute a significant portion of our net revenue. Our ability to grow will depend in part on the expansion of international sales. Our international sales primarily depend on the success of our resellers and distributors. The failure of these resellers and distributors to sell our products internationally would limit our ability to sustain and grow our revenue. There are a number of risks arising from our international business, including:

- longer accounts receivable collection cycles;
- difficulties in managing operations across disparate geographic areas;
- difficulties associated with enforcing agreements through foreign legal systems;
- higher credit risks requiring cash in advance or letters of credit;
- difficulties in safeguarding intellectual property;
- political and economic turbulence;
- terrorism, war or other armed conflict;
- natural disasters and epidemics;
- potential adverse tax consequences;
- compliance with regulatory requirements of foreign countries, including compliance with rapidly evolving environmental regulations;
- compliance with U.S. laws and regulations pertaining to the sale and distribution of products to customers in foreign countries, including export controls and the Foreign Corrupt Practices Act; and
- the payment of operating expenses in local currencies, which exposes us to risks of currency fluctuations.

All of our international sales are U.S. dollar-denominated. Future increases in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. In the future, we may elect to invoice some of our international customers in local currency, which would expose us to fluctuations in exchange rates between the U.S. dollar and the particular local currency. If we do so, we may decide to engage in hedging transactions to minimize the risk of such fluctuations.

We have entered into foreign exchange forward contracts to offset the impact of payment of operating expenses in local currencies to some of our operating foreign subsidiaries. However, if we are not successful in managing these foreign currency transactions, we could incur losses from these activities.

We must continue to develop and increase the productivity of our indirect distribution channels to increase net revenue and improve our operating results.

Our distribution strategy focuses primarily on developing and increasing the productivity of our indirect distribution channels. If we fail to develop and cultivate relationships with significant channel partners, or if these channel partners are not successful in their sales efforts, sales of our products may decrease and our operating results could suffer. Many of our channel partners also sell products from other vendors that compete with our products. Our channel partners may not continue to market or sell our products effectively or to devote the resources necessary to provide us with effective sales, marketing and technical support. We may not be able to successfully manage our sales channels or enter into additional reseller and/or distribution agreements. Our failure to do any of these could limit our ability to grow or sustain revenue.

Our operating results for any given period have and will continue to depend to a significant extent on large orders from a relatively small number of channel partners and other customers. However, we do not have binding purchase commitments from any of them. A substantial reduction or delay in sales of our products to a significant reseller, distributor or other customer could harm our business, operating results and financial condition because our expense levels are based on our expectations as to future revenue and to a large extent are fixed in the short term. Under specified conditions, some third-party distributors are allowed to return products to us and unexpected returns could

adversely affect our results.

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The sales cycle for our products is long and we may incur substantial non-recoverable expenses or devote significant resources to sales that do not occur when anticipated.

Our products represent a significant strategic decision by a customer regarding its communications infrastructure. The decision by customers to purchase our products is often based on the results of a variety of internal procedures associated with the evaluation, testing, implementation and acceptance of new technologies. Accordingly, the product evaluation process frequently results in a lengthy sales cycle, typically ranging from three months to longer than a year, and as a result, our ability to sell products is subject to a number of significant risks, including risks that:

- budgetary constraints and internal acceptance reviews by customers will result in the loss of potential sales;
- there may be substantial variation in the length of the sales cycle from customer to customer, making decisions on the expenditure of resources difficult to assess;
- we may incur substantial sales and marketing expenses and expend significant management time in an attempt to initiate or increase the sale of products to customers, but not succeed;
- if a sales forecast from a specific customer for a particular quarter is not achieved in that quarter, we may be unable to compensate for the shortfall, which could harm our operating results; and
- downward pricing pressures could occur during the lengthy sales cycle for our products.

To successfully manage our business or achieve our goals, we must attract, retain, train, motivate, develop and promote key employees, and failure to do so can harm us.

Our success depends to a significant degree upon the continued contributions of our key management, engineering, sales and marketing, service and operations personnel, many of whom would be difficult to replace. We do not have employment contracts with these individuals that mandate that they render services for any specific term, nor do we carry life insurance on any of our key personnel. We have experienced and may in the future experience significant turnover in our executive personnel. In addition, retention has generally become more difficult for us, in part because the exercise price of most of the stock options granted to many of our employees is below the market price. As a result, we experienced high levels of attrition. We believe our future success will also depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing, service, finance and operations personnel. The market for these personnel is competitive, and we have had difficulty in hiring employees, particularly engineers, in the time-frame we desire.

Companies in the networking industry whose employees accept positions with competitors frequently claim that competitors have engaged in unfair hiring practices. We have from time to time been involved in claims like this with other companies and, although to date they have not resulted in material litigation, we do not know whether we will be involved in additional claims in the future. We could incur substantial costs in litigating any such claims, regardless of the merits.

Failure to successfully expand our sales and support teams or educate them in regard to technologies and our product families may harm our operating results.

The sale of our products and services requires a concerted effort that is frequently targeted at several levels within a prospective customer's organization. We may not be able to increase net revenue unless we expand our sales and support teams in order to address all of the customer requirements necessary to sell our products.

We cannot assure you that we will be able to successfully integrate employees into our company or to educate current and future employees in regard to rapidly evolving technologies and our product families. A failure to do so may hurt our revenue growth and operating results.

Failure of our products to comply with evolving industry standards and complex government regulations may adversely impact our business.

If we do not comply with existing or evolving industry standards and government regulations, we may not be able to sell our products where these standards or regulations apply. The network equipment industry in which we compete is characterized by rapid changes in technology and customers' requirements and evolving industry standards. As a result, our success depends on:

- the timely adoption and market acceptance of industry standards, and timely resolution of conflicting U.S. and international industry standards; and

- our ability to influence the development of emerging industry standards and to introduce new and enhanced products that are compatible with such standards.

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In the past, we have introduced new products that were not compatible with certain technological standards, and in the future, we may not be able to effectively address the compatibility and interoperability issues that arise as a result of technological changes and evolving industry standards.

Our products must also comply with various U.S. federal government regulations and standards defined by agencies such as the Federal Communications Commission, standards established by governmental authorities in various foreign countries and recommendations of the International Telecommunication Union. In some circumstances, we must obtain regulatory approvals or certificates of compliance before we can offer or distribute our products in certain jurisdictions or to certain customers. Complying with new regulations or obtaining certifications can be costly and disruptive to our business.

If we do not comply with existing or evolving industry standards or government regulations, we will not be able to sell our products where these standards or regulations apply, which may prevent us from sustaining our net revenue or achieving profitability.

Changes in the effective tax rate including from the release of the valuation allowance recorded against our net U.S. deferred tax assets, or adverse outcomes resulting from examination of our income or other tax returns or change in ownership, could adversely affect our results.

Our future effective tax rates may be volatile or adversely affected by changes in our business or U.S. or foreign tax laws, including: the partial or full release of the valuation allowance recorded against our net U.S. deferred tax assets; expiration of or lapses in the research and development tax credit laws; transfer pricing adjustments; tax effects of stock-based compensation; or costs related to restructurings. In addition, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. Although we regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes, there is no assurance that such determinations by us are in fact adequate. Changes in our effective tax rates or amounts assessed upon examination of our tax returns may have a material, adverse impact on our cash flows and our financial condition.

Our future effective tax rate in particular could be adversely affected by a change in ownership pursuant to U.S. Internal Revenue Code Section 382. If a change in ownership occurs, it may limit our ability to utilize our net operating losses to offset our U.S. taxable income. If U.S. taxable income is greater than the change in ownership limitation, we will pay a higher rate of tax with respect to the amount of taxable income that exceeds the limitation. This could have a material adverse impact on our results of operations. On April 26, 2012, we adopted an Amended and Restated Rights Agreement to help protect our assets (the “Rights Agreement”). In general, this does not allow a stockholder to acquire more than 4.95% of our outstanding common stock without a waiver from our board of directors, who must take into account the relevant tax analysis relating to potential limitation of our net operating losses. The Rights Agreement is effective through April 30, 2014.

If we do not adequately manage and evolve our financial reporting and managerial systems and processes, our ability to manage and grow our business may be harmed.

Our ability to successfully implement our business plan and comply with regulations requires an effective planning and management process. We need to continue improving our existing, and implement new, operational and financial systems, procedures and controls. Any delay in the implementation of, or disruption in the transition to, new or enhanced systems, procedures or controls, could harm our ability to record and report financial and management information on a timely and accurate basis, or to forecast future results.

Compliance with laws, rules and regulations relating to corporate governance and public disclosure may result in additional expenses.

Federal securities laws, rules and regulations, as well as NASDAQ rules and regulations, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their Chief Executive Officers, Chief Financial Officers and directors for securities law violations. These laws, rules and regulations and the interpretation of these requirements are evolving, and we are making investments to evaluate current practices and to continue to achieve compliance.

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Our headquarters and some significant supporting businesses are located in northern California and other areas subject to natural disasters that could disrupt our operations and harm our business.

Our corporate headquarters are located in Silicon Valley in Northern California. Historically, this region as well as our R&D center in North Carolina has been vulnerable to natural disasters and other risks, such as earthquakes, fires, floods and tropical storms, which at times have disrupted the local economy and posed physical risks to our property. We have contract manufacturers located in Taiwan where similar natural disasters and other risks may disrupt the local economy and pose physical risks to our property and the property of our contract manufacturer.

In addition, the continued threat of terrorism and heightened security and military action in response to this threat, or any future acts of terrorism, may cause further disruptions to the economies of the U.S. and other countries. If such disruptions result in delays or cancellations of customer orders for our products, our business and operating results will suffer.

We currently do not have redundant, multiple site capacity in the event of a natural disaster, terrorist act or other catastrophic event. In the event of such an occurrence, our business would suffer.

Our stock price has been volatile in the past and our stock price may significantly fluctuate in the future.

In the past, our common stock price has fluctuated significantly. This could continue as we or our competitors announce new products, our results or those of our customers or competition fluctuate, conditions in the networking or semiconductor industry change, or when investors, change their sentiment toward stocks in the networking technology sector.

In addition, fluctuations in our stock price and our price-to-earnings multiple may make our stock attractive to momentum, hedge or day-trading investors who often shift funds into and out of stock rapidly, exacerbating price fluctuations in either direction, particularly when viewed on a quarterly basis.

Provisions in our charter documents and Delaware law and our adoption of a stockholder rights plan may delay or prevent an acquisition of Extreme, which could decrease the value of our Common Stock.

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our Board of Directors. Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, our Board of Directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Although we believe these provisions of our certificate of incorporation and bylaws and Delaware law will provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our Board of Directors, these provisions apply even if the offer may be considered beneficial by some of our stockholders.

Our Rights Agreement provides that if a single stockholder (or group) acquires more than 4.95% of our outstanding common stock without a waiver from our Board of Directors, each holder of one share of our common stock (other than the stockholder or group who acquired in excess of 4.95% of our common stock) may purchase a fractional share of our preferred stock that would result in substantial dilution to the triggering stockholder or group. Accordingly, although this plan is designed to prevent any limitation on the utilization of our net operating losses by avoiding issues raised under Section 382 of the U.S. Internal Revenue Code, the Rights Agreement could also serve as a deterrent to stockholders wishing to effect a change of control.

We rely on the availability of third-party licenses

Some of our products are designed to include software or other intellectual property licensed from third parties. It may be necessary in the future to seek or renew licenses relating to various aspects of these products. There can be no assurance that the necessary licenses would be available on acceptable terms, if at all. The inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could have a material adverse effect on our business, operating results, and financial condition. Moreover, the inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability to protect our proprietary rights in our products.

Market conditions and changes in the industry could lead to discontinuation of our products or businesses resulting in asset impairments

In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as inventory and technology-related write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Although in certain instances,

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our supply agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed, our loss contingencies may include liabilities for contracts that we cannot cancel with contract manufacturers and suppliers. Further, our estimates relating to the liabilities for excess facilities are affected by changes in real estate market conditions.

If our products do not effectively inter-operate with our customers' networks and result in cancellations and delays of installations our business could be harmed.

Our products are designed to interface with our customers' existing networks, each of which have different specifications and utilize multiple protocol standards and products from other vendors. Many of our customers' networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products must inter-operate with many or all of the products within these networks as well as future products in order to meet our customers' requirements. If we find errors in the existing software or defects in the hardware used in our customers' networks, we may need to modify our software or hardware to fix or overcome these errors so that our products will inter-operate and scale with the existing software and hardware, which could be costly and could negatively affect our business, financial condition, and results of operations. In addition, if our products do not inter-operate with those of our customers' networks, demand for our products could be adversely affected or orders for our products could be cancelled. This could hurt our operating results, damage our reputation, and seriously harm our business and prospects.

System security risks, data protection breaches, and cyber-attacks could compromise our proprietary information, disrupt our internal operations and harm public perception of our products, which could adversely affect our business.

In the ordinary course of business, we store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners on our networks. The secure maintenance of this information is critical to our operations and business strategy. Increasingly, companies, including Extreme Networks, are subject to a wide variety of attacks on their networks on an ongoing basis. Despite our security measures, Extreme Networks' information technology and infrastructure may be vulnerable to penetration or attacks by computer programmers and hackers, or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks, creating system disruptions or slowdowns and exploiting security vulnerabilities of our products, and the information stored on our networks could be accessed, publicly disclosed, lost or stolen, which could subject us to liability to our customers, suppliers, business partners and others, and cause us reputational and financial harm. In addition, sophisticated hardware and operating system software and applications that we produce or procure from third parties may contain defects in design or manufacture, including "bugs" and other problems that could unexpectedly interfere with the operation of our networks.

If an actual or perceived breach of network security occurs in our network or in the network of a customer of our networking products, regardless of whether the breach is attributable to our products, the market perception of the effectiveness of our products could be harmed. In addition, the economic costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software systems and security vulnerabilities could be significant and may be difficult to anticipate or measure. Because the techniques used by computer programmers and hackers, many of whom are highly sophisticated and well-funded, to access or sabotage networks change frequently and generally are not recognized until after they are used, we may be unable to anticipate or immediately detect these techniques. This could impede our sales, manufacturing, distribution or other critical functions, which could adversely affect our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We currently have authority granted by our Board of Directors to repurchase up to $75 million in common stock over a three year period starting October 1, 2012. For the three month period ended September 30, 2013, the Company did not repurchase any shares of its common stock.

Item 3. Defaults Upon Senior Securities - Not applicable

Item 4. Mine Safety Disclosure - Not Applicable

Item 5. Other Information

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Item 6. Exhibits

(a) Exhibits:

Exhibit Number	Description of Document	Incorporated by Reference			Filed Herewith
		Form	Filing Date	Number	
10.1	Offer Letter between Extreme Networks, Inc. and Ed Carney.	8-K	7/29/2013	10.1	
10.2	Release of Claims, dated August 20, 2013, between Extreme Networks, Inc. and David Ginsburg.	8-K	8/23/2013	10.1	
2.1	Stock Purchase Agreement, dated September 12, 2013, between Extreme Networks, Inc. and Enterprise Networks Holdings, Inc.	8-K	9/13/2013	2.1	
31.1	Section 302 Certification of Chief Executive Officer				X
31.2	Section 302 Certification of Chief Financial Officer				X
32.1	Section 906 Certification of Chief Executive Officer				X
32.2	Section 906 Certification of Chief Financial Officer				X
101.INS	XBRL Instance Document.*				
101.SCH	XBRL Taxonomy Extension Schema Document.*				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*				

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended; are

deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended; and otherwise are not subject to liability under these sections.

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SIGNATURES

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

EXTREME NETWORKS, INC.
(Registrant)

/S/ JOHN KURTZWEIL
JOHN KURTZWEIL
Senior Vice President, Chief Financial Officer, and Chief Accounting Officer
November 4, 2013