CIENA CORP
Form 10-Q/A
May 15, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q/A

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

For the quarterly period ended January 31, 2002

OR

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

For the transition period from.................to........................

Commission file number: 0-21969

CIENA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**23-2725311** (I.R.S. Employer Identification No.)
1201 Winterson Road, Linthicum, MD (Address of Principal Executive Offices)	**21090** (Zip Code)

(410) 865-8500
(Registrant s telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Class	Outstanding at February 21, 2002
Common stock. $.01 par value	328,730,443

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

This *Management s Discussion and Analysis of Financial Condition and Results of Operations* contains certain forward-looking statements that involve risks and uncertainties. CIENA has set forth in its Form 10-K Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations-Risk Factors, as filed with the Securities and Exchange Commission on December 13, 2001, a detailed statement of risks and uncertainties relating to the Company s business. In addition, set forth below under the heading Risk Factors is a further discussion of certain of those risks as they relate to the period covered by this report, the Company s near-term outlook with respect thereto, and the forward-looking statements set forth herein. Investors should review this quarterly report in combination with the Form 10-K in order to have a more complete understanding of the principal risks associated with an investment in the Company s Common Stock.

Overview

CIENA is a leader in the intelligent optical networking equipment market. We offer a portfolio of products for communications service providers worldwide. Our customers include long-distance carriers, competitive and incumbent local exchange carriers, Internet service providers, wireless and wholesale carriers. CIENA offers optical transport and intelligent optical switching systems that enable service providers to provision, manage and deliver high-bandwidth services to their customers. We have pursued a strategy to develop and leverage the power of disruptive technologies to change the fundamental economics of building carrier-class tele- and data-communications networks, thereby providing our customers with a competitive advantage. CIENA s intelligent optical networking products are designed to enable carriers to deliver any time, any size, any priority bandwidth to their customers.

For much of the last five years the market for our equipment has been influenced by the entry into the communications services business of a substantial number of new companies. In the United States, this was due largely to changes in the regulatory environment, in particular those brought about by the Telecommunications Act of 1996. These new companies raised billions of dollars in capital, much of which they invested in new plant, causing an acceleration in the growth of the market for telecommunications equipment.

The last year or so has seen a reversal of this trend, including the failure of a large number of the new entrants and a sharp contraction of the availability of capital to the industry. This, in turn, has caused a substantial reduction in demand for telecommunications equipment, including our products.

This industry trend has been compounded by the slowing not only of the United States economy, but the economies in virtually all of the countries in which we are marketing our products. Moreover, the economic uncertainty has been accentuated by the events of September 11, 2001. The combination of these factors has caused most of our customers to become more conservative in their capital investment plans and more uncertain about their future purchases. As a consequence, we are facing a market that is both reduced in absolute size and more difficult to predict and plan for. We recently received information that leads us to believe that two of our historically most important customers may purchase significantly less from us than they had previously indicated. As a result, we now anticipate that our fiscal second quarter revenue is likely to be in the neighborhood of $100 million. See Risk Factors.

As of January 31, 2002, CIENA and its subsidiaries employed approximately 3,294 persons, which was a reduction of 484 persons from the approximate 3,778 employed on October 31, 2001. On November 12, 2001, we announced a workforce reduction of approximately 380 employees concentrated in manufacturing operations staff. We recorded a restructuring charge of $6.8 million associated with this action, in the first quarter of fiscal 2002. On November 16, 2001, CIENA sold 80.1% of its ownership in ATI International Investments, Inc., the parent company of ATI Telecom International Ltd. (Alta), which resulted in a reduction of approximately 84 employees concentrated in engineering, furnishing and installation operations staff. On February 5, 2002, we announced a workforce reduction of approximately 400 employees largely concentrated in manufacturing operations and research and development activities associated with the closure of our Marlborough, Massachusetts, research and development facility. We expect to record a restructuring charge of between $9.0 million and $11.0 million in our second quarter of fiscal 2002 associated with the February 5, 2002 workforce reduction, lease terminations, non-cancelable lease costs and the write-down of certain property, equipment and leasehold improvements.

On February 18, 2002, CIENA announced that it had entered into an agreement to acquire by merger ONI Systems Corp. (ONI), a NASDAQ-listed corporation headquartered in San Jose, California. ONI is a provider of optical networking equipment specifically designed to address bandwidth and service limitations of regional and metropolitan networks. Under the terms of the agreement, each outstanding share of capital stock of ONI will be exchanged for 0.7104 shares of CIENA common stock, and CIENA will assume all of ONI s outstanding options and warrants as well as its outstanding convertible debt. Based on the closing price of CIENA common stock on Friday, February 15, 2002, the transaction is valued at approximately $900.0 million. CIENA expects to complete the acquisition during the second or third calendar quarter of 2002. The ONI acquisition is subject to various conditions and approval by appropriate government agencies and the stockholders of CIENA and ONI. CIENA expects to issue approximately 100,500,000 shares of its common stock in the acquisition and will become obligated for ONI s $300 million issue of convertible subordinated debt. See Risk Factors below.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements requires CIENA to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, CIENA evaluates its estimates, including those related to bad debts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring, and contingencies and litigation. CIENA bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. CIENA believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

CIENA recognizes product revenue in accordance with the shipping terms specified and where collection is reasonably assured. For transactions where CIENA has yet to obtain customer acceptance, revenue is deferred until the terms of acceptance are satisfied. Revenue for installation services is recognized as the services are performed unless the terms of the supply contract combine product acceptance with installation, in which case revenues for installation services are recognized when the terms of acceptance are satisfied and installation is completed. Revenues from installation service fixed price contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date compared to estimated total costs for each contract. Amounts received in excess of revenue recognized are included as deferred revenue in the accompanying balance sheets. For transactions involving the sale of software, revenue is recognized in accordance with Statement of Position No. 97-2 (SOP 97-2), Software Revenue Recognition , including deferral of revenue recognition in instances where vendor specific objective evidence for undelivered elements is not determinable. For distributor sales where risks of ownership have not transferred, CIENA recognizes revenue when the product is shipped through to the end user.

CIENA maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of CIENA s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

CIENA provides for the estimated cost of product warranties at the time revenue is recognized. While CIENA engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, CIENA s warranty obligation is affected by product failure rates and material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from CIENA s estimates, revisions to the estimated warranty liability would be required.

CIENA writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

CIENA holds minority interests in companies having operations or technology in areas within its strategic focus, some of which are publicly traded and have highly volatile share prices. CIENA records an investment impairment charge when it believes an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment s current carrying value, thereby possibly requiring an impairment charge in the future.

Although realization is not assured, CIENA has concluded that it is more likely than not that the deferred tax assets as of January 31, 2002 will be realized based on the scheduling of deferred tax liabilities and projected taxable income. The amount of the deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the actual amounts of future taxable income. Should CIENA determine that it would not be able to realize all or part of its deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Results of Operations

Three Months Ended January 31, 2001 Compared to Three Months Ended January 31, 2002

Revenue. CIENA recognized revenues of $352.0 million and $162.2 million for the quarters ended January 31, 2001 and 2002, respectively. The approximate $189.8 million or 53.9% decrease in revenues in the first quarter 2002 compared to the first quarter 2001 was the result of a decrease in revenues recognized from 41 different optical networking equipment customers in the quarter ended January 31, 2002, as compared to 30 such customers in the same quarter of the prior year. Additionally, during the quarter ended January 31, 2002, each of two optical networking equipment customers accounted for 10% or more of CIENA s quarterly revenue and, combined, accounted for 52.2% of CIENA s quarterly revenue. This compares to the quarter ended January 31, 2001 where each of three optical transport equipment customers accounted for 10% or more of the Company s quarterly revenue and, combined, accounted for approximately 62.3%. Revenues derived from foreign sales accounted for approximately 42.0% and 22.4% of the Company s revenues during the quarters ended January 31, 2001 and January 31, 2002, respectively.

Revenues during CIENA s first quarter 2002 were largely derived from sales of our long distance optical transport products and intelligent core switching products. CIENA s first quarter 2001 revenues, were largely derived from sales of our long distance optical transport products. Revenue derived from services accounted for approximately 5.3% and 13.7% of revenue during the first quarters of 2001 and 2002, respectively.

Gross Profit. Cost of goods sold consists of component costs, direct compensation costs, warranty and other contractual obligations, royalties, license fees, inventory obsolescence costs and overhead related to the Company s manufacturing and engineering, furnishing and installation (EF&I) operations. Gross profits were $160.2 million and $22.5 million for the quarters ended January 31, 2001 and 2002, respectively. The approximate $137.7 million or 86.0% decrease in gross profit from the first quarter 2002 to the first quarter 2001 was the result of decreased revenues and gross profit margin. Gross margin was 45.5% and 13.9% of revenues for the first fiscal quarters of 2001 and 2002, respectively. The decrease was largely attributable to increases in inventory obsolescence costs, lower manufacturing volumes resulting in reduced manufacturing efficiencies, and changes in product mix resulting in sales of a higher proportion of revenue from lower margin installation and tech support services.

As discussed above, our current ability to make reliable forecasts for fiscal 2002 is limited. It is possible, however, that we could continue to experience reductions of gross margins compared to fiscal 2001 as a result of one or more of several factors, including changes in product mix, downward pressure on pricing due to more aggressive competition, decreased manufacturing efficiencies, increases in inventory obsolescence, and increased costs of components.

Research and Development Expenses. Research and development expenses (exclusive of stock compensation costs of $0 and $4.0 million) were $42.5 million and $64.8 million for the quarters ended January 31, 2001 and 2002, respectively. During the first quarters of 2001 and 2002, research and development expenses were 12.1% and 39.9% of revenue, respectively. The approximate $22.3 million or 52.4% increase in research and development expenses in the first quarter 2002 compared to the first quarter 2001 was the result of increases in staffing levels, depreciation expense, and facilities-related costs. CIENA expenses research and development costs as incurred.

Selling and Marketing Expenses. Selling and marketing expenses (exclusive of stock compensation costs of $0 and $1.0 million) were $29.6 million and $37.6 million for the quarters ended January 31, 2001 and 2002, respectively. During the first quarters of 2001 and 2002, selling and marketing expenses were 8.4% and 23.2% of revenues, respectively. The approximate $8.0 million or 26.9% increase in selling and marketing expenses in the first quarter 2002 compared to the first quarter 2001 was primarily the result of increased staffing levels in the areas of sales, marketing, technical assistance and field support, depreciation expense and facilities-related costs.

General and Administrative Expenses. General and administrative expenses (exclusive of stock compensation costs of $0 and $0.2 million) were $11.1 million and $13.7 million for the quarters ended January 31, 2001 and 2002, respectively. General and administrative expenses were 3.2% and 8.4% of revenues, respectively. The approximate $2.5 million or 22.5% increase in general and administrative expenses was primarily the result of increases in outside consulting services and facilities-related costs.

Deferred Stock Compensation Costs. Deferred stock compensation costs were $5.1 million for the three months ended January 31, 2002. As part of our acquisition of Cyras, we recorded $98.5 million of deferred stock compensation related to the unvested stock options and restricted stock assumed in the acquisition. Deferred stock compensation is presented as a reduction of stockholders equity and is amortized over the remaining vesting period of the applicable options. As of January 31, 2002 the balance of unearned deferred stock compensation was $44.2 million.

Amortization of Goodwill. Amortization of goodwill was $0.9 million for the three months ended January 2001. In July 2001 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (SFAS No. 142). SFAS No. 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition. This statement requires goodwill amortization to cease and for goodwill to be periodically reviewed for impairment, for fiscal years beginning after October 31, 2001. SFAS No. 142 supercedes APB Opinion No. 17, Intangible Assets . The Company adopted the provisions of this standard for its first quarter of fiscal 2002. There was no impairment of goodwill recorded for the quarter ended January 31, 2002.

Amortization of Intangible Assets. Amortization of intangible assets was $0.1 million and $1.8 million for the three months ended January 2001 and 2002, respectively. As part of our acquisition of Cyras we recorded $47.7 million worth of other intangible assets. The intangible assets from the Cyras purchase are being amortized over a seven-year period.

Restructuring Costs. On November 12, 2001, we announced a workforce reduction of approximately 380 employees concentrated in manufacturing operations staff. We recorded a restructuring charge of $6.8 million associated with this action in the first quarter of fiscal 2002. On February 5, 2002, we announced a workforce reduction of approximately 400 employees largely concentrated in manufacturing operations and research and development activities associated with the closure of our Marlborough, Massachusetts, research and development facility. We expect to record a restructuring charge of between $9.0 million and $11.0 million in our second quarter of fiscal 2002 associated with the February 5, 2002 workforce reduction, lease terminations, non-cancelable lease costs and the write-down of certain property, equipment and leasehold improvements.

Interest and Other Income (Expense), Net. Interest income and other income (expense), net were $4.3 million and $16.2 million for the first quarters ended January 31, 2001 and 2002, respectively. The approximate $11.9 million or 276.4% increase in interest income and other income (expense), net was largely attributable to higher invested cash balances.

Interest Expense. Interest expense was $0.1 million and $10.5 million for the quarters ended January 31, 2001 and 2002, respectively. The $10.4 million or 119.7% increase in interest expense was attributable to the increase in our debt obligations between the two periods.

Loss on Equity Investments, Net. Loss on equity investments, net was $5.3 million for the first quarter of fiscal 2002. We realized a loss of approximately $1.9 million from the sale of a public equity investment and a loss of approximately $6.2 million from a decline in the fair value of a public equity investment that was determined to be other than temporary. On November 16, 2001 CIENA sold 80.1% of its ownership in ATI International Investments, Inc., the parent company of ATI Telecom International Ltd. (Alta), which resulted in a gain of approximately $2.8 million. CIENA retains a 19.9% ownership in ATI International Investments, Inc.

Provision (Benefit) for Income Taxes. CIENA s provision for income taxes was $26.8 million for the quarter ended January 31, 2001. We recorded a tax benefit of $36.4 million for the quarter ended January 31, 2002. During the first quarters of 2001 and 2002, the tax rate used for income taxes were 33.5% and 34.0% of income (loss) before income taxes, respectively. The increase in the income tax rate in first quarter 2002 compared to first quarter 2001 was due to a reduction in the marginal benefits derived from research and development credits. As of January 31, 2002 CIENA s deferred tax asset was $220.7 million. The realization of this asset could be adversely affected if future earnings are lower than anticipated.

Net Income (Loss). CIENA s net loss for the quarter ended January 31, 2001 was $70.6 million.

Liquidity and Capital Resources

At January 31, 2002, CIENA s principal source of liquidity was its cash and cash equivalents, short-term and long-term investments. The Company had $472.5 million in cash and cash equivalents, and $1,467.4 million in short-term and long-term investments.

The Company s operating activities provided cash of $177.1 million and $54.4 million for the three months ended January 31, 2002 and 2001, respectively. Cash provided by operations for the three months ended January 31, 2002 was primarily attributable to net loss adjusted for the non-cash charges of depreciation and amortization, decreases in accounts receivable, and the increase in provisions for inventory obsolescence, and warranty, offset by increases in inventory, accounts payable and deferred income tax assets.

Cash used in investing activities for three months ended January 31, 2002 and 2001, was $105.9 million and $30.0 million, respectively. Included in investment activities were additions to capital equipment and leasehold improvements for the three months ended January 31, 2002 and 2001, of $29.5 million and $42.2 million, respectively. The capital equipment expenditures were primarily for test, manufacturing and computer equipment. The Company expects additional combined capital equipment and leasehold improvement expenditures of approximately $60.5 million to be made during the remaining nine months of fiscal 2002 to support selling and marketing, manufacturing and product development activities and the construction of leasehold improvements for its facilities.

We generated $3.5 million and $9.1 million in cash from financing activities in the three months ended January 31, 2002 and 2001, respectively. During the three months ended January 31, 2002 and 2001, cash from financing activities included receipts of $3.0 million and $8.6 million from the exercise of stock options, respectively.

Cyras Systems LLC, our wholly owned subsidiary, has $150 million of 4.5% convertible subordinated notes outstanding. In the event that the holders of the Cyras notes convert their notes into our common stock, we would have to issue a significant number of shares of additional common stock. Based on the exchange ratio for the Cyras acquisition of approximately 0.13, we will have to issue approximately 1,037,055 shares of our common stock if holders of the entire $150 million of convertible notes decided to convert their notes. At our current stock price it appears more likely that the holders of the Cyras notes will not elect to convert them into our common stock before March 31, 2002. As a result, it is probable that we will have to make an offer to repurchase the notes at 118.942% of their principal balance on April 30, 2002. If all of the note holders accept that offer, we will have to expend approximately $178 million of our cash and cash equivalents for the repurchase.

When the merger with ONI Systems, Inc. is consummated (assuming that the necessary shareholder and regulatory approvals are obtained), we will acquire to the cash, cash equivalents, short-term and long-term investments held by ONI and assume ONI s debt obligations. As of December 31, 2001, ONI had approximately $678.8 million in cash, cash equivalents and short-term and long-term investments and had outstanding $300 million of 5% convertible subordinated debentures, due October 15, 2005.

CIENA does not engage in any off-balance sheet financing arrangements. In particular, we do not have any interest in so-called limited purpose entities, which include special purpose entities (SPEs) and structured finance entities.

We believe that our existing cash balances and investments will be sufficient to meet our liquidity and capital spending requirements for the next 18 to 24 months. However, possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing prior to such time. There can be no assurance that additional debt or equity financing will be available when required or, if available, can be secured on terms satisfactory to us.

Risk Factors

Investing in our securities involves a high degree of risk. In addition to the other information contained in this quarterly report, including the reports we incorporate by reference, you should consider the following factors before investing in our securities.

Our Business Has Been Adversely Affected by Recent Developments in the Communications Industry and the Economy in General

For much of the last five years, the market for our equipment has been influenced by the entry into the communications services business of a substantial number of new companies. In the United States this was due largely to changes in the regulatory environment, in particular those brought about by the Telecommunications Act of 1996. These new companies raised billions of dollars in capital, much of which they invested in new plants, causing an acceleration in the growth of the market for telecommunications equipment.

The last year or so has seen a reversal of this trend, including the failure of a large number of the new entrants and a sharp contraction of the availability of capital to the industry. This, in turn, has caused a substantial reduction in demand for telecommunications equipment, including our products.

This industry trend has been compounded by the slowing not only of the United States economy, but the economies in virtually all of the countries in which we are marketing our products. Moreover, the economic uncertainty has been accentuated by the events of September 11, 2001. The combination of these factors has caused most of our customers to become more conservative in their capital investment plans and more uncertain about their future purchases. As a consequence, we are facing a market that is both reduced in absolute size and more difficult to predict and plan for.

We expect the factors described above to affect our business, for at least several quarters if not longer, in several significant ways compared to the recent past:

- it is likely that our markets will be characterized by reduced capital expenditures by our customers; our ability to forecast the volume and product mix of our sales will be substantially reduced;
- managing our expenditures will be significantly more difficult in light of the uncertainties surrounding our business;
- increased competition resulting from reduced demand will put substantial downward pressures on the pricing of our products, tending to reduce our profit margins;

- increased competition has also enabled customers to insist on more favorable terms and conditions for sales, including extended payment terms or other financing assistance, as a condition of procuring their business; and
- the result in any or combination of these factors could be reduced revenues and profitability and perhaps losses in particular periods or for the entire year.

We recently received information that leads us to believe that two of our historically most important customers may purchase significantly less from us than they had previously indicated. As a result, we now expect that our fiscal second quarter revenue is likely to be in the neighborhood of $100 million. We believe that the decline in purchases by these customers is temporary, we cannot now predict when they can be expected to return to levels more representative of past volumes.

Economic Conditions May Require Us to Reduce the Size of Our Business Further

In November, 2001, and again in February, 2002, we undertook significant reductions in force, accompanied by dispositions of assets, as part of our effort to reduce the size of our operations to better match the reduced sales of our products and services. Weakness in the global economy generally and the telecommunications equipment market in particular continue to affect our business substantially. If those conditions continue, we may be required to undertake further reductions in capacity. Any such steps would likely result in significant charges from write-downs or write-offs of assets, costs of lease terminations, and expenses resulting from the termination of personnel.

Our Results Can Fluctuate Unpredictably

In general, our revenues and operating results in any reporting period may fluctuate significantly due to a variety of factors including:

- fluctuations in demand for our products;
- changes in our pricing policies or the pricing policies of our competitors;
- the timing and size of orders from customers;
- changes in customers requirements, including changes or cancellations to orders from customers;
- the introduction of new products by us or our competitors;
- changes in the price or availability of components for our products;
- readiness of customer sites for installation;
- satisfaction of contractual customer acceptance criteria and related revenue recognition issues;
- manufacturing and shipment delays and deferrals;
- increased service, installation, warranty or repair costs;
- the timing and amount of employer payroll tax to be paid on employee gains on stock options exercised; and
- changes in general economic conditions as well as those specific to the telecommunications and intelligent optical networking industries.

Our intelligent optical networking products require large investments. We have only a limited number of potential customers in each geographic market, and each has unique needs. Our customers are generally technically sophisticated and demanding. As a result, the sales cycles for our products are long, often as much as a year or two between initial contact with a potential customer and the recognition of revenue from sales to the customer. Our customers purchases tend to be large and sporadic, depending upon their need to build a customer base, their plans for expanding their networks, the availability of financing, and the effects of regulatory and business conditions in the countries in which they operate. As a result, their purchase decisions can be unpredictable and subject to unanticipated changes. Our results, in turn, tend to fluctuate unpredictably. This tendency has been amplified by conditions arising from the current uncertain economic environment.

Current economic conditions have made it more difficult to make reliable estimates of future revenues. Fluctuations in our revenues can lead to even greater fluctuations in our operating profits. We budget expense levels on our expectations of long-term future revenue. These budgets reflect the substantial investments in financial, engineering, manufacturing and logistics support resources we must make to support large customers, even though we are unsure of the volume, duration or timing of their purchases. In addition, we continue to make substantial expenditures on the development of new and enhanced products. Any substantial adjustment to expenses to account for lower levels of revenue is difficult and takes time. Consequently if our revenue does decline, in the short run our levels of inventory, operating expenses and general overhead would be high relative to our revenue, reducing our profitability, and perhaps resulting in operating losses.

Our Future Success Will Depend on Our Ability to Acquire New Customers

Historically, a large percentage of our sales have been made to emerging carriers, many of which have recently begun to experience severe financial difficulties. Consequently, we expect our sales to emerging carriers to be reduced, and our future success will depend on our ability to increase our sales to incumbent carriers, including, in the United States, the regional bell operating companies (RBOCs), and abroad, the large, traditional telecommunications operators (TOs), many of which were formerly government-owned post, telephone and telegraph enterprises. These large companies typically require longer sales cycles, many have long-standing supplier relationships with other vendors, and our experience in selling to them is limited. If we do not succeed in penetrating this segment of the market, our business could suffer.

We May Not Be Able to Successfully Complete Development and Achieve Commercial Acceptance of New Products

It is necessary for us to continually enhance our products. Certain enhancements to our products are in the development phase and are not yet ready for commercial manufacturing or deployment. For example, we expect to offer additional feature enhancement releases of the MultiWave CoreDirector product line over the life of the product and we expect to continue to enhance features of our MultiWave CoreStream, MultiWave Metro and MultiWave MetroDirector K2 products over the life of these products. The maturing process from laboratory prototype to customer trials, and subsequently to general availability, involves a number of steps, including:

- completion of product development;
- the qualification and multiple sourcing of critical components, including ASICs;
- validation of manufacturing methods and processes;
- extensive quality assurance and reliability testing, and staffing of testing infrastructure;
- validation of software; and
- establishment of systems integration and systems test validation requirements.

Each of these steps in turn presents serious risks of failure, rework or delay, any one of which could decrease the speed and scope of product introduction and marketplace acceptance of the product. Specialized ASICs and intensive software testing and validation are key to the timely introduction of enhancements to the MultiWave CoreDirector and MultiWave MetroDirector K2 product lines; and schedule delays are common in the final validation phase, as well as in the manufacture of specialized ASICs. In addition, unexpected intellectual property disputes, failure of critical design elements, and a host of other execution risks may delay or even prevent the introduction of these products. If we do not develop and successfully introduce these products in a timely manner, our business, financial condition and results of operations would be harmed.

The markets for our MultiWave CoreDirector and MultiWave MetroDirector K2 product lines are relatively new. We are only beginning to establish commercial acceptance of these products, and we cannot be certain that the substantial sales and marketing efforts necessary to achieve commercial acceptance in traditionally long sales cycles will be successful. If the markets for these products do not develop, or the products are not accepted by the market, our business, financial condition and results of operations would suffer. We have recently written down the value of the goodwill associated with our acquisition of Cyras, the source of our MultiWave MetroDirector K2 product, in recognition of what we believe to be a significant and permanent decline in the market for these types of products.

We Face Intense Competition which Could Hurt Our Sales and Profitability

The market for optical networking equipment is extremely competitive. Competition in the optical networking market is based on varying combinations of price, functionality, software functionality, manufacturing capability, installation, services, scalability and the ability of the system solution to meet customers immediate and future network requirements. A small number of very large companies, including Alcatel, Cisco Systems, Fujitsu Group, Hitachi, Lucent Technologies, NEC Corporation, Nortel Networks, Siemens AG and Telefon AB LM Ericsson, have historically dominated the telecommunications equipment industry. They all have substantial financial, marketing, manufacturing and intellectual property resources and greater resources than CIENA, to develop or acquire new technologies than we do. They also often have existing relationships with our potential customers.

Because we sell systems that compete directly with product offerings of these companies, and in some cases displace or replace their equipment, we represent a competitive threat. The continued expansion of our product offerings with the MultiWave CoreDirector and MultiWave MetroDirector K2 product lines and enhancements to our MultiWave CoreStream and MultiWave Metro product lines likely will increase this perceived threat. The recent decline in the market for optical networking equipment has resulted in even greater competitive pressures. We expect that the aggressive tactics we have confronted on the part of many of these competitors will continue, and perhaps become more severe. These tactics include:

price discounting; particularly when a competitor is selling used equipment or inventory that a competitor has written down or written off;

early announcements of competing products and other marketing efforts;

one-stop shopping options;

customer financing assistance;

marketing and advertising assistance; and

intellectual property disputes.

These tactics can be particularly effective in a highly concentrated customer base such as ours. Our customers are under increasing competitive pressure to deliver their services at the lowest possible cost. This pressure may result in the pricing of optical networking systems becoming a more important factor in customer decisions, which may favor larger competitors that can spread the effect of price discounts in their optical networking products across a larger array of products and services and across a larger customer base than ours. If we are unable to offset any reductions in the average sales price for our products by a reduction in the cost of our products, our gross profit margins will be adversely affected. Our inability to compete successfully against our competitors and maintain our gross profit margins would harm our business, financial condition and results of operations.

Many of our customers have indicated that they intend to establish a relationship with at least two vendors for optical networking products. With respect to customers for whom we are the only supplier of intelligent optical products, we do not know when or if these customers will select a second vendor or what impact the selection might have on purchases from us. If a second optical networking supplier is chosen, these customers could reduce their purchases from us, which could in turn have a material adverse effect on us.

New competitors are emerging to compete with our existing products as well as our future products. We expect new competitors to continue to emerge as the optical networking market continues to expand. These companies may achieve commercial availability of their products more quickly due to the narrow and exclusive focus of their efforts. Several of these competitors have raised significant cash and they have in some cases offered stock in their companies, positions on technical advisory boards, or have provided significant vendor financing to attract new customers. Our inability to compete successfully against these companies would harm our business, financial condition and results of operations.

If We Fail to Respond Rapidly to Technological Changes, Our Products Will Become Obsolete, Damaging Our Short-Term Prospects and Threatening Our Long-Term Survival

The market for optical networking products is likely to be characterized by rapid technological change, frequent introductions of new products, and recurring changes in customer requirements. To succeed in this market, we must continue to develop new products and new features for existing products. Doing so is difficult and costly, and there is no assurance that we will continue to be successful. In addition, we must be able to identify and gain access to promising new technologies. Failure to keep pace with technological advances would impair the competitiveness of our products and sooner or later do serious harm to our business.

Several of our new products, including the MultiWave CoreDirector, the MultiWave MetroDirector K2 and enhancements to the MultiWave CoreStream and MultiWave Metro, are based on complex technology which could result in unanticipated delays in the development, manufacturing or deployment of these products. Our LightWorks initiative, which involves modifying these products to enable customers to implement a new type of network architecture, entails similar development risks.

Our customers often require extensive testing of new products before accepting them, and we are typically unable to recognize revenue until the tests are completed satisfactorily. The certification process for new telecommunications equipment used in the networks of the RBOCs and TOs tends to be particularly lengthy and difficult. Complying with these certification requirements may involve unanticipated delays that could adversely affect the timing of our ability to sell our products to these larger carriers.

Concentration of Customers

Although the number of customers who make purchases from us continues to grow, a substantial portion of our revenues continues to come from sales to a small number of customers. In fiscal 2001, 50.5% of our revenues came from our two most significant customers, Sprint and Qwest. The loss of, or a substantial reduction in purchases by, either of these customers could reduce our revenues materially. Both of these companies have been affected to some extent by the current economic recession and the even more difficult conditions in

the communications industry. The communications industry is, moreover, undergoing a period of consolidation. It is possible that either of these customers could become a party to a merger or other business combination. The distraction and uncertainty inevitably attendant on such a transaction could delay or alter decisions on network deployments or capital expenditures, and this could result in delayed or reduced purchases from us.

We Are Exposed to the Credit Risk of Our Customers

Industry and economic conditions have weakened the financial position of some of our customers. To sell to some of these customers we may be required to take risks of uncollectable accounts. While we monitor these situations carefully and attempt to take appropriate measures to protect ourselves, it is possible that we may have to write down or write off doubtful accounts. Such write-downs or write-offs, if large, could have a material adverse effect on our operating results and financial condition.

We also continue to experience demands from customers to finance sales to them. While we have done only a limited amount of such financing in the past, the increasingly competitive environment in which we are now operating may require us to engage in more customer financing in the future. Our ability to recognize revenue from financed sales will depend on the relative financial condition of the specific customer, among other factors. Further, we will need to evaluate the collectability of receivables from these customers if their financial condition deteriorates in the future. Any change in the financial condition of customers to which we provide financing could have a material adverse effect on our operating results and financial condition.

Our Strategy Involves Pursuing Strategic Acquisitions and Investments that May Not Be Successful

Our business strategy includes acquiring or making strategic investments in other companies with a view to expanding our portfolio of products and services, acquiring new technologies, and accelerating the development of new or improved products. To do so, we may issue equity that would dilute our current shareholders percentage ownership or incur debt or assume indebtedness. In addition, we may incur significant amortization expenses related to intangible assets. In the fourth quarter fiscal 2001 we incurred a significant write-off of goodwill associated with our Cyras acquisition completed in March 2001.

Acquisitions and strategic investments involve numerous risks, including difficulties in integrating the operations, technologies, and products of the acquired companies; diversion of management s attention from our core business; potential difficulties in completing projects of the acquired company; the potential loss of key employees of the acquired company; and dependence on unfamiliar or relatively small supply partners. In addition acquisitions and strategic investments may involve risks of entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions and of obtaining insufficient revenues to offset increased expenses associated with acquisitions. Mergers and acquisitions are inherently risky. Not all of those we have made in the past have been successful; and it is possible that acquisitions we make in the future may be unsuccessful, even to the extent of materially and adversely affecting our business.

We May Not Succeed in Completing the Proposed Merger with ONI

On February 17, 2002, we entered into an agreement to merge with ONI Systems Corp. The merger is subject to obtaining approval of federal regulatory authorities under the Hart-Scott-Rodino Anti-trust Improvements Act as well as approval by majority vote of the shareholders of both companies. It is also subject to certain other closing conditions. There is a risk that we may not be successful in consummating the transaction because of the failure to meet one of these conditions. If the merger is not completed, we could suffer a number of consequences that would adversely affect our business including:

- failure to realize the enhanced financial and competitive position we expect as a result of the acquisition;
- the diversion of management attention from our day-to-day business and the unavoidable disruption to our employees and our relationships with customers as a result of efforts and uncertainties relating to the anticipated merger may detract from our ability to grow revenues and minimize costs, which, in turn may lead to a loss of market position;
- the significant expenses related to the merger we have incurred and will continue to occur prior to closing of the transaction; and
- the possibility that we could, under certain circumstances, be required to pay ONI a substantial termination fee if our Board of Directors were to change recommendations in favor of the merger.

Once the joint proxy statement/prospectus has been declared effective by the SEC, such definitive joint proxy statement/prospectus will be mailed to all holders of CIENA stock and will contain important information about CIENA, ONI and the proposed merger, risks relating to the merger and the combined company, and related matters. CIENA urges all of its stockholders to read the definitive joint proxy statement/prospectus when it becomes available.

We May Not Be Able to Achieve the Benefits We Anticipate from the Merger with ONI

Integrating two businesses of the sizes of ours and ONI s is difficult. We have limited experience with acquisitions and cannot be certain that we can integrate the two businesses successfully or achieve the benefits we envision from the merger. Success will depend, among other things, on our ability

- to assimilate ONI s operations and personnel with ours;
- to maintain uniform standards, controls, procedures and policies in the merged company;
- to integrate ONI s products with ours so that they can operate, and be sold as, part of an integrated system;
- to achieve substantial reductions in manufacturing and operating costs following the merger; and
- to retain key personnel from both companies.

Failure to meet these challenges or other problems we encounter in connection with the merger could have a material adverse effect on our business, results of operations and financial condition. We will also incur substantial non-cash charges in connection with the merger related to goodwill and amortization of other intangibles.

We Depend on a Limited Number of Suppliers, and for Some Items We Do Not Have a Substitute Supplier

We depend on a limited number of suppliers for components of our products, as well as for equipment used to manufacture and test our products. Our products include several high-performance components for which reliable, high-volume suppliers are particularly limited. Furthermore, some key optical and electronic components we use in our optical transport systems are currently available only from sole or limited sources, and in some cases, that source also is a competitor. Any delay in component availability for any of our products could result in delays in deployment of these products and in our ability to recognize revenues. These delays could also harm our customer relationships and our results of operations.

Failures of components affect the reliability and performance of our products and can reduce customer confidence in them, perhaps to the extent of adversely affecting our financial performance. On occasion, we have experienced delays in receipt of components and have received components that do not perform according to their specifications. Any future difficulty in obtaining sufficient and timely delivery of components could result in delays or reductions in product shipments which, in turn, could harm our business. A consolidation among suppliers of these components or adverse developments in their businesses affecting their ability to supply us, could adversely impact the availability of components on which we depend. Delayed deliveries of key components from these sources could adversely affect our business.

Any delays in component availability for any of our products or test equipment could result in delays in deployment of these products and in our ability to recognize revenue from them. These delays could also harm our customer relationships and our results of operations.

We Rely on Contract Manufacturers for Our Products

We rely on a small number of contract manufacturers to manufacture our MultiWave CoreDirector and MultiWave MetroDirector K2 product lines and some of the components for our other products. The qualification of these manufacturers is an expensive and time-consuming process, and these contract manufacturers build modules for other companies, including our competitors. In addition, we do not have contracts in place with many of these manufacturers. We may not be able to effectively manage our relationships with our manufacturers and we cannot be certain that they will be able to fill our orders in a timely manner. We provide forecasts of our demand to our contract manufacturers several months prior to scheduled delivery of products. If we overestimate our future product requirements, the contract manufacturers may have excess inventory, which would increase our costs. Conversely, if we underestimate our future product requirements the contract manufacturer may not have enough product to meet our customer requirements, and this could result in delays in the shipment of our products and our ability to recognize revenue. If we cannot effectively manage these manufacturers and forecast future demand, or if they fail to deliver components on time, our business may suffer.

Some of Our Suppliers Are Also Competitors

Some of our component suppliers are both primary sources for components and major competitors in the market for system equipment. For example, we buy components from Alcatel, Lucent Technologies, NEC Corporation, Nortel Networks, and Siemens AG. Each of these companies offers optical communications systems and equipment that are competitive with our products. A decline in reliability or other adverse change in these supply relationships could harm our business.

Our Ability to Compete Could Be Harmed If We Are Unable to Protect and Enforce Our Intellectual Property Rights or If We Infringe on Intellectual Property Rights of Others

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into non-disclosure and proprietary rights agreements with our employees and consultants, and license agreements with our corporate partners, and control access to and distribution of our products, documentation and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If competitors are able to use our technology, our ability to compete effectively could be harmed. We are involved in an intellectual property dispute regarding the use of our technology and may become involved with additional disputes in the future. Such lawsuits can be costly and may significantly divert time and attention from some members of our personnel.

We have received, and may receive in the future, notices from holders of patents in the optical technology field that raise issues of possible infringement by our products. Questions of infringement in the optical networking equipment market often involve highly technical and subjective analysis. We cannot assure you that any of these patent holders or others will not in the future initiate legal proceedings against us, or that we will be successful in defending against these actions. We are involved in an intellectual property dispute regarding the possible infringement of our products. In the past, we have been forced to take a license from the owner of the infringed intellectual property, or to redesign or stop selling the product that includes the challenged intellectual property. If we are sued for infringement and are unsuccessful in defending the suit, we could be subject to significant damages, and our business and customer relationships could be adversely affected.

Product Performance Problems Could Limit Our Sales Prospects

The production of new optical networking products and systems with high technology content involves occasional problems as the technology and manufacturing methods mature. If significant reliability, quality or network monitoring problems develop, including those due to faulty components, a number of negative effects on our business could result, including:

- costs associated with reworking our manufacturing processes;
- high service and warranty expenses;
- high inventory obsolescence expense;
- high levels of product returns;
- delays in collecting accounts receivable;
- reduced orders from existing customers; and
- declining interest from potential customers.

Although we maintain accruals for product warranties, actual costs could exceed these amounts. From time to time, there will be interruptions or delays in the activation of our products at a customer s site. These interruptions or delays may result from product performance problems or from aspects of the installation and activation activities, some of which are outside our control. If we experience significant interruptions or delays that we can not promptly resolve, confidence in our products could be undermined, which could harm our business.

We Face Risks Associated with our International Operations

We market, sell and service our products globally. We have established offices around the world, including in North America, Europe, Latin America and in the Asia Pacific region. We will continue to expand our international operations and enter new international markets. This expansion will require significant management attention and financial resources to develop successfully direct and indirect international sales and support channels. We may not be able to maintain or increase international market demand for our products.

International operations are subject to inherent risks, and our future results could be adversely affected by a variety of uncontrollable and changing factors. These include greater difficulty in collecting accounts receivable and longer collection periods; difficulties and costs of staffing and managing foreign operations; the impact of recessions in economies outside the United States; unexpected changes in regulatory requirements; certification requirements, reduced protection for intellectual property rights in some countries; potentially adverse tax consequences; political and economic instability; trade protection measures and other regulatory requirements; service provider and government spending patterns; and natural disasters. Such factors could have a material adverse impact on our operating results and financial condition.

Leverage and Debt Service Obligations May Adversely Affect Our Cash Flow and Our Ability to Repay or Repurchase our Notes

We have approximately $840 million of outstanding principal indebtedness, primarily related to notes offered by us and the assumption of notes from the acquisition of Cyras Systems, Inc. As a result of this indebtedness, we have significant principal and interest payment obligations. There is the possibility that we may be unable to generate sufficient cash to pay the principal of, interest on and other amounts due in respect of our indebtedness, including the notes, when due. We may also add equipment loans and lease lines to finance capital expenditures and may obtain additional long-term debt, working capital lines of credit and lease lines.

Our leverage could have important negative consequences, including:

- increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain additional financing;
- requiring the dedication of a substantial portion of our expected cash flow from operations to service our indebtedness, thereby reducing the amount of our expected cash flow available for other purposes, including capital expenditures;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete;
- placing us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have better access to capital resources; and
- making it difficult or impossible for us to pay the principal amount of the notes at maturity or the repurchase price of the notes upon a change of control, thereby causing an event of default under the indenture.

Cyras Systems LLC, our wholly owned subsidiary, has $150 million of 4.5% convertible subordinated notes outstanding. In the event that the holders of the Cyras notes convert their notes into our common stock, we would have to issue a significant number of shares of additional common stock. Based on the exchange ratio for the Cyras acquisition of approximately 0.13, we will have to issue approximately 1,037,055 shares of our common stock if holders of the entire $150 million of convertible notes decided to convert their notes. At our current stock price it appears more likely that the holders of the Cyras notes will not elect to convert them into our common stock before March 31, 2002. As a result, it is probable that we will have to make an offer to repurchase the notes at 118.942% of their principal balance on April 30, 2002. If all of the note holders accept that offer, we will have to expend approximately $178 million of our cash and cash equivalents for the repurchase.

If we complete the merger with ONI, we will become obligated on its $300 million issue of 5% convertible subordinated notes, due October 15, 2005. While we will also acquire its cash, cash equivalents, short-term and long-term investments currently approximately $678.8 million, we will be obligated to make semiannual interest payments of $7.5 million on April 15th and October 15th of each year, and to repay the notes when they mature.

Our Stock Price May Exhibit Volatility

Our common stock price has experienced substantial volatility in the past, and is likely to remain volatile in the future. Volatility can arise as a result of the activities of short sellers and risk arbitrageurs, and may have little relationship to our financial results or prospects. Volatility can also result from any divergence between our actual or anticipated financial results and published expectations of analysts, and announcements that we, our competitors, or our customers may make.

Divergence between our actual results and our anticipated results, analyst estimates and public announcements by us, our competitors, or by customers will occur from time to time in the future, with resulting stock price volatility, irrespective of our overall year-to-year performance or long-term prospects. As long as we continue to depend on a limited customer base, and particularly when a substantial majority of their purchases consist of newly-introduced products, there is substantial chance that our quarterly results will vary widely.

Forward-Looking Statements

Some of the statements contained, or incorporated by reference, in this quarterly report discuss future expectations, contain projections of results of operations or financial condition or state other forward-looking information. Those statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions. In some cases, you can identify these so-called forward-looking statements by words like may, will, should, expects, plans, anticipates, believes, estimates, predicts, continue or the negative of those words and other comparable words. You should be aware that those statements only reflect our predictions. Actual events or results may differ substantially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly under the heading Risk Factors above.

SIGNATURES

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

CIENA CORPORATION

Date: May 15, 2002

By: /s/ Gary B. Smith

Gary B. Smith
President, Chief Executive Officer and Director
(Duly Authorized Officer)