FINISAR CORP
Form 424B3
August 15, 2005

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Filed Pursuant to Rule 424(b)(3)
Registration No. 333-124879

19,496,177 Shares
FINISAR CORPORATION
Common Stock

This prospectus relates to the public offering of a maximum of 19,496,177 shares of common stock of Finisar Corporation registered for sale under this prospectus that will be owned by Data Transit Corp., a Delaware corporation, upon their issuance. Data Transit Corp. is the holder of a $16,270,000 8% convertible installment note, which was issued to it in connection with our acquisition of substantially all of its assets. The terms of the convertible installment note provide for automatic conversion of the outstanding principal and interest into shares of our common stock. Since the number of shares to be issued to Data Transit Corp. is based upon the market price of our common stock at the time of conversion, we are unable to determine the exact number of shares that may be issued pursuant to the convertible installment note. As of July 29, 2005, the outstanding principal amount of the convertible installment note was $12,044,771.45.

The shares of our common stock may be offered from time to time by the selling stockholder. All of the expenses of registration incurred in connection with this offering are being borne by us, but all selling and other expenses incurred by the selling stockholder will be borne by the selling stockholder. The common stock offered in this prospectus may be offered and sold by the selling stockholder directly or through broker-dealers acting as agents or principals. The distribution of the common stock may be effected in one or more of the following types of transactions:

transactions on any national securities exchange or quotation service on which the common stock may be listed or quoted at the time of the sale, including the Nasdaq National Market;

transactions in the over-the-counter market; or

transactions otherwise than on such exchanges or services or in the over-the-counter market.

We will receive no part of the proceeds of the sale of the shares offered in this prospectus.

Our common stock is traded on the Nasdaq National Market under the symbol FNSR. On August 11, 2005, the last reported sales price for the common stock was $1.03 per share.

INVESTING IN THE COMMON STOCK OFFERED IN THIS PROSPECTUS INVOLVES A HIGH DEGREE OF RISK. SEE RISK FACTORS BEGINNING ON PAGE 4.

The selling stockholder and any brokers executing selling orders on behalf of the selling stockholder may be deemed to be underwriters within the meaning of the Securities Act of 1933. Commissions received by a broker executing selling orders may be deemed to be underwriting commissions under the Securities Act.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus is August 12, 2005.

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You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. The selling stockholder is not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

Finisar is a registered trademark of Finisar Corporation. This prospectus contains product names, trade names and trademarks of Finisar and other organizations.

The terms Finisar, we, us, our, and the company, as used in this prospectus, refer to Finisar Corporation and consolidated subsidiaries.

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements in this prospectus and in the documents incorporated by reference constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We use words like anticipates, believes, plans, expects, future, intends and similar expressions to identify these forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events; however, our business and operations are subject to a variety of risks and uncertainties, including those listed under Risk Factors and elsewhere in this prospectus, and, consequently, actual results may materially differ from those projected by any forward-looking statements. You should not place undue reliance on these forward-looking statements. Factors that could cause actual results to differ from those projected include, but are not limited to, the following:

- uncertainty regarding our future operating results;
- our ability to introduce new products in a cost-effective manner that are accepted in the marketplace;
- delays or loss of sales due to long product qualification cycles for our products;
- the possibility of lower prices, reduced gross margins and loss of market share due to increased competition;
- increased demands on our resources due to the integration of several companies and product lines that we have acquired or may acquire;
- cost reductions related to our current or future operations which may further reduce our available resources and negatively impact our competitive market position; and
- the sufficiency of cash flow to meet our debt service obligations and the potential dilution that would result from the conversion of our outstanding subordinated convertible notes.

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SUMMARY

This summary highlights selected information contained elsewhere in this prospectus. You should read the entire prospectus and the documents incorporated by reference in this prospectus carefully before making an investment decision.

Finisar Corporation

We are a leading provider of optical subsystems and components and network performance test and monitoring systems. These products enable high-speed data communications over local area networks, or LANs, storage area networks, or SANs, and metropolitan area networks, or MANs. Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for SAN, LAN and MAN applications. Optical subsystems also include multiplexers, demultiplexers and optical add/drop modules used in MAN applications. We are focused on the application of digital fiber optics to provide a broad line of high-performance, reliable, value-added optical subsystems for data networking and storage equipment manufacturers. Our line of optical subsystems supports a wide range of network protocols, transmission speeds, distances, physical mediums and configurations. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications. We also provide network performance test and monitoring systems to original equipment manufacturers for testing and validating equipment designs and to operators of networking and storage data centers for testing, monitoring and troubleshooting the performance of their installed systems. We sell our products primarily to leading storage and networking equipment manufacturers such as Brocade, Cisco Systems, EMC, Emulex, Hewlett-Packard Company and Qlogic.

We were incorporated in California in April 1987 and reincorporated in Delaware in November 1999. Our principal executive offices are located at 1308 Moffett Park Drive, Sunnyvale, California 94089, and our telephone number is (408) 548-1000 and our website is located at www.finisar.com. Information on our website is not a part of this prospectus.

Recent Developments

During our fiscal year ended April 30, 2005, we acquired one company and certain assets and businesses of two other companies. In the first quarter of fiscal 2006, we completed the acquisition of another company. These acquisitions have enabled us to broaden our product offerings, add new sources of revenues and obtain advanced technologies.

Acquisition of Assets of Data Transit Corp.

On August 6, 2004, we completed the purchase of substantially all the assets of Data Transit Corp. in exchange for a cash payment of $500,000 and the issuance of a convertible installment note in the original principal amount of approximately $16.3 million, convertible into shares of our common stock. The acquired business, previously based in San Jose, California, manufactures protocol analyzers and traffic generators and is now operated as a part of our Network Tools Division at our facility in Sunnyvale, California.

Acquisition of Transceiver and Transponder Product Line from Infineon Technologies AG

On April 29, 2004, we entered into an agreement with Infineon Technologies AG to acquire Infineon s fiber optics business unit. On October 11, 2004, we entered into an amended purchase agreement under which the terms of the original acquisition agreement were modified. On January 25, 2005, we and Infineon terminated the amended purchase agreement and entered into a new agreement under which we acquired certain assets of Infineon s fiber optics business unit associated with the design, development and manufacture of optical transceiver and transponder products in exchange for 34 million shares of our common stock. The closing of the acquisition took place on January 31, 2005, the first day of our fourth quarter of fiscal 2005. The transaction involved the acquisition of product lines, equipment and intellectual property related to Infineon s optical transceiver and transponder products.

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Acquisition of I-TECH CORP.

On April 8, 2005, we completed the acquisition of I-TECH CORP., a privately-held network test and monitoring company based in Eden Prairie, Minnesota in exchange for promissory notes in the aggregate principal amount of approximately $12.1 million, convertible into shares of our common stock. The acquired business is being consolidated with the other operations of our Network Tools Division located in Sunnyvale, California.

Acquisition of InterSAN, Inc.

On May 12, 2005, we completed the acquisition of InterSAN, Inc., a privately-held company located in Scotts Valley, California in exchange for approximately 7.1 million shares of our common stock. InterSAN provides network testing and monitoring software and is now operated as a part of our Network Tools Division located in Sunnyvale, California.

The Offering

All of the shares of common stock registered for sale under this prospectus will be owned by Data Transit Corp., a Delaware corporation, upon their issuance. Data Transit Corp. is the holder of a $16,270,000 8% convertible installment note, which was issued to it in connection with our acquisition of substantially all of its assets in August 2004. The terms of the convertible installment note provide for automatic conversion of the outstanding principal and interest. Since the number of shares to be issued to Data Transit Corp. is based upon the market price of our common stock at the time of conversion, we are unable to determine the exact number of shares that may be issued pursuant to the convertible installment note.

Pursuant to the terms of the acquisition, we agreed to register for resale the shares of common stock issuable upon conversion of the convertible installment note. This prospectus covers the resale by Data Transit Corp. of the shares of common stock that it will receive upon conversion of the convertible installment note. Except in very limited circumstances, at no time will Data Transit Corp. own more than 4.99% of our outstanding shares of common stock.

Common stock offered by selling stockholder	19,496,177 shares(1).
Common stock outstanding	277,048,404 shares outstanding as of June 30, 2005(2).
Use of proceeds	We will not receive any of the proceeds from the sale of shares by the selling stockholder.
Nasdaq National Market symbol	FNSR

(1) Estimated by multiplying the original principal amount of the convertible installment note plus an estimated amount of interest by 120% (to take into account possible share fluctuations) and dividing by the estimated conversion price of $1.085 (the average of the high and low sales prices of our common stock on June 13, 2005, the day prior to the effective date of the original registration statement which is amended by the registration statement of which this prospectus is a part). At July 29, 2005, the outstanding principal amount of the convertible installment note was $12,044,771.45.

(2) The number of shares that will be outstanding after the offering is based on the number of shares outstanding as of June 30, 2005, and excludes (i) shares of common stock reserved for issuance under our stock option plans and employee stock purchase plan and upon exercise of stock options and warrants assumed in connection with our acquisitions of six privately-held companies; (ii) the shares of common stock issuable upon conversion of the principal amount of $13,964,549.26 outstanding as of June 30, 2005 under the convertible installment note issued as consideration for our acquisition of the assets of Data Transit Corp. in August 2004; (iii) a portion of the shares of common stock issued in connection with the acquisition of InterSAN, Inc. in May 2005; (iv) the shares of common stock issuable upon conversion of the principal amount of $4,776,545.56 outstanding as of June 30, 2005 under the promissory notes issued as consideration for our acquisition of I-TECH CORP in April 2005; and (v) the shares of common stock issuable upon conversion of the principal amount of $937,500 outstanding as of June 30, 2005 under a promissory note issued to CyOptics Inc. in April 2005.

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Summary Financial Data
(In thousands, except per share data)

The following summary financial data should be read together with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto included elsewhere in this prospectus. The statement of operations data set forth below for the fiscal years ended April 30, 2005, 2004 and 2003 and the balance sheet data as of April 30, 2005 and 2004 are derived from, and are qualified by reference to, our audited consolidated financial statements included elsewhere in this prospectus. The statement of operations data set forth below for the fiscal years ended April 30, 2002 and 2001 and the balance sheet data as of April 30, 2003, 2002 and 2001 are derived from audited financial statements not included in this prospectus. The Management s Discussion and Analysis of Financial Condition and Results of Operations related to the statement of operations and balance sheet data for the fiscal years ended April 30, 2002 and 2001 are not included in this prospectus.

	Fiscal Years Ended April 30,				
	2005	2004	2003	2002	2001
Statement of Operations Data:					
Revenues	$ 280,823	$ 185,618	$ 166,482	$ 147,265	$ 188,800
Gross profit (loss)	49,268	22,794	13,998	(16,480)	46,349
Loss from operations	(88,597)	(83,451)	(100,931)	(258,596)	(117,192)
Net loss	$ (114,107)	$ (113,833)	$ (619,753)	$ (218,738)	$ (85,449)
Net loss per share basic and diluted:	$ (0.49)	$ (0.53)	$ (3.17)	$ (1.21)	$ (0.53)
Shares used in per share calculations:					
Basic and diluted	232,210	216,117	195,666	181,136	160,014

	As of April 30,				
	2005	2004	2003	2002	2001
Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 102,362	$ 143,398	$ 119,438	$ 144,097	$ 146,111
Working capital	120,272	172,892	149,967	222,603	249,000
Total assets	488,985	494,705	423,606	1,041,281	1,029,995
Long-term liabilities	265,274	233,732	101,531	106,869	45,354
Convertible preferred stock					1
Total stockholders equity	144,290	202,845	274,980	879,002	941,851

Net income in fiscal 2003 reflects our adoption of Statements of Financial Accounting Standards 141 and 142 on May 1, 2002. As a result of our adoption, reported net loss decreased by approximately $127.8 million, or $0.65 per share, due to the cessation of the amortization of goodwill and the amortization of acquired workforce and customer base.

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RISK FACTORS

An investment in the securities offered by this prospectus involves a high degree of risk. You should carefully consider the following factors and other information in this prospectus and in the documents incorporated by reference in this prospectus before deciding to purchase shares of our common stock. If any of these risks occur, our business could be harmed, the trading price of our stock could decline and you may lose all or part of your investment.

We are subject to a number of special risks as a result of our recent acquisition of the fiber optics transceiver business of Infineon Technologies AG

On January 25, 2005, we entered into an agreement with Infineon Technologies AG to acquire certain assets associated with the design, development and manufacture of the optical transceiver and transponder products of Infineon s fiber optics business unit in exchange for 34,000,000 shares of Finisar common stock. The acquisition closed on January 31, 2005. Our future results of operation will be substantially influenced by the operations of the new business, and we are subject to a number of risks and uncertainties related to the acquisition, including the following:

The integration of the former Infineon transceiver and transponder products and technology with our products and technology and the transition of the manufacturing operations for such products to our facilities will be complex, time-consuming and expensive. The execution of these activities could potentially disrupt our ongoing business operations and distract management from day-to-day operational matters, as well as other strategic opportunities, and could strain our financial and managerial controls and reporting systems and procedures. In addition, unanticipated costs could arise during the integration of the products and technology and the transition of manufacturing operations to our facilities. If we are unable to successfully integrate the former Infineon products and technology with our products and technology, or if actual integration and transition costs are significantly greater than currently anticipated, we may not achieve the anticipated benefits of the acquisition and our revenues and operating results could be adversely affected.

We will be dependent on Infineon to supply us with finished goods for a transition period of up to one year while we transfer manufacturing operations to our facilities. Infineon s failure to supply us with high quality products in a timely manner could adversely affect our operating results and our ability to retain the former customers of Infineon. In addition, we expect to realize lower gross profit margins on the sale of products supplied by Infineon than on the sale of products we manufacture until such time as those products are manufactured by us.

We plan to transition the manufacture of the former Infineon transceiver and transponder products from Infineon s production facilities to our facilities over a period of time. Some of the former Infineon customers may be unwilling to purchase products manufactured at our facilities without subjecting the products to new qualification testing procedures, and some customers may be unwilling to undertake these procedures and may elect to buy products from other suppliers. Delays in or losses of sales due to these requalification issues could result in lower revenues which could adversely affect our future operating results.

Some of the existing customers for the Infineon products may decide for other reasons to purchase similar products from other competitors. The loss of one or more significant customers of the former Infineon business could result in lower revenues which would adversely affect our future operating results.

Immediately prior to the acquisition, Infineon was engaged in a number of ongoing research and development projects related to its transceiver products and related technologies. We may not be able to successfully complete some or all of these projects, and our inability to do so could prevent us from achieving some of the strategic objectives and other anticipated potential benefits of the acquisition, and could have a material adverse effect on our revenues and operating results.

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We may incur charges to operations in amounts that are not currently estimable to reflect costs associated with integrating the acquired business with our company. These costs could adversely affect our future operating results.

At the closing of the acquisition, we issued 34 million shares of our common stock to Infineon, which represented approximately 13% of the outstanding capital stock of Finisar at that time. The issuance of these shares caused a significant reduction in the relative percentage interest of current Finisar stockholders. In April 2005, Infineon sold the 34 million shares to certain funds managed by VantagePoint Venture Partners in a private transaction.

As a result of the acquisition, Finisar has become a substantiality larger organization, and if our management is unable to effectively manage the combined business, our operating results will suffer.

Past and future acquisitions could be difficult to integrate, disrupt our business, dilute stockholder value and harm our operating results

Since October 2000, we have completed the acquisition of eight privately-held companies, including our recent acquisitions of I-TECH CORP. in April 2005 and InterSAN, Inc. in May 2005, and certain businesses and assets from five other companies, including our recently completed acquisitions of certain assets related to the transceiver and transponder business of the fiber optics business unit of Infineon. We continue to review opportunities to acquire other businesses, product lines or technologies that would complement our current products, expand the breadth of our markets or enhance our technical capabilities, or that may otherwise offer growth opportunities, and we from time to time make proposals and offers, and take other steps, to acquire businesses, products and technologies. Several of our past acquisitions have been material, and acquisitions that we may complete in the future may be material. In 10 of our 13 acquisitions, we issued stock as all or a portion of the consideration. We will issue additional shares upon conversion of the promissory notes issued as consideration for the acquisitions of Data Transit and I-TECH. The issuance of stock in these and any future transactions has or would dilute stockholders percentage ownership.

Other risks associated with acquiring the operations of other companies include:

problems assimilating the purchased operations, technologies or products;

unanticipated costs associated with the acquisition;

diversion of management s attention from our core business;

adverse effects on existing business relationships with suppliers and customers;

risks associated with entering markets in which we have no or limited prior experience; and

potential loss of key employees of purchased organizations.

Several of our past acquisitions have not been successful. During fiscal 2003, we sold some of the assets acquired in two prior acquisitions, discontinued a product line and closed one of our acquired facilities. As a result of these activities, we have incurred significant restructuring charges and charges for the write-down of assets associated with those acquisitions. We cannot assure you that we will be successful in overcoming future problems encountered in connection with our past or future acquisitions, and our inability to do so could significantly harm our business. In addition, to the extent that the economic benefits associated with any of our acquisitions diminish in the future, we may be required to record additional write downs of goodwill, intangible assets or other assets associated with such acquisitions, which would adversely affect our operating results.

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We have incurred significant net losses, our future revenues are inherently unpredictable, our operating results are likely to fluctuate from period to period, and if we fail to meet the expectations of securities analysts or investors, our stock price could decline significantly

We incurred net losses of $114.1 million, $113.8 million and $619.8 million in our fiscal years ended April 30, 2005, 2004 and 2003, respectively. Our operating results for future periods are subject to numerous uncertainties, and we cannot assure you that we will be able to achieve or sustain profitability.

Our quarterly and annual operating results have fluctuated substantially in the past and are likely to fluctuate significantly in the future due to a variety of factors, some of which are outside of our control. Accordingly, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indications of future performance. Some of the factors that could cause our quarterly or annual operating results to fluctuate include market acceptance of our products, market demand for the products manufactured by our customers, the introduction of new products and manufacturing processes, manufacturing yields, competitive pressures and customer retention.

We may experience a delay in generating or recognizing revenues for a number of reasons. Orders at the beginning of each quarter typically represent a small percentage of expected revenues for that quarter and are generally cancelable at any time. Accordingly, we depend on obtaining orders during each quarter for shipment in that quarter to achieve our revenue objectives. Failure to ship these products by the end of a quarter may adversely affect our operating results. Furthermore, our customer agreements typically provide that the customer may delay scheduled delivery dates and cancel orders within specified timeframes without significant penalty. Because we base our operating expenses on anticipated revenue trends and a high percentage of our expenses are fixed in the short term, any delay in generating or recognizing forecasted revenues could significantly harm our business. It is likely that in some future quarters our operating results will again decrease from the previous quarter or fall below the expectations of securities analysts and investors. In this event, it is likely that the trading price of our common stock would significantly decline.

We may have insufficient cash flow to meet our debt service obligations, including payments due on our subordinated convertible notes

We will be required to generate cash sufficient to conduct our business operations and pay our indebtedness and other liabilities, including all amounts due on our outstanding 2 1/2% and 5 1/4% convertible subordinated notes due 2010 and 2008, respectively. The aggregate outstanding principal amount of these notes was $250 million at April 30, 2005. Holders of the notes due in 2010 have the right to require us to repurchase some or all of their notes on October 15, 2007. We may choose to pay the repurchase price in cash, shares of our common stock or a combination thereof. We may not be able to cover our anticipated debt service obligations from our cash flow. This may materially hinder our ability to make payments on the notes. Our ability to meet our future debt service obligations will depend upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. Accordingly, we cannot assure you that we will be able to make required principal and interest payments on the notes when due.

We may not be able to obtain additional capital in the future, and failure to do so may harm our business

We believe that our existing balances of cash, cash equivalents and short-term investments will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may, however, require additional financing to fund our operations in the future or to repay the principal of our outstanding 2 1/2% and 5 1/4% convertible subordinated notes due 2010 and 2008, respectively. The significant contraction in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we continue to experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, we could be required to significantly reduce or restructure our business operations.

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Failure to accurately forecast our revenues could result in additional charges for obsolete or excess inventories or non-cancelable purchase commitments

We base many of our operating decisions, and enter into purchase commitments, on the basis of anticipated revenue trends which are highly unpredictable. Some of our purchase commitments are not cancelable, and in some cases we are required to recognize a charge representing the amount of material or capital equipment purchased or ordered which exceeds our actual requirements. In the past, we have sometimes experienced significant growth followed by a significant decrease in customer demand such as occurred in fiscal 2001, when revenues increased by 181% followed by a decrease of 22% in fiscal 2002. Based on projected revenue trends during these periods, we acquired inventories and entered into purchase commitments in order to meet anticipated increases in demand for our products which did not materialize. As a result, we recorded significant charges for obsolete and excess inventories and non-cancelable purchase commitments which contributed to substantial operating losses in fiscal 2002. Should revenue in future periods again fall substantially below our expectations, or should we fail again to accurately forecast changes in demand mix, we could be required to record additional charges for obsolete or excess inventories or non-cancelable purchase commitments.

Our operating expenses may need to be further reduced which could impact our future growth

We experienced a significant decline in revenues and operating results during fiscal 2002. While revenues have recovered to some extent beginning in fiscal 2003, they have not yet reached levels required to operate on a profitable basis due primarily to higher fixed expenses related to a number of acquisitions, low gross margins and continued high levels of spending for research and development in anticipation of future revenue growth. While we continue to expect future revenue growth, we have taken steps to reduce our operating expenses in order to conserve our cash, and we may be required to take further action to reduce expenses. These expense reduction measures may adversely affect our ability to market our products, introduce new and improved products and increase our revenues, which could adversely affect our business and cause the price of our stock to decline. In order to be successful in the future, we must reduce our operating and product expenses, while at the same time completing our key product development programs and penetrating new customers.

We are dependent on widespread market acceptance of two product families, and our revenues will decline if the market does not continue to accept either of these product families

We currently derive substantially all of our revenue from sales of our optical subsystems and components and network performance test and monitoring systems. We expect that revenue from these products will continue to account for substantially all of our revenue for the foreseeable future. Accordingly, widespread acceptance of these products is critical to our future success. If the market does not continue to accept either our optical subsystems and components or our network performance test and monitoring systems, our revenues will decline significantly. Factors that may affect the market acceptance of our products include the continued growth of the markets for LANs, SANs, and MANs and, in particular, Gigabit Ethernet and Fibre Channel-based technologies, as well as the performance, price and total cost of ownership of our products and the availability, functionality and price of competing products and technologies.

Many of these factors are beyond our control. In addition, in order to achieve widespread market acceptance, we must differentiate ourselves from our competition through product offerings and brand name recognition. We cannot assure you that we will be successful in making this differentiation or achieving widespread acceptance of our products. Failure of our existing or future products to maintain and achieve widespread levels of market acceptance will significantly impair our revenue growth.

We depend on large purchases from a few significant customers, and any loss, cancellation, reduction or delay in purchases by these customers could harm our business

A small number of customers have accounted for a significant portion of our revenues. For example, sales to our top three customers represented 39% of our revenues in fiscal 2005, including sales to Cisco Systems, which represented 28%. Our success will depend on our continued ability to develop and manage relationships

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with significant customers. Although we are attempting to expand our customer base, we expect that significant customer concentration will continue for the foreseeable future.

The markets in which we sell our products are dominated by a relatively small number of systems manufacturers, thereby limiting the number of our potential customers. Our dependence on large orders from a relatively small number of customers makes our relationship with each customer critically important to our business. We cannot assure you that we will be able to retain our largest customers, that we will be able to attract additional customers or that our customers will be successful in selling their products that incorporate our products. We have in the past experienced delays and reductions in orders from some of our major customers. In addition, our customers have in the past sought price concessions from us, and we expect that they will continue to do so in the future. Cost reduction measures that we have implemented during the past several quarters, and additional action we may take to reduce costs, may adversely affect our ability to introduce new and improved products which may, in turn, adversely affect our relationships with some of our key customers. Further, some of our customers may in the future shift their purchases of products from us to our competitors or to joint ventures between these customers and our competitors. The loss of one or more of our largest customers, any reduction or delay in sales to these customers, our inability to successfully develop relationships with additional customers or future price concessions that we may make could significantly harm our business.

Because we do not have long-term contracts with our customers, our customers may cease purchasing our products at any time if we fail to meet our customers needs

Typically, we do not have long-term contracts with our customers. As a result, our agreements with our customers do not provide any assurance of future sales. Accordingly:

our customers can stop purchasing our products at any time without penalty;

our customers are free to purchase products from our competitors; and

our customers are not required to make minimum purchases.

Sales are typically made pursuant to individual purchase orders, often with extremely short lead times. If we are unable to fulfill these orders in a timely manner, it is likely that we will lose sales and customers.

Our market is subject to rapid technological change, and to compete effectively we must continually introduce new products that achieve market acceptance

The markets for our products are characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards with respect to the protocols used in data communications networks. We expect that new technologies will emerge as competition and the need for higher and more cost-effective bandwidth increases. Our future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address these changes as well as current and potential customer requirements. The introduction of new and enhanced products may cause our customers to defer or cancel orders for existing products. In addition, a slowdown in demand for existing products ahead of a new product introduction could result in a write-down in the value of inventory on hand related to existing products. We have in the past experienced a slowdown in demand for existing products and delays in new product development and such delays may occur in the future. To the extent customers defer or cancel orders for existing products due to a slowdown in demand or in the expectation of a new product release or if there is any delay in development or introduction of our new products or enhancements of our products, our operating results would suffer. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, or to license these technologies from third parties. Product development delays may result from numerous factors, including:

changing product specifications and customer requirements;

unanticipated engineering complexities;

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expense reduction measures we have implemented, and others we may implement, to conserve our cash and attempt to accelerate our return to profitability;

difficulties in hiring and retaining necessary technical personnel;

difficulties in reallocating engineering resources and overcoming resource limitations; and

changing market or competitive product requirements.

The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation and highly skilled engineering and development personnel, as well as the accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product announcements by competitors, technological changes or emerging industry standards. Any failure to respond to technological change would significantly harm our business.

Continued competition in our markets may lead to a reduction in our prices, revenues and market share

The markets for optical subsystems and components and network performance test and monitoring systems for use in LANs, SANs and MANs are highly competitive. Our current competitors include a number of domestic and international companies, many of which have substantially greater financial, technical, marketing and distribution resources and brand name recognition than we have. Other companies, including some of our customers, may enter the market for optical subsystems and network test and monitoring systems. We may not be able to compete successfully against either current or future competitors. Increased competition could result in significant price erosion, reduced revenue, lower margins or loss of market share, any of which would significantly harm our business. For optical subsystems, we compete primarily with Agilent Technologies, Inc. and JDS Uniphase Corporation and a number of smaller venders. Our competitors continue to introduce improved products with lower prices, and we will have to do the same to remain competitive. In addition, some of our current and potential customers may attempt to integrate their operations by producing their own optical components and subsystems and network test and monitoring systems or acquiring one of our competitors, thereby eliminating the need to purchase our products. Furthermore, larger companies in other related industries, such as the telecommunications industry, may develop or acquire technologies and apply their significant resources, including their distribution channels and brand name recognition, to capture significant market share.

Decreases in average selling prices of our products may reduce gross margins

The market for optical subsystems is characterized by declining average selling prices resulting from factors such as increased competition, overcapacity, the introduction of new products and increased unit volumes as manufacturers continue to deploy network and storage systems. We have in the past experienced, and in the future may experience, substantial period-to-period fluctuations in operating results due to declining average selling prices. We anticipate that average selling prices will decrease in the future in response to product introductions by competitors or us, or by other factors, including price pressures from significant customers. Therefore, in order to achieve and sustain profitable operations, we must continue to develop and introduce on a timely basis new products that incorporate features that can be sold at higher average selling prices. Failure to do so could cause our revenues and gross margins to decline, which would result in additional operating losses and significantly harm our business.

We may be unable to reduce the cost of our products sufficiently to enable us to compete with others. Our cost reduction efforts may not allow us to keep pace with competitive pricing pressures and could adversely affect our margins. In order to remain competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes. We may not be successful in redesigning our products or delivering our products to market in a timely manner. We cannot assure you that any redesign will result in sufficient cost reductions to allow us to reduce the price of our products to remain competitive or improve our gross margins.

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Shifts in our product mix may result in declines in gross margins

Our gross profit margins vary among our product families, and are generally higher on our network test and monitoring systems than on our optical subsystems and components. Our optical products sold for longer distance MAN and telecom applications typically have higher gross margins than our products for shorter distance LAN or SAN applications. Our gross margins are generally lower for newly introduced products and improve as unit volumes increase. Our overall gross margins have fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices for older products and our ability to reduce product costs, and these fluctuations are expected to continue in the future.

Our customers often evaluate our products for long and variable periods, which causes the timing of our revenues and results of operations to be unpredictable

The period of time between our initial contact with a customer and the receipt of an actual purchase order may span a year or more. During this time, customers may perform, or require us to perform, extensive and lengthy evaluation and testing of our products before purchasing and using them in their equipment. Our customers do not typically share information on the duration or magnitude of these qualification procedures. The length of these qualification processes also may vary substantially by product and customer, and, thus, cause our results of operations to be unpredictable. While our potential customers are qualifying our products and before they place an order with us, we may incur substantial research and development and sales and marketing expenses and expend significant management effort. Even after incurring such costs we ultimately may not sell any products to such potential customers. In addition, these qualification processes often make it difficult to obtain new customers, as customers are reluctant to expend the resources necessary to qualify a new supplier if they have one or more existing qualified sources. Once our products have been qualified, the agreements that we enter into with our customers typically contain no minimum purchase commitments. Failure of our customers to incorporate our products into their systems would significantly harm our business.

We depend on facilities located outside of the United States to manufacture a substantial portion of our products, which subjects us to additional risks

In addition to our principal manufacturing facility in Malaysia, we operate smaller facilities in China and Singapore and also rely on two contract manufacturers located outside of the United States. We also rely on Infineon to manufacture transceiver and transponder products for us until we are able to transfer manufacturing operations to our production facilities. Each of these facilities and manufacturers subjects us to additional risks associated with international manufacturing, including:

unexpected changes in regulatory requirements;

legal uncertainties regarding liability, tariffs and other trade barriers;

inadequate protection of intellectual property in some countries;

greater incidence of shipping delays;

greater difficulty in overseeing manufacturing operations;

greater difficulty in hiring technical talent needed to oversee manufacturing operations;

potential political and economic instability;

currency fluctuations; and

the outbreak of infectious diseases such as severe acute respiratory syndrome, or SARS, which could result in travel restrictions or the closure of our facilities or the facilities of our customers and suppliers.

Any of these factors could significantly impair our ability to source our contract manufacturing requirements internationally.

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Our business and future operating results are subject to a wide range of uncertainties arising out of the continuing threat of terrorist attacks and ongoing military action in the Middle East

Like other U.S. companies, our business and operating results are subject to uncertainties arising out of the continuing threat of terrorist attacks on the United States and ongoing military action in the Middle East, including the potential worsening or extension of the current global economic slowdown, the economic consequences of the war in Iraq or additional terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. In particular, due to these uncertainties we are subject to:

- increased risks related to the operations of our manufacturing facilities in Malaysia;
- greater risks of disruption in the operations of our Asian contract manufacturers and more frequent instances of shipping delays; and
- the risk that future tightening of immigration controls may adversely affect the residence status of non-U.S. engineers and other key technical employees in our U.S. facilities or our ability to hire new non-U.S. employees in such facilities.

We may lose sales if our suppliers fail to meet our needs

We currently purchase several key components used in the manufacture of our products from single or limited sources. We are also dependent on Infineon to supply finished transceiver and transponder products during a transition period of up to one year until we have transitioned the manufacturing operations to other facilities. We depend on these current and future sources to meet our production needs. Moreover, we depend on the quality of the products supplied to us over which we have limited control. We have encountered shortages and delays in obtaining components in the past and expect to encounter shortages and delays in the future. If we cannot supply products due to a lack of components, or are unable to redesign products with other components in a timely manner, our business will be significantly harmed. We generally have no long-term contracts for any of our components. As a result, a supplier can discontinue supplying components to us without penalty. If a supplier discontinued supplying a component, our business may be harmed by the resulting product manufacturing and delivery delays. We are also subject to potential delays in the development by our suppliers of key components which may affect our ability to introduce new products.

We use rolling forecasts based on anticipated product orders to determine our component requirements. Lead times for materials and components that we order vary significantly and depend on factors such as specific supplier requirements, contract terms and current market demand for particular components. If we overestimate our component requirements, we may have excess inventory, which would increase our costs. If we underestimate our component requirements, we may have inadequate inventory, which could interrupt our manufacturing and delay delivery of our products to our customers. Any of these occurrences would significantly harm our business.

We have made and may continue to make strategic investments which may not be successful and may result in the loss of all or part of our invested capital

Through fiscal 2005, we recorded minority equity investments in early-stage technology companies, totaling $52.4 million. Our recent investment of $4.75 million in CyOptics is a similar minority equity investment. Our investments in these early stage companies were primarily motivated by our desire to gain early access to new technology. We intend to review additional opportunities to make strategic equity investments in pre-public companies where we believe such investments will provide us with opportunities to gain access to important technologies or otherwise enhance important commercial relationships. We have little or no influence over the early-stage companies in which we have made or may make these strategic, minority equity investments. Each of these investments in pre-public companies involves a high degree of risk. We may not be successful in achieving the financial, technological or commercial advantage upon which any given investment is premised, and failure by the early-stage company to achieve its own business objectives or to raise capital needed on acceptable economic terms could result in a loss of all or part of our invested capital. In

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fiscal 2003, we wrote off $12.0 million in two investments which became impaired. In fiscal 2004, we wrote off $1.6 million in two additional investments, and in fiscal 2005, we wrote off $10.0 million in another investment. We may be required to write off all or a portion of the $21.4 million in such investments remaining on our balance sheet as of April 30, 2005 in future periods.

We are subject to pending legal proceedings

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased our common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, Jerry S. Rawls, our President and Chief Executive Officer, Frank H. Levinson, our Chairman of the Board and Chief Technical Officer, Stephen K. Workman, our Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for our initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were dismissed without prejudice. On February 19, 2003, our motion to dismiss the complaint was denied. In July 2004, we and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs will dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers will be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, we would be responsible to pay our pro rata portion of the shortfall, up to the amount of the self-insured retention under our insurance policy, which may be up to $2 million. The timing and amount of payments that we could be required to make under the proposed settlement will depend on several factors, principally the timing and amount of any payment that the insurers may be required to make pursuant to the $1 billion guaranty. On February 15, 2005, the Court issued an order providing preliminary approval of the proposed settlement except insofar as the settlement would have cut off contractual indemnification claims that underwriters may have against securities issuers, such as the Company. On April 13, 2005, the Court held a further conference to determine the final form, substance and program of class notice and set a hearing for January 9, 2006 to consider final approval of the settlement. If the settlement is not approved by the Court, we intend to defend the lawsuit vigorously. Because of the inherent uncertainty of litigation, however, we cannot predict its outcome. If, as a result of this dispute, we are required to pay significant monetary damages, our business would be substantially harmed.

We have identified material weaknesses in our internal control over financial reporting which could lead to errors in our financial statements

We identified material weaknesses in our internal control over financial reporting, as discussed in this prospectus in the section of Management s Discussion and Analysis titled Management s Report on Internal Control Over Financial Reporting. Although steps are being taken to remediate these deficiencies, there can be no assurance that these remediation steps will be successful or that, as a result of our ongoing evaluation of our internal control over financial reporting, we will not identify additional material weaknesses. Although management determined that the material weaknesses did not affect the financial results reported in our consolidated financial statements as of, and for the year ended, April 30, 2005, there can be no assurance that unremediated weaknesses in our internal control over financial reporting will not result in errors that are material to the financial results reported in our consolidated financial statements for future periods.

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Because of competition for technical personnel, we may not be able to recruit or retain necessary personnel

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, technical, sales and marketing, finance and manufacturing personnel. In particular, we may need to increase the number of technical staff members with experience in high-speed networking applications as we further develop our product lines. Competition for these highly skilled employees in our industry is intense. Our failure to attract and retain these qualified employees could significantly harm our business. The loss of the services of any of our qualified employees, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel could hinder the development and introduction of and negatively impact our ability to sell our products. In addition, employees may leave our company and subsequently compete against us. Moreover, companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices. We have been subject to claims of this type and may be subject to such claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation. We could incur substantial costs in defending ourselves against these claims, regardless of their merits.

Our products may contain defects that may cause us to incur significant costs, divert our attention from product development efforts and result in a loss of customers

Networking products frequently contain undetected software or hardware defects when first introduced or as new versions are released. Our products are complex and defects may be found from time to time. In addition, our products are often embedded in or deployed in conjunction with our customers products which incorporate a variety of components produced by third parties. As a result, when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relation problems or loss of customers, all of which would harm our business.

Our failure to protect our intellectual property may significantly harm our business

Our success and ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements to establish and protect our proprietary rights. We license certain of our proprietary technology, including our digital diagnostics technology, to customers who include current and potential competitors, and we rely largely on provisions of our licensing agreements to protect our intellectual property rights in this technology. Although a number of patents have been issued to us, we have obtained a number of other patents as a result of our acquisitions, and we have filed applications for additional patents, we cannot assure you that any patents will issue as a result of pending patent applications or that our issued patents will be upheld. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of a competitive advantage and decreased revenues. Despite our efforts to protect our proprietary rights, existing patent, copyright, trademark and trade secret laws afford only limited protection. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may not be able to prevent misappropriation of our technology or deter others from developing similar technology. Furthermore, policing the unauthorized use of our products is difficult. We are currently engaged in pending litigation to enforce certain of our patents, and additional litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. This litigation could result in substantial costs and diversion of resources and could significantly harm our business.

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Claims that we infringe third-party intellectual property rights could result in significant expenses or restrictions on our ability to sell our products

The networking industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We have been involved in the past in patent infringement lawsuits. From time to time, other parties may assert patent, copyright, trademark and other intellectual property rights to technologies and in various jurisdictions that are important to our business. Any claims asserting that our products infringe or may infringe proprietary rights of third parties, if determined adversely to us, could significantly harm our business. Any claims, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could significantly harm our business. Royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. In addition, our agreements with our customers typically require us to indemnify our customers from any expense or liability resulting from claimed infringement of third party intellectual property rights. In the event a claim against us was successful and we could not obtain a license to the relevant technology on acceptable terms or license a substitute technology or redesign our products to avoid infringement, our business would be significantly harmed.

Our executive officers and directors and entities affiliated with them own a large percentage of our voting stock, and VantagePoint Venture Partners has recently acquired a large block of our common stock, that has resulted in a substantial concentration of control and could have the effect of delaying or preventing a change in our control

As of June 30, 2005, our executive officers and directors and certain entities affiliated with them beneficially owned approximately 36.7 million shares of our common stock, or approximately 13.1% of the outstanding shares. These stockholders, acting together, may be able to substantially influence the outcome of matters requiring approval by stockholders, including the election or removal of directors and the approval of mergers or other business combination transactions. In addition, certain funds managed by VantagePoint Venture Partners, of which David C. Fries, a director of the Company, is a managing director hold approximately 12.3% of our outstanding common stock. Accordingly, if VantagePoint Venture Partners continues to hold its shares, it may also be able to influence the outcome of matters requiring stockholder approval, and VantagePoint Venture Partners, our executive officers, directors and entities affiliated with them, voting together, may be able to effectively control the outcome of such matters. This concentration of ownership could have the effect of delaying or preventing a change in control or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could have an adverse effect on the market price of our common stock or prevent our stockholders from realizing a premium over the market price for their shares of common stock.

The conversion of our outstanding convertible subordinated notes would result in substantial dilution to our current stockholders

We currently have outstanding 5¼% convertible subordinated notes due 2008 in the principal amount of $100.3 million and 2½% convertible subordinated notes due 2010 in the principal amount of $150.0 million. The 5¼% notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of our common stock at a conversion price of $5.52 per share. The 2½% notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of our common stock at a conversion price of $3.705 per share. An aggregate of 58,647,060 shares of common stock would be issued upon the conversion of all outstanding convertible subordinated notes at these exchange rates, which would significantly dilute the voting power and ownership percentage of our existing stockholders. Holders of the notes due in 2010 have the right to require us to repurchase some or all of their notes on October 15, 2007. We may choose to pay the repurchase price in cash, shares of our common stock or a combination thereof. Our right to repurchase the notes, in whole or in part, with shares of our common stock is subject to the registration of the shares of our common stock to be issued upon repurchase under the Securities Act, if required, and registration with or approval of any state or federal governmental authority if such registration or approval is required before such

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shares may be issued. We have previously entered into privately negotiated transactions with certain holders of our convertible subordinated notes for the repurchase of notes in exchange for a greater number of shares of our common stock than would have been issued had the principal amount of the notes been converted at the original conversion rate specified in the notes, thus resulting in more dilution. Although we do not currently have any plans to enter into similar transactions in the future, if we were to do so there would be additional dilution to the voting power and percentage ownership of our existing stockholders.

Delaware law, our charter documents and our stockholder rights plan contain provisions that could discourage or prevent a potential takeover, even if such a transaction would be beneficial to our stockholders

Some provisions of our certificate of incorporation and bylaws, as well as provisions of Delaware law, may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable. These include provisions:

authorizing the board of directors to issue additional preferred stock;

prohibiting cumulative voting in the election of directors;

limiting the persons who may call special meetings of stockholders;

prohibiting stockholder actions by written consent;

creating a classified board of directors pursuant to which our directors are elected for staggered three-year terms;

permitting the board of directors to increase the size of the board and to fill vacancies;

requiring a super-majority vote of our stockholders to amend our bylaws and certain provisions of our certificate of incorporation; and

establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law which limit the right of a corporation to engage in a business combination with a holder of 15% or more of the corporation s outstanding voting securities, or certain affiliated persons.

In addition, in September 2002, our board of directors adopted a stockholder rights plan under which our stockholders received one share purchase right for each share of our common stock held by them. Subject to certain exceptions, the rights become exercisable when a person or group (other than certain exempt persons) acquires, or announces its intention to commence a tender or exchange offer upon completion of which such person or group would acquire, 20% or more of our common stock without prior board approval. Should such an event occur, then, unless the rights are redeemed or have expired, our stockholders, other than the acquirer, will be entitled to purchase shares of our common stock at a 50% discount from its then-Current Market Price (as defined) or, in the case of certain business combinations, purchase the common stock of the acquirer at a 50% discount.

Although we believe that these charter and bylaw provisions, provisions of Delaware law and our stockholder rights plan provide an opportunity for the board to assure that our stockholders realize full value for their investment, they could have the effect of delaying or preventing a change of control, even under circumstances that some stockholders may consider beneficial.

Our business and future operating results may be adversely affected by events outside of our control

Our business and operating results are vulnerable to events outside of our control, such as earthquakes, fire, power loss, telecommunications failures and uncertainties arising out of terrorist attacks in the United States and overseas. Our corporate headquarters and a portion of our manufacturing operations are located in California. California in particular has been vulnerable to natural disasters, such as earthquakes,

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fires and floods, and other risks which at times have disrupted the local economy and posed physical risks to our property. We are also dependent on communications links with our overseas manufacturing locations and would be significantly harmed if these links were interrupted for any significant length of time. We presently do not have adequate redundant, multiple site capacity if any of these events were to occur, nor can we be certain that the insurance we maintain against these events would be adequate.

Our stock price has been and is likely to continue to be volatile

The trading price of our common stock has been and is likely to continue to be subject to large fluctuations. Our stock price may increase or decrease in response to a number of events and factors, including:

trends in our industry and the markets in which we operate;

changes in the market price of the products we sell;

changes in financial estimates and recommendations by securities analysts;

acquisitions and financings;

quarterly variations in our operating results;

the operating and stock price performance of other companies that investors in our common stock may deem comparable; and

purchases or sales of blocks of our common stock.

Part of this volatility is attributable to the current state of the stock market, in which wide price swings are common. This volatility may adversely affect the prices of our common stock regardless of our operating performance.

Our future operating results may be subject to volatility as a result of exposure to foreign exchange risks.

We are also exposed to foreign exchange risks. Foreign currency fluctuations may affect both our revenues and our costs and expenses and significantly affect our operating results. Prices for our products are currently denominated in U.S. dollars for sales to our customers throughout the world. If there is a significant devaluation of the currency in a specific country relative to the dollar, the prices of our products will increase relative to that country s currency, our products may be less competitive in that country and our revenues may be adversely affected.

Although we price our products in U.S. dollars, portions of both our cost of revenues and operating expenses are incurred in foreign currencies, principally the Malaysian ringit, the Chinese yuan and the Euro. As a result, we bear the risk that the rate of inflation in one or more countries will exceed the rate of the devaluation of that country s currency in relation to the U.S. dollar, which would increase our costs as expressed in U.S. dollars. On July 21, 2005, the People s Bank of China announced that the yuan will no longer be pegged to the U.S. dollar but will be allowed to float in a band (and, to a limited extent, increase in value) against a basket of foreign currencies. This development increases the risk that Chinese-sourced materials and labor could become more expensive for us. To date, we have not engaged in currency hedging transactions to decrease the risk of financial exposure from fluctuations in foreign exchange rates.

USE OF PROCEEDS

We will not receive any proceeds from the sale by the selling stockholder of the common stock offered hereby.

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PRICE RANGE OF OUR COMMON STOCK

Our common stock is traded on the Nasdaq National Market under the symbol FNSR. The following table sets forth the range of high and low closing sales prices of our common stock for the periods indicated:

	High	Low
Fiscal 2006 Quarter Ended:		
October 31, 2005 (through August 11)	$ 1.10	$ 1.03
July 31, 2005	$ 1.30	$ 1.01
Fiscal 2005 Quarter Ended:		
April 30, 2005	$ 1.26	$ 1.12
January 31, 2005	$ 1.78	$ 1.66
October 31, 2004	$ 1.47	$ 1.42
July 31, 2004	$ 1.53	$ 1.41
Fiscal 2004 Quarter Ended:		
April 30, 2004	$ 3.26	$ 1.77
January 31, 2004	$ 4.14	$ 2.80
October 31, 2003	$ 3.41	$ 1.62
July 31, 2003	$ 1.94	$ 1.09

The closing price of our common stock as reported on the Nasdaq National Market on August 11, 2005 was $1.03. The approximate number of stockholders of record on June 30, 2005 was 471. This number does not include stockholders whose shares are held in trust by other entities. The number of beneficial stockholders of our shares is greater than the number of stockholders of record.

DIVIDEND POLICY

We have never declared or paid cash dividends on our common stock and currently intend to retain earnings for use in our business and do not anticipate paying any cash dividends in the foreseeable future. The payment of dividends in the future will be subject to the discretion of our Board of Directors, will be subject to applicable law and will depend on our results of operations, earnings, financial condition, contractual limitations, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

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CAPITALIZATION

The following table sets forth our total capitalization as of April 30, 2005:

		April 30, 2005 (In thousands, except share data)
Current portion of long-term liabilities	$	2,242
Convertible notes, net of unamortized portion of beneficial conversion feature, other long-term liabilities and deferred income taxes		265,274
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized, no shares issued or outstanding		
Common stock, $0.001 par value; 500,000,000 shares authorized, 258,931,278 shares issued and outstanding(1)		259
Additional paid-in capital		1,314,960
Accumulated other comprehensive income		381
Accumulated deficit		(1,171,310)
Total stockholders equity		144,290
Total capitalization	$	409,564

(1) Excludes:

shares of common stock reserved for issuance under our stock option plans and employee stock purchase plan and upon exercise of stock options and warrants assumed in connection with our acquisitions of six privately-held companies;

shares of common stock reserved for issuance upon conversion of the convertible installment note issued as consideration for our acquisition of the assets of Data Transit Corp. in August 2004;

shares of common stock issued in connection with the acquisition of InterSAN, Inc. in May 2005;

shares of common stock reserved for issuance upon conversion of promissory notes issued as consideration for our acquisition of I-TECH CORP in April 2005; and

shares reserved for issuance upon conversion of the CyOptics Note.

See Management Equity Compensation Plan Information, Description of Capital Stock and Note 14 to our audited consolidated financial statements included elsewhere in this prospectus.

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SELECTED FINANCIAL DATA

The following summary financial data should be read together with Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and the notes thereto included elsewhere in this prospectus. The statement of operations data set forth below for the fiscal years ended April 30, 2005, 2004 and 2003 and the balance sheet data as of April 30, 2005 and 2004 are derived from, and are qualified by reference to, our audited consolidated financial statements included elsewhere in this prospectus. The statement of operations data set forth below for the fiscal years ended April 30, 2002 and 2001 and the balance sheet data as of April 30, 2003, 2002 and 2001 are derived from audited financial statements not included in this prospectus. The Management s Discussion and Analysis of Financial Condition and Results of Operations related to the statement of operations and balance sheet data for the fiscal years ended April 30, 2002 and 2001 are not included in this prospectus.

	Fiscal Years Ended April 30,				
	2005	2004	2003	2002	2001
	(In thousands, except per share data)				
Statement of Operations Data:					
Revenues	$ 280,823	$ 185,618	$ 166,482	$ 147,265	$ 188,800
Cost of revenues	205,631	143,585	130,501	136,626	131,551
Amortization of acquired developed technology	22,268	19,239	21,983	27,119	10,900
Impairment of acquired developed technology	3,656				
Gross profit (loss)	49,268	22,794	13,998	(16,480)	46,349
Operating expenses:					
Research and development	62,799	62,193	60,295	54,372	33,696
Sales and marketing	29,783	20,063	20,232	21,448	16,673
General and administrative	23,374	16,738	15,201	19,419	10,160
Amortization of (benefit from) deferred stock compensation	162	(105)	(1,719)	11,963	13,542
Acquired in-process research and development	1,558	6,180		2,696	35,218
Amortization of goodwill and other purchased intangibles	1,104	572	758	129,099	53,122
Impairment of tangible assets	18,798				
Impairment of goodwill and intangible assets			10,586		
Restructuring costs	287	382	9,378		
Other acquisition costs		222	198	3,119	1,130
Total operating expenses	137,865	106,245	114,929	242,116	163,541
Loss from operations	(88,597)	(83,451)	(100,931)	(258,596)	(117,192)
Interest income (expense), net	(12,072)	(25,701)	(6,699)	(68)	14,217
Other income (expense), net	(12,582)	(4,347)	(51,314)	1,360	18,546

Loss before income taxes and cumulative effect of an accounting change	(113,251)	(113,499)	(158,944)	(257,304)	(84,429)
Provision (benefit) for income taxes	856	334	229	(38,566)	1,020
Loss before cumulative effect of an accounting change	(114,107)	(113,833)	(159,173)	(218,738)	(85,449)
Cumulative effect of an accounting change to adopt SFAS 142			(460,580)		
Net loss	$ (114,107)	$ (113,833)	$ (619,753)	$ (218,738)	$ (85,449)

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	Fiscal Years Ended April 30,				
	2005	2004	2003	2002	2001
	(In thousands, except per share data)				
Net loss per share basic and diluted:					
Before cumulative effect of an accounting change	$ (0.49)	$ (0.53)	$ (0.82)	$ (1.21)	$ (0.53)
Cumulative effect of an accounting change to adopt SFAS 142	$	$	$ (2.35)	$	$
Net loss per share	$ (0.49)	$ (0.53)	$ (3.17)	$ (1.21)	$ (0.53)
Shares used in per share calculations:					
Basic and diluted	232,210	216,117	195,666	181,136	160,014
Pro forma amounts assuming the change in accounting principle was applied retroactively (unaudited):					
Net loss	$ (114,107)	$ (113,833)	$ (619,753)	$ (90,957)	$ (32,857)
Net loss per share basic and diluted	$ (0.49)	$ (0.53)	$ (3.17)	$ (0.50)	$ (0.21)
Shares used in computing pro forma net loss per share:					
Basic and diluted	232,210	216,117	195,666	181,136	160,014

	As of April 30,				
	2005	2004	2003	2002	2001
	(In thousands)				
Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 102,362	$ 143,398	$ 119,438	$ 144,097	$ 146,111
Working capital	120,272	172,892	149,967	222,603	249,000
Total assets	488,985	494,705	423,606	1,041,281	1,029,995
Long-term liabilities	265,274	233,732	101,531	106,869	45,354
Convertible preferred stock					1
Total stockholders equity	144,290	202,845	274,980	879,002	941,851

Net income in fiscal 2003 reflects our adoption of Statements of Financial Accounting Standards 141 and 142 on May 1, 2002. As a result of our adoption, reported net loss decreased by approximately $127.8 million, or $0.65 per share, due to the cessation of the amortization of goodwill and the amortization of acquired workforce and customer base.

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

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ substantially from those anticipated in these forward-looking statements as a result of many factors, including those set forth under Risk Factors. The following discussion should be read together with our consolidated financial statements and related notes thereto included elsewhere in this document.

Overview

We were incorporated in 1987 and funded our initial product development efforts largely through revenues derived under research and development contracts. After shipping our first products in 1991, we continued to finance our operations principally through internal cash flow and periodic bank borrowings until November 1998. At that time we raised $5.6 million of net proceeds from the sale of equity securities and bank borrowings to fund the continued growth and development of our business. In November 1999, we received net proceeds of $151.0 million from the initial public offering of shares of our common stock, and in April 2000 we received $190.6 million from an additional public offering of shares of our common stock. In October 2001, we sold $125 million aggregate principal amount of 5¼% convertible subordinated notes due October 15, 2008, and in October 2003, we sold $150 million aggregate principal amount of 2½% convertible subordinated notes due October 15, 2010.

Since October 2000, we have acquired a number of companies and certain businesses and assets of other companies in order to broaden our product offerings and provide new sources of revenue, production capabilities and access to advanced technologies that we believe will enable us to reduce our product costs and develop innovative and more highly integrated product platforms while accelerating the timeframe required to develop such products.

In October 2002, we sold our subsidiary, Sensors Unlimited, Inc. to a new company organized by a management group led by Dr. Greg Olsen, then an officer and director of Finisar and a former majority owner of Sensors Unlimited. The intellectual property developed after the acquisition of Sensors Unlimited was transferred to other operations within Finisar. In November 2002, we discontinued a product line at our Demeter Technologies subsidiary that was not making a significant contribution to our operating results and was no longer considered a key part of our product strategy. Certain assets of Demeter Technologies were sold in conjunction with the product line discontinuation. In April 2003, we acquired Genoa Corporation and announced the closure of Demeter Technologies and the consolidation of all active device development and wafer fabrication operations into the Genoa facility. The consolidation was completed in fiscal 2004. During the second quarter of fiscal 2004, we completed the closure of our German facility associated with the acquisition of AIFOtec, GmbH. The intellectual property, technical know-how and certain assets related to the German operations were consolidated with our operations in Sunnyvale, California, during the second quarter of fiscal 2004.

The principal strategic goal of most of our acquisitions to date related to our optical subsystems and components business has been to gain access to leading-edge technology for the manufacture of optical components in order to improve the performance and reduce the cost of our optical subsystem products. We have also sold these optical components on a stand-alone basis to other manufacturers; however, prior to our acquisition of Honeywell International Inc. s VCSEL Optical Products business unit in March 2004, the sale of these components into this so-called merchant market had not been a strategic priority, and our revenues from the sale of optical subsystems and components consisted predominantly of subsystems sales. As a result of the Honeywell acquisition, we are now selling vertical cavity surface emitting lasers, or VCSELs, in the merchant market, and we intend to evaluate opportunities to increase the sale of these and other components in the merchant market. The principal strategic goal of most of our acquisitions to date related to our network test and monitoring business has been to broaden our product portfolio and to gain access to new distribution channels. The acquisition of assets and intellectual property of Data Transit, Inc. in August 2004, I-TECH CORP. in April 2005, and InterSAN, Inc. in May 2005 were examples of our pursuit of this strategy. As a

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result of these acquisitions, we have expanded our product offerings for SAN test, analysis and monitoring tools to include additional products which test and monitor storage networks using the SAS and SATA protocols as well as additional tools for testing and reconfiguring SANs.

To date, our revenues have been principally derived from sales of our optical subsystems to networking and storage systems manufacturers and sales of our network performance test systems to these manufacturers as well as end users. Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for SANs, LANs, and MAN applications. A large proportion of our sales are concentrated with a relatively small number of customers. Although we are attempting to expand our customer base, we expect that significant customer concentration will continue for the foreseeable future.

We recognize revenue when persuasive evidence of an arrangement exists, title and risk of loss pass to the customer, which is generally upon shipment, the price is fixed or determinable and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, we allocate revenue to the separate elements based upon each element s fair value as determined by the list price for such element.

We sell our products through our direct sales force, with the support of our manufacturers representatives, directly to domestic customers and indirectly through distribution channels to international customers. The evaluation and qualification cycle prior to the initial sale for our optical subsystems may span a year or more, while the sales cycle for our test and monitoring systems is usually considerably shorter.

The market for optical subsystems and components is characterized by declining average selling prices resulting from factors such as industry over-capacity, increased competition, the introduction of new products and the growth in unit volumes as manufacturers continue to deploy network and storage systems. We anticipate that our average selling prices will continue to decrease in future periods, although the timing and amount of these decreases cannot be predicted with any certainty.

Our cost of revenues consists of materials, salaries and related expenses for manufacturing personnel, manufacturing overhead, warranty expense, inventory adjustments for obsolete and excess inventory and the amortization of acquired developed technology associated with acquisitions that we have made. Historically, we outsourced the majority of our assembly operations. However, in fiscal 2002, we commenced manufacturing of our optical subsystem products at our subsidiary in Ipoh, Malaysia. We conduct component manufacturing, manufacturing engineering, supply chain management, quality assurance and documentation control at our facilities in Sunnyvale, California and Richardson, Texas and at our subsidiaries facilities in Fremont, California, Shanghai, China and Ipoh, Malaysia. With the transition of most of our production to Malaysia and the added manufacturing infrastructure associated with several acquisitions completed during the past two years, our cost structure has become more fixed, making it more difficult to reduce costs during periods when demand for our products is weak, product mix is unfavorable or selling prices are generally lower. While we undertook measures to reduce our operating costs during fiscal 2003, 2004 and 2005, there can be no assurance that we will be able to reduce our cost of revenues enough to achieve or sustain profitability during periods of weak demand or when average selling prices are low.

Our gross profit margins vary among our product families, and are generally higher on our network test and monitoring systems than on our optical subsystems and components. Our optical products sold for longer distance MAN and telecom applications typically have higher gross margins than our products for shorter distance LAN and SAN applications. Our overall gross margins have fluctuated from period to period as a result of overall revenue levels, shifts in product mix, the introduction of new products, decreases in average selling prices and our ability to reduce product costs.

Research and development expenses consist primarily of salaries and related expenses for design engineers and other technical personnel, the cost of developing prototypes and fees paid to consultants. We charge all research and development expenses to operations as incurred. We believe that continued investment in research and development is critical to our long-term success.

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Sales and marketing expenses consist primarily of commissions paid to manufacturers representatives, salaries and related expenses for personnel engaged in sales, marketing and field support activities and other costs associated with the promotion of our products.

General and administrative expenses consist primarily of salaries and related expenses for administrative, finance and human resources personnel, professional fees, and other corporate expenses.

In connection with the grant of stock options to employees between August 1, 1998 and October 15, 1999, we recorded deferred stock compensation representing the difference between the deemed value of our common stock for accounting purposes and the exercise price of these options at the date of grant. In connection with the assumption of stock options previously granted to employees of companies we acquired, we recorded deferred compensation representing the difference between the fair market value of our common stock on the date of closing of each acquisition and the exercise price of the unvested portion of options granted by those companies which we assumed. Deferred stock compensation is presented as a reduction of stockholder s equity, with accelerated amortization recorded over the vesting period, which is typically three to five years. The amount of deferred stock compensation expense to be recorded in future periods could decrease if options for which accrued but unvested compensation has been recorded are forfeited prior to vesting and could increase if we modify the terms of an option grant resulting in a new measurement date.

Acquired in-process research and development represents the amount of the purchase price in a business combination allocated to research and development projects underway at the acquired company that had not reached the technologically feasible stage as of the closing of the acquisition and for which we had no alternative future use.

A portion of the purchase price in a business combination is allocated to goodwill and intangibles. Prior to May 1, 2002, goodwill and purchased intangibles were amortized over their estimated useful lives. Subsequent to May 1, 2002, goodwill and intangible assets with indefinite lives are no longer amortized but subject to annual impairment testing.

Impairment charges consist of write downs to the carrying value of intangible assets and goodwill arising from various business combinations to their implied fair value.

Restructuring costs generally include termination costs for employees associated with a formal restructuring plan and the cost of facilities or other unusable assets abandoned or sold.

Other acquisition costs primarily consist of incentive payments for employee retention included in certain of the purchase agreements of companies we acquired and costs incurred in connection with transactions that were not completed.

Other income and expenses generally consist of bank fees, gains or losses as a result of the periodic sale of assets and other-than-temporary decline in the value of investments.

Recent Acquisitions

Acquisition of Honeywell VCSEL Optical Products Business

On March 1, 2004, we completed the acquisition of Honeywell International Inc. s VCSEL Optical Products business unit for a purchase price and transaction expenses totaling approximately $80.9 million in cash and $1.2 million in our common stock. The acquisition was accounted for under the purchase method of accounting. The acquisition was undertaken to lower our cost of goods sold as a result of being more vertically integrated, to gain access to intellectual property and know-how associated with making short wavelength VCSELs for both data communications and other market applications in the future and the additional revenue and earnings growth associated with new product opportunities. The amount of goodwill recorded in this acquisition reflected the value to be realized associated with these incremental cost savings and future revenue opportunities. The results of operations of this business unit, which we now refer to as our Advanced Optical Components, or AOC, Division are included in our consolidated financial statements beginning on March 1, 2004.

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Acquisition of Assets of Data Transit Corp.

On August 6, 2004, we completed the purchase of substantially all of the assets of Data Transit Corp. in exchange for a cash payment of $500,000 and the issuance of a convertible promissory note in the original principal amount of $16.3 million. Transaction costs totaled $682,000. The acquisition of Data Transit expanded our product offering for testing and monitoring systems, particularly those systems based on the SAS and SATA protocols used in the disk drive industry. The amount of goodwill recorded with this acquisition reflected the incremental earnings associated with selling this new test and monitoring capability, the underlying know-how for making these products which we plan to incorporate into our XGig product platform and cost synergies associated with integrating the operations of Data Transit with our Network Tools Division. The principal balance of the note issued in this acquisition bears interest at 8% per annum and is due and payable, if not sooner converted, on the second anniversary of its issuance. Generally, the terms of the convertible promissory note provide for automatic conversion of the outstanding principal and interest into shares of our common stock on a biweekly basis, commencing on the later of the effectiveness of a registration statement covering the resale of the shares or one year after the closing date. The conversion price is the average closing bid price of the stock for the three days preceding the date of conversion. The amount of principal and interest to be converted on each conversion date is based on the average trading volume of our common stock over the preceding 14 days. The acquisition was accounted for as a purchase and, accordingly, the results of operations of the acquired assets (beginning with the closing date of the acquisition) and the estimated fair value of assets acquired were included in our consolidated financial statements beginning in the second quarter of fiscal 2005.

Acquisition of Transceiver and Transponder Product Line From Infineon Technologies AG

On April 29, 2004, we entered into an agreement with Infineon Technologies AG to acquire Infineon s fiber optics business unit. On October 11, 2004, we entered into an amended purchase agreement under which the terms of the acquisition were modified. On January 25, 2005, we and Infineon terminated the amended purchase agreement and entered into a new agreement under which we acquired certain assets of Infineon s fiber optics business unit associated with the design, development and manufacture of optical transceiver and transponder products in exchange for 34 million shares of our common stock. The closing of the acquisition took place on January 31, 2005, the first day of our fourth quarter of fiscal 2005. The acquisition expanded our product offering and customer base for optical transceivers and transponders and expanded our portfolio of intellectual property used in designing and manufacturing these products as well as those to be developed in the future. The amount of goodwill recorded in this acquisition reflected the value to be realized associated with cost savings resulting from integrating these products with our Optical Subsystems and Components Division as well as the incremental growth in revenue and earnings from the sale of future products. We did not acquire any employees or assume any liabilities as part of the acquisition, except for obligations under customer contracts. The 34 million shares of our common stock issued to Infineon were valued at approximately $59.5 million based on the closing price of our common stock on January 31, 2005. The acquisition was accounted for as a purchase and, accordingly, the results of operations of the acquired assets (beginning with the closing date of the acquisition) and the estimated fair value of assets acquired were included in our consolidated financial statements beginning in the fourth quarter of fiscal 2005.

Acquisition of I-TECH CORP.

On April 8, 2005, we completed our acquisition of I-TECH CORP., a privately-held network test and monitoring company based in Eden Prairie, Minnesota. The acquisition expanded our product offering for testing and monitoring systems, particularly for systems relying on the Fibre Channel protocol, and expanded our portfolio of intellectual property used in designing and manufacturing these products as well as those to be developed in the future. The amount of goodwill recorded with this acquisition reflected the underlying patents and know-how used in manufacturing future products and cost synergies associated with integrating the operations of I-TECH with our Network Tools Division. The acquisition agreement provided for the merger of I-TECH with a wholly-owned subsidiary of Finisar and the issuance by Finisar to the sole holder of I-TECH s common stock of promissory notes in the aggregate principal amount of approximately $12.1 million. The

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notes are convertible into shares of Finisar common stock over a period of one year following the closing of the acquisition. The exact number of shares of Finisar common stock to be issued pursuant to the promissory notes is dependent on the trading price of Finisar s common stock on the dates of conversion of the notes. The results of operations of I-TECH (beginning with the closing date of the acquisition) and the estimated fair value of assets acquired were included in our consolidated financial statements beginning in the fourth quarter of fiscal 2005.

Acquisition of InterSAN, Inc.

On May 12, 2005, we completed the acquisition of InterSAN, Inc., a privately-held company located in Scotts Valley, California. Under the terms of the acquisition agreement, InterSAN merged with a wholly-owned subsidiary of Finisar and the holders of InterSAN s securities will be entitled to receive up to 7,132,186 shares of Finisar common stock having a value of approximately $8.8 million. Approximately 10% of the shares of Finisar common stock that would otherwise be distributed to the holders of InterSAN s securities at the closing of the acquisition were deposited into an escrow account for 12 months following the closing for the purpose of providing a fund against which Finisar may assert claims for damages, if any, based on breaches of the representations and warranties made by InterSAN in the agreement. The results of operations of InterSAN (beginning with the closing date of the acquisition) and the estimated fair value of assets acquired will be included in our consolidated financial statements beginning in the first quarter of fiscal 2006 ending July 31, 2005.

Critical Accounting Policies

The preparation of our financial statements and related disclosures require that we make estimates, assumptions and judgments that can have a significant impact on our net revenue and operating results, as well as on the value of certain assets, contingent assets and liabilities on our balance sheet. We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements and, therefore, consider these to be our critical accounting policies. See Note 1 to our consolidated financial statements included elsewhere in this prospectus for more information about these critical accounting policies, as well as a description of other significant accounting policies.

Revenue Recognition, Warranty and Sales Returns

Our revenue recognition policy follows SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. Specifically, we recognize revenue when persuasive evidence of an arrangement exists, title and risk of loss have passed to the customer, generally upon shipment, the price is fixed or determinable and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, we invoice and charge for each separate element and allocate revenue to the separate elements based upon each element s fair value as determined by the list price for each element.

At the time revenue is recognized, we establish an accrual for estimated warranty expenses associated with our sales, recorded as a component of cost of revenues. Our warranty period usually extends 12 months from the date of sale and our warranty accrual represents our best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. While we believe that our warranty accrual is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable could differ materially from what actually transpire in the future. If our actual warranty costs are greater than the accrual, costs of revenue will increase in the future. We also provide an allowance for estimated customer returns, which is netted against revenue. This provision is based on our historical returns, analysis of credit memo data and our return policies. If the historical data used by us to calculate the estimated sales returns does not properly reflect future returns, revenue could be overstated.

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Allowance for Doubtful Accounts

We evaluate the collectability of our accounts receivable based on a combination of factors. In circumstances where, subsequent to delivery, we become aware of a customer s potential inability to meet its obligations, we record a specific allowance for the doubtful account to reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize an allowance for doubtful accounts based on the length of time the receivables are past due. A material adverse change in a major customer s ability to meet its financial obligations to us could result in a material reduction in the estimated amount of accounts receivable that can ultimately be collected and an increase in our general and administrative expenses for the shortfall.

Slow Moving and Obsolete Inventories

We make inventory commitment and purchase decisions based upon sales forecasts. To mitigate the component supply constraints that have existed in the past and to fill orders with non-standard configurations, we build inventory levels for certain items with long lead times and enter into certain longer-term commitments for certain items. We permanently write off 100% of the cost of inventory that we specifically identify and consider obsolete or excessive to fulfill future sales estimates. We define obsolete inventory as inventory that will no longer be used in the manufacturing process. We periodically discard obsolete inventory. Excess inventory is generally defined as inventory in excess of projected usage, and is determined using our best estimate of future demand at the time, based upon information then available to us. In making these assessments, we are required to make judgments as to the future demand for current or committed inventory levels. We use a 12-month demand forecast, and in addition to the demand forecast, we also consider:

parts and subassemblies that can be used in alternative finished products;

parts and subassemblies that are unlikely to be engineered out of our products; and

known design changes which would reduce our ability to use the inventory as planned.

Significant differences between our estimates and judgments regarding future timing of product transitions, volume and mix of customer demand for our products and actual timing, volume and demand mix may result in additional write-offs in the future, or additional usage of previously written-off inventory in future periods for which we would benefit by a reduced cost of revenues in those future periods.

Investment in Equity Securities

For strategic reasons, we may make minority investments in private or public companies or extend loans or receive equity or debt from these companies for services rendered or assets sold. Our minority investments in private companies are primarily motivated by our desire to gain early access to new technology. Our investments in these companies are passive in nature in that we generally do not obtain representation on the boards of directors. Our investments have generally been part of a larger financing in which the terms were negotiated by other investors, typically venture capital investors. These investments are generally made in exchange for preferred stock with a liquidation preference that helps protect the underlying value of our investment. At the time we made our investments, in most cases the companies had not completed development of their products and we did not enter into any significant supply agreements with the companies in which we invested. In determining if and when a decline in the market value of these investments below their carrying value is other-than-temporary, we evaluate the market conditions, offering prices, trends of earnings and cash flows, price multiples, prospects for liquidity and other key measures of performance. Our policy is to recognize an impairment in the value of its minority equity investments when clear evidence of an impairment exists, such as (a) the completion of a new equity financing that may indicate a new value for the investment, (b) the failure to complete a new equity financing arrangement after seeking to raise additional funds or (c) the commencement of proceedings under which the assets of the business may be placed in receivership or liquidated to satisfy the claims of debt and equity stakeholders. As of April 30, 2005, the carrying value of these investments totaled $21.4 million. Future adverse changes in market conditions or poor

operating results at any of the companies in which we hold a minority position could result in losses or an inability to recover the carrying value of these investments.

Restructuring Accrual

During the fiscal year ended April 30, 2003, we initiated actions to reduce our cost structure due to sustained negative economic conditions that had impacted our operations and resulted in lower than anticipated revenues. In May and October 2002, we reduced its workforce in the United States. The restructuring actions in fiscal 2003 resulted in a reduction in the U.S. workforce of approximately 255 employees, or 36% of our U.S. workforce measured as of the beginning of fiscal 2003, and affected all areas of our U.S. operations. During fiscal 2003, we sold certain assets and transferred certain liabilities of our subsidiary, Sensors Unlimited, Inc, closed our Hayward facility, and began the process of closing the facilities occupied by our subsidiary, Demeter Technologies, Inc. As facilities in the United States were consolidated, related leasehold improvement and equipment were written off. As a result of these restructuring activities, we incurred a charge of $9.4 million in fiscal 2003. The restructuring charge included approximately $5.4 million for the write-off of leasehold improvements and equipment in the vacated buildings, approximately $1.8 million of severance-related charges, approximately $1.5 million of excess committed facilities payments and approximately $700,000 of miscellaneous costs required to effect the closures.

During the first quarter of fiscal 2004, we completed the closure of our subsidiary, Demeter Technologies, Inc. In addition, we began closing our German operations and reducing the German workforce of approximately 10 employees engaged in research and development in the optical subsystems and components reporting segment. As a result of these restructuring activities, a charge of $2.2 million was incurred in the first quarter. The restructuring charge included $800,000 of severance-related charges, approximately $600,000 of fees associated with the early termination of our facilities lease in Germany, approximately $450,000 for remaining payments for excess leased equipment and approximately $300,000 of miscellaneous costs incurred to effect the closures.

During the second quarter of fiscal 2004, we completed the closure of our German facility. The intellectual property, technical know-how and certain assets related to our German operations were consolidated with our operations in Sunnyvale, California, during the second quarter. We incurred an additional $317,000 of net restructuring expenses in the second quarter. This amount included an additional $273,000 of restructuring expenses related to the closure of German operations, consisting of $373,000 for legal and exit fees associated with the closure, additional severance-related payments and the write-off of abandoned assets, partially offset by lower than anticipated fees associated with the termination of the German facilities lease of $100,000. The expenses related to the closure of the German facility were partially offset by an $85,000 reduction in restructuring expenses associated with the closure of our subsidiary, Demeter Technologies, Inc. offset by additional severance-related expenses.

During the third quarter of fiscal 2004, we realized a benefit of $1.2 million related to restructuring expenses due to lower than anticipated fees and the consequent reversal of an associated accrual from the termination of a purchasing agreement related to the closure of our subsidiary, Demeter Technologies, Inc.

During the fourth quarter of fiscal 2004, we realized a benefit of $791,000 related to restructuring expenses due to lower than anticipated lease and facility clean-up costs related to the closure of the Demeter facility.

The facilities consolidation charges were calculated using estimates and were based upon the remaining future lease commitments for vacated facilities from the date of facility consolidation, net of estimated future sublease income. The estimated costs of vacating these leased facilities were based on market information and trend analyses, including information obtained from third party real estate sources. We have engaged brokers to locate tenants to sublease the Hayward facility. As of April 30, 2005, $509,000 of committed facilities payments, net of anticipated sublease income, remains accrued and is expected to be fully utilized by fiscal 2006.

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Goodwill, Purchased Intangibles and Other Long-Lived Assets

Our long-lived assets include significant investments in goodwill and other intangible assets. Under accounting standards in effect through April 30, 2002, we were required to make judgments about the recoverability of these assets whenever events or changes in circumstances indicated that the carrying value of these assets may be impaired or not recoverable. In order to make such judgments, we were required to make assumptions about the value of these assets in the future including future prospects for earnings and cash flows of the businesses underlying these investments. While we determined that no impairment was recorded or necessary during fiscal 2001 and 2002 under then applicable accounting standards, the judgments and assumptions we made about the future were complex, subjective and can be affected by a variety of factors including industry and economic trends, our market position and the competitive environment of the businesses in which we operate.

In June 2001, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS 141 Business Combinations and SFAS 142 Goodwill and Other Intangible Assets. SFAS 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting. SFAS 141 also included guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. SFAS 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. SFAS 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives.

We applied SFAS 142 beginning in the first quarter of fiscal 2003. Application of the non-amortization provisions of SFAS 142 significantly reduced amortization expense, which included $123.7 million and $51.5 million of goodwill amortization for the fiscal years ended April 30, 2002 and 2001, respectively. We reclassified assembled workforce and customer base of $6.1 million to goodwill as required by SFAS 142 at the date of adoption. SFAS 142 also requires that goodwill be tested for impairment at the reporting unit level at adoption and at least annually thereafter, utilizing a two-step methodology. The initial step requires us to determine the fair value of each reporting unit and compare it to the carrying value, including goodwill, of such unit. We believe that we operate two reporting units, optical subsystems and components and network test and monitoring systems. If the fair value of the reporting unit exceeds the carrying value, no impairment loss would be recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the unit may be impaired. The amount, if any, of the impairment would then be measured in the second step.

In July 2002, we performed the required impairment testing of goodwill and indefinite-lived intangible assets. As a result of that testing, we incurred a transitional impairment charge of $460.6 million in the first quarter of fiscal 2003, representing substantially all of our goodwill attributable to our optical subsystems and components reporting unit as of April 30, 2002. The resulting impairment charge was reflected as the cumulative effect of a change in accounting principles in the first quarter of fiscal 2003. The largest portion of the transitional impairment charge arose from the acquisition of a number of companies designed to strengthen our capabilities within our optical subsystems and components business. The goodwill resulted from our acquisition of these companies when valuations were generally much higher than current levels. However, we made such acquisitions principally in exchange for shares of our common stock which were also more highly valued at the time the acquisitions were made. As a result, none of the transactions associated with the creation of a significant amount of goodwill resulted from a corresponding outlay of our cash. Had these transactions taken place when valuations were lower, and at the same share exchange ratios, the goodwill amounts would have been considerably smaller.

During the fourth quarters of fiscal 2003, 2004 and 2005, we performed the required annual impairment testing of goodwill and indefinite-lived intangible assets and determined that no impairment charge was required. At April 30, 2005 our investment in goodwill and intangible assets was $119.7 and $37.5 million, respectively.

We are required to make judgments about the recoverability of our long-lived assets, other than goodwill, whenever events or changes in circumstances indicate that the carrying value of these assets may be impaired

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or not recoverable. In order to make such judgments, we are required to make assumptions about the value of these assets in the future including future prospects for earnings and cash flows. If impairment is indicated, we write those assets down to their fair value which is generally determined based on discounted cash flows. Judgments and assumptions about the future are complex, subjective and can be affected by a variety of factors including industry and economic trends, our market position and the competitive environment of the businesses in which we operate.

During fiscal 2003, we discontinued a product line at our Demeter Technologies subsidiary that was not making a significant contribution to our operating results and was no longer considered a key part of our product strategy. The discontinued product line had been included in the optical subsystems and components segment. Certain assets of Demeter Technologies were sold to an unaffiliated party in conjunction with the product line discontinuation. As a result of the discontinuation of the product line, we determined that we would no longer utilize certain intangible assets obtained in the Demeter Technologies acquisition that were associated with that product line. We wrote off those intangible assets, with a net book value of $10.1 million and, the resulting charge was reported as an impairment of goodwill and intangible assets in fiscal 2003. During the second fiscal quarter of fiscal 2005, we determined that the remaining intangible assets related to certain purchased passive optical technology, acquired from New Focus, Inc., was obsolete, and had a fair value of zero. Accordingly an impairment charge of $3.7 million was recorded against the remaining net book value of these assets during the second quarter of fiscal 2005.

Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the periods indicated:

	Fiscal Years Ended April 30,		
	2005	**2004**	**2003**
Revenues:			
Optical subsystems and components	86.0%	86.2%	82.2%
Network test and monitoring systems	14.0	13.8	17.8
Total revenues	100.0	100.0	100.0
Cost of revenues	73.2	77.4	78.4
Amortization of acquired developed technology	7.9	10.4	13.2
Impairment of acquired developed technology	1.4		
Gross profit	17.5	12.3	8.4
Operating expenses:			
Research and development	22.4	33.5	36.2
Sales and marketing	10.6	10.8	12.2
General and administrative	8.3	9.0	9.1
Amortization of (benefit from) deferred stock compensation	0.1	(0.1)	(1.0)
Acquired in-process research and development	0.6	3.3	
Amortization of purchased intangibles	0.4	0.3	0.5
Impairment of tangible assets	6.7		
Impairment of goodwill and intangible assets			6.4
Restructuring costs	0.1	0.2	5.6
Other acquisition costs		0.1	0.1
Total operating expenses	49.1	57.2	69.0

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	Fiscal Years Ended April 30,		
	2005	2004	2003
Loss from operations	(31.5)	(45.0)	(60.6)
Interest income, net	0.9	1.7	2.8
Interest expense, net	(5.2)	(15.6)	(6.8)
Other income (expense), net	(4.5)	(2.3)	(30.8)
Loss before income taxes and cumulative effect of an accounting change	(40.3)	(61.1)	(95.5)
Provision for income taxes	0.3	0.2	0.1
Loss before cumulative effect of an accounting change	(40.6)	(61.3)	(95.6)
Cumulative effect of an accounting change			(276.7)
Net loss	(40.6)%	(61.3)%	(372.3)%

Comparison of Fiscal Years Ended April 30, 2005 and 2004

Revenues. Revenues increased $95.2 million, or 51.3%, to $280.8 million in fiscal 2005 compared to $185.6 million in fiscal 2004. Sales of optical subsystems and components and network test and monitoring systems represented 86.0% and 14.0%, respectively, of total revenues in fiscal 2005, compared to 86.2% and 13.8%, respectively, in fiscal 2004.

Optical subsystems and components revenues increased $81.6 million, or 51.0%, to $241.6 million in fiscal 2005 compared to $160.0 million in fiscal 2004. Our Advanced Optical Components, or AOC, division, acquired on March 1, 2004 from Honeywell International Inc., contributed $30.9 million for the full 2005 fiscal year compared to $6.7 million in fiscal 2004. Our acquisition on January 31, 2005, of certain assets of Infineon s fiber optics business unit contributed $4.9 million in the fourth quarter of 2005. Excluding the effect of acquisitions, sales of optical subsystems and components increased $52.5 million, or 29%, in fiscal 2005. Of this increase, $36.1 million was related to sales of products for MAN and telecom applications and $19.3 million was related to sales of products for short distance LAN/ SAN applications. Increased sales in these product lines were partially offset by a $2.9 million decline in sales of other products. The increase in revenues from the sale of these products was primarily the result of an increase in the volume of units sold to new and existing customers, partially offset by a decrease in average selling prices.

Network test and monitoring systems revenues increased $13.6 million, or 53.3%, to $39.2 million in fiscal 2005 compared to $25.6 million in fiscal 2004. Approximately $7.8 million of the increase was related to product lines acquired from Data Transit in August 2004 with the remainder due to increased sales of new test and monitoring products used in the development of Fibre Channel SANs operating at 2 and 4 Gbps.

Sales to Cisco Systems, our largest customer, represented 27.8% of total revenues, or $78.1 million, in fiscal 2005 compared to 22.2% of total revenues, or $41.3 million, in fiscal 2004.

Amortization and Impairment of Acquired Developed Technology. Amortization of acquired developed technology, a component of cost of revenues, increased $6.7 million, or 34.7%, in fiscal 2005 to $25.9 million compared to $19.2 million in fiscal 2004. The increase was due to the acquisition of Honeywell s VCSEL Optical Products business in March 2004 which contributed an additional $3.0 million in fiscal 2005 compared to fiscal 2004, and the fiscal 2005 acquisitions of Data Transit, I-TECH and certain product lines from Infineon which contributed $1.0 million, $25,000 and $424,000, respectively in fiscal 2005. Additionally, in the second quarter of fiscal 2005 we recorded an impairment charge of $3.7 million to write-off the remaining net book value of certain passive optical

technology associated with our acquisition of assets of New Focus, Inc in May 2002.

Gross Profit. Gross profit increased $26.5 million, or 116.1%, to $49.3 million in fiscal 2005 compared to $22.8 million in fiscal 2004. Gross profit as a percentage of total revenue was 17.5% in fiscal 2005 compared to 12.3% in fiscal 2004. We recorded charges of $11.3 million for obsolete and excess inventory in fiscal 2005

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and $22.3 million in fiscal 2004. We sold inventory that was written-off in previous periods resulting in a benefit of $9.3 million in fiscal 2005 and $17.9 million in fiscal 2004. As a result, we recognized a net charge of $2.0 million in fiscal 2005 compared to $4.4 million in fiscal 2004. Excluding the amortization of acquired developed technology and the impairments thereon and the net impact of excess and obsolete inventory charges, gross profit would have been $77.2 million, or 27.5% of revenue, in fiscal 2005, compared to $46.4 million, or 25.0% of revenue in fiscal 2004. The increase in gross profit was primarily due to an increase in unit sales across most of our product lines, which spread our fixed overhead costs over a higher production volume, reduced material costs, and a favorable shift of product mix to an increased percentage of sales of products for longer distance MAN and telecom applications that typically have higher margins than our products for shorter distance LAN/ SAN applications, as well as increased sales of network test and monitoring systems that have higher margins than optical subsystems and components.

Research and Development Expenses. Research and development expenses increased $606,000, or 1.0%, to $62.8 million in fiscal 2005 compared to $62.2 million in fiscal 2004. The increase in research and development expenses was primarily due to a $3.8 million increase in spending as a result of our acquisition of Honeywell s VCSEL optical products business unit, partially offset by lower depreciation costs which were the result of accelerated depreciation recorded in conjunction with the shutdown of our operations at Demeter in the first quarter of 2004. Research and development expenses as a percent of revenues decreased to 22.4% in fiscal 2005 compared to 33.5% in fiscal 2004 as a result of increased revenues.

Sales and Marketing Expenses. Sales and marketing expenses increased $9.7 million, or 48.4%, to $29.8 million in fiscal 2005 compared to $20.1 million in fiscal 2004. The increase in sales and marketing expenses was primarily due to a $5.0 million increase in personnel-related costs, a $1.6 million increase in commission expense and a $1.3 million increase in advertising and marketing costs, all associated with our increase in revenue. Sales and marketing expenses as a percent of revenues decreased to 10.6% in fiscal 2005 compared to 10.8% in fiscal 2004.

General and Administrative Expenses. General and administrative expenses increased $6.6 million, or 39.6%, to $23.4 million in fiscal 2005 compared to $16.7 million in fiscal 2004. The increase was primarily due to additional costs associated with the evaluation and testing of internal control systems required under Section 404 of the Sarbanes-Oxley Act of 2002, a $2.2 million increase in audit fees, a $1.8 million increase in legal expense and a $554,000 increase in personnel-related costs primarily related to the acquisition of Honeywell s VCSEL Optical Products business unit. General and administrative expenses as a percent of revenues decreased to 8.3% in fiscal 2005 compared to 9.0% in fiscal 2004.

Amortization of (Benefit from) Deferred Stock Compensation. Amortization of deferred stock compensation costs increased by $267,000 to $162,000 in fiscal 2005, compared to a credit of $105,000 in fiscal 2004. The benefit from deferred stock compensation is related to the termination of employees during a period with deferred compensation associated with their stock options and the effects of the graded vested method of amortization which accelerates the amortization of deferred compensation.

Acquired In-process Research and Development. In-process research and development, or IPR&D, expenses decreased $4.6 million, or 74.8%, to $1.6 million in fiscal 2005 compared to $6.2 million recorded in fiscal 2004. In fiscal 2005, $318,000 was related to the acquisition of Data Transit, $1.1 million was related to the acquisition of Infineon s optical transceiver products, and $114,000 was related to the acquisition of I-TECH. The amount recorded in fiscal 2004 was related to the acquisition of Honeywell s VCSEL Optical Products business unit.

Amortization of Purchased Intangibles. Amortization of purchased intangibles increased $532,000, or 93.0%, to $1.1 million in fiscal 2005 compared to $572,000 in fiscal 2004. The increase was due to purchased intangibles related to our acquisition of Data Transit.

Impairment of Tangible Assets. During the quarter ended January 31, 2005, we recorded an impairment charge if $18.8 million to write down the carrying value of one of our corporate office facilities located in Sunnyvale, California upon entering into a sale-leaseback agreement. The property was written down to its appraised value, which was based on the work of an independent appraiser in conjunction with the sale-

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leaseback agreement. Due to retention by the Company of an option to acquire the leased properties at fair value at the end of the fifth year of the lease, the sale-leaseback transaction was recorded in the Company s fourth quarter ending April 30, 2005 as a financing transaction under which the sale will not be recorded until the option expires or is otherwise terminated. At April 30, 2005, the carrying value of the financing liability, included in Other Long-Term Liabilities, was $12.3 million and the current portion of the financing liability, included in Current Portion of Long-term Liabilities, was $200,000.

Restructuring Costs. We recorded a restructuring charge of $287,000 in fiscal 2005 to adjust the operating lease liability for our Hayward facility that was closed in fiscal 2003. During 2004, we recorded $382,000 in restructuring charges.

Interest Income. Interest income decreased $775,000, or 24.4%, to $2.4 million in fiscal 2005 compared to $3.2 million in fiscal 2004. The decrease was primarily the result of decreasing investment balances during fiscal 2005.

Interest Expense. Interest expense is primarily related to our convertible subordinated notes due in 2008 and 2010. Interest expense decreased $14.4 million, or 49.9%, to $14.5 million in fiscal 2005 compared to $28.9 million in fiscal 2004. The decrease was primarily due to the conversion and repurchase in fiscal 2004 of $24.8 million in principal amount of convertible notes due in 2008. In connection with the conversion, we recorded non-cash interest expense of $10.8 million representing the fair value of the incremental shares issued to induce the exchange and $5.8 million representing the remaining unamortized discount for the beneficial conversion feature. Of our total interest expense, $4.3 million and $10.2 million was the amortization of the beneficial conversion feature of these notes in fiscal 2005 and 2004, respectively.

Other Income (Expense), Net. Other income (expense), net, increased $8.2 million, or 189.4%, to an expense of $12.6 million in fiscal 2005 compared to an expense of $4.3 million in fiscal 2004. In the fourth quarter of fiscal 2005, we recorded an impairment charge of $10.0 million to write-off a minority equity investment in a company. The remaining expense in fiscal 2005 and 2004 primarily consisted of our proportional share of losses associated with a minority investment and amortization of subordinated loan costs.

Provision for Income Taxes. We recorded an income tax provision of $856,000 for fiscal 2005 compared to $334,000 for fiscal 2004. A deferred tax liability has been established to reflect tax amortization of goodwill for which no book amortization has occurred. Due to the uncertainty regarding the timing and extent of our future profitability, we have recorded a valuation allowance to offset potential income tax benefits associated with our operating losses. As a result, we did not record any income tax benefit in either fiscal 2005 or 2004. There can be no assurance that deferred tax assets subject to the valuation allowance will ever be realized.

Comparison of Fiscal Years Ended April 30, 2004 and 2003

Revenues. Revenues increased $19.1 million, or 11.5%, to $185.6 million in fiscal 2004 compared to $166.5 million in fiscal 2003. This increase reflected a $23.2 million, or 16.9%, increase in sales of optical subsystems and components, to $160.0 million in fiscal 2004 compared to $136.8 million in fiscal 2003, partially offset by a $4.0 million, or 13.6%, decrease in sales of network test and monitoring systems, to $25.6 million in fiscal 2004 compared to $29.6 million in fiscal 2003. Sales of optical subsystems and components and network test and monitoring systems represented 86.2% and 13.8%, respectively, of total revenues in fiscal 2004, compared to 82.2% and 17.8%, respectively, in fiscal 2003. The increase in revenues from the sale of optical subsystems and components in fiscal 2004 was primarily the result of an increase in volume of units sold to new and existing customers, as well as contributions of $6.7 million from sales by our Advanced Optical Components division, the former Honeywell VCSEL Optical Products business unit, that we acquired on March 2, 2004 from Honeywell International Inc., partially offset by a decrease in average selling prices. The decrease in revenues from the sale of network test and monitoring systems was due to decreased demand for new test equipment used in the development of Fibre Channel SANs operating at 2 Gbps and a continued reduction in global IT spending which affected the demand for equipment used in monitoring Gigabit Ethernet networks.

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Sales to Cisco Systems represented 22.2%, or $41.3 million, and 10.4%, or $17.2 million, of our total revenues during fiscal 2004 and fiscal 2003, respectively.

Amortization and Impairment of Acquired Developed Technology. Amortization of acquired developed technology decreased $2.7 million, or 12.5% in 2004 to $19.2 million compared to $22.0 million in 2003 as a result of a $10.1 million impairment charge for acquired developed technology that was recorded in 2003 related to a discontinued product line at our Demeter subsidiary.

Gross Profit. Gross profit increased $8.8 million, or 62.8%, to $22.8 million in fiscal 2004 compared to $14.0 million in fiscal 2003. Gross profit as a percentage of total revenue was 12.3% in 2004 compared to 8.4% in 2003. The increase in gross profit was primarily the result of a decline in the charge for excess and obsolete inventory, which was $22.3 million in 2004 compared to $24.3 million in 2003, which was offset by sales of previously written off inventory, with associated costs of zero, of $17.9 million in fiscal 2004 and $15.1 million in fiscal 2003. Gross profit also improved due to reductions in material costs, and an increase in unit sales which spread our fixed overhead costs over a higher production volume. Additionally, amortization of acquired developed technology, a component of cost of revenues, decreased $2.7 million, or 12.5%, in 2004 to $19.2 million compared to $22.0 million in 2003 as a result of a $10.1 million impairment charge for acquired developed technology that was recorded in 2003 related to a discontinued product line at our Demeter subsidiary.

Research and Development Expenses. Research and development expenses increased $1.9 million, or 3.1%, to $62.2 million in fiscal 2004 compared to $60.3 million in fiscal 2003. The increase was primarily due to the full-year effect of the operations of our Genoa Corporation subsidiary, acquired on April 3, 2003, offset by a 10% decline in personnel. Research and development expenses as a percent of revenues decreased to 33.5% in fiscal 2004 compared to 36.2% in fiscal 2003 as a result of increased revenues.

Sales and Marketing Expenses. Sales and marketing expenses decreased $169,000, or 0.8%, to $20.1 million in fiscal 2004 compared to $20.2 million in fiscal 2003. Sales and marketing expenses as a percent of revenues decreased to 10.8% in fiscal 2004 compared to 12.2% in fiscal 2003.

General and Administrative Expenses. General and administrative expenses increased $1.5 million, or 9.9%, to $16.7 million in fiscal 2004 compared to $15.2 million in fiscal 2003. The increase was primarily due to a $996,000 increase in bad debt expense and a $529,000 increase in legal expenses compared to those in fiscal 2003 as a result of increased efforts to obtain patents for and license our technology. The increase in bad debt expense was primarily due to the application of our existing reserve policy, which we periodically evaluate based on our actual experience, against a larger accounts receivable balance at the end of fiscal 2004. General and administrative expenses as a percent of revenues decreased to 9.0% in fiscal 2004 compared to 9.1% in fiscal 2003.

Amortization of (Benefit from) Deferred Stock Compensation. Amortization of deferred stock compensation costs decreased by $1.6 million, or 93.9%, to a credit of $105,000 in fiscal 2004 compared to a credit of $1.7 million in fiscal 2003. This decrease was related to the termination of employees with deferred compensation associated with their stock options and the effects of the graded vested method of amortization which accelerates the amortization of deferred compensation.

Acquired In-process Research and Development. In-process research and development, or IPR&D, expenses of $6.2 million recorded in fiscal 2004 related to the acquisition of the VCSEL Optical Products business unit from Honeywell in March 2004. There was no IPR&D expense in fiscal 2003 related to the acquisition of Genoa.

Amortization of Goodwill and Other Purchased Intangibles. Amortization of goodwill and other purchased intangibles decreased $186,000 or 24.5%, to $572,000 in fiscal 2004 compared to $758,000 in fiscal 2003.

Impairment of Goodwill and Intangible Assets. No impairment of goodwill or intangible assets was recorded during fiscal 2004. In fiscal 2003, we discontinued a product line at our Demeter subsidiary resulting

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in an impairment of acquired developed technology totaling $10.1 million and a goodwill impairment of $485,000 related to our Transwave acquisition.

Restructuring Costs. Restructuring costs decreased $9.0 million, or 95.9%, to $382,000 in fiscal 2004 compared to $9.4 million in fiscal 2003. During fiscal 2003, we recorded charges of $1.2 million for severance costs associated with a reduction in our U.S.-based workforce, $3.1 million to consolidate our facilities and operations located in Hayward, California into our facilities in Sunnyvale, California, and $5.2 million to close our El Monte, California, facilities. These restructuring activities were completed during fiscal 2004.

Other Acquisition Costs. Other acquisition costs increased $24,000, or 12.1%, to $222,000 in fiscal 2004 compared to $198,000 in fiscal 2003.

Interest Income. Interest income decreased $1.5 million, or 31.9%, to $3.2 million in fiscal 2004 compared to $4.7 million in fiscal 2003. The decrease in interest income was primarily the result of decreasing investment balances during fiscal 2004.

Interest Expense. Interest expense increased $17.5 million, or 153.5%, to $28.9 million in fiscal 2004 compared to $11.4 million in fiscal 2003. The increase in interest expense was primarily due to the conversion and repurchase of $24.8 million in principal amount of convertible notes due 2008. In connection with the conversion, we recorded non-cash interest expense of $10.8 million representing the fair value of the incremental shares issued to induce the exchange and $5.8 million representing the remaining unamortized discount for the beneficial conversion feature. Additionally, we issued an additional $150 million of convertible debt in October 2003. Of the total interest expense, $10.2 million and $4.8 million was related to the amortization of the beneficial conversion feature of these notes in fiscal 2004 and 2003, respectively.

Other Income (Expense), Net. Other income (expense), net, decreased $47.0 million, or 91.6%, to an expense of $4.3 million in fiscal 2004 compared to an expense of $51.3 million in fiscal 2003. In fiscal 2003, we incurred costs of $36.8 million associated with the sale of assets of our Sensors Unlimited subsidiary, which was primarily due to the write off of certain intangible assets associated with the original acquisition of Sensors Unlimited, which we had no plans to utilize and had abandoned, as well as the payment of contingent consideration related to the original acquisition of Sensors Unlimited. In fiscal 2003, we also recorded an impairment charge of $12.0 million on our minority equity investments in two companies. During fiscal 2003, these two companies raised additional funds in financings in which we declined to participate. As a result of the financings, our investments in the two companies was diluted to an immaterial interest and we determined that an impairment event had occurred and wrote off these investments in full.

Provision for Income Taxes. We recorded an income tax provision of $334,000 in fiscal 2004 compared to $229,000 in fiscal 2003. The tax provision consists of state and foreign taxes. Due to the uncertainty regarding the timing and extent of our future profitability, we have recorded a valuation allowance to offset potential income tax benefits associated with our operating losses. As a result, we had no income tax benefit in fiscal 2004 or 2003.

Liquidity and Capital Resources

At April 30, 2005, cash, cash equivalents and short-term investments were $102.4 million compared to $143.4 million at April 30, 2004. Restricted securities, used to secure future interest payments on our convertible debt were $9.1 million at April 30, 2005 compared to $15.2 million at April 30, 2004. At April 30, 2005, total short and long term debt was $267.8 million, compared to $233.7 million at April 30, 2004. Of the $34.1 million increase in debt, $32.1 million was related to the issuance of convertible notes in connection with the acquisitions of Data Transit and I-TECH and a minority investment in a private company.

Net cash used by operating activities totaled $28.0 million in fiscal 2005, compared to $32.8 million in fiscal 2004 and $18.9 million in fiscal 2003. The use of cash in operating activities in fiscal 2005 was primarily a result of operating losses adjusted for non-cash related items. Working capital uses of cash in fiscal 2005 included cash inflows of $10.9 million offset by outflows of $18.6 million. Cash inflows were primarily due to a $5.3 million increase in deferred revenue and a $1.9 million increase in accrued liabilities. The increase in deferred revenue was the result of increased sales through distributor channels. The increase in accrued

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liabilities was primarily due to an increase in our warranty reserve as a result of increased revenues. Cash outflows were primarily due to a $13.3 million increase in accounts receivable as a result of increased revenue and an increase in other assets of $5.3 million, which consisted primarily of investments in our patent portfolio.

Net cash used in investing activities totaled $27.9 million in fiscal 2005 compared to $88.3 million in fiscal 2004, and $17.6 million in fiscal 2003. The use of cash for investing activities in fiscal 2005 was primarily related to facility improvements and purchases of equipment at our new AOC Division manufacturing facility in Texas as well as purchases of equipment for our facility in Malaysia to support increased production volume. The use of cash for investing activities in fiscal 2004 consisted primarily of our purchase of the assets of Honeywell s VCSEL Optical Products business unit and purchases of equipment to support increased production volume in our Malaysian manufacturing facility. The use of cash for investing activities in fiscal 2003 primarily consisted of purchases of plant, property and equipment totaling $18.8 million, offset in part by $5.6 million of proceeds from the sale of product lines.

Net cash provided by financing activities was $15.5 million in fiscal 2005 compared to $150.0 million in fiscal 2004 and $1.5 million in fiscal 2003. Cash provided by financing activities in fiscal 2005 included $12.9 million in proceeds from the sale-leaseback of one of our corporate offices and proceeds of $2.5 million from the exercise of stock options. Cash provided by financing activities in fiscal 2004 primarily represented the net proceeds of $145.1 million from issuance of convertible debt, and proceeds of $6.1 million from the exercise of employee stock options, offset by repayments of $1.9 million on our convertible notes. Cash provided by financing activities in fiscal 2003 was primarily due to proceeds from the exercise of employee stock options.

On April 29, 2005, we entered into a letter of credit reimbursement agreement with Silicon Valley Bank for a period of one year. Under the terms of the agreement, Silicon Valley Bank is providing a $7 million letter of credit facility to house existing letters of credit issued by Silicon Valley Bank and any other letters of credit that may be required by the Company. Cost related to the credit facility consisted of a loan fee of 0.50% of the credit facility amount, or $35,000, plus the bank s out of pocket expenses associated with the credit facility. The credit facility is unsecured with a negative pledge on all assets, including intellectual property. The agreement requires us to maintain our primary banking and cash management relationships with Silicon Valley Bank or SVB Securities and to maintain a minimum unrestricted cash and cash equivalents balance, net of any outstanding debt and letters of credit exposure, of $40 million at all times. At April 30, 2005 outstanding letters of credit secured by this facility totaled $2,950,510.

We believe that our existing balances of cash, cash equivalents and short-term investments, together with the cash expected to be generated from our future operations, will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may however require additional financing to fund our operations in the future. The significant contraction in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, our business, financial condition and results of operations will be adversely affected.

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At April 30, 2005, we had contractual obligations of $350.1 million as shown in the following table (in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 Years**
Short-term debt	$ 15,811	$ 15,811	$	$	$
Long-term debt	266,520		16,270	100,250	150,000
Lease commitment under sale-leaseback agreement	51,464	2,962	6,124	6,403	35,975
Operating leases	7,865	4,814	2,420	631	
Purchase obligations	6,449	6,449			
Minimum royalty obligation	2,000	2,000			
Total contractual obligations	$ 350,109	$ 32,036	$ 24,814	$ 107,284	$ 185,975

Short-term debt consists of a convertible promissory note for $12.1 million due in fiscal 2006, related to our fiscal 2005 acquisition of I-TECH, and a convertible promissory note for $3.75 million to CyOptics, issued in conjunction with our purchase of CyOptics preferred stock in the fourth quarter of fiscal 2005. (See note 13 to the consolidated financial statements included elsewhere in this prospectus.)

Long-term debt consists of a convertible promissory note in the principal amount of $16.3 million due on August 6, 2006, if not sooner converted, and two series of convertible subordinated notes in the aggregate principal amount of $100.3 million due October 15, 2008, and $150.0 million due October 15, 2010. The two series of notes are convertible by the holders of the notes at any time prior to maturity into shares of Finisar common stock at specified conversion prices. The two series of notes are redeemable by us, in whole or in part, after October 15, 2004 and October 15, 2007, respectively. Holders of the notes due in 2010 have the right to require us to repurchase some or all of their notes on October 15, 2007. We may choose to pay the repurchase price in cash, shares of Finisar common stock, or a combination thereof.

Lease commitment under the sale-leaseback agreement for our corporate office building, which we entered into in the fourth quarter of 2005 and includes $12.6 million recorded on our balance sheet as of April 30, 2005 as other long-term liabilities and current portion of long-term liabilities. (See Note 9 to the consolidated financial statements included elsewhere in this prospectus.)

Operating lease obligations consist primarily of base rents for facilities we occupy at various locations.

Purchase obligations consist of standby repurchase obligations and are related to materials purchased and held by subcontractors on our behalf to fulfill the subcontractors purchase order obligations at their facilities. Our repurchase obligations of $6.5 million has been expensed and recorded on the balance sheet as non-cancelable purchase obligations as of April 30, 2005.

The minimum commitment for royalty payments is related to the purchase of certain assets of New Focus and has been recorded on our balance sheet as of April 30, 2005 as current portion of long-term liabilities.

Off-Balance-Sheet Arrangements

At April 30, 2005 and April 30, 2004, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

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Effect of New Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Accounting Standards (SFAS) 123R, which replaces SFAS 123 and supersedes Accounting Principles Board (APB) 25. As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB 25 s intrinsic value method. Under APB 25 the Company generally recognizes no compensation expense for employee stock options, as the exercise prices of the options granted are usually equal to the quoted market price of our common stock on the day of the grant. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS 123 will no longer be an alternative to financial statement recognition. In April 2005, the Securities and Exchange Commission (SEC) issued a rule delaying the required adoption date for SFAS 123R to the first interim period of the first fiscal year beginning on or after June 15, 2005. The Company will adopt SFAS 123R as of May 1, 2006.

Under SFAS 123R, we must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method of compensation cost and the transition method to be used at date of adoption. The transition methods include retroactive and prospective adoption options. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption. The retroactive method requires that compensation expense for all unvested stock options and restricted stock begins with the first period restated. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. We expect to adopt SFAS 123R under the prospective method. We are evaluating the requirements of SFAS 123R and have not yet determined the effect of adopting SFAS 123R or whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123, although we expect that the adoption of SFAS 123R will result in significant stock-based compensation expense.

In December 2004, the FASB issued SFAS 153, Exchanges of Nonmonetary Assets, as an amendment of APB 29, Accounting for Nonmonetary Transactions. SFAS 153 addresses the measurement of exchanges of nonmonetary assets and eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in APB 29 and replaces it with an exception for exchanges that do not have commercial substance. This Statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005 and must be applied prospectively. The Company do not expect that the adoption of SFAS 153 will have a material effect on our results of operations.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an Amendment of APB No. 43, Chapter 4, or SFAS 151, which is the result of the FASB s efforts to converge U.S. accounting standards for inventory with International Accounting Standards. SFAS 151 requires abnormal amounts of idle facility expense, freight, handling costs, and wasted material to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect the adoption of SFAS 151 to have a material impact on our results of operations.

Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. We place our investments with high credit issuers in short-term securities with maturities ranging from overnight up to 36 months or have characteristics of such short-term investments. The average maturity of the portfolio will not exceed 18 months. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity. We have no investments denominated in foreign country currencies and therefore our investments are not subject to foreign exchange risk.

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We invest in equity instruments of privately-held companies for business and strategic purposes. These investments are included in other long-term assets and are accounted for under the cost method when our ownership interest is less than 20% and we do not have the ability to exercise significant influence. For entities in which we hold greater than a 20% ownership interest, or where we have the ability to exercise significant influence, we use the equity method. We recorded losses of $1.8 million in fiscal 2005, $1.3 million in fiscal 2004 and $764,000 in fiscal 2003 for investments accounted for under the equity method. For these non-quoted investments, our policy is to regularly review the assumptions underlying the operating performance and cash flow forecasts in assessing the carrying values. We identify and record impairment losses when events and circumstances indicate that such assets are impaired. We recognized impairment on these assets of $10.0 million in fiscal 2005, $1.6 million in fiscal 2004 and $12.0 million in fiscal 2003. If our investment in a privately-held company becomes marketable equity securities upon the company s completion of an initial public offering or its acquisition by another company, our investment would be subject to significant fluctuations in fair market value due to the volatility of the stock market.

The following table summarizes the expected maturity, average interest rate and fair market value of the short-term debt securities held by us (and related receivables) and debt securities issued by us as of April 30, 2005 (in thousands):

	Fiscal Years Ended April 30,				
	2006	2007	2008 and Thereafter	Total Cost	Fair Market Value
Assets					
Available for sale debt securities	$ 51,364	$ 18,312	$ 10,517	$ 80,193	$ 79,697
Average interest rate	2.90%	4.01%	4.24%		
Restricted securities	$ 3,717	$ 5,393	$	$ 9,110	$ 8,967
Average interest rate	1.59%	2.36%			
Loan receivable from I-TECH	$ 2,004	$	$	$ 2,004	$ 2,004
Average interest rate	3.35%				
Loan receivable from Data Transit	$ 1,000	$	$	$ 1,000	$ 1,000
Average interest rate	8.00%				
Liabilities					
Long-term debt:					
Fixed rate	$	$	$ 100,250	$ 100,250	$ 89,974
Average interest rate			5.25%		
Fixed rate	$	$	$ 150,000	$ 150,000	$ 116,625
Average interest rate			2.50%		
Convertible note from Data Transit	$	$ 16,270	$	$ 16,270	$ 16,270
Average interest rate		8.00%			
Convertible note from I-TECH	$ 12,061	$	$	$ 12,061	$ 12,061
Average interest rate	3.35%				
Convertible note from CyOptics	$ 3,750	$	$	$ 3,750	$ 3,750
Average interest rate	3.35%				

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The following table summarizes the expected maturity, average interest rate and fair market value of the short-term debt securities held by us and debt securities issued by us as of April 30, 2004 (in thousands):

	Fiscal Years Ended April 30,				
	2005	2006	2007 and Thereafter	Total Cost	Fair Market Value
Assets					
Available for sale debt securities	$ 47,833	$ 15,780	$ 9,944	$ 73,557	$ 73,526
Average interest rate	4.19%	4.21%	3.98%		
Restricted securities	$ 6,329	$ 3,658	$ 5,263	$ 15,250	$ 15,187
Average interest rate	2.03%	1.60%	2.34%		
Liabilities					
Long-term debt:					
Fixed rate	$	$	$ 100,250	$ 100,250	$ 98,746
Average interest rate			5.25%		
Fixed rate	$	$	$ 150,000	$ 150,000	$ 131,437
Average interest rate			2.50%		

We also have subsidiaries in China, Malaysia, Europe and Singapore. Due to the relative volume of transactions through these subsidiaries, we do not believe that we have significant exposure to foreign currency exchange risks. We currently do not use derivative financial instruments to mitigate this exposure. In July 2005, China and Malaysia changed the system by which the value of their currencies are determined. Both currencies moved from a fixed rate pegged to the U.S. dollar to a managed float pegged to a basket of currencies. We expect that this will have a minor negative impact on our future costs. We continue to review this issue and may consider hedging certain foreign exchange risks through the use of currency forwards or options in future years.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of April 30, 2005 based on the guidelines established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of the operations acquired from Infineon Technologies AG on January 31, 2005 (the Acquired Infineon Operations) or of I-TECH CORP. (I-TECH), acquired on April 8, 2005, which are included in our fiscal 2005 consolidated financial statements and which, in the aggregate, consisted of $72.0 million and $71.7 million of total assets and net assets, respectively, as of April 30, 2005 and which, in the aggregate, represented $5.2 million and $0.8 million of revenues and loss from operations, respectively, for the year then ended. Based on management s assessment of internal control over financial reporting and as more fully explained below, we have identified certain control deficiencies that we have determined represented material weaknesses in our internal control over financial reporting as of April 30, 2005.

A material weakness is a control deficiency, or a combination of control deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. In connection with the evaluation and testing of our internal

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control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002, we identified the following material weaknesses that existed at April 30, 2005:

A material weakness in our financial reporting processes arising from a shortage of, and turnover in, qualified financial reporting personnel with sufficient skills and experience to apply generally accepted accounting principles to our transactions, to provide for timely review of account reconciliations, and to prepare financial statements that comply with U.S. generally accepted accounting principles. This material weakness relates to all of our significant financial statement accounts. Significant accounts adjusted for this material weakness include prepaid assets, intangible assets, other long-term assets, most current liabilities and amortization of intangibles expense.

A material weakness related to our accounting for income, and sales/use taxes, including (a) ineffective controls over the application of U.S. generally accepted accounting principles pertaining to income taxes; (b) ineffective controls over the monitoring and accounting for income tax matters arising from business combinations and other complex and non-routine business transactions; (c) insufficient personnel with adequate technical skills relative to accounting for and disclosure of income taxes; and (d) inadequate accounting policies and procedures that do not provide for effective supervisory review of income and sales/use tax accounting amounts and analyses and related recordkeeping and disclosure activities. Significant accounts affected by, and adjusted for, this material weakness include income tax expense and deferred income taxes, as well as related disclosures for income taxes and accrued liabilities, cost of revenues, research and development expense, sales and marketing expense, and general and administrative expense for sales/use taxes.

A material weakness related to the effectiveness of our controls, including ineffective controls to physically verify the existence of inventory on consignment at customer locations and inventory acquired in recent business acquisitions. Significant accounts affected by, and adjusted for, this material weakness include inventory and cost of revenues.

A material weakness in our controls to monitor our Network Test and Monitoring segment sales agreements which have multiple elements such that revenue received under these agreements is properly allocated to each element and recognized in the proper period. Significant accounts affected by, and adjusted for, this material weakness include revenues and deferred revenue.

As a result of the identified material weaknesses, our management has concluded that, as of April 30, 2005, our internal control over financial reporting was not effective. The material weaknesses set out above could result in a material misstatement to the Company s annual or interim financial statements that would not be prevented or detected.

Notwithstanding the above-mentioned material weaknesses, we believe that the consolidated financial statements included in this report fairly present our consolidated financial position as of, and the consolidated results of operations for the year ended, April 30, 2005.

Changes in Internal Control Over Financial Reporting

Regulations under the Exchange Act require public companies to evaluate any change in internal control over financial reporting. Other than as discussed herein, there were no changes in our internal control over financial reporting that occurred during our fiscal quarter ended April 30, 2005 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As described above, we have determined that the identified deficiencies in our internal control over financial reporting as of April 30, 2005 constitute material weaknesses.

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Remediation Efforts

We have been, and intend to continue, planning and implementing changes to our processes to improve and our internal control over financial reporting. We anticipate that these remediation efforts will continue throughout fiscal 2006, and include the following:

1. *Financial Reporting Processes:* Management lost critical financial and accounting resources during the fourth quarter of fiscal 2005 at a time when we were in the process of acquiring two companies and the transceiver and transponder product lines of Infineon while financial and accounting resources were also supporting management s business planning process and assessing cost reduction opportunities. This situation contributed to the weakness in the financial statement close process for preparing and compiling financial statements for external reporting purposes. In response, management has hired an assistant controller and is seeking to hire a division controller for its Network Tools Division as well as additional resources within our corporate accounting organization.

2. *Income and Sales/ Use Taxes:* The total income tax provision for the year ended April 30, 2005 was $856,000 which consisted of a current tax benefit of $776,000 net of a deferred tax provision of $1.6 million. Sales/use tax expense for the same period was $2.1 million. Management plans to secure additional external resources by hiring a consulting firm specializing in accounting for income and sales/use taxes to provide the following services:

Assistance in the preparation of the accounting entry and disclosure footnote with the proper application of U.S. generally accepted accounting principles, plus all supporting schedules and account analyses; and

Monitor and assist with income tax matters arising from business combinations and other complex and non-routine business transactions.

3. *Customer Managed Inventory:* Customer managed inventory was $3.3 million as of April 30, 2005. Management will be undertaking a more frequent physical count of inventory located at customer locations in fiscal 2006 beginning in the quarter ending July 31, 2005. Inventory acquired in conjunction with the acquisition of I-TECH totaled approximately $1.3 million as of April 30, 2005. This inventory will be included as part of our normal cycle counting process going forward.

4. *Sales agreements at Network Tools:* Management has undertaken the following measures to ensure that sales agreements with multiple elements are recorded properly in our financial reports:

Adopt a more thorough review process with the management of this division in evaluating transactions with multiple elements in any given period; and

Hire a business unit controller to provide additional oversight for this division.

In addition to the actions described above, management intends to strengthen the Company s internal audit function by adding additional staff and implementing formal training programs on governance and controls for management and key process owners.

Although we have already taken some actions to remediate these material weaknesses, further action is required to complete our remediation including the addition of finance staff and the development and implementation of enhanced processes. Our management and Audit Committee will monitor closely the implementation of our remediation plan. The effectiveness of the steps we have taken to date and the steps we are still in the process of completing is subject to continued management review, as well as Audit Committee oversight, and we may make additional changes to our internal control over financial reporting.

Currently, we are not aware of any material weaknesses in our internal control over financial reporting other than as described above. However, we are continuing to evaluate and test our internal control over financial reporting, and there can be no assurance that, as a result of our ongoing evaluation of our internal control over financial reporting, we will not identify additional material weaknesses.

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Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and our Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting are or will be capable of preventing or detecting all errors and all fraud. Any 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. 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 the company 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, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to 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.

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BUSINESS

Overview

We are a leading provider of optical subsystems and components and network performance test and monitoring systems. These products enable high-speed data communications over local area networks, or LANs, storage area networks, or SANs, and metropolitan area networks, or MANs. Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for SAN, LAN and MAN applications. Optical subsystems also include multiplexers, demultiplexers and optical add/drop modules used in MAN applications. We are focused on the application of digital fiber optics to provide a broad line of high-performance, reliable, value-added optical subsystems for data networking and storage equipment manufacturers. Our line of optical subsystems supports a wide range of network protocols, transmission speeds, distances, physical mediums and configurations. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications. We also provide network performance test and monitoring systems to original equipment manufacturers for testing and validating equipment designs and to operators of networking and storage data centers for testing, monitoring and troubleshooting the performance of their installed systems. We sell our products primarily to leading storage and networking equipment manufacturers such as Brocade, Cisco Systems, EMC, Emulex, Hewlett-Packard Company and Qlogic.

Industry Background

The proliferation of electronic commerce, communications and broadband entertainment has resulted in the digitization and accumulation of enormous amounts of data. Much of this data has become increasingly mission-critical to business enterprises and other organizations that must ensure that it is accessible on a continuous and reliable basis by employees, suppliers and customers over a diverse geographic area. The need to quickly transmit, store and retrieve large blocks of data across networks in a cost-effective manner has resulted in large-scale equipment expenditures by enterprises and service providers to expand the capacity, or bandwidth, of their network and storage infrastructures using fiber optic transmission technology.

Computer networks are frequently described in terms of the distance they span and by the hardware and software protocols used to transport and store data. These networks are generally classified as LANs, SANs, MANs, and WANs. The portion of a network nearest residential and business customers that connects a LAN or SAN to the public network is frequently referred to as the First Mile. The technologies used to build these networks are continuously changing but retain a common thread the growing use of digital fiber optics and internet-based protocols to move data faster over greater distances.

Demand for Optical Subsystems in Gigabit Ethernet LANs

Early LANs were implemented to connect a limited number of users within relatively close proximity. Most of these LANs used the Ethernet transmission protocol that was developed to allow users to share basic common services such as file servers and printers. Because these early LANs had relatively limited performance requirements, short connection distances and low transmission speeds, the equipment used in these LANs were generally connected by copper cabling.

In response to continually increasing bandwidth and performance requirements, the Gigabit Ethernet standard, which allows LANs to operate at 1 gigabit per second, or Gbps, was introduced in 1998. The use of low-cost optical transceivers has enabled the widespread deployment of Gigabit Ethernet LANs. Ethernet has become the de facto standard user interface for connecting to the public network with nearly 3 billion Ethernet ports deployed worldwide since Ethernet was introduced and 200 million ports shipped in 2004 alone. As a result, most residential and business subscriber traffic begins and ends over Ethernet. And while Ethernet was originally developed as a data-oriented protocol, it has evolved to support a wide range of services including digital voice and video as well as data.

The growth in Gigabit Ethernet connectivity within the enterprise is fueling increased demand for equipment based on the next generation of Ethernet solutions, 10 Gigabit Ethernet, or 10GigE. Since the

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10GigE standard was ratified in June 2002, a number of optical products have been introduced for this protocol. These devices include transceivers packaged in various physical form factors, such as Xenpak, XPAK and X2, all of which use a parallel data transmission method known as XAUI. Another solution, known as XFP, supports 10GigE directly through a high-speed serial interface in a smaller physical form factor. The XFP standard combines the advantages of smaller size and lower power requirements with the flexibility to handle data traffic transmitted on 10GigE LANs and Fibre Channel-based SANs as well as MANs and WANs using equipment supporting the Synchronous Optical Network (SONET) and Synchronous Digital Hierarchy (SDH) protocols.

According to industry analyst Communications Industry Researchers, Inc. (CIR), sales of network equipment for 10GigE solutions are expected to grow at a compound annual growth rate of 55% between 2005 and 2009. Some of this growth is expected to come at the expense of growth for Gigabit Ethernet links as 10GigE will, in certain instances, replace multiple 1Gbps links. As a result, growth for Gigabit Ethernet connectivity is expected to moderate over this same period. One of the factors driving this growth in demand is the fact that the 10GigE protocol was designed to be compatible with SONET. CIR noted that OC-192 router ports used in SONET networks are 50 times more expensive that the average 10GigE port. We believe that demand for optical subsystems based on 10GigE will initially be focused on upgrading data centers and corporate backbones where businesses and other organizations can consolidate their file servers into a smaller number of high-capacity servers, yielding significant cost savings in the process.

Demand for Optical Subsystems and Components Used in SANs

Like LAN technology, data storage technology has evolved rapidly over the past decade. Storage devices were initially connected directly to servers using a standard interface protocol known as the Small Computer Systems Interface, or SCSI. The SCSI protocol allows storage devices and servers to communicate at speeds of up to 160 megabytes per second, or Mbps, over a maximum transmission distance of 12 meters and supports a maximum of 16 devices on a shared single bus. Although these distances and speeds were sufficient for early storage applications, SCSI became a limiting technology for today s storage applications, which require networking at high speeds over long distances in order to connect large numbers of simultaneous users.

With the evolution of the Internet, the amount of data to be stored has increased to the point where the cost of managing and protecting this data has become the dominant cost of a typical information technology department. According to industry analyst IDC, the total capacity of data storage equipment shipped in 2004 increased by 55% over the preceding year and is expected to grow at a compound annual growth rate of 50% through 2008. In addition, IDC predicts that spending on data storage will outpace spending on servers, telephony and even security software in 2005. This increase in data storage in turn has created a demand for faster, more efficient interconnection of data storage systems with servers and LANs. Contributing to this demand are:

the need to connect increasing numbers of storage devices and servers to a growing number of users;

the need to interconnect servers and storage systems supplied by multiple vendors;

the need to provide switched access to multiple storage systems simultaneously;

the increasingly mission-critical nature of stored data and the need for rapid access to this data;

the expense and complexity associated with managing increasingly large amounts of data storage;

the increasing cost of downtime and the growing importance of disaster recovery capabilities;

the limitations of copper wiring in terms of speed versus distance;

the migration of smaller discrete SAN islands to single integrated SANs;

an increase in demand for higher bandwidth solutions as larger SANs serve a greater number of users across longer distances; and

an increase in the number of SANs deployed by small and medium sized businesses.

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In response to these needs, the Fibre Channel interconnect protocol, operating at 1 Gbps, was introduced in 1995 to address the speed, distance and connectivity limitations of SCSI while maintaining backward compatibility with the installed base of SCSI-based storage systems. A Fibre Channel SAN consists of a dedicated network that interconnects file servers and their applications to storage resources through a switch or hub. The switch or hub routes the data between servers and storage devices and, to ensure continuous data availability, often is used to route data over multiple paths. Key to enabling the interconnection of equipment in a SAN is the use of fiber optic cable and cost-effective optical transceivers which combine a transmitter for converting an electrical signal into an optical signal and a receiver for performing the reverse function. SANs generally include multiple transceivers, or ports, along the path connecting a server to storage devices so that several signals may be processed at the same time.

SANs allow sharing of resources thereby reducing the required investment in storage infrastructure and driving a recentralization of the storage function and the creation of larger enterprise SANs. The centralization of storage, in turn, is increasing the demand for higher-bandwidth solutions to provide real time replication of data between different sites for disaster recovery applications. In order to send data over long distances for these applications, SANs can encapsulate the Fibre Channel protocol using Fibre Channel over IP, or FCIP, via the Internet Fibre Channel Protocol, or iFCP, or may use the Internet Small Computer Systems Interface, or iSCSI. We believe that IP-based SANs using the iSCSI interface operating at 10 Gbps in conjunction with higher speed disk drives and using the SATA protocol will simplify the implementation and administration of a SAN while lowering costs compared to Fibre Channel-based SANs. We believe this trend will accelerate the deployment of SANs within the small to medium business market. According to the Dell Oro Group report, the market for market for SAN equipment will grow at a compound annual growth rate of 20% per year between 2005 and 2009.

The original Fibre Channel specifications for transmitting data at 1 Gbps also included the capability for data transmission at 2, 4, 8 and 10 Gbps. Manufacturers of switches, HBAs (used in file servers), and storage systems for Fibre Channel SANs are currently deploying hardware and software solutions that transmit data at 2 Gbps and have recently begun to deploy devices operating at 4 Gbps. We believe that the widespread deployment of optical transceivers operating 8 and 10 Gbps will not begin until 2007 or thereafter.

Demand for Optical Subsystems in Metropolitan Area Networks and the First Mile

The need of residential and business users, who now have extensive gigabyte per second transmissions capacity in their buildings and local networks, to connect to the public network has resulted in new choke points in today s network infrastructure: in the First Mile or local loop for network access and in MANs themselves, where islands of data are connected by a copper straw reducing transmission rates to megabits per second or slower over a combination of twisted pair wire, T-1 lines, frame relay and wireless links.

Technologies used to supply multi-gigabit bandwidth in WANs, such as dense wavelength division multiplexing, or DWDM, solutions using up to 32 wavelengths, are proving to be too costly in most cases to deploy in MANs on any large scale. Coarse wavelength division multiplexing, or CWDM, which combines fewer wavelengths, can provide additional bandwidth on more economical terms. CWDM systems typically use only eight wavelengths, spaced 20 nanometers, or nm, apart. While offering less capacity than DWDM systems, CWDM systems are also far less complex than DWDM systems that must be cooled and highly controlled, further adding to their cost. We believe that new technologies such as 10GigE used in conjunction with CWDM are likely to be the preferred solution in many MAN applications with DWDM solutions deployed on a limited basis where network congestion is particularly severe.

In addition to lower transmission rates, the copper straw through which data must travel in a MAN often requires that the data be converted to formats based on an array of protocols including point-to-point (PPP), asynchronous transfer mode (ATM) or SONET/ SDH or a combination thereof before it arrives at its intended destination, and then reconverted once again to Ethernet format. The complexity of translating protocols adds to the cost of the networking infrastructure required to perform this translation as well as carrier operating expenses.

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The benefits of moving data in native Ethernet format are considerable. End-to-end Ethernet solutions enable users to reduce carrier operating expenses and the investment in network infrastructure compared to legacy private line, frame relay and ATM services. These savings emanate from three sources:

- engineering and operational support related to the configuration and maintenance of multiple protocols as well as fault isolation and diagnosis of network problems;
- network inefficiencies resulting from the need to convert data into multiple formats which often results in usage of less than 20% of the available bandwidth; and
- the ability to benefit from economies of scale as a result of using standard Ethernet interfaces.

The provisioning of incremental Ethernet-based bandwidth can be remotely adjusted using software whereas SONET/ SDH-based solutions typically require additional equipment at the network operating center and additional operations to change the connection at the customer demarcation point. The ubiquity of the Ethernet interface results in substantially lower costs per port compared to other lower-speed solutions, allowing users to significantly reduce their capital expenditures. The commonality of an end-to-end solution also means suppliers can combine multiple network devices into a single network element.

As a result of these developments, industry analyst Infometrics estimates that the carrier market for metro Ethernet ports is expected to increase at a compound annual rate of 75% between 2004 and 2008. As with all emerging technologies, these estimates are subject to a wide range of possible outcomes. Nevertheless, we believe that the adoption of next generation Ethernet-based solutions for MANs will stimulate the use of modular optical transceivers as the technology of choice as equipment designers develop next generation systems.

Demand for Optical Subsystems in Wide Area Networks

WANs were originally designed to handle voice signals that required bandwidth to be reserved for each call for as long as it lasted despite periods of limited use. These networks were the first to utilize digital fiber optics due to the limitations of copper wire over long distances. The SONET and SDH communications protocols were created to transmit and receive data transported over these networks.

Early equipment designs relied on the use of expensive discrete components which, in many cases, were integrated onto board assemblies by systems designers themselves. These discrete components included the use of a semiconductor source laser combined with a semiconductor modulator (for encoding data onto light signals) and, in some instances, optical amplifiers so that the light signals could be amplified without having to be converted to an electrical signal first before being retransmitted to their ultimate destination.

Until the mid-1990s, most WAN networks relied on a single wavelength of light to carry the digital information to be transmitted between various points on the network. With the introduction of DWDM, multiple wavelengths of light spaced 1.6 nm apart could be combined or multiplexed onto a single fiber, thus enhancing the capacity of these networks by up to 12,000% without the added cost associated with laying new fiber in the ground. Today wavelength spacing is even finer with spacing of 0.8 nm or even 0.4 nm resulting in systems with literally hundreds of wavelengths transmitted on a single optical fiber.

The introduction of DWDM-based systems in 1997 resulted in enormous amounts of additional bandwidth. As a result, CIBC World Markets estimates that spending for all networking equipment fell on the order of 55% between 2000 and 2003 reflecting this excess capacity as well as a slowing economy. In response, many systems manufacturers sold their captive internal optical technologies to independent suppliers during the past several years in order to focus on their core competency of system design. It has also freed systems designers to pursue the adoption of more cost effective technologies in their new equipment designs including the use of modular optics originally designed for use in LANs and SANs but modified for the longer distance transmission requirements of MANs and WANs. We believe that, as these new systems are adopted and deployed, there will be an increased demand for modular optical subsystems and components for use in MAN and WAN applications.

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Demand for High-Speed Data Communication Test and Monitoring Systems

The demand for equipment to test and monitor the performance of high-speed data communications networks can generally be categorized into two major segments: equipment for testing and monitoring Gigabit Ethernet LANs; and equipment for testing and monitoring SANs. In each of these segments, equipment is sold both to original equipment manufacturers, or OEMs, who require extensive testing in the development of their products to ensure system performance and reliability and to operators of data centers who require their networks to be tested or monitored on an ongoing basis to ensure maximum uptime and to optimize performance in order to minimize the investment in expensive upgrades. Systems manufacturers for both LANs and SANs typically focus on the design and development of their own products and turn to specialized independent suppliers for state-of-the-art test equipment in order to accelerate the time required to develop new products.

The market for testing and monitoring Gigabit Ethernet LANs is well established. As higher speed transmission protocols such as 10GigE are introduced, system testing becomes more difficult, requiring increasingly sophisticated and specialized test systems capable of capturing data at high speeds, filtering the data and identifying various types of intermittent errors and other network problems. We believe the emergence of 10GigE will drive new product designs by OEMs as well as the need to test and monitor that equipment in data centers and will be an important driver of demand for high performance, easy-to-use test systems for LANs.

The market for testing and monitoring SANs is more challenging in many respects than the more pervasive Ethernet-based LAN networks due in part to the fact that multiple protocols have emerged including iSCSI, Fibre Channel, FCIP, and, more recently, the SAS and SATA protocols used in the disk drive industry. In addition, higher speed versions of these protocols are being introduced such as 4Gbps Fibre Channel which are also creating demand for new test equipment by systems manufacturers. The market for test equipment for systems manufacturers is well established. The market for testing and monitoring SANs within data centers is fragmented with each system manufacturer supplying testing and monitoring systems for the equipment which they supply. Due to the fact that multiple protocols are encountered in a typical SAN, including Ethernet, and the fact that variety of equipment is used to build a SAN, including storage arrays, file servers, switches and disk drives, the typical data center operator has had to rely on a disparate array of testing and monitoring tools, none of which provide a single unbiased view of the performance of the network. The need for such a capability has become more critical with the ongoing accumulation of data which must be stored and managed and the growing number of users who are connected to and dependent on the information residing at these data centers. We believe the market for testing and monitoring solutions for data center operators that offer a single correlated view of network traffic and that alert data center operators even before network performance becomes an issue is just emerging.

Business Strategy

In order to maintain our position as a leading supplier of fiber optic subsystems and components and network performance test and monitoring systems, we are pursuing the following business strategies:

Continue to Invest in Critical Technologies. Our years of engineering experience, our multi-disciplinary technical expertise and our participation in the development of industry standards have enabled us to become a leader in the design and development of fiber optic subsystems and network performance test systems. We have been at the forefront of a number of important breakthroughs in the development of innovative products for fiber optic applications including the first transceiver incorporating digital diagnostics (1995), the first CWDM GBIC transceiver (2001), the first DWDM GBIC transceiver (2002) and the first 4Gbps transceiver to ship in volume (2004). We have also been a pioneer in the use of the XFP small form factor for 10GigE applications, having shipped the first product under this protocol in 2002 and the first 40 km and 80 km versions in 2004. In network performance testing and monitoring, we introduced the first Fibre Channel analyzer (1997), the first IP storage (iSCSI) protocol analyzer (2001), the first blade-based analysis system for multi-protocol SANs (2003) and the first 4Gbps and 10Gbps Fibre Channel analyzers (2004). We intend to maintain our technological leadership through continual enhancement of our existing products and the

development of new products as evolving technology permits higher speed transmission of data, with greater capacity, over longer distances. We are also focused on increased product integration to enhance the price/performance capabilities of our products.

Expand Our Broad Product Line of Optical Subsystems. We offer a broad line of optical subsystems which operate at varying protocols, speeds, fiber types, voltages, wavelengths and distances and are available in a variety of industry standard packaging configurations, or form factors. Our optical subsystems are designed to comply with key networking protocols such as Fibre Channel, Gigabit Ethernet, 10GigE and SONET and to plug directly into standard port configurations used in our customers products. The breadth of our optical subsystems product line is important to many of our customers who are seeking to consolidate their supply sources for a wide range of networking products for diverse applications, and we are focused on the expansion of our product line to add key products to meet our customers needs.

Expand Our Broad Product Line of Network Performance Test and Monitoring Systems. We offer a broad line of test and monitoring systems to assist our customers in efficiently designing reliable, high-speed networking systems and testing and monitoring the performance of storage-based and Ethernet-based networks, and we are currently focusing our efforts on the development of products that address the emerging storage-based network market. We believe our test systems enable original equipment manufacturers to focus their attention on the development of new products, reduce overall development costs and accelerate time to market. Our monitoring solutions for these networks provide real time feedback to data center operators enabling them to detect network bottlenecks and other performance related hardware issues. We have recently completed several acquisitions that have enabled us to improve and expand our line of test and monitoring systems.

Leverage Core Competencies Across Multiple, High-Growth Markets. We believe that fiber optic technology will remain the transmission technology of choice for multiple data communication markets, including Gigabit and 10-Gigabit Ethernet-based LANs and MANs, Fibre Channel-based SANs and SONET-based MANs and WANs. These markets are characterized by differentiated applications with unique design criteria such as product function, performance, cost, in-system monitoring, size limitations, physical medium and software. We intend to target opportunities where our core competencies in high-speed data transmission protocols can be leveraged into leadership positions as these technologies are extended across multiple data communications applications and into other markets and industries such as automotive and consumer electronics products.

Strengthen and Expand Customer Relationships. Over the past 18 years, we have established valuable relationships and a loyal base of customers by providing high-quality products and superior service. Our service-oriented approach has allowed us to work closely with leading data and storage network system manufacturers, understand and address their current needs and anticipate their future requirements. We intend to leverage our relationships with our existing customers as they enter new, high-speed data communications markets.

Acquire Critical Technologies. Since 2000, we have acquired a number of companies and certain businesses and assets of other companies in order to broaden our product offerings and provide new sources of revenue, production capabilities, and access to advanced technologies that we believe will enable us to reduce our product costs and develop innovative and more highly integrated product platforms while accelerating the timeframe required to develop such products. These acquisitions have enabled us to:

- create an internal capability for manufacturing certain active optical components such as vertical cavity surface emitting lasers, or VCSELs, Fabry-Perot, or FP, lasers and distributed feedback, or DFP, lasers;

- create an internal capability for manufacturing certain passive optical products such as isolators, filters, splitters, quarter wave plates, interleavers and polarization beam combiners; and

- expand our product lines and know-how to address new markets such as the testing and monitoring of Gigabit Ethernet and SAN networks and optical subsystems and components for automotive and consumer electronics applications.

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We will continue to review opportunities to acquire businesses, product lines and technologies that may enable us to expand our product offerings, introduce new innovative products or reduce our product costs.

Develop Low Cost Manufacturing Capabilities. We believe that new markets can be created by the introduction of new, low-cost, high value-added products. Lower product costs can be achieved through the introduction of new technologies, product design or market presence. Access to low-cost manufacturing resources are a key factor in the ability to offer a low-cost product solution. We acquired a manufacturing facility in Ipoh, Malaysia in order to take advantage of low-cost off-shore labor while protecting access to our intellectual property and know-how. We continue to seek ways to lower our production costs through improved product design and improved manufacturing and testing processes.

Products

In accordance with the guidelines established by the Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131), we have determined that we operate in two segments: optical subsystems and components; and network test and monitoring systems. We provide a broad line of complementary products within each of these segments.

Optical Subsystems and Components

Optical data networks require optical subsystems that convert electrical signals into optical signals and back into electrical signals at high speeds. Our optical subsystems are integrated into our customers systems and used for both short- and intermediate-distance fiber optic communications applications.

Our family of optical subsystem products consists of transmitters, receivers and transceivers principally based on the Gigabit Ethernet, Fibre Channel and SONET protocols. A transmitter converts electrical signals into optical signals for transmission over fiber optics. Receivers incorporating photo detectors convert incoming optical signals into electric signals. A transceiver combines both transmitter and receiver functions in a single device. Our optical subsystem products perform these functions with high reliability and data integrity and support a wide range of protocols, transmission speeds, fiber types, wavelengths, transmission distances, physical configurations and software enhancements.

Our high-speed fiber optic subsystems are engineered to deliver value-added functionality and intelligence. Most of our optical subsystem products include a microprocessor with proprietary embedded software that allows customers to monitor transmitted and received optical power, temperature, drive current and other link parameters of each port on their systems in real time. In addition, our intelligent optical subsystems are used by many enterprise networking and storage system manufacturers to enhance the ability of their systems to diagnose and correct abnormalities in fiber optic networks.

For SAN applications which rely on the Fibre Channel standard, we currently provide optical subsystems for transmission applications at 1, 2 and 4 Gbps and have demonstrated products operating at 8 Gbps. We currently provide optical subsystems for data networking applications based on the Gigabit Ethernet standard which transmit signals at 1 Gbps. As a result of the acquisition of Infineon s transceiver product lines, we now offer such products based on the XAUI interface as well as the XFP form factor. For SONET-based MANs, we supply optical subsystems which are capable of transmitting at 2.5 Gbps, and we have recently expanded that product line to include products that operate at less than 1 Gbps.

We have introduced a full line of optical subsystems for MANs using CWDM technologies designed to deliver dramatic cost savings to optical networking manufacturers, compared to solutions based on the use of DWDM technologies. Our CWDM subsystems include every major optical transport component needed to support a MAN, including transceivers, optical add/drop multiplexers, or OADMs, for adding and dropping wavelengths in a network without the need to convert to an electrical signal and multiplexers/demultiplexers for SONET, Gigabit Ethernet and Fibre Channel protocols. Where the need for additional bandwidth exists, we have introduced optical subsystems which incorporate DWDM technologies that allow these CWDM subsystem products to scale incrementally in terms of the amount of bandwidth handled, thus providing

additional cost savings to network operators, whose customers are in the early stages of deploying new IP-based systems.

As a result of several acquisitions, we have gained access to leading-edge technology for the manufacture of a number of active and passive optical components including VCSELs, FP lasers, DFB lasers, PIN detectors, fused fiber couplers, isolators, filters, polarization beam combiners, interleavers and linear semiconductor optical amplifiers. Most of these optical components are used internally in the manufacture of our optical subsystems. We currently sell VCSELs and limited quantities of other components in the so-called merchant market to other subsystems manufacturers.

Network Performance Test and Monitoring Systems

Our testing and monitoring solutions allow engineers, service technicians and network managers to generate and capture data at high speeds, filter the data and identify various types of intermittent errors and other network problems for SANs, LANs, wireless networks, voice-over-internet protocol applications and newly emerging technologies including 10GigE, iSCSI, FCIP, SAS and SATA. Our test and monitoring solutions have historically been sold primarily to system manufacturers who use such equipment in the development of new products for SANs. We believe we have a significant share of this market and a much smaller share of the market for testing and monitoring solutions for LANs.

Our products for testing and monitoring solutions include our new Xgig product platform for Fibre Channel and Gigabit Ethernet SANs (iSCSI and FCIP), probes which tap and analyze network traffic, and other specialized equipment for testing SANs and LANs at high speeds or for network functionality and reliability.

The Xgig is the industry s first blade based approach to testing and monitoring data networks and allows multiple protocols to be tested within the same hardware platform. Separate blades exist for the following capabilities:

- traffic analysis (analyzers) at 1, 2, 4 and 10 Gbps that capture data traffic into a large memory buffer so that the data can be analyzed by developers to detect problems on a Fibre Channel network;
- jammers that inject errors into data networks to simulate how the network responds and recovers from such problems; and
- bit-error rate testers, or BERTs, that debug and test switches and disk array products.

Our line of probes are typically sold to operators of data centers for monitoring their installed networks on a 24 × 7 basis. They include the following:

- our THG product line and Surveyor software for monitoring Gigabit Ethernet networks;
- Netwisdom which provides a comprehensive view of SAN performance including routers, switches and file servers which are typically used in a SAN network; and
- PATHLINE SAN management software, which we acquired in May 2005 with our acquisition of InterSAN, features of which we plan to incorporate into our Xgig product platform.

We also offer other specialized test equipment including generators for generating Fibre Channel traffic to stress SAN networks which are typically used in conjunction with an analyzer.

Customers

To date, our revenues have been principally derived from sales of optical subsystems and components to original equipment manufacturers. Sales to these customers accounted for 86% of our total revenues in both fiscal 2005 and 2004 and 82% in 2003, with the remainder of revenues in each year representing sales of network performance test and monitoring systems. Sales of products for LAN and SAN applications represented 59%, 60% and 55% of our total optical subsystems revenues in fiscal 2005, 2004 and 2003, respectively. Our test and monitoring systems are sold to original equipment manufacturers for testing and

validating equipment designs and to operators of data centers for testing, monitoring and troubleshooting the performance of their Ethernet and storage-based networks. Approximately 23% of our test and monitoring revenues in 2005 were derived from sales for monitoring applications, and most of the remainder consisted of sales to equipment manufacturers. Sales to our top three customers represented approximately 39% of our total revenues in both fiscal 2005 and 2004 and 29% in fiscal 2003. Sales to Cisco Systems accounted for 28%, 22% and 10% of our total revenues in fiscal 2005, 2004 and 2003, respectively. No other customer accounted for 10% of revenues in any of these years.

Technology

The development of high quality fiber optic subsystems and components and network performance test and monitoring systems for high-speed data communications requires multidisciplinary expertise in the following technology areas:

High Frequency Semiconductor Design. Our fiber optic subsystems development efforts are supported by an engineering team that specializes in analog/digital integrated circuit design. This group works in both silicon, or Si CMOS, and Silicon Germanium, or SiGe BiCMOS, semiconductor technologies where circuit element frequencies are very fast and can be as high as 60 gigahertz, or GHz. We have designed proprietary circuits including laser drivers, receiver pre-and post-amplifiers and controller circuits for handling digital diagnostics at 1, 2, 4 and 10 Gbps. These advanced semiconductor devices provide significant cost advantages and will be critical in the development of future products capable of even faster data rates.

Optical Subassembly Design. We established ourselves as a low-cost design leader beginning with our initial Gbps optical subsystems in 1992. From that base we have developed single-mode laser alignment approaches and low-cost, all-metal packaging techniques for improved EMI performance and environmental tolerance. We develop our own component and packaging designs and integrate these designs with proprietary manufacturing processes that allow our products to be manufactured in high volume.

Complex Logic Design. Our network test and monitoring equipment designs are based on field programmable gate arrays, or FPGAs. Our network products are being used to operate with clock frequencies of up to 212.5 megahertz, or MHz, and logic densities up to 6 million gates per chip. Our test systems use FPGAs that are programmed by the host PC and therefore can be configured differently for different tests. All of our logic design is done in the very high density logic, or VHDL, hardware description language which will enable migration to application specific integrated circuits, or ASICs, as volumes warrant. We develop VHDL code in a modular fashion for reuse in logic design which comprises a critical portion of our intellectual property. This re-usable technology base of logic design is available for use in both our test system and optical subsystem product lines and allows us to reduce the time to market for our new and enhanced products.

Software Technology. We devote substantial engineering resources to the development of software technology for use in all of our product lines. We have developed software to control our test systems, analyze data collected by our test systems, and monitor, maintain, test and calibrate our optical subsystems. A majority of our software technology and expertise is focused on the use of object-oriented development techniques to develop software subsystems that can be reused across multiple product lines. We have created substantial intellectual property in the area of data analysis software for our Fibre Channel test equipment. This technology allows us to rapidly sort, filter and analyze large amounts of data using a proprietary database format. This database format is both, hardware platform-independent and protocol-independent. This independence allows all of the software tools developed for our existing test products to be utilized in all of our new test products that collect data traces. Because the database format is also protocol-independent, new protocols can be added quickly and easily. Another important component of our intellectual property is our graphical user interface, or GUI, design. Many years of customer experience with our test products have enabled us to define a simple yet effective method to display complex protocols in clear and concise GUIs for intuitive use by engineers.

System Design. The design of all of our products requires a combination of sophisticated technical competencies optical engineering, high-speed digital and analog design, ASIC design and software engineering. We have built an organization of people with skills in all of these areas. It is the integration of

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these technical competencies that enables us to produce products that meet the needs of our customers. Our combination of these technical competencies has enabled us to design and manufacture optical subsystems with built-in optical test multiplexing and network monitoring, as well as test systems that integrate optical and protocol testing with user interface software.

Manufacturing System Design. The design skills gained in our test systems group are also used in the manufacture of our optical subsystems. We utilize our high-speed FPGA design blocks and concepts and GUI software elements to provide specialized manufacturing test systems for our internal use. These test systems are optimized for test capacity and broad test coverage. We use automated, software-controlled testing to enhance the field reliability of all Finisar products. All of our products are subjected to temperature testing of powered systems as well as full functional tests.

Wafer Fabrication. The ability to manufacture our own optical components can provide significant cost savings while the ability to create unique component designs, enhances our competitive position in terms of performance, time-to-market and intellectual property. We design and manufacture a number of active components that are used in our optical subsystems. The acquisition of Genoa Corporation in April 2003 provided us with a state-of-the-art foundry for making PIN receivers and 1310nm FP and DFB lasers used in our longer distance transceivers. While these longer distance products comprised approximately 40% of our optical subsystem revenues in fiscal 2005, this foundry currently supplies only our internal demand for PIN receivers and FP lasers. We expect to qualify our internally fabricated DFB lasers during fiscal 2006. Our acquisition of Honeywell s VCSEL Optical Products business unit in March 2004 provided us with wafer fabrication capability for designing and making 850nm VCSEL components used in all of our short distance transceivers for LAN and SAN applications. These applications represented 59% of our optical subsystem revenues in fiscal 2005.

Competition

Several of our competitors in the optical subsystems and components market have recently been acquired or announced plans to be acquired. These announcements reflect an ongoing realignment of industry capacity with market demand in order to restore the financial health of the optics industry. Despite this trend, the market for optical subsystems and components for use in LANs, SANs and MANs as well as the market for testing and monitoring systems remains highly competitive. We believe the principal competitive factors in these markets are:

product performance, features, functionality and reliability;

price/performance characteristics;

timeliness of new product introductions;

breadth of product line;

adoption of emerging industry standards;

service and support;

size and scope of distribution network;

brand name;

access to customers; and

size of installed customer base.

We believe we compete favorably with our competitors with respect to most of the foregoing factors based, in part, upon having one of the broadest product lines in the industry, a sizeable installed base and a low-cost manufacturing facility in Ipoh, Malaysia. We believe that the addition of our new Xgig product line for testing and

monitoring multiple network protocols within the same hardware platform combined with unique software solutions for monitoring and troubleshooting SANs, has strengthened our competitive position within the network test and monitoring market.

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Sales, Marketing and Technical Support

We sell our products in North America through our direct sales force and a network of independent manufacturers representatives. For sales of our optical subsystems and components, we utilize a direct sales force augmented by two domestic distributors, 16 domestic manufacturers representatives, two international manufacturers representatives and 30 international resellers. For sales of our performance network test and monitoring systems, we utilize a direct sales force augmented by 10 domestic manufacturers representatives and 31 international resellers. Our direct sales force maintains close contact with our customers and provides technical support to our manufacturers representatives. In our international markets, our direct sales force works with local resellers who assist us in providing support and maintenance to the territories they cover.

Our marketing efforts are focused on increasing awareness of our product offerings for optical subsystems and network test and monitoring systems and our brand name. Key components of our marketing efforts include:

- continuing our active participation in industry associations and standards committees to promote and further enhance Gigabit Ethernet and Fibre Channel technologies, promote standardization in the LAN, SAN and MAN markets, and increase our visibility as industry experts;

- leveraging major trade show events and LAN, SAN, and MAN conferences to promote our broad product lines; and

- advertising our products for network test and monitoring solutions for storage and networking data centers in industry publications and other electronic media.

In addition, our marketing group provides marketing support services for our executive staff, our direct sales force and our manufacturers representatives and resellers. Through our marketing activities, we provide technical and strategic sales support to our direct sales personnel and resellers, including in-depth product presentations, technical manuals, sales tools, pricing, marketing communications, marketing research, trademark administration and other support functions.

A high level of continuing service and support is critical to our objective of developing long-term customer relationships. We emphasize customer service and technical support in order to provide our customers and their end users with the knowledge and resources necessary to successfully utilize our product line. Our customer service organization utilizes a technical team of field and factory applications engineers, technical marketing personnel and, when required, product design engineers. We provide extensive customer support throughout the qualification and sale process. In addition, we also provide many resources through our World Wide Web site, including product documentation and technical information. We intend to continue to provide our customers with comprehensive product support and believe it is critical to remaining competitive.

Backlog

A substantial portion of our revenues are derived from sales to OEMs pursuant to individual purchase orders with short lead times. Commitments under these purchase orders remain subject to negotiation with respect to quantities and delivery schedules and are generally cancelable without significant penalties. In addition, manufacturing capacity and availability of key components may impact the timing and amount of revenue ultimately recognized under such sale arrangements. Accordingly, we do not believe that the backlog of undelivered product under these purchase orders are a meaningful indicator of our future financial performance.

Manufacturing

We manufacture most of our optical subsystems at our production facility in Ipoh, Malaysia. This facility consists of 640,000 square feet, of which 240,000 square feet is suitable for cleanroom operations. The acquisition of this facility in May 2001 has allowed us to transfer most of our manufacturing processes from contract manufacturers to a lower-cost manufacturing facility and to maintain greater control over our intellectual property. We expect to continue to use contract manufacturers for a portion of our manufacturing

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needs. During fiscal 2005, we transferred a portion of our new product introduction operations from our facility in Sunnyvale, California to our Ipoh, Malaysia facility. We continue to conduct a portion of our new product introduction activities at our Sunnyvale facility where we also conduct supply chain management for certain components, quality assurance and documentation control operations. We conduct wafer fabrication operations at our facilities in Fremont, California. The operations of our Advanced Optical Components, or AOC, Division, which we acquired from Honeywell International Inc. in March 2004, including wafer fabrication, are currently conducted at a facility in Richardson, Texas that we lease from Honeywell. In the fourth quarter of fiscal 2005, we leased a facility in Allen, Texas, and we are preparing to transfer the operations of the AOC Division to this facility in the second half of fiscal 2006.

We design and develop a number of the key components of our products, including photodetectors, lasers, ASICs, printed circuit boards and software. In addition, our manufacturing team works closely with our engineers to manage the supply chain. To assure the quality and reliability of our products, we conduct product testing and burn-in at our facilities in conjunction with inspection and the use of testing and statistical process controls. In addition, most of our optical subsystems have an intelligent interface that allows us to monitor product quality during the manufacturing process. Our facilities in Sunnyvale, Fremont, Richardson and Malaysia are qualified under ISO 9001-9002.

Although we use standard parts and components for our products where possible, we currently purchase several key components from single or limited sources. Our principal single source components purchased from external suppliers include ASICs and DFB lasers. In addition, all of the short wavelength VCSEL lasers used in our LAN and SAN products are currently produced by our AOC Division at our facility in Richardson, Texas. Generally, purchase commitments with our single or limited source suppliers are on a purchase order basis. We generally try to maintain a buffer inventory of key components. However, any interruption or delay in the supply of any of these components, or the inability to procure these components from alternate sources at acceptable prices and within a reasonable time, would substantially harm our business. In addition, qualifying additional suppliers can be time-consuming and expensive and may increase the likelihood of errors.

We use a rolling 12-month forecast of anticipated product orders to determine our material requirements. Lead times for materials and components we order vary significantly, and depend on factors such as the demand for such components in relation to each supplier s manufacturing capacity, internal manufacturing capacity, contract terms and demand for a component at a given time.

Research and Development

In fiscal 2005, fiscal 2004 and fiscal 2003, our research and development expenses were $62.8 million, $62.2 million and $60.3 million, respectively. We believe that our future success depends on our ability to continue to enhance our existing products and to develop new products that maintain technological competitiveness. We focus our product development activities on addressing the evolving needs of our customers within the LAN, SAN and MAN markets, although we also are seeking to leverage our core competencies by developing products for other markets, including the automotive and consumer electronics industries. We work closely with our original equipment manufacturers and system integrators to monitor changes in the marketplace. We design our products around current industry standards and will continue to support emerging standards that are consistent with our product strategy. Our research and development groups are aligned with our various product lines, and we also have specific groups devoted to ASIC design and test, subsystem design and test equipment hardware and software design. Our product development operations include the active involvement of our manufacturing engineers who examine each product for its manufacturability, predicted reliability, expected lifetime and manufacturing costs.

We believe that our research and development efforts are key to our ability to maintain technical competitiveness and to deliver innovative products that address the needs of the market. However, there can be no assurance that our product development efforts will result in commercially successful products, or that our products will not be rendered obsolete by changing technology or new product announcements by other companies.

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Intellectual Property

Our success and ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We currently own 333 issued U.S. patents and 790 patent applications with additional foreign counterparts. We cannot assure you that any patents will issue as a result of pending patent applications or that our issued patents will be upheld. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of a competitive advantage and decreased revenues. Despite our efforts to protect our proprietary rights, existing patent, copyright, trademark and trade secret laws afford only limited protection. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may not be able to prevent misappropriation of our technology or deter others from developing similar technology. Furthermore, policing the unauthorized use of our products is difficult. We are currently engaged in pending litigation to enforce certain of our patents (see Pending Litigation), and additional litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. This litigation could result in substantial costs and diversion of resources and could significantly harm our business.

The networking industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We have previously been involved in a series of patent infringement lawsuits. From time to time, other parties may assert patent, copyright, trademark and other intellectual property rights to technologies and in various jurisdictions that are important to our business. Any claims asserting that our products infringe or may infringe proprietary rights of third parties, if determined adversely to us, could significantly harm our business. Any such claims, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could significantly harm our business. Royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. In addition, our agreements with our customers typically require us to indemnify our customers from any expense or liability resulting from claimed infringement of third party intellectual property rights. In the event a claim against us was successful and we could not obtain a license to the relevant technology on acceptable terms or license a substitute technology or redesign our products to avoid infringement, our business would be significantly harmed.

Pending Litigation

A securities class action lawsuit was filed on November 30, 2001 in the United States District Court for the Southern District of New York, purportedly on behalf of all persons who purchased our common stock from November 17, 1999 through December 6, 2000. The complaint named as defendants Finisar, Jerry S. Rawls, our President and Chief Executive Officer, Frank H. Levinson, our Chairman of the Board and Chief Technical Officer, Stephen K. Workman, our Senior Vice President and Chief Financial Officer, and an investment banking firm that served as an underwriter for our initial public offering in November 1999 and a secondary offering in April 2000. The complaint, as subsequently amended, alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(b) of the Securities Exchange Act of 1934, on the grounds that the prospectuses incorporated in the registration statements for the offerings failed to disclose, among other things, that (i) the underwriter had solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriter allocated to those investors material portions of the shares of our stock sold in the offerings and (ii) the underwriter had entered into agreements with customers whereby the underwriter agreed to allocate shares of our stock sold in the offerings to those customers in exchange for which the customers agreed to purchase additional shares of our stock in the aftermarket at pre-determined prices. No specific damages are claimed. Similar allegations have been made in lawsuits relating to more than 300 other initial public offerings conducted in 1999 and 2000, which were consolidated for pretrial purposes. In October 2002, all claims against the individual defendants were

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dismissed without prejudice. On February 19, 2003, the Court denied our motion to dismiss the complaint. In July 2004, we and the individual defendants accepted a settlement proposal made to all of the issuer defendants. Under the terms of the settlement, the plaintiffs will dismiss and release all claims against participating defendants in exchange for a contingent payment guaranty by the insurance companies collectively responsible for insuring the issuers in all related cases, and the assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. Under the guaranty, the insurers will be required to pay the amount, if any, by which $1 billion exceeds the aggregate amount ultimately collected by the plaintiffs from the underwriter defendants in all the cases. If the plaintiffs fail to recover $1 billion and payment is required under the guaranty, we would be responsible to pay our pro rata portion of the shortfall, up to the amount of the self-insured retention under our insurance policy, which may be up to $2 million. The timing and amount of payments that we could be required to make under the proposed settlement will depend on several factors, principally the timing and amount of any payment that the insurers may be required to make pursuant to the $1 billion guaranty. The settlement is subject to approval of the Court, which cannot be assured. If the settlement is not approved by the Court, we intend to defend the lawsuit vigorously. However, the litigation is in the preliminary stage, and we cannot predict its outcome. The litigation process is inherently uncertain. If litigation proceeds and its outcome is adverse to us and if we are required to pay significant monetary damages, our business would be significantly harmed.

On April 4, 2005, we filed an action in the United States District Court, against the DirecTV Group, Inc.; DirecTV Holdings, LLC; DirecTV Enterprises, LLC; DirecTV Operations, LLC; DirecTV, Inc.; and Hughes Network Systems, Inc. (collectively DirecTV). The lawsuit alleges that DirecTV willfully infringes our U.S. Patent No. 5,404,505 by making, using, selling, offering to sell and/or importing systems and/or methods that embody one or more of the claims of our patent. On May 13, 2005, DirecTV answered the Complaint. DirecTV s counterclaim seeks a declaration of non-infringement, patent invalidity and patent unenforceability. The presiding judge held an initial case management conference on July 13, 2005 setting discovery schedules and dates for motion practice. The trial is scheduled for June 6, 2006.

Facilities

Our principal facilities are located in California, Texas, Malaysia and China.

We lease a 75,000 square foot building in Sunnyvale, California for our corporate headquarters under a lease that expires in July 2006. We also lease a 92,000 square foot facility in Sunnyvale consisting of three buildings under a lease that expires in February 2020. We conduct research and development, sales and marketing, general and administrative, and limited manufacturing operations at our Sunnyvale facilities. We plan to move some of these operations to our Fremont facility (described below) and consolidate the remaining Sunnyvale operations into the 92,000 square foot facility in the second half of fiscal 2006.

We own a 640,000 square foot manufacturing facility in Ipoh, Malaysia, where we conduct our principal manufacturing operations. The land upon which the facility is located is subject to a long term lease.

We lease facilities, totaling approximately 44,000 square feet, in Fremont, California under leases that expire in February 2006. We conduct wafer fabrication operations at these facilities. We are currently negotiating an extension of this lease.

We lease approximately 54,300 square feet in Hayward, California. This lease expires in January 2006, and the facility is currently vacant.

We lease approximately 18,250 square feet of general office space in Scotts Valley, California under a lease that expires in November 2010. We acquired this leased facility in connection with our acquisition of InterSAN in May 2005.

We lease approximately 26,400 square feet of general office space in Eden Prairie, Minnesota under a lease that expires in March 2010. We acquired this leased facility in connection with our acquisition of I-TECH in April 2005. We intend to consolidate the former I-TECH operations at our other facilities in the first quarter of fiscal 2006 and seek to sublease the Minnesota facility thereafter.

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We lease approximately 57,000 square feet of general office and manufacturing space in Shanghai, China to house the operations of our subsidiary, Transwave Fiber (Shanghai), Inc. This lease expires in September 2005, and we are currently negotiating an extension of this lease.

In connection with our acquisition of Honeywell s VCSEL Optical Products business unit, we entered into a lease with Honeywell for a manufacturing facility in Richardson, Texas, totaling approximately 50,000 square feet, where the operations of our AOC Division are currently being conducted. This lease expires in November 2006. In February 2005, we leased a 160,000 square foot facility in Allen, Texas, and we are preparing to transfer the operations of the AOC Division to this facility in the second half of fiscal 2006. A portion of this facility consisting of approximately 35,000 square feet is currently subleased.

We lease approximately 16,000 square feet of general office space in Austin, Texas, to house the operations of our Medusa Technologies Division. This lease expires in July 2008.

We lease approximately 4,540 square feet of general office space in Singapore under a lease that expires in February 2008. We conduct research and development and logistics operations at this facility.

Employees

As of April 30 2005, we employed approximately 2,580 full-time employees, 636 of whom were located in the United States and 1,944 of whom were located at our production facilities in Ipoh, Malaysia and Shanghai, China and in Singapore where we conduct research and development activities. We also from time to time employ part-time employees and hire contractors. Our employees are not represented by any collective bargaining agreement, and we have never experienced a work stoppage. We believe that our employee relations are good.

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MANAGEMENT

Executive Officers and Directors

Our executive officers and directors, and their ages as of June 30, 2005, are as follows:

Name	Position(s)	Age
Jerry S. Rawls	President, Chief Executive Officer and Director	60
Frank H. Levinson	Chairman of the Board and Chief Technical Officer	52
David Buse	Senior Vice President and General Manager, Network Tools Group	54
Anders Olsson	Senior Vice President, Engineering	52
Stephen K. Workman	Senior Vice President, Chief Financial Officer & Secretary	54
Joseph A. Young	Senior Vice President and General Manager, Optics Group	47
Michael C. Child	Director	50
Roger C. Ferguson	Director	62
David C. Fries	Director	60
Larry D. Mitchell	Director	62

Jerry S. Rawls has served as a member of our board of directors since March 1989 and as our Chief Executive Officer since August 1999. Mr. Rawls has also served as our President since April 2003 and previously held that title from April 1989 to September 2002. From September 1968 to February 1989, Mr. Rawls was employed by Raychem Corporation, a materials science and engineering company, where he held various management positions including Division General Manager of the Aerospace Products Division and Interconnection Systems Division. Mr. Rawls holds a B.S. in Mechanical Engineering from Texas Tech University and an M.S. in Industrial Administration from Purdue University.

Frank H. Levinson founded Finisar in April 1987 and has served as a member of our board of directors since February 1988 and as our Chairman of the Board and Chief Technical Officer since August 1999. Dr. Levinson also served as our Chief Executive Officer from February 1988 to August 1999. From September 1980 to December 1983, Dr. Levinson was a member of Technical Staff at AT&T Bell Laboratories. From January 1984 to July 1984, he was a Member of Technical Staff at Bellcore, a provider of services and products to the communications industry. From April 1985 to December 1985, Dr. Levinson was the principal optical scientist at Raychem Corporation, and from January 1986 to February 1988, he was Optical Department Manager at Raynet, Inc., a fiber optic systems company. Dr. Levinson serves as a director of Fabrinet, Inc., a privately held contract manufacturing company. Dr. Levinson holds a B.S. in Mathematics/ Physics from Butler University and an M.S. and Ph.D. in Astronomy from the University of Virginia.

David Buse has served as our Senior Vice President and General Manager, Network Tools Group, since June 2005. Mr. Buse joined Finisar in December 2003 as our Senior Vice President, Sales and Marketing. From May 2002 to September 2003, Mr. Buse was employed as Vice President of Worldwide Sales and Marketing of Silicon Bandwidth, an interconnect technology company. Prior thereto, he spent over 20 years at Raychem/ Tyco in various positions, most recently serving as Americas National Sales Manager. Mr. Buse holds a B.S. in Engineering Management from the United States Air Force Academy and an M.B.A. from UCLA.

Anders Olsson joined Finisar in January 2004 as our Senior Vice President, Engineering. From April 2003 to December 2003, Dr. Olsson was President and Chief Executive Officer of Photon-X Inc., an optical sensing company. From April 2000 to April 2003, Dr. Olsson was the Chief Operating Officer and Chief Technical Officer of CENiX Inc, a high-speed integrated subsystems company for data-com and telecom markets. Before co-founding CENiX, Dr. Olsson held a number of positions at Bell Laboratories, Lucent Network

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Systems, and Lucent Microelectronics; the first in basic research and the last as Optoelectronics General Manager and Vice President. Dr. Olsson holds an M.S. in Engineering from Chalmers University of Technology of Gothenburg, Sweden, and a Ph.D. in Electrical Engineering from Cornell University.

Stephen K. Workman has served as our Senior Vice President, Finance and Chief Financial Officer since March 1999 and as our Secretary since August 1999. From November 1989 to March 1999, Mr. Workman served as Chief Financial Officer at Ortel Corporation. Mr. Workman holds a B.S. in Engineering Science and an M.S. in Industrial Administration from Purdue University.

Joseph A. Young has served as our Senior Vice President and General Manager, Optics Group, since June 2005. Mr. Young joined Finisar in October 2004 as our Senior Vice President, Operations. Prior to joining the Company, Mr. Young served as Director of Enterprise Products, Optical Platform Division of Intel Corporation from May 2001 to October 2004. Mr. Young served as Vice President of Operations of LightLogic, Inc. from September 2000 to May 2001, when it was acquired by Intel, and as Vice President of Operations of Lexar Media, Inc. from December 1999 to September 2000. Mr. Young was employed from March 1983 to December 1999 by Tyco/ Raychem, where he served in various positions, including his last position as Director of Worldwide Operations for the OEM Electronics Division of Raychem Corporation. Mr. Young holds a B.S. in Industrial Engineering from Rensselaer Polytechnic Institute, an M.S. in Operations Research from the University of New Haven and an M.B.A. from the Wharton School at the University of Pennsylvania.

Michael C. Child has been a member of our board of directors since November 1998. Mr. Child has been employed by TA Associates, Inc., a venture capital investment firm, since July 1982 where he currently serves as a Managing Director. Mr. Child holds a B.S. in Electrical Engineering from the University of California at Davis and an M.B.A. from the Stanford Graduate School of Business.

Roger C. Ferguson has been a member of our board of directors since August 1999. From June 1999 to December 2001, Mr. Ferguson served as Chief Executive Officer of Semio Corp., an early stage software company. Mr. Ferguson has served as a principal in VenCraft, LLC, a venture capital partnership, since July 1997. From August 1993 to July 1997, Mr. Ferguson was Chief Executive Officer of DataTools, Inc., a database software company. From 1987 to 1993, Mr. Ferguson served as Chief Operating Officer for Network General Inc., a network analysis company. Mr. Ferguson also serves as the Chairman of the Board of Directors of Semio Corp. Mr. Ferguson holds a B.A. in Psychology from Dartmouth College and an M.B.A. from the Amos Tuck School at Dartmouth.

David C. Fries has served as a member of our board of directors since June 2005. Dr. Fries has been employed by VantagePoint Venture Partners, a venture capital investment firm, since August 2001 where he currently serves as a Managing Director and Co-Head of the Semiconductor and Components Practice. Prior to joining VantagePoint, he was the Chief Executive Officer of Productivity Solutions, Inc., a Florida-based developer of automated checkout technologies for food and discount retailers, from 1995 to 1999. For seven years prior to that, he was a general partner of Canaan Partners, a venture capital firm. Dr. Fries served 17 years in numerous executive roles in engineering, manufacturing, senior management and finance at General Electric Company, including directing GE Venture Capital s California operation, which later became Canaan Partners. Dr. Fries holds a B.S. in Chemistry from Florida Atlantic University and a Ph.D. in Physical Chemistry from Case Western Reserve University. See also Related Party Transactions regarding the agreement between us and VantagePoint Venture Partners regarding the appointment of a representative of VantagePoint Venture Partners to our board of directors.

Larry D. Mitchell has been a member of our board of directors since October 1999. Mr. Mitchell has been retired since October 1997. From October 1994 to October 1997, he served as a site General Manager in Roseville, California for Hewlett-Packard. Mr. Mitchell also serves on the Board of Directors of Placer Sierra Bancshares and its wholly-owned subsidiary, Placer Sierra Bank. Mr. Mitchell holds a B.A. in Engineering Science from Dartmouth College and an M.B.A. from the Stanford Graduate School of Business.

Our President, Secretary and Chief Financial Officer are elected by the Board of Directors, all other executive officers are elected by the Board of Directors or appointed by the President, and all officers serve at

the discretion of the Board of Directors. Each of our officers and directors, other than nonemployee directors, devotes his full time to the affairs of Finisar.

New Directors

On July 28, 2005 the following individuals were elected to the Board of Directors, effective on August 31, 2005:

Robert N. Stephens served as the Chief Executive Officer since April 1999 and President since October 1998 of Adaptec, Inc, a storage solutions provider, until his retirement in May 2005. Mr. Stephens joined Adaptec in November 1995 as Chief Operating Officer. Before joining Adaptec, Mr. Stephens was the founder and chief executive officer of Power I/ O, a company that developed serial interface solutions and silicon expertise for high-speed data networking, that was acquired by Adaptec in 1995. Prior to founding Power I/ O, Mr. Stephens was President and CEO of Emulex Corporation, which designs, develops, and supplies Fibre Channel host bus adapters. Before joining Emulex, Mr. Stephens was senior vice president, general manger, and founder of the Microcomputer Products Group at Western Digital Corporation. He began his career at IBM, where he served over 15 years in a variety of management positions. Mr. Stephens holds bachelor s and master s degrees from San Jose State University.

Dominique Trempont has been a CEO in residence at Battery Ventures since August 2003. Prior to joining Battery Ventures, Mr. Trempont was Chairman, President and Chief Executive Officer of Kanisa, Inc., a software company focused on enterprise self-service applications, from November 1999 to November 2002. Mr. Trempont was President and Chief Executive Officer of Gemplus Corporation, a smart card company, from May 1997 to June 1999. Prior to Gemplus, Mr. Trempont served as Chief Financial Officer and later Chief Operating Officer at NeXT Software. Mr. Trempont began his career at Raychem Corporation, a high-tech material science company focused on telecommunications, electronics, automotive and other industries. Mr. Trempont received an undergraduate degree in Economics from College Saint Louis (Belgium), a B.A. in Business Administration and Computer Sciences from the University of Louvain (Belgium) and a masters in Business Administration from INSEAD (France).

Composition of the Board of Directors

Our Board of Directors is currently fixed at six directors. Our certificate of incorporation provides that the terms of office of the members of the Board of Directors will be divided into three classes: Class I, whose term will expire at the annual meeting of stockholders to be held in 2006, Class II, whose term will expire at the annual meeting of stockholders to be held in 2007 and Class III, whose term will expire at the annual meeting of stockholders to be held in 2005. The Class I directors are Messrs. Ferguson and Mitchell, the Class II directors are Messrs. Fries and Levinson, and the Class III directors are Messrs. Child and Rawls. At each annual meeting of stockholders after the initial classification, the successors to directors whose term will then expire will be elected to serve from the time of election and qualification until the third annual meeting following their election. Our nonemployee directors devote such time to our affairs as is necessary to discharge their duties. There are no family relationships among any of our directors, officers or key employees.

Independence of Directors

Our board has determined that, except for Mr. Rawls, our President and Chief Executive Officer, and Mr. Levinson, our Chairman and Chief Technical Officer, each of the current members of our board of directors is independent in accordance with the applicable listing standards of Nasdaq as currently in effect.

Meetings of the Board of Directors

During the fiscal year ended April 30, 2005, our board of directors held 23 meetings. During that period, the Audit Committee of the board held 23 meetings, the Compensation Committee of the board held two meetings, and the Nominating and Corporate Governance Committee of the board held three meetings. No director attended fewer than 75% of the total number of meetings of the board and all of the committees of the board on which such director served during that period.

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Corporate Governance and Board Committees

Our board of directors has adopted a Code of Business Conduct and Ethics (the Code) that outlines the principles of legal and ethical business conduct under which Finisar does business. The Code, which is applicable to all directors, employees and officers of the Company, is available at *http:*//investor.finisar.com/corpgov.cfm. Any substantive amendment or waiver of the Code may be made only by the board of directors upon a recommendation of the Audit Committee, and will be disclosed on our website. In addition, disclosure of any waiver of the Code for directors and executive officers will also be made by the filing of a Form 8-K with the SEC.

The board has also adopted a written charter for each of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee. Each charter is available on the Company s website at *http:*//investor.finisar.com/corpgov.cfm.

The members of the Audit Committee are Messrs. Child, Ferguson and Mitchell. The functions of the Audit Committee include overseeing the quality of our financial reports and other financial information and our compliance with legal and regulatory requirements; appointing and evaluating our independent auditors, including reviewing their independence, qualifications and performance and reviewing and approving the terms of their engagement for audit services and non-audit services; and establishing and observing complaint procedures regarding accounting, internal auditing controls and auditing matters. Our board has determined that each member of the Audit Committee meets the independence criteria set forth in the applicable rules of Nasdaq and the SEC for audit committee membership. The board has also determined that all members of the Audit Committee possess the level of financial literacy required by applicable Nasdaq and SEC rules and that at least one member of the Audit Committee, Mr. Ferguson, is qualified as an audit committee financial expert as defined by the SEC. For additional information about the Audit Committee, see Report of the Audit Committee below.

The members of the Compensation Committee during fiscal 2005 were Messrs. Child, Ferguson and Mitchell. Mr. Fries was appointed to the Compensation Committee in June 2005. The Compensation Committee reviews and approves the compensation and benefits of our executive officers and establishes and reviews general policies relating to compensation and benefits of our employees. Each of the members of the Compensation Committee is independent for purposes of the Nasdaq rules. For additional information about the Compensation Committee, see Report of the Compensation Committee on Executive Compensation and Executive Compensation and Related Matters below.

The Nominating and Corporate Governance Committee was established in June 2004. The members of the Nominating and Corporate Governance Committee during fiscal 2005 were Messrs. Child, Ferguson and Mitchell. Mr. Fries was appointed to the Committee in June 2005. Each of the members of the Nominating and Corporate Governance Committee is independent for purposes of the Nasdaq rules. The Nominating and Corporate Governance Committee considers qualified candidates for appointment and nomination for election to the board of directors and makes recommendations concerning such candidates, develops corporate governance principles for recommendation to the board of directors and oversees the regular evaluation of our directors and management.

Director Nominations

Nominations of candidates for election as directors may be made by the board of directors or by stockholders. The Nominating and Corporate Governance Committee is responsible for, among other things, the selection and recommendation to the board of directors of nominees for election as directors.

When considering the nomination of directors for election at an annual meeting, the Nominating and Corporate Governance Committee reviews the needs of the board of directors for various skills, background, experience and expected contributions and the qualification standards established from time to time by the Nominating and Corporate Governance Committee. When reviewing potential nominees, including incumbents, the Nominating and Corporate Governance Committee considers the perceived needs of the board of directors, the candidate s relevant background, experience and skills and expected contributions to the board

of directors. The Nominating and Corporate Governance Committee also seeks appropriate input from the Chief Executive Officer in assessing the needs of the board of directors for relevant background, experience and skills of its members.

The Nominating and Corporate Governance Committee s goal is to assemble a board of directors that brings to Finisar a diversity of experience at policy-making levels in business and technology, and in areas that are relevant to Finisar s global activities. Directors should possess the highest personal and professional ethics, integrity and values and be committed to representing the long-term interests of our stockholders. They must have an inquisitive and objective outlook and mature judgment. They must also have experience in positions with a high degree of responsibility and be leaders in the companies or institutions with which they are affiliated. Director candidates must have sufficient time available in the judgment of the Nominating and Corporate Governance Committee to perform all board and committee responsibilities that will be expected of them. Members of the board of directors are expected to rigorously prepare for, attend and participate in all meetings of the board of directors and applicable committees. Other than the foregoing, there are no specific minimum criteria for director nominees, although the Nominating and Corporate Governance Committee believes that it is preferable that a majority of the board of directors meet the definition of independent director set forth in Nasdaq and SEC rules. The Nominating and Corporate Governance Committee also believes it appropriate for one or more key members of the Company s management, including the Chief Executive Officer, to serve on the board of directors.

The Nominating and Corporate Governance Committee will consider candidates for directors proposed by directors or management, and will evaluate any such candidates against the criteria and pursuant to the policies and procedures set forth above. If the Nominating and Corporate Governance Committee believes that the board of directors requires additional candidates for nomination, the Nominating and Corporate Governance Committee may engage, as appropriate, a third party search firm to assist in identifying qualified candidates. All incumbent directors and nominees will be required to submit a completed directors and officers questionnaire as part of the nominating process. The process may also include interviews and additional background and reference checks for non-incumbent nominees, at the discretion of the Nominating and Corporate Governance Committee.

The Nominating and Corporate Governance Committee will also consider candidates for directors recommenced by a stockholder, provided that any such recommendation is sent in writing to the board of directors, c/o Corporate Secretary, 1308 Moffett Park Drive, Sunnyvale, California 94089-1113; Fax: (408) 745-6097; Email address: corporate.secretary@finisar.com, at least 120 days prior to the anniversary of the date definitive proxy materials were mailed to stockholders in connection with the prior year s annual meeting of stockholders and contains the following information:

- the candidate s name, age, contact information and present principal occupation or employment; and
- a description of the candidate s qualifications, skills, background and business experience during at least the last five years, including his or her principal occupation and employment and the name and principal business of any company or other organization where the candidate has been employed or has served as a director.

The Nominating and Corporate Governance Committee will evaluate any candidates recommended by stockholders against the same criteria and pursuant to the same policies and procedures applicable to the evaluation of candidates proposed by directors or management.

In addition, stockholders may make direct nominations of directors for election at an annual meeting, provided the advance notice requirements set forth in our bylaws have been met. Under our bylaws, written notice of such nomination, including certain information and representations specified in the bylaws, must be delivered to our principal executive offices, addressed to the Corporate Secretary, at least 120 days prior to the anniversary of the date definitive proxy materials were mailed to stockholders in connection with the prior year s annual meeting of the stockholders, except that if no annual meeting was held in the previous year or the date of the annual meeting has been advanced by more than 30 days from the date contemplated at the

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time of the previous year s proxy statement, such notice must be received not later than the close of business on the 10th day following the day on which the public announcement of the date of such meeting is first made.

Communications by Stockholders with Directors

Stockholders may communicate with the board of directors, or any individual director, by transmitting correspondence by mail, facsimile or email, addressed as follows: Board of Directors or individual director, c/o Corporate Secretary, 1308 Moffett Park Drive, Sunnyvale, California 94089-1113; Fax: (408) 745-6097; Email Address: corporate.secretary@finisar.com. The Corporate Secretary will maintain a log of such communications and will transmit as soon as practicable such communications to the board of directors or to the identified director(s), although communications that are abusive, in bad taste or that present safety or security concerns may be handled differently, as determined by the Corporate Secretary.

Director Attendance at Annual Meetings

We will make every effort to schedule our annual meeting of stockholders at a time and date to accommodate attendance by directors taking into account the directors schedules. All directors are encouraged to attend the Company s annual meeting of stockholders. Four directors attended the Company s annual meeting of stockholders held on May 6, 2005.

Compensation of Directors

Non-employee directors receive an annual retainer of $17,500, $1,500 for attendance in person at each meeting of the board of directors or committee meeting (with meetings of the board of directors and all committees held within any 24 hour period considered to be a single meeting) and $500 for attendance at such meetings via telephone. In addition, members of the Audit Committee receive an annual retainer of $5,000, and the Chairman of the Audit Committee receives $2,500 for annual service in such capacity. Non-employee directors are also eligible to receive stock options. We reimburse directors for their reasonable expenses incurred in attending meetings of the board of directors.

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Compensation of Executive Officers

Summary Compensation Information

The following table sets forth information concerning the compensation of our Chief Executive Officer and our four other most highly compensated executive officers, as of April 30, 2005, during the fiscal years ended April 30, 2005, 2004 and 2003.

Summary Compensation Table

		Annual Compensation			Long Term Compensation Awards	
Name and Principal Position	**Year**	**Salary**	**Bonus**	**Other Annual Compensation**	**Securities Underlying Options**	**All Other Compensation**
Jerry S. Rawls	2005	$ 224,135		$ 6,724	400,000(1)	
President and Chief	2004	202,500		6,075	200,000(1)	
Executive Officer	2003	218,077		5,340	1,000,000(1)	
Dave Buse(2)	2005	200,000		5,615	200,000(1)	
Senior Vice President and	2004	73,077		2,077	400,000(1)	
General Manager, Network Tools Group						
Kevin Cornell(3)	2005	222,142		2,350	200,000(1)	
Senior Vice President and	2004	217,854		500		
General Manager	2003	40,312	$ 44,727(4	)	400,000(1)	
Network Tools Division						
Anders Olsson(5)	2005	217,350		70,370(6)	200,000(1)	
Senior Vice President,	2004	56,250		5,159	500,000(1)	
Engineering						
Stephen K. Workman	2005	215,000		6,202	200,000(1)	
Senior Vice President,	2004	185,385		2,031	440,000(1)	
Finance, Chief Financial	2003	193,846		1,685		
Officer and Secretary						

(1) Option vests at the rate of 20% per year over a period of five years.

(2) Mr. Buse became Senior Vice President, Sales and Marketing, in December 2003. He became Senior Vice President and General Manager, Network Tools Group, in June 2005.

(3) Mr. Cornell became Senior Vice President and General Manager, Network Tools Division, in July 2003. He resigned from Finisar in July 2005.

(4) Signing bonus.

(5) Mr. Olsson became Senior Vice President, Engineering, in January 2004.

(6) Includes a moving allowance of $64,120.

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Stock Options Granted in Fiscal 2005

The following table sets forth information regarding grants of stock options to the executive officers named in the Summary Compensation Table above during the fiscal year ended April 30, 2005. All of these options were granted under our 1999 Stock Option Plan. The percentage of total options set forth below is based on an aggregate of 14,797,398 options granted during the fiscal year. All options were granted at the fair market value of our common stock, as determined by the board of directors on the date of grant. Potential realizable values are net of exercise price, but before taxes associated with exercise. Amounts represent hypothetical gains that could be achieved for the options if exercised at the end of the option term. The assumed 5% and 10% rates of stock price appreciation are provided in accordance with rules of the SEC and do not represent Finisar s estimate or projection of the future common stock price.

Options Granted in Fiscal Year Ended April 30, 2005

	Individual Grants						
						Potential Realizable Value at Assumed	
	Number of Securities Underlying Options Granted(1)	Percentage of Total Options Granted to Employees in Fiscal Year	Exercise Price ($/Share)	Expiration Date	Deemed Value per Share at Date of Grant	Annual Rates of Stock Price Appreciation for Option Term	
Name						5%	10%
Jerry S. Rawls	400,000	2.70	$ 1.92	6/2/14	$ 1.92	$ 482,991	$ 1,223,994
Dave Buse	200,000	1.35	1.92	6/2/14	1.92	241,496	611,997
Kevin Cornell	200,000	1.35	1.92	6/2/14	1.92	241,496	611,997
Anders Olsson	200,000	1.35	1.92	6/2/14	1.92	241,496	611,997
Stephen K. Workman	200,000	1.35	1.92	6/2/14	1.92	241,496	611,997

(1) These options were granted June 2, 2004 and vest at the rate of 20% per year over a period of five years.

Option Exercises and Fiscal 2005 Year-End Values

The following table provides the specified information concerning exercises of options to purchase our common stock during the fiscal year ended April 30, 2005, and unexercised options held as of April 30, 2005, by the executive officers named in the Summary Compensation Table above.

Aggregate Option Exercises In Fiscal 2005 and Values at April 30, 2005

			Number of Securities Underlying Unexercised Options at Fiscal Year End		Value of Unexercised In-The Money Options at Fiscal Year End(1)	
Name	Shares Acquired on Exercise	Value Realized	Exercisable (2)	Unexercisable (2)	Exercisable (2)	Unexercisable (2)

Jerry S. Rawls	440,000	1,160,000		
Dave Buse	80,000	520,000		
Kevin Cornell	160,000	440,000	$ 201,600	$ 302,400
Anders Olsson	100,000	600,000		
Stephen K. Workman	207,000	433,000		

(1) Based on a fair market value of $1.26, the closing price of our common stock on April 29, 2005, as reported by the Nasdaq National Market.

(2) Stock options granted under the 1999 Stock Option Plan are generally not immediately exercisable at the date of grant and vest at the rate of 20% per year over a period of five years.

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Employment Contracts and Termination of Employment and Change-In-Control Arrangements

Jerry S. Rawls, Frank H. Levinson, David Buse, Anders Olsson, Stephen K. Workman and Joseph A. Young are eligible to participate in the Finisar Executive Retention and Severance Plan. This plan provides that in the event of a qualifying termination each of the participating executives will be entitled to receive (i) a lump sum payment equal to two years base salary (excluding bonus) and (ii) medical, dental and insurance coverage for two years, or reimbursement of premiums for COBRA continuation coverage during such period. A qualifying termination is defined as an involuntary termination other than for cause or a voluntary termination for good reason upon or within 18 months following a change in control, as such terms are defined in the executive severance plan. In addition, the plan provides that the vesting of stock options held by eligible officers will be accelerated as follows: (i) one year of accelerated vesting upon a change of control, if the options are assumed by a successor corporation, (ii) 100% accelerated vesting if the options are not assumed by a successor corporation, and (iii) 100% accelerated vesting upon a qualifying termination.

Additionally, pursuant to the 1999 Stock Option Plan, upon a change in control, as defined therein, the vesting of options not assumed or substituted by the surviving corporation will accelerate and the options will become immediately exercisable and vested in full.

Indemnification of Directors and Executive Officers and Limitation of Liability

As permitted by the Delaware General Corporation Law, we have adopted provisions in our certificate of incorporation which provide that our directors shall not be personally liable for monetary damages to Finisar or its stockholders for a breach of fiduciary duty as a director, except liability for:

- a breach of the director s duty of loyalty to Finisar or its stockholders;
- acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- an act related to our unlawful stock repurchase or payment of a dividend under Section 174 of the Delaware General Corporation Law; or
- transactions from which the director derived an improper personal benefit.

These limitations of liability do not apply to liabilities arising under the federal securities laws and do not affect the availability of equitable remedies such as injunctive relief or rescission. Our certificate of incorporation also authorizes us to indemnify our officers, directors and other agents to the fullest extent permitted under Delaware law.

As permitted by the Delaware General Corporation Law, our bylaws provide that:

- we are required to indemnify our directors and officers to the fullest extent permitted by the Delaware General Corporation Law, subject to limited exceptions;
- we are required to advance expenses, as incurred, to our directors and officers in connection with a legal proceeding to the fullest extent permitted by the Delaware General Corporation Law, subject to limited exceptions; and
- the rights provided in the bylaws are not exclusive.

We intend to enter into separate indemnification agreements with each of our directors and officers which may be broader than the specific indemnification provisions contained in the Delaware General Corporation Law. These indemnification agreements may require us, among other things, to indemnify our directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct. These indemnification agreements also may require us to advance any expenses incurred by the directors or officers as a result of any proceeding against them as to which they could be indemnified and to obtain directors and officers insurance if available on reasonable terms.

Our Chief Executive Officer, Chairman of the Board and Chief Technical Officer and Senior Vice President, Finance and Chief Financial Officer have been named as defendants in the securities class action lawsuit described

under the caption Risk Factors We are subject to pending legal proceedings in this

prospectus. These officers are likely to assert a claim for indemnification in connection with that litigation. Other than the securities class action litigation, there is no pending litigation or proceeding involving any of our directors, officers, employees or agents where indemnification by us is sought. In addition, we are not aware of any threatened litigation or proceeding which may result in a claim for indemnification.

We intend to maintain directors and officers liability insurance.

Compensation Committee Interlocks and Insider Participation in Compensation Decisions

The Compensation Committee during fiscal 2005 was composed of Michael C. Child, Roger C. Ferguson and Larry D. Mitchell. David C. Fries was appointed to the Compensation Committee in June 2005. No member of our Compensation Committee serves as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving as a member of our board of directors or Compensation Committee.

REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION

Compensation Philosophy

The goals of our compensation policy are to attract, retain and reward executive officers who contribute to our overall success by offering compensation that is competitive in the networking industry, to motivate executives to achieve our business objectives and to align the interests of officers with the long-term interests of stockholders. We currently use salary, bonuses and stock options to meet these goals.

Forms of Compensation

We provide our executive officers with a compensation package consisting of base salary, incentive bonuses and participation in benefit plans generally available to other employees. In setting total compensation, the Compensation Committee considers individual and company performance, as well as market information regarding compensation paid by other companies in our industry.

Base Salary. Salaries for our executive officers are initially set based on negotiation with individual executive officers at the time of recruitment and with reference to salaries for comparable positions in the networking industry for individuals of similar education and background to the executive officers being recruited. We also give consideration to the individual s experience, reputation in his or her industry and expected contributions to Finisar. Salaries are generally reviewed annually by the Compensation Committee and are subject to increases based on (i) the Compensation Committee s determination that the individual s level of contribution to Finisar has increased since his or her salary had last been reviewed and (ii) increases in competitive pay levels.

Bonuses. It is our policy that a substantial component of each officer s potential annual compensation take the form of a performance-based bonus. Bonus payments to officers other than the Chief Executive Officer are determined by the Compensation Committee, in consultation with the Chief Executive Officer, based on our financial performance and the achievement of the officer s individual performance objectives. The Chief Executive Officer s bonus is determined by the Compensation Committee, without participation by the Chief Executive Officer, based on the same factors.

Long-Term Incentives. Longer term incentives are provided through stock options, which reward executives and other employees through the growth in value of our stock. The Compensation Committee believes that employee equity ownership is highly motivating, provides a major incentive for employees to build stockholder value and serves to align the interests of employees with those of stockholders. Grants of stock options to executive officers are based upon each officer s relative position, responsibilities, historical and expected contributions to Finisar, and the officer s existing stock ownership and previous option grants, with primary weight given to the executive officers relative rank and responsibilities. Initial stock option grants designed to recruit an executive officer to join Finisar may be based on negotiations with the officer and with

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reference to historical option grants to existing officers. Stock options are granted at an exercise price equal to the market price of our common stock on the date of grant and will provide value to the executive officers only when the price of our common stock increases over the exercise price.

Compliance with Internal Revenue Code Section 162(m). Section 162(m) of the Internal Revenue Code restricts deductibility of executive compensation paid to our Chief Executive Officer and each of the four other most highly compensated executive officers holding office at the end of any year to the extent such compensation exceeds $1,000,000 for any of such officers in any year and does not qualify for an exception under Section 162(m) or related regulations. The Committee s policy is to qualify its executive compensation for deductibility under applicable tax laws to the extent practicable. Income related to stock options granted under the 1999 Stock Option Plan generally qualifies for an exemption from these restrictions imposed by Section 162(m). In the future, the Committee will continue to evaluate the advisability of qualifying its executive compensation for full deductibility.

2005 Compensation

Compensation for our Chief Executive Officer and other executive officers for fiscal 2005 was set according to the established compensation policy described above. At the end of fiscal 2005, we determined that no performance bonuses would be paid to our executive officers; however, we approved salary increases for the Chief Executive Officer and certain other executive officers, effective as of June 1, 2005.

COMPENSATION COMMITTEE

Michael C. Child
Roger C. Ferguson
Larry D. Mitchell

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COMPARISON OF STOCKHOLDER RETURN

Set forth below is a line graph comparing the annual percentage change in the cumulative total return on our common stock with the cumulative total returns of the CRSP Total Return Index for the Nasdaq Stock Market and the Amex Networking Index for the period commencing on April 28, 2000 and ending on April 29, 2005.

COMPARISON OF CUMULATIVE TOTAL RETURN FROM
APRIL 28, 2000 THROUGH APRIL 29, 2005(1):
FINISAR, NASDAQ INDEX AND AMEX NETWORKING INDEX

April 28, 2000	April 30, 2001	April 30, 2002	April 30, 2003	April 30, 2004	April 29, 2005