CIENA CORP
Form 10-Q
March 08, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
(Mark one)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended January 31, 2017
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission file number: 001-36250
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.)
7035 Ridge Road, Hanover, MD (Address of Principal Executive Offices)	21076 (Zip Code)

(410) 694-5700
(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 þ NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (do not check if smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as determined in Rule 12b-2 of the Exchange Act). YES o NO þ
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 March 3, 2017
common stock, $0.01 par value	141,317,330

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CIENA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Quarter Ended January 31, 2017	Quarter Ended January 31, 2016
Revenue:		
Products	$506,993	$457,589
Services	114,504	115,526
Total revenue	621,497	573,115
Cost of goods sold:		
Products	286,811	260,482
Services	60,901	61,183
Total cost of goods sold	347,712	321,665
Gross profit	273,785	251,450
Operating expenses:		
Research and development	116,869	108,046
Selling and marketing	85,002	82,478
General and administrative	35,864	31,142
Acquisition and integration costs	—	1,299
Amortization of intangible assets	14,551	16,862
Restructuring costs	2,395	384
Total operating expenses	254,681	240,211
Income from operations	19,104	11,239
Interest and other income (loss), net	370	(8,776)
Interest expense	(15,203)	(12,710)
Income (loss) before income taxes	4,271	(10,247)
Provision for income taxes	410	1,299
Net income (loss)	$3,861	$(11,546)
Basic net income (loss) per common share	$0.03	$(0.08)
Diluted net income (loss) per potential common share	$0.03	$(0.08)
Weighted average basic common shares outstanding	140,682	136,675
Weighted average dilutive potential common shares outstanding	142,184	136,675

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

CIENA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	Quarter Ended January 31,	
	2017	2016
Net income (loss)	$3,861	$(11,546)
Change in unrealized gain (loss) on available-for-sale securities, net of tax	(249)	22
Change in unrealized gain (loss) on foreign currency forward contracts, net of tax	1,425	(2,520)
Change in unrealized gain (loss) on forward starting interest rate swap, net of tax	4,492	(329)
Change in cumulative translation adjustments	490	(2,823)
Other comprehensive income (loss)	6,158	(5,650)
Total comprehensive income (loss)	$10,019	$(17,196)

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

CIENA CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	January 31, 2017	October 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$693,853	$777,615
Short-term investments	250,056	275,248
Accounts receivable, net	595,706	576,235
Inventories	284,595	211,251
Prepaid expenses and other	173,842	172,843
Total current assets	1,998,052	2,013,192
Long-term investments	109,934	90,172
Equipment, building, furniture and fixtures, net	293,150	288,406
Goodwill	267,169	266,974
Other intangible assets, net	127,847	146,711
Other long-term assets	63,942	68,120
Total assets	$2,860,094	$2,873,575
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$273,513	$235,942
Accrued liabilities and other short-term obligations	264,555	310,353
Deferred revenue	113,371	109,009
Current portion of long-term debt	190,122	236,241
Total current liabilities	841,561	891,545
Long-term deferred revenue	78,565	73,854
Other long-term obligations	121,320	124,394
Long-term debt, net	1,019,755	1,017,441
Total liabilities	$2,061,201	$2,107,234
Commitments and contingencies (Note 21)		
Stockholders' equity:		
Preferred stock – par value $0.01; 20,000,000 shares authorized; zero shares issued and outstanding	—	—
Common stock – par value $0.01; 290,000,000 shares authorized; 141,262,606 and 139,767,627 shares issued and outstanding	1,413	1,398
Additional paid-in capital	6,737,996	6,715,478
Accumulated other comprehensive loss	(18,171)	(24,329)
Accumulated deficit	(5,922,345)	(5,926,206)
Total stockholders' equity	798,893	766,341
Total liabilities and stockholders' equity	$2,860,094	$2,873,575

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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CIENA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended January 31,	
	2017	2016
Cash flows provided by operating activities:		
Net income (loss)	$3,861	$(11,546)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation of equipment, building, furniture and fixtures, and amortization of leasehold improvements	16,699	14,449
Share-based compensation costs	12,825	14,477
Amortization of intangible assets	18,864	20,506
Provision for inventory excess and obsolescence	5,431	7,016
Provision for warranty	553	4,971
Other	4,452	11,087
Changes in assets and liabilities:		
Accounts receivable	(21,956)	63,332
Inventories	(78,749)	(22,134)
Prepaid expenses and other	(1,004)	6,761
Accounts payable, accruals and other obligations	4,037	(80,014)
Deferred revenue	8,737	(13,925)
Net cash provided by (used in) operating activities	(26,250)	14,980
Cash flows used in investing activities:		
Payments for equipment, furniture, fixtures and intellectual property	(25,706)	(28,873)
Purchase of available for sale securities	(89,897)	(134,869)
Proceeds from maturities of available for sale securities	95,000	30,000
Settlement of foreign currency forward contracts, net	440	(295)
Net cash used in investing activities	(20,163)	(134,037)
Cash flows provided by financing activities:		
Payment of long-term debt	(46,296)	(14,639)
Payment of debt and equity issuance costs	—	(797)
Payment of capital lease obligations	(605)	(1,627)
Proceeds from issuance of common stock	9,708	8,870
Net cash used in financing activities	(37,193)	(8,193)
Effect of exchange rate changes on cash and cash equivalents	(156)	(3,400)
Net decrease in cash and cash equivalents	(83,762)	(130,650)
Cash and cash equivalents at beginning of period	777,615	790,971
Cash and cash equivalents at end of period	$693,853	$660,321
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$11,831	$9,902
Cash paid during the period for income taxes, net	$5,521	$3,702
Non-cash investing activities		
Purchase of equipment in accounts payable	$5,293	$8,782
Equipment acquired under capital lease	$—	$1,219
Construction in progress subject to build-to-suit lease	$—	$11,522

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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CIENA CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) INTERIM FINANCIAL STATEMENTS
The interim financial statements included herein for Ciena Corporation and its wholly owned subsidiaries (“Ciena”) have been prepared by Ciena, without audit, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). In the opinion of management, the financial statements included in this report reflect all normal recurring adjustments that Ciena considers necessary for the fair statement of the results of operations for the interim periods covered and of the financial position of Ciena at the date of the interim balance sheets. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. The Condensed Consolidated Balance Sheet as of October 31, 2016 was derived from audited financial statements, but does not include all disclosures required by GAAP. However, Ciena believes that the disclosures are adequate to understand the information presented herein. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with Ciena’s audited consolidated financial statements and the notes thereto included in Ciena’s annual report on Form 10-K for the fiscal year ended October 31, 2016.
Ciena has a 52 or 53-week fiscal year, with quarters ending on the Saturday nearest to the last day of January, April, July and October, respectively, of each year. Fiscal 2017 and 2016 are 52-week fiscal years. For purposes of financial statement presentation, each fiscal year is described as having ended on October 31, and the fiscal quarters are described as having ended on January 31, April 30 and July 31 of each fiscal year.

(2) SIGNIFICANT ACCOUNTING POLICIES

Business Combinations

Ciena records acquisitions using the purchase method of accounting. All of the assets acquired, liabilities assumed, contractual contingencies and contingent consideration are recognized at their fair value as of the acquisition date. The excess of the purchase price over the estimated fair values of the net tangible and net intangible assets acquired is recorded as goodwill. The application of the purchase method of accounting for business combinations requires management to make significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to allocate purchase price consideration properly between assets that are depreciated and amortized from goodwill. These assumptions and estimates include a market participant's use of the asset and the appropriate discount rates for a market participant. Ciena's estimates are based on historical experience, information obtained from the management of the acquired companies and, when appropriate, include assistance from independent third-party appraisal firms. Significant assumptions and estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and unpredictable. In addition, unanticipated events and circumstances may occur which may affect the accuracy or validity of such estimates.

Use of Estimates

The preparation of the financial statements and related disclosures in conformity with GAAP requires management to make estimates and judgments that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Estimates are used for selling prices for multiple element arrangements, shared-based compensation, convertible notes payable valuations, bad debts, valuation of inventories and investments, recoverability of intangible assets, other long-lived assets and goodwill, income taxes, warranty obligations, restructuring liabilities, derivatives, incentive compensation, contingencies and litigation. Ciena bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results may differ materially from management's estimates.

Cash and Cash Equivalents

Ciena considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. Any restricted cash collateralizing letters of credit is included in other current assets and other long-term assets depending upon the duration of the restriction.

Investments

Ciena's investments are classified as available-for-sale and are reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (loss). Ciena recognizes losses in the income statement when it determines that declines in the fair value of its investments below their cost basis are other-than-temporary. In determining whether a decline in fair value is other-than-temporary, Ciena considers various factors, including market price (when available), investment ratings, the financial condition and near-term prospects of the investee, the length of time and the extent to which the fair value has been less than Ciena's cost basis, and Ciena's intent and ability to hold the investment until maturity or for a period of time sufficient to allow for any anticipated recovery in market value. Ciena considers all marketable debt securities that it expects to convert to cash within one year or less to be short-term investments, with all others considered to be long-term investments.

Ciena has minority equity investments in privately held technology companies that are classified in other long-term assets. These investments are carried at cost because Ciena owns less than 20% of the voting equity and does not have the ability to exercise significant influence over the companies. Ciena monitors these investments for impairment and makes appropriate reductions to the carrying value when necessary. As of January 31, 2017, the combined carrying value of these investments was $6.0 million. Ciena has not estimated the fair value of these cost method investments because determining the fair value is not practicable. Ciena has not evaluated these investments for impairment as there have not been any events or changes in circumstances that Ciena believes would have had a significant adverse effect on the fair value of these investments.

Inventories

Inventories are stated at the lower of cost or market, with cost computed using standard cost, which approximates actual cost, on a first-in, first-out basis. Ciena records a provision for excess and obsolete inventory when an impairment has been identified.

Segment Reporting

Ciena's chief operating decision maker, its chief executive officer, evaluates the Company's performance and allocates resources based on multiple factors, including measures of segment profit (loss). Operating segments are defined as components of an enterprise that engage in business activities that may earn revenue and incur expense, for which discrete financial information is available, and for which such information is evaluated regularly by the chief operating decision maker for purposes of allocating resources and assessing performance. Ciena considers the following to be its operating segments for reporting purposes: (i) Networking Platforms, (ii) Software and Software-Related Services, and (iii) Global Services. See Note 20 below.

Goodwill

Goodwill is the excess of the purchase price over the fair values assigned to the net assets acquired in a business combination. Ciena tests goodwill for impairment on an annual basis, which it has determined to be the last business day of fiscal September each year. Ciena also tests goodwill for impairment between annual tests if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the reporting unit below its carrying value.

The first step in the process of assessing goodwill impairment is to compare the fair value of the reporting unit with the unit’s carrying amount, including goodwill. If this test indicates that the fair value is less than the carrying value, then step two as amended by ASU No. 2017-04, Simplifying the Test for Goodwill Impairment, adopted by Ciena in the first quarter of fiscal 2017, requires goodwill impairments to be measured on the basis of the fair value of the reporting unit relative to the reporting unit's carrying amount. A non-cash goodwill impairment charge would have the effect of decreasing earnings or increasing losses in such period. If Ciena is required to take a substantial impairment charge, its operating results would be materially adversely affected in such period.

Long-lived Assets

Long-lived assets include: equipment, building, furniture and fixtures; intangible assets; and maintenance spares. Ciena tests long-lived assets for impairment whenever triggering events or changes in circumstances indicate that the asset's carrying amount is not recoverable from its undiscounted cash flows. An impairment loss is measured as the amount by which the carrying amount of the asset or asset group exceeds its fair value. Ciena's long-lived assets are assigned to asset groups that represent the lowest level for which cash flows can be identified.

Equipment, Building, Furniture and Fixtures and Internal Use Software

Equipment, building, furniture and fixtures are recorded at cost. Depreciation and amortization are computed using the straight-line method over useful lives of two to five years for equipment and furniture and fixtures and the shorter of useful life or lease term for leasehold improvements.

Ciena establishes assets and liabilities for the estimated construction costs incurred under build-to-suit lease arrangements to the extent that Ciena is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease. See Notes 10 and 13 below.

Qualifying internal use software and website development costs incurred during the application development stage, which consist primarily of outside services and purchased software license costs, are capitalized and amortized straight-line over the estimated useful lives of two to five years.

Intangible Assets

Ciena has recorded finite-lived intangible assets as a result of several acquisitions. Finite-lived intangible assets are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the expected economic lives of the respective assets, up to seven years, which approximates the use of intangible assets.

Ciena has recorded in-process research and development projects acquired as the result of an acquisition as indefinite-lived intangible assets. Upon completion of the projects, the assets will be amortized on a straight-line basis over the expected economic life of the asset, which will be determined on that date. Should the project be determined to be abandoned, and the asset developed has no alternative use, the full value of the asset will be charged to expense.

Maintenance Spares

Maintenance spares are recorded at cost. Spares usage cost is expensed ratably over four years.

Concentrations

Substantially all of Ciena's cash and cash equivalents are maintained at a small number of major U.S. financial institutions. The majority of Ciena's cash equivalents consist of money market funds. Deposits held with banks may exceed the amount of insurance provided on such deposits. Because these deposits generally may be redeemed upon demand, management believes that they bear minimal risk.

Historically, a significant percentage of Ciena's revenue has been concentrated among sales to a small number of large communications service providers. Consolidation among Ciena's customers has increased this concentration. Consequently, Ciena's accounts receivable are concentrated among these customers. See Note 20 below.

Additionally, Ciena's access to certain materials or components is dependent upon sole or limited source suppliers. The inability of any of these suppliers to fulfill Ciena's supply requirements, or significant changes in supply cost, could affect future results. Ciena relies on a small number of contract manufacturers to perform the majority of the manufacturing for its products. If Ciena cannot effectively manage these manufacturers or forecast future demand, or if these manufacturers fail to deliver products or components on time, Ciena's business and results of operations may suffer.

Revenue Recognition

Ciena recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the price to the buyer is fixed or determinable; and collectibility is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and evidence of customer acceptance, when applicable, are used to verify delivery or services rendered. Ciena assesses whether the price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. Ciena assesses collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history. Revenue for maintenance services is deferred and recognized ratably over the period during which the services are performed. Shipping and handling fees billed to customers are included in revenue, with the associated expenses included in product cost of goods sold.

Software revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. In instances where final acceptance criteria of the software are specified by the customer, revenue is deferred until there are no uncertainties regarding customer acceptance.

Ciena limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations or subject to customer-specified return or refund privileges.

Revenue for multiple element arrangements is allocated to each unit of accounting based on the relative selling price of each delivered element, with revenue recognized for each delivered element when the revenue recognition criteria are met. Ciena determines the selling price for each deliverable based upon the selling price hierarchy for multiple-deliverable arrangements. Under this hierarchy, Ciena uses vendor-specific objective evidence ("VSOE") of selling price, if it exists, or third party evidence ("TPE") of selling price if VSOE does not exist. If neither VSOE nor TPE of selling price exists for a deliverable, Ciena uses its best estimate of selling price ("BESP") for that deliverable. For multiple element software arrangements where VSOE of undelivered maintenance does not exist, revenue for the entire arrangement is recognized over the maintenance term.

VSOE, when determinable, is established based on Ciena's pricing and discounting practices for the specific product or service when sold separately. In determining whether VSOE exists, Ciena requires that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range. Ciena has been unable to establish TPE of selling price because its go-to-market strategy differs from that of others in its markets, and the extent of customization and differentiated features and functions varies among comparable products or services from its peers. Ciena determines BESP based upon management-approved pricing guidelines, which consider multiple factors including the type of product or service, gross margin objectives, competitive and market conditions, and the go-to-market strategy, all of which can affect pricing practices.

Warranty Accruals

Ciena provides for the estimated costs to fulfill customer warranty obligations upon recognition of the related revenue. Estimated warranty costs include estimates for material costs, technical support labor costs and associated overhead. Warranty is included in cost of goods sold and is determined based upon actual warranty cost experience, estimates of component failure rates and management's industry experience. Ciena's sales contracts do not permit the right of return of the product by the customer after the product has been accepted.

Accounts Receivable, Net

Ciena's allowance for doubtful accounts is based on its assessment, on a specific identification basis, of the collectibility of customer accounts. Ciena performs ongoing credit evaluations of its customers and generally has not required collateral or other forms of security from them. In determining the appropriate balance for Ciena's allowance for doubtful accounts, management considers each individual customer account receivable in order to determine collectibility. In doing so, management considers creditworthiness, payment history, account activity and communication with the customer. If a customer's financial condition changes, Ciena may be required to record an allowance for doubtful accounts for that customer, which could negatively affect its results of operations.

Research and Development

Ciena charges all research and development costs to expense as incurred. Types of expense incurred in research and development include employee compensation, prototype equipment, consulting and third party services, depreciation, facility costs and information technology.

Advertising Costs

Ciena expenses all advertising costs as incurred.

Legal Costs

Ciena expenses legal costs associated with litigation defense as incurred.

Share-Based Compensation Expense

Ciena measures and recognizes compensation expense for share-based awards based on estimated fair values on the date of grant. Ciena estimates the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This model is affected by Ciena's stock price as well as estimates regarding a number of variables, including expected stock price volatility over the expected term of the award and projected employee stock option exercise behaviors. Ciena estimates the fair value of each restricted stock unit award based on the fair value of the underlying common stock on the date of grant. In each case, Ciena only recognizes expense in its Condensed Consolidated Statement of Operations for those stock options or restricted stock units that are expected ultimately to vest. Ciena recognizes the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, using graded vesting, which considers each performance period or tranche separately, based upon Ciena's determination of whether it is probable that the performance targets will be achieved. At the end of each reporting period, Ciena reassesses the probability of achieving the performance targets and the performance period required to meet those targets, and the expense is adjusted accordingly. Ciena uses the straight-line method to record expense for share-based awards with only service-based vesting. See Note 19 below.

Income Taxes

Ciena accounts for income taxes using an asset and liability approach that recognizes deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases, and for operating loss and tax credit carryforwards. In estimating future tax consequences, Ciena considers all expected future events other than the enactment of changes in tax laws or rates. Valuation allowances are provided if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

In the ordinary course of business, transactions occur for which the ultimate outcome may be uncertain. In addition, tax authorities periodically audit Ciena’s income tax returns. These audits examine significant tax filing positions, including the timing and amounts of deductions and the allocation of income tax expenses among tax jurisdictions. Ciena is currently under audit in India for 2010 and 2012 through 2014 and in Canada for 2011 through 2013. Management does not expect the outcome of these audits to have a material adverse effect on Ciena’s consolidated financial position, results of operations or cash flows. Ciena’s major tax jurisdictions and the earliest open tax years are as follows: United States (2013), United Kingdom (2014), Canada (2011) India (2010) and Brazil (2012). Limited adjustments can be made to Federal U.S. tax returns in earlier years in order to reduce net operating loss carryforwards. Ciena classifies interest and penalties related to uncertain tax positions as a component of income tax expense.

Ciena has not provided for U.S. deferred income taxes on the cumulative unremitted earnings of its non-U.S. affiliates, as it plans to indefinitely reinvest cumulative unremitted foreign earnings outside the U.S., and it is not practicable to determine the unrecognized deferred income taxes. These cumulative unremitted foreign earnings relate to ongoing operations in foreign jurisdictions and are required to fund foreign operations, capital expenditures and future expansion requirements. See Note 21 below.

Ciena recognizes windfall tax benefits associated with the exercise of stock options or release of restricted stock units directly to stockholders’ equity only when realized. A windfall tax benefit occurs when the actual tax benefit realized by Ciena upon an employee’s disposition of a share-based award exceeds the deferred tax asset, if any, associated with the award that Ciena had recorded. When assessing whether a tax benefit relating to share-based compensation has been realized, Ciena follows the “with-and-without” method. Under the with-and-without method, the windfall is considered realized and recognized for financial statement purposes only when an incremental benefit is provided after considering all other tax benefits including Ciena’s net operating losses. The with-and-without method results in the windfall from share-based compensation awards always being effectively the last tax benefit to be considered. Consequently, the windfall attributable to share-based compensation will not be considered realized in instances where Ciena’s net operating loss carryover (that is unrelated to windfalls) is sufficient to offset the current year’s taxable income before considering the effects of current-year windfalls.

Loss Contingencies

Ciena is subject to the possibility of various losses arising in the ordinary course of business. These may relate to disputes, litigation and other legal actions. Ciena considers the likelihood of loss or the incurrence of a liability, as well as Ciena's ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. Ciena regularly evaluates current information available to it in order to determine whether any accruals should be adjusted and whether new accruals are required.

Fair Value of Financial Instruments

The carrying value of Ciena's cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximates fair market value due to the relatively short period of time to maturity. For information related to the fair value of Ciena's convertible notes and term loans, see Note 16 below.

Fair value for the measurement of financial assets and liabilities is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. Ciena utilizes a valuation hierarchy for disclosure of the inputs for fair value measurement. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities;

- Level 2 inputs are quoted prices for identical or similar assets or liabilities in less active markets or model-derived valuations in which significant inputs are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument; and

- Level 3 inputs are unobservable inputs based on Ciena's assumptions used to measure assets and liabilities at fair value.

By distinguishing between inputs that are observable in the marketplace, and therefore more objective, and those that are unobservable, and therefore more subjective, the hierarchy is designed to indicate the relative reliability of the fair value measurements. A financial asset's or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Restructuring

From time to time, Ciena takes actions to better align its workforce, facilities and operating costs with perceived market opportunities, business strategies and changes in market and business conditions. Ciena recognizes a liability for the cost associated with an exit or disposal activity in the period in which the liability is incurred, except for one-time employee termination benefits related to a service period, typically of more than 60 days, which are accrued over the service period. See Note 3 below.

Foreign Currency

Certain of Ciena's foreign branch offices and subsidiaries use the U.S. Dollar as their functional currency because Ciena Corporation, as the U.S. parent entity, exclusively funds the operations of these branch offices and subsidiaries. For those subsidiaries using the local currency as their functional currency, assets and liabilities are translated at exchange rates in effect at the balance sheet date, and the statement of operations is translated at a monthly average rate. Resulting translation adjustments are recorded directly to a separate component of stockholders' equity. Where the monetary assets and liabilities are transacted in a currency other than the entity's functional currency, re-measurement adjustments are recorded in interest and other income (loss), net on the Condensed Consolidated Statement of Operations. See Note 4 below.

Derivatives

From time to time, Ciena uses foreign currency forward contracts to reduce variability in certain forecasted non-U.S. Dollar denominated cash flows. Generally, these derivatives have maturities of 12 months or less. Ciena also has interest rate hedge arrangements to reduce variability in certain forecasted interest expense associated with its term loans. All of these derivatives are designated as cash flow hedges. At the inception of the cash flow hedge, and on an ongoing basis, Ciena assesses whether the derivative has been effective in offsetting changes in cash flows attributable to the hedged risk during the hedging period. The effective portion of the derivative's net gain or loss is initially reported as a component of accumulated other comprehensive income (loss), and, upon occurrence of the forecasted transaction, is subsequently reclassified to the line item in the Condensed Consolidated Statement of Operations to which the hedged transaction relates. Any net gain or loss associated with the ineffectiveness of the hedging instrument is reported in interest and other income (loss), net. To date, no ineffectiveness has occurred.

From time to time, Ciena uses foreign currency forward contracts to hedge certain balance sheet exposures. These forward contracts are not designated as hedges for accounting purposes, and any net gain or loss associated with these derivatives is reported in interest and other income (loss), net on the Condensed Consolidated Statement of Operations.

Ciena records derivative instruments in the Condensed Consolidated Statements of Cash Flows within operating, investing, or financing activities consistent with the cash flows of the hedged items.

See Notes 6 and 14 below.

Computation of Net Income (Loss) per Share

Ciena calculates basic earnings per share ("EPS") by dividing earnings attributable to common stock by the weighted average number of common shares outstanding for the period. Diluted EPS includes other potential dilutive shares that would be outstanding if securities or other contracts to issue common stock were exercised or converted into common stock. Ciena uses a dual presentation of basic and diluted EPS on the face of its income statement. A reconciliation of the numerator and denominator used for the basic and diluted EPS computations is set forth in Note 18 below.

Software Development Costs

Ciena develops software for sale to its customers. GAAP requires the capitalization of certain software development costs that are incurred subsequent to the date technological feasibility is established and prior to the date the product is generally available for sale. The capitalized cost is then amortized straight-line over the estimated life of the product. Ciena defines technological feasibility as being attained at the time a working model is completed. To date, the period between Ciena achieving technological feasibility and the general availability of such software has been short, and software development cost qualifying for capitalization has been insignificant. Accordingly, Ciena has not capitalized any software development costs.

Newly Issued Accounting Standards - Effective

In April 2015, Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). ASU 2015-03 requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying value of that debt liability, consistent with debt discounts. ASU 2015-03 is to be applied on a retrospective basis and represents a change in accounting principle. In August 2015, the FASB issued Accounting Standards Update No. 2015-15, “Interest — Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements — Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting” (“ASU 2015-15”), which clarifies the treatment of debt issuance costs from line-of-credit arrangements after the adoption of ASU 2015-03. In particular, ASU 2015-15 clarifies that the SEC staff would not object to an entity deferring and presenting debt issuance costs related to a line-of-credit arrangement as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of such arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. Ciena adopted these ASU's during the first quarter of fiscal 2017. The adoption of ASU 2015-03 resulted in the reclassification of unamortized debt issuance costs related to Ciena's convertible notes and term loans from other long-term assets to current portion of long-term debt and long-term debt, net in Ciena's Consolidated Balance sheets in the amount of $7.9 million at January 31, 2017 and $8.9 million at October 31, 2016. As permitted by ASU 2015-15, Ciena elected not to reclassify unamortized debt issuance costs associated with its ABL Credit Facility (described in Note 17 below) and continue to present such capitalized costs in other assets.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment ("ASU 2017-04"), which simplifies the accounting for goodwill impairments by eliminating step two from the goodwill impairment test. ASU 2017-04 requires goodwill impairments to be measured on the basis of the fair value of the reporting unit relative to the reporting unit's carrying amount rather than on the basis of the implied amount of goodwill relative to the goodwill balance of the reporting unit. ASU 2017-04 is effective for annual and interim impairment tests for periods beginning after December 15, 2021. Early adoption is allowed for annual and interim impairment tests occurring after January 1, 2017. Ciena has elected to adopt ASU 2017-04 during the first quarter of fiscal 2017.

Newly Issued Accounting Standards - Not Yet Effective

In May 2014, FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. The standard will be effective for Ciena beginning in the first quarter of fiscal 2019. For multiple element software arrangements where VSOE of undelivered maintenance does not exist, Ciena currently recognizes revenue for the entire arrangement over the maintenance term. Ciena expects that the adoption of this ASU will require Ciena to determine the stand alone selling price for each of the elements at the contract inception and consequently Ciena expects certain software deliverables will be recognized at a point in time rather than over a period of time. Ciena is continuing to evaluate other possible impacts of the adoption of this ASU on its Consolidated Financial Statements and disclosures, as well as the transition method.

In February 2016, FASB issued ASU No. 2016-02, Leases, which requires an entity to recognize assets and liabilities on the balance sheet for the rights and obligations created by leased assets and to provide additional disclosures. ASU 2016-02 is effective for Ciena beginning in the first quarter of fiscal 2020. Under current GAAP, the majority of Ciena’s leases for its properties are considered operating leases and Ciena expects that the adoption of this ASU will require these leases to be classified as financing leases and to be recognized as assets and liabilities on Ciena’s balance sheet. Ciena is continuing to evaluate other possible impacts of the adoption of this ASU on its Consolidated Financial Statements and disclosures.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which provides guidance on several aspects of accounting for share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification on the statement of cash flows. ASU 2016-09 is effective for Ciena beginning in the first quarter of fiscal 2018. Under the new guidance, Ciena would recognize all excess tax benefits previously unrecognized, along with any valuation allowance, on a modified retrospective basis as a cumulative-effect adjustment to retained earnings as of the date of adoption of this updated standard.

(3) RESTRUCTURING COSTS

Ciena has undertaken a number of restructuring activities intended to reduce expense and better align its workforce and costs with market opportunities, product development and business strategies. The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the three months ended January 31, 2017 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2016	$ 868	$ 1,970	$2,838
Additional liability recorded	2,008	387	2,395
Cash payments	(2,512)	(652)	(3,164)
Balance at January 31, 2017	$ 364	$ 1,705	$2,069
Current restructuring liabilities	$ 364	$ 1,269	$1,633
Non-current restructuring liabilities	$ —	$ 436	$436

The following table sets forth the restructuring activity and balance of the restructuring liability accounts for the three months ended January 31, 2016 (in thousands):

	Workforce reduction	Consolidation of excess facilities	Total
Balance at October 31, 2015	$ 591	$ 688	$1,279
Additional liability recorded	393	—	393
Adjustment to previous estimates	—	(9)	(9)
Cash payments	(613)	(148)	(761)
Balance at January 31, 2016	$ 371	$ 531	$902
Current restructuring liabilities	$ 371	$ 336	$707
Non-current restructuring liabilities	$ —	$ 195	$195

(4) INTEREST AND OTHER INCOME (LOSS), NET

The components of interest and other income (loss), net, are as follows (in thousands):

	Quarter Ended January 31,	
	2017	2016
Interest income	$1,282	$686
Gains (losses) on non-hedge designated foreign currency forward contracts	1,024	(4,614)
Foreign currency exchange losses	(2,417)	(4,377)
Other	481	(471)
Interest and other income (loss), net	$370	$(8,776)

Ciena Corporation, as the U.S. parent entity, uses the U.S. Dollar as its functional currency; however, some of its foreign branch offices and subsidiaries use the local currency as their functional currency. During the first three months of fiscal 2017 and the first three months of fiscal 2016, Ciena recorded $2.4 million and $4.4 million in foreign currency exchange rate losses, respectively, as a result of monetary assets and liabilities that were transacted in a currency other than the entity's functional currency, and the re-measurement adjustments were recorded in interest and other income (loss), net on the Condensed Consolidated Statement of Operations. From time to time, Ciena uses foreign currency forwards to hedge these balance sheet exposures. These forwards are not designated as hedges for accounting purposes and any net gain or loss associated with these derivatives is reported in interest and other income (loss), net on the Condensed Consolidated Statement of Operations. During the first three months of fiscal 2017 and fiscal 2016, Ciena recorded gains of $1.0 million and losses of $4.6 million, respectively, from non-hedge designated foreign currency forward contracts.

(5) SHORT-TERM AND LONG-TERM INVESTMENTS

As of the dates indicated, investments are comprised of the following (in thousands):

	January 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations:				
Included in short-term investments	$230,090	$ 60	(46)	$230,104
Included in long-term investments	110,035	5	(106)	109,934
	$340,125	$ 65	$ (152)	$340,038
Commercial paper:				
Included in short-term investments	$19,952	—	—	$19,952
	$19,952	$ —	$ —	$19,952

	October 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government obligations:				
Included in short-term investments	$260,125	$ 140	$ (6)	$260,259
Included in long-term investments	90,145	57	(30)	90,172
	$350,270	$ 197	$ (36)	$350,431
Commercial paper:				
Included in short-term investments	$14,989	—	—	$14,989
	$14,989	$ —	$ —	$14,989

The following table summarizes the final legal maturities of debt investments at January 31, 2017 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than one year	$250,042	$250,056
Due in 1-2 years	110,035	109,934
	$360,077	$359,990

(6) FAIR VALUE MEASUREMENTS

As of the date indicated, the following table summarizes the assets and liabilities that are recorded at fair value on a recurring basis (in thousands):

	January 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$529,967	$—	$ —	$529,967
U.S. government obligations	—	340,038	—	340,038
Commercial paper	—	39,925	—	39,925
Foreign currency forward contracts	—	361	—	361
Total assets measured at fair value	$529,967	$380,324	$ —	$910,291
Liabilities:				
Foreign currency forward contracts	$—	$496	$ —	$496
Forward starting interest rate swap	—	1,475	—	1,475
Total liabilities measured at fair value	$—	$1,971	$ —	$1,971

	October 31, 2016			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$625,277	$—	$ —	$625,277
U.S. government obligations	—	350,431	—	350,431
Commercial paper	—	69,959	—	69,959
Foreign currency forward contracts	—	175	—	175
Total assets measured at fair value	$625,277	$420,565	$ —	$1,045,842
Liabilities:				
Foreign currency forward contracts	$—	$1,396	$ —	$1,396
Forward starting interest rate swap	—	5,967	—	5,967
Total liabilities measured at fair value	$—	$7,363	$ —	$7,363

As of the date indicated, the assets and liabilities above are presented on Ciena’s Condensed Consolidated Balance Sheet as follows (in thousands):

	January 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$529,967	$19,973	$ —	$549,940
Short-term investments	—	250,056	—	250,056
Prepaid expenses and other	—	361	—	361
Long-term investments	—	109,934	—	109,934
Total assets measured at fair value	$529,967	$380,324	$ —	$910,291
Liabilities:				
Accrued liabilities	$—	$496	$ —	$496
Other long-term obligations	—	1,475	—	1,475
Total liabilities measured at fair value	$—	$1,971	$ —	$1,971

	October 31, 2016			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents	$625,277	$54,970	$ —	$680,247
Short-term investments	—	275,248	—	275,248
Prepaid expenses and other	—	175	—	175
Long-term investments	—	90,172	—	90,172
Total assets measured at fair value	$625,277	$420,565	$ —	$1,045,842
Liabilities:				
Accrued liabilities	$—	$1,396	$ —	$1,396
Other long-term obligations	—	5,967	—	5,967
Total liabilities measured at fair value	$—	$7,363	$ —	$7,363

Ciena did not have any transfers between Level 1 and Level 2 fair value measurements during the periods presented.

(7) ACCOUNTS RECEIVABLE

As of January 31, 2017, one customer accounted for 10.5% of Ciena's net accounts receivable and as of October 31, 2016, a different customer accounted for 10.4% of Ciena's net accounts receivable. Ciena has not historically experienced a significant amount of bad debt expense. The allowance for doubtful accounts was $4.0 million as of January 31, 2017 and October 31, 2016.