NEOPHOTONICS CORP
Form 10-Q
November 10, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2014

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: 001-35061

NeoPhotonics Corporation

(Exact name of registrant as specified in its charter)

Delaware	94-3253730
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2911 Zanker Road

San Jose, California 95134

(Address of principal executive offices, zip code)

(408) 232-9200

(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 ("Exchange Act") 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 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 x No ¨

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

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

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

As of October 31, 2014, there were 32,522,714 shares of the registrant's Common Stock outstanding.

NEOPHOTONICS CORPORATION

For the Quarter Ended September 30, 2014

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except per share data)	As of September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$35,269	$ 57,101
Short-term investments	—	17,916
Restricted cash and investments	10,401	2,138
Accounts receivable, net of allowance for doubtful accounts	79,174	64,533
Inventories, net	58,819	64,908
Prepaid expenses and other current assets	13,830	9,977
Total current assets	197,493	216,573
Property, plant and equipment, net	62,352	68,851
Restricted cash and investments, non-current	12,250	—
Purchased intangible assets, net	11,600	15,005
Other long-term assets	1,959	1,798
Total assets	$285,654	$ 302,227
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$52,378	$ 48,569
Notes payable and short-term borrowing	20,677	9,738
Current portion of long-term debt	10,198	10,325
Accrued and other current liabilities	19,002	23,643
Total current liabilities	102,255	92,275
Long-term debt, net of current portion	15,448	24,150
Deferred income tax liabilities	1,165	1,004
Other noncurrent liabilities	7,634	7,987
Total liabilities	126,502	125,416

Commitments and contingencies (Note 10)

Stockholders' equity:		
Preferred stock, $0.0025 par value		
At September 30, 2014 and December 31, 2013: 10,000 shares authorized, no shares issued or outstanding	—	—
Common stock, $0.0025 par value		
At September 30, 2014: 100,000 shares authorized, 32,523 shares issued and outstanding;		
At December 31, 2013: 100,000 shares authorized, 31,572 shares issued and outstanding	81	79
Additional paid-in capital	454,108	447,467
Accumulated other comprehensive income	8,689	11,687
Accumulated deficit	(303,726)	(282,422)
Total stockholders' equity	159,152	176,811
Total liabilities and stockholders' equity	$285,654	$ 302,227

See accompanying Notes to Condensed Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Revenue	$81,576	$76,814	$227,195	$207,867
Cost of goods sold	61,512	58,635	178,763	162,330
Gross profit	20,064	18,179	48,432	45,537
Operating expenses:				
Research and development	11,842	12,227	35,983	33,021
Sales and marketing	3,075	3,580	10,057	10,515
General and administrative	6,712	8,905	23,892	21,853
Restructuring charges	504	450	504	775
Amortization of purchased intangible assets	378	381	1,136	1,128
Adjustment to fair value of contingent consideration	—	1,026	—	1,026
Escrow settlement gain	—	—	(3,886)	—
Acquisition-related transaction costs	—	126	—	5,317
Total operating expenses	22,511	26,695	67,686	73,635
Loss from operations	(2,447)	(8,516)	(19,254)	(28,098)
Interest income	52	66	155	269
Interest expense	(375)	(251)	(937)	(756)
Other income (expense), net	1,735	115	493	(432)
Total interest and other income (expense), net	1,412	(70)	(289)	(919)
Loss before income taxes	(1,035)	(8,586)	(19,543)	(29,017)
Provision for income taxes	(902)	(777)	(1,761)	(870)
Net loss	$(1,937)	$(9,363)	$(21,304)	$(29,887)
Basic and diluted net loss per share	$(0.06)	$(0.30)	$(0.67)	$(0.97)
Basic and diluted weighted average shares used to compute net loss per share	32,383	31,185	31,930	30,848

See accompanying Notes to Condensed Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2014	2013	2014	2013
Net loss	$ (1,937)	$ (9,363)	$ (21,304)	$ (29,887)
Foreign currency translation adjustments, net of tax of zero	(2,281)	533	(3,118)	1,394
Defined benefit pension plans adjustment, net of tax of $73	—	—	118	—
Unrealized gains (losses) on investments, net of tax of zero	—	3	3	(51)
Comprehensive loss	$ (4,218)	$ (8,827)	$ (24,301)	$ (28,544)

See accompanying Notes to Condensed Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	Nine Months Ended September 30, 2014	2013
Cash flows from operating activities		
Net loss	$(21,304)	$(29,887)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	17,492	14,863
Stock-based compensation expense	4,812	4,265
Deferred taxes	76	(6)
Investment-related amortization and accrued interest	197	859
Loss on disposal of property and equipment	131	125
Allowance for doubtful accounts	(289)	(22)
Adjustment to fair value of penalty payment derivative	287	100
Foreign currency remeasurement and other, net	(1,233)	582
Change in assets and liabilities, net of acquisition related effects:		
Accounts receivable	(14,781)	(7,629)
Inventories, net	5,224	(6,183)
Prepaid expenses and other assets	(4,270)	(1,556)
Accounts payable	4,974	13,732
Accrued and other liabilities	(2,744)	5,750
Net cash used in operating activities	(11,428)	(5,007)
Cash flows from investing activities		
Purchase of property, plant and equipment	(9,124)	(14,346)
Purchase of marketable securities	(9,654)	(57,893)
Proceeds from sale of marketable securities	9,634	45,247
Proceeds from maturity of securities	9,448	49,155
(Increase) decrease in restricted cash	(12,251)	1,037
Acquisition, net of notes payable	—	(13,128)
Proceeds from disposition of property, plant and equipment	8	92
Net cash (used in) provided by investing activities	(11,939)	10,164
Cash flows from financing activities		
Proceeds from exercise of stock options and issuance of stock under ESPP	1,992	2,200
Tax withholding on restricted stock units	(370)	(483)
Payment of acquisition-related contingent consideration	(1,985)	—
Proceeds from bank loans	8,105	26,443
Repayment of bank loans	(8,651)	(22,360)
Proceeds from issuance of notes payable	18,822	14,152
Repayment of notes payable	(15,851)	(18,457)
Net cash provided by financing activities	2,062	1,495
Effect of exchange rates on cash and cash equivalents	(527)	64
Net (decrease) increase in cash and cash equivalents	(21,832)	6,716

Cash and cash equivalents at the beginning of the period	57,101	36,940
Cash and cash equivalents at the end of the period	$35,269	$43,656
Supplemental disclosure of noncash investing and financing activities:		
Transfer of short-term investments to restricted investments	$8,295	$—
Changes in accounts payable and accrued liabilities related to property, plant and equipment	302	(734)
Issuance of notes to the seller of acquired business	—	11,130

See accompanying Notes to Condensed Consolidated Financial Statements.

NeoPhotonics Corporation

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Basis of presentation and significant accounting policies

Basis of Presentation and Consolidation

The condensed consolidated financial statements of NeoPhotonics Corporation ("NeoPhotonics" or the "Company") as of September 30, 2014 and December 31, 2013 and for the three and nine months ended September 30, 2014 and 2013, have been prepared in accordance with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). In accordance with those rules and regulations, the Company has omitted certain information and notes normally provided in the Company's annual consolidated financial statements. In the opinion of management, the condensed consolidated financial statements contain all adjustments, consisting only of normal recurring items, except as otherwise noted, necessary for the fair presentation of the Company's financial position and results of operations for the interim periods. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles ("U.S. GAAP"). These condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated.

Certain Significant Risks and Uncertainties

The Company operates in a dynamic industry and, accordingly, can be affected by a variety of factors. For example, any of the following areas could have a negative effect on the Company in terms of its future financial position, results of operations or cash flows: the general state of the U.S. and world economies, the highly cyclical nature of the industries the Company serves; the loss of any of a small number of its larger customers; ability to obtain additional financing; inability to meet certain debt covenants; failure to successfully integrate completed acquisitions; fundamental changes in the technology underlying the Company's products; the hiring, training and retention of key employees; successful and timely completion of product design efforts; and new product design introductions by competitors.

Concentration

In the three months ended September 30, 2014, Huawei Technologies ("Huawei") and Ciena Corporation accounted for 35% and 17% of the Company's total revenue, respectively, and the Company's top ten customers represented 88% of its total revenue. In the nine months ended September 30, 2014, Huawei Technologies, Ciena Corporation and Alcatel-Lucent SA accounted for 36%, 15% and 11% of the Company's total revenue, respectively, and the Company's top ten customers represented 88% of its total revenue.

As of September 30, 2014, three customers accounted for 39%, 14% and 10% of the Company's total accounts receivable. As of December 31, 2013, two customers accounted for 14% and 10% of the Company's total accounts receivable.

Use of Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenue and expenses during the reporting period. Significant estimates made by management include: the useful lives of property, plant and equipment and intangible assets as well as future cash flows to be generated by those assets; fair values of identifiable assets acquired and liabilities assumed in business combinations; allowances for doubtful accounts; valuation allowances for deferred tax assets; write off of excess and obsolete inventories and the valuations, warranty reserves and recognition of stock-based compensation, among others. Actual results could differ from these estimates.

Summary of Significant Accounting Policies

There have been no changes in the Company's significant accounting policies for the three and nine months ended September 30, 2014, as compared to the significant accounting policies described in its Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-15, Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"), which requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. An entity must provide certain disclosures in its financial statements if conditions or events raise substantial doubt about its ability to continue as a going concern. ASU 2014-15 is effective for the Company's annual reporting periods ending December 31, 2016, and interim periods thereafter, with early adoption permitted. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures ("ASU 2014-11"). The standard (1) requires companies to account for repurchase-to-maturity transactions as secured borrowings, (2) requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, resulting in secured borrowing accounting for repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings. ASU 2014-11 is effective for the interim and annual reporting periods beginning after December 15, 2014. Early adoption is not permitted for public entities. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 will be effective for the Company on January 1, 2017. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU 2014-08") which raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. ASU 2014-08 is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals that have not been reported in financial statements previously issued. The adoption of this guidance will not impact the consolidated financial statements unless the Company disposes of operations in the future.

In July 2013, the FASB issued amendments to the FASB Accounting Standard Codification on Income Taxes, to improve the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance is expected to reduce diversity in practice and is expected to better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exists. This guidance is effective for reporting periods beginning after December 15, 2013. The adoption of this guidance did not have an impact on the Company's consolidated financial statements.

Note 2. Net loss per share

The following table sets forth the computation of the basic and diluted net loss per share for the periods indicated (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Numerator:				
Net loss	$(1,937)	$(9,363)	$(21,304)	$(29,887)
Denominator:				
Weighted average shares used to compute basic and diluted net loss per share	32,383	31,185	31,930	30,848
Basic and diluted net loss per share	$(0.06)	$(0.30)	$(0.67)	$(0.97)

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The Company has excluded the impact of the following outstanding employee stock options, restricted stock units, common stock warrants and shares expected to be issued under its employee stock purchase plan from the computation of diluted net loss per share, as their effect would have been antidilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Employee stock options	3,735	3,980	3,735	3,980
Restricted stock units	668	1,136	668	1,136
Employee stock purchase plan	258	236	258	236
Common stock warrants	4	4	4	4
	4,665	5,356	4,665	5,356

Note 3. Cash, cash equivalents, short-term investments, and restricted cash and investments

The following table summarizes the Company's cash, cash equivalents, short-term investments, and restricted cash and investments at September 30, 2014 and December 31, 2013 (in thousands):

	September 30, 2014	December 31, 2013
Cash and cash equivalents:		
Cash	$ 35,269	$ 50,550
Cash equivalents	—	6,551
Cash and cash equivalents	$ 35,269	$ 57,101
Short-term investments	$ —	$ 17,916
Restricted cash and investments:		
Restricted cash and investments	$ 10,401	$ 2,138
Restricted cash and investments, non-current	12,250	—
Total restricted cash and investments	$ 22,651	$ 2,138

The Company classifies cash equivalents and investments in marketable securities as restricted cash and investments on its condensed consolidated balance sheets, respectively, for compensating balance requirements related to (i) its term loan facility with Comerica Bank in the U.S., (ii) the notes payable issued to its suppliers in China and (iii) notes payable to its subsidiary in China in exchange for intercompany accounts payable (see Note 8).

The following table summarizes the Company's unrealized gains and losses related to its cash equivalents, short-term investments, and restricted cash and investments in marketable securities designated as available-for-sale (in thousands):

	As of September 30, 2014	As of December 31, 2013

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash equivalents:								
Money market funds	$—	$ —	$ —	$—	$11	$ —	$ —	$11
Time deposits	—	—	—	—	6,540	—	—	6,540
Total	—	—	—	—	6,551	—	—	6,551
Short-term investments and restricted cash and investments:								
Money market funds	15,495	—	—	15,495	4,577	—	—	4,577
Corporate bonds	2,007	6	—	2,013	6,708	3	(5)	6,706
Foreign bonds and notes	—	—	—	—	4,827	5	—	4,832
Variable rate demand notes	1,700	—	—	1,700	1,801	—	—	1,801
Total	19,202	6	—	19,208	17,913	8	(5)	17,916
Total marketable securities	$19,202	$ 6	$ —	$19,208	$24,464	$ 8	$ (5)	$24,467

The following is based on the maturity dates of the underlying marketable securities (in thousands):

	September 30, 2014	December 31, 2013
Less than 1 year	$ 15,495	$ 20,658
Due in 1 to 2 years	2,013	2,008
Due in 2 to 5 years	—	—
Due after 5 years	1,700	1,801
Total	$ 19,208	$ 24,467

Realized gains and losses on the sale of marketable securities during the three and nine months ended September 30, 2014 and 2013 were immaterial. The Company did not recognize any impairment losses on its marketable securities during the three and nine months ended September 30, 2014 or 2013. As of September 30, 2014, the Company did not have any investments in marketable securities that were in an unrealized loss position for a period in excess of 12 months.

Note 4. Fair value disclosures

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the Company's assets that are measured at fair value on a recurring basis (in thousands):

	As of September 30, 2014				As of December 31, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash, cash equivalents, restricted cash and investments								
Money market funds	$15,495	$ —	$ —	$ 15,495	$4,588	$—	$ —	$4,588
Time deposits	—	—	—	—	—	6,540	—	6,540
Corporate bonds	—	2,013	—	2,013	—	6,706	—	6,706
U.S. federal agencies	—	—	—	—	—	—	—	—
Foreign bonds and notes	—	—	—	—	—	4,832	—	4,832
Variable rate demand notes	—	1,700	—	1,700	—	1,801	—	1,801
Total	$15,495	$ 3,713	$ —	$ 19,208	$4,588	$19,879	$ —	$24,467
Mutual funds held in Rabbi Trust	$410	$ —	$ —	$ 410	$442	$—	$ —	$442

The Company offers a Non-Qualified Deferred Compensation Plan (“NQDC Plan”) to a select group of its highly compensated employees. The NQDC Plan provides participants the opportunity to defer payment of certain compensation as defined in the NQDC Plan. A Rabbi Trust has been established to fund the NQDC Plan obligation, which was fully funded at September 30, 2014. The assets held by the Rabbi Trust are substantially in the form of exchange traded mutual funds and are included in the Company’s other long-term assets on its condensed consolidated balance sheets as of September 30, 2014 and December 31, 2013.

The following table presents the Company's liabilities that are measured at fair value on a recurring basis (in thousands):

	As of September 30, 2014				As of December 31, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Contingent consideration (Note 10)	$—	$ —	$ —	$—	$—	$ —	$ 1,985	$ 1,985
Penalty payment derivative (Note 10)	$—	$ —	$ 526	$526	$—	$ —	$ 239	$ 239

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

There were no assets or liabilities measured at fair value on a nonrecurring basis as of September 30, 2014 or December 31, 2013.

Assets and Liabilities Not Measured at Fair Value

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and notes payable approximate their fair values due to the short-term nature and liquidity of these financial instruments.

The fair values of the Company's long-term debt have been calculated using an estimate of the interest rate the Company would have had to pay on the issuance of liabilities with a similar maturity and discounting the cash flows at that rate which it considers to be a level 2 fair value measurement. The fair values do not necessarily give an indication of the amount that the Company would currently have to pay to extinguish any of this debt.

The fair value of the Company's variable rate bank borrowings and acquisition-related debt was not materially different than its carrying value as of September 30, 2014 and December 31, 2013 as the interest rates approximated rates currently available to the Company.

Note 5. Business combination

On March 29, 2013 (the "closing date") the Company acquired certain assets and assumed certain liabilities related to the semiconductor Optical Components Business Unit (the "OCU") of LAPIS Semiconductor Co., Ltd., a wholly owned subsidiary of Rohm Co., Ltd ("LAPIS") of Japan with the intention of operating the OCU as an ongoing business. The business is now known as NeoPhotonics Semiconductor Godo Keisha ("NeoPhotonics Semiconductor").

Total consideration for NeoPhotonics Semiconductor was $24.3 million, including cash of $13.1 million and notes payable of $11.1 million (see Note 8). The cash paid included $2.0 million that was withheld and placed into escrow to cover certain indemnity obligations.

In connection with the acquisition, the Company incurred approximately $5.3 million in acquisition-related transaction costs during the nine months ended September 30, 2013 related to investment banking, legal, accounting and other professional services and transfer taxes related to real property acquired. The acquisition costs were expensed as incurred and were included in operating expenses in the Company's condensed consolidated statement of operations.

The Company accounted for its acquisition of the NeoPhotonics Semiconductor assets and assumed liabilities as a business combination. NeoPhotonics Semiconductor's tangible and identifiable intangible assets acquired and liabilities assumed were recorded based upon their estimated fair values as of the closing date of the acquisition. The estimated fair values of the identifiable assets acquired and liabilities assumed approximated the purchase price; therefore, no goodwill was recorded. The following table summarizes the acquisition accounting and the tangible and intangible assets acquired as of the date of acquisition and subsequent adjustments (in thousands):

Total purchase consideration:	
Cash paid	$13,128
Notes payable	11,130
	$24,258
Liabilities assumed:	
Pension and retirement obligations	$6,471
Other compensation-related liabilities	1,083
Other current liabilities	1,265
	$8,819
Fair value of assets acquired:	
Inventory	$13,309
Other current assets	35
Land, property, plant and equipment	14,433
Intangible assets acquired:	

Developed technology	2,120
Customer relationships	3,180
	$33,077

The following unaudited supplemental pro forma information presents the combined results of operations of NeoPhotonics Corporation and NeoPhotonics Semiconductor for the nine months ended September 30, 2013 as though the companies had been combined as of the beginning of the period presented. The pro forma financial information includes elimination of $5.3 million of transaction costs and $1.9 million of revenue and $1.8 million of costs related to sales from NeoPhotonics Semiconductor to the Company.

The unaudited pro forma results do not assume any operating efficiencies as a result of the consolidation of operations (in thousands, except per share data):

	Nine Months Ended September 30, 2013
Revenue	$ 220,558
Net loss	$ (18,942)
Basic and diluted net loss per share	$ (0.61)

Note 6. Balance sheet components

Restricted cash and investments

Restricted cash and investments consist of the following (See Note 8) (in thousands):

	September 30, 2014	December 31, 2013
Restricted in connection with notes payable	$ 3,401	$ 2,138
Restricted in connection with Comerica Bank term loan	19,250	—
Total restricted cash and investments	$ 22,651	$ 2,138
Reported as:		
Restricted cash and investments	$ 10,401	$ 2,138
Restricted cash and investments, non-current	12,250	—
Total restricted cash and investments	$ 22,651	$ 2,138

Accounts receivable, net

Accounts receivable, net consists of the following (in thousands):

	September 30, 2014	December 31, 2013
Accounts receivable	$ 71,262	$ 57,010
Trade notes receivable	8,130	8,054
Allowance for doubtful accounts	(218)	(531)
Total	$ 79,174	$ 64,533

Inventories, net

Inventories, net consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Raw materials	$ 26,206	$ 26,379
Work in process	14,554	14,341
Finished goods [(1)]	18,059	24,188
Total	$ 58,819	$ 64,908

[(1)] Finished goods inventory at customer vendor managed inventory locations was $6.7 million and $5.4 million as of September 30, 2014 and December 31, 2013, respectively.

Purchased intangible assets

Purchased intangible assets consist of the following (in thousands):

	September 30, 2014			December 31, 2013		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Technology and patents	$34,164	$ (27,747)	$6,417	$34,524	$ (25,931)	$8,593
Customer relationships	14,957	(10,873)	4,084	15,004	(9,732)	5,272
Leasehold interest	1,384	(285)	1,099	1,406	(266)	1,140
Non-compete agreements	862	(862)	—	950	(950)	—
	$51,367	$ (39,767)	$11,600	$51,884	$ (36,879)	$15,005

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Amortization expense relating to technology and patents and the leasehold interest intangible assets is included within cost of goods sold, and customer relationships within operating expenses. The following table presents details of the amortization expense of the Company's purchased intangible assets as reported in the condensed consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Cost of goods sold	$ 709	$ 738	$ 2,137	$ 1,937
Operating expenses	378	381	1,136	1,128
Total	$ 1,087	$ 1,119	$ 3,273	$ 3,065

The estimated future amortization expense of purchased intangible assets as of September 30, 2014, is as follows (in thousands):

2014 (remaining three months)	$ 1,082
2015	4,373
2016	3,628
2017	765
2018	560
Thereafter	1,192
	$ 11,600

Accrued and other current liabilities

Accrued and other current liabilities consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Employee-related accrued expenses	$ 10,502	$ 12,297
Other accrued expenses	7,974	11,346
Penalty payment derivative	526	—
	$ 19,002	$ 23,643

Warranty Accrual

The table below summarizes the movement in the warranty accrual, which is included in accrued and other current liabilities (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013

Beginning balance	$ 1,811	$ 1,461	$ 1,737	$ 1,072
Warranty accruals	100	703	631	1,137
Settlements and adjustments	(89)	(219)	(546)	(264)
Ending balance	$ 1,822	$ 1,945	$ 1,822	$ 1,945

Other noncurrent liabilities

Other noncurrent liabilities consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Pension and other employee-related accrued expenses	$ 5,635	$ 6,206
Penalty payment derivative	—	239
Other	1,999	1,542
	$ 7,634	$ 7,987

Note 7. Restructuring

In the three months ended September 30, 2014, the Company initiated a restructuring plan (the “2014 Restructuring Plan”) to refocus on its strategy execution, optimize its structure, and improve operational efficiencies. The 2014 Restructuring Plan consists of workforce reductions primarily in the U.S and in China. In the three and nine months ended September 30, 2014, the Company recorded $0.8 million in restructuring charges, within costs of goods sold and operating expenses, related to the 2014 Restructuring Plan. In the three and nine months ended September 30, 2013, restructuring charges, recorded in costs of goods sold and operating expenses, were $1.1 million and $1.4 million, respectively. The 2014 Restructuring Plan is expected to be completed in the fourth quarter of 2014.

The following table summarizes activity associated with restructuring obligations during the nine months ended September 30, 2014 (in thousands):

	Workforce Reduction	Facilities	Contract Termination	Total
Restructuring obligations, December 31, 2013	$ —	$ 211	$ 66	$277
Restructuring costs incurred	796	—	—	796
Cash payments	(779)	(82)	(66)	(927)
Restructuring obligations, September 30, 2014	$ 17	$ 129	$ —	$146

Note 8. Debt

The table below summarizes the carrying amount and weighted average interest rate of the Company’s debt (in thousands, except percentages):

	September 30, 2014		December 31, 2013	
	Carrying Amount	Weighted Average Interest Rate	Carrying Amount	Weighted Average Interest Rate
Notes payable	$12,553	—	$9,738	—
Short-term borrowing	8,124	7.00%	—	—
Total notes payable and short-term borrowing	$20,677		$9,738	
Long-term debt:				
Acquisition-related	$6,396	1.50%	$9,975	1.50 %
Bank borrowings	19,250	3.15%	24,500	2.92 %
Total long-term debt	25,646		34,475	
Less: current portion of long-term debt	(10,198)		(10,325)	
Total long-term debt, net of current portion	$15,448		$24,150	

Notes payable

The Company regularly issues notes payable to its suppliers in China in exchange for accounts payable. These notes are supported by noninterest bearing bank acceptance drafts issued under the Company's existing line of credit facility and are due three to six months after issuance. As a condition of the notes payable arrangements, the Company is required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the amounts are settled.

In June 2014, the Company's subsidiary in China renewed a short-term line of credit facility with a banking institution which expires in June 2015. Under the agreement, RMB 160.0 million ($26.0 million) can be used for bank acceptance drafts (with a 25% to 30% compensating balance requirement) and up to RMB 120.0 million ($19.5 million) can be used for short-term loans, which will bear interest at varying rates. In September 2014, the Company's China subsidiary renewed its second short-term line of credit facility with a banking institution, under which RMB 150.0 million ($24.4 million) can be used for bank acceptance drafts (with a 30% compensating balance requirement) or short-term loans. This line of credit facility expires in September 2015. As of September 30, 2014, the non-interest bearing bank acceptance drafts issued in connection with the Company's notes payable to its suppliers in China, under these line of credit facilities, had an outstanding balance of $12.6 million.

In May 2014, one of the Company's subsidiaries in China issued a bank acceptance draft of RMB 50 million ($8.1 million) to its subsidiary. This bank acceptance draft required a compensating balance of RMB 15 million ($2.4 million) prior to its cancellation in August 2014.

As of September 30, 2014 and December 31, 2013, compensating balances relating to these bank acceptance drafts issued to suppliers and the Company's subsidiaries totaled $3.4 million and $2.1 million, respectively. Compensating balances are classified as restricted cash and investments on the Company's condensed consolidated balance sheets.

Short-term borrowing

In May 2014, the Company's subsidiary in China borrowed CNY 50 million ($8.1 million) under a working capital loan agreement with a bank, which was outstanding as of September 30, 2014. The loan bears interest at 7% per annum. Interest is payable monthly and the principal is due on November 23, 2014. The loan was repaid in full in November 2014.

In October 2014, the Company's subsidiary in China entered into a short-term advance financing agreement, under one of its line of credit facilities, to borrow $5.0 million against export sales to its parent company. This financing agreement bears interest at 4.02% per annum. Interest and the principal are due on April 27, 2015.

Acquisition-related

In connection with the acquisition of NeoPhotonics Semiconductor on March 29, 2013, the Company was obligated to pay 1,050 million Japanese Yen in three equal installments on the anniversaries of the closing date for the purchase of the real estate used by NeoPhotonics Semiconductor, of which 700 million Japanese Yen ($6.4 million) was outstanding at September 30, 2014. The obligation bears interest at 1.5% per year, payable annually, and is secured by the acquired real estate property.

Bank borrowings

The Company has a credit agreement with Comerica Bank as lead bank in the U.S., which has been amended several times. The components of the available credit facilities are as follows:

A revolving credit facility under which there was no outstanding borrowing at September 30, 2014 or December 31, 2013 and $20.0 million was available for borrowing at September 30, 2014, subject to covenant requirements. Amounts borrowed, if any, are due on or before March 2016 and bear interest at an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of September 30, 2014 the rate on the LIBOR option was 2.90%.

A term loan facility of $28.0 million, under which $19.3 million and $24.5 million was outstanding at September 30, 2014 and December 31, 2013, respectively. Interest is payable monthly in arrears and the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan bear interest at an interest rate option of a base rate as defined in the agreement plus 2.0% or LIBOR plus 3.0%. As of September 30, 2014 the rate on the LIBOR option was 3.15%.

The Company's credit agreement requires the maintenance of specified financial covenants, including a debt to EBITDA ratio and liquidity ratios. The agreement also restricts the Company's ability to incur certain additional debt or to engage in specified transactions, restricts the payment of dividends and is secured by substantially all of its U.S. assets, other than intellectual property assets.

On May 19, 2014, the Company executed an amendment to the credit agreement that waived the testing of certain covenants for compliance, provided that the Company maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. The Company intends to restructure the bank credit agreement, including the compensating balance requirements. In the absence of a restructured agreement, the Company believes it will need to continue to maintain the compensating balances at least through the end of 2014. As of September 30, 2014, the amount of the Company's cash and investments in its compensating balance accounts for the term loan facility with Comerica Bank was $19.3 million, which is classified as current and non-current restricted cash and investments on the Company's September 30, 2014 condensed consolidated balance sheet (see Note 6).

At September 30, 2014, maturities of long-term debt were as follows (in thousands):

2014 (remaining three months)	$1,750
2015	10,198
2016	10,198
2017	3,500
	$25,646

Note 9. Japan pension plans

In connection with its acquisition of NeoPhotonics Semiconductor on March 29, 2013, the Company assumed responsibility for two defined benefit plans that provide retirement benefits to its NeoPhotonics Semiconductor employees in Japan: the Retirement Allowance Plan (“RAP”) and the Defined Benefit Corporate Pension Plan (“DBCPP”). The RAP is an unfunded plan administered by the Company. Effective February 28, 2014, the DBCPP was converted to a defined contribution plan (“DCP”). In May 2014, in accordance with the acquisition agreements, LAPIS transferred approximately $2.0 million into the newly formed DCP which is the allowable amount that can be transferred according to the Japanese regulations. LAPIS also paid the Company approximately $0.3 million in connection with the conversion of the plan. Additionally, the Company transferred the net unfunded projected benefit obligation amount from the DBCPP to the RAP and froze the RAP benefit at the February 28, 2014 amount.

As a result of these changes to the DBCPP and the RAP, the Company recorded a curtailment gain of $0.1 million in the first quarter of 2014. The pension liability at September 30, 2014 was $5.3 million and recorded in accrued and other current liabilities and in other noncurrent liabilities on the Company’s condensed consolidated balance sheet.

The Company contributed $15,000 to the DBCPP from January 1, 2014 to February 28, 2014. Because the DBCPP transitioned to the DCP on that date, no further contributions to the DBCPP are required.

Net periodic pension cost associated with these plans for the period from December 31, 2013 to February 28, 2014 included the following components (in thousands):

Service cost	$53
Interest cost	13
Amortization	1
Net periodic pension costs	$67

Note 10. Commitments and contingencies

Litigation

From time to time, the Company is subject to various claims and legal proceedings, either asserted or unasserted, that arise in the ordinary course of business. The Company accrues for legal contingencies if the Company can estimate the potential liability and if the Company believes it is more likely than not that the case will be ruled against it. If a legal claim for which the Company did not accrue is resolved against it, the Company would record the expense in the period in which the ruling was made. The Company does not believe that the ultimate amount of liability, if any, for any pending claims of any type (alone or combined) will materially affect the Company’s financial position, results of operations or cash flows. The ultimate outcome of any litigation is uncertain, however, and unfavorable outcomes could have a material negative impact on the Company’s financial condition and operating results. Regardless of outcome, litigation can have an adverse impact on the Company because of defense costs, negative publicity, diversion of management resources and other factors.

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and the Company, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the codefendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. On March 23, 2010, the Company filed an answer to the complaint and counterclaims, asserting two claims of patent infringement and additional claims asserting that Finisar has violated state and federal competition laws and violated its obligations to license on reasonable and non-discriminatory terms. On May 5, 2010, the court dismissed without prejudice all co-defendants (including the Company) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against the Company. On January 18, 2011, the Company and Finisar agreed to suspend their respective claims and not to refile the originally asserted claims against each other until at least 90 days after one or more specified events occur resulting in the partial or complete resolution of litigation involving the same Finisar patents between Oplink Communications, Inc. and Finisar. This tolling period expired on April 30, 2012. On May 3, 2012 the Company and Finisar agreed to further toll their respective claims until the refiling of certain of the previously asserted claims from this dispute. As a result, Finisar is permitted to bring a new lawsuit against the Company if it chooses to do so, and the Company may bring new claims against Finisar upon seven days written notice prior to filing such claims. The Company is currently unable to predict the outcome of this dispute and therefore cannot determine the likelihood of loss nor estimate a range of possible loss.

Indemnifications

In the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and provide for general indemnification. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations. As of September 30, 2014, the Company did not have any material indemnification claims that were probable or reasonably possible.

Leases

The Company leases various facilities under non-cancelable operating leases expiring through 2023. Future minimum payments under these operating leases totaled $8.3 million as of September 30, 2014. Rent expense was $0.5 million for the three months ended September 30, 2014 and 2013 and $1.6 million and $1.7 million for the nine months ended September 30, 2014 and 2013, respectively. Asset retirement obligations associated with the leases are not material.

Settlement with Santur

In May 2014, the Company entered into a settlement agreement covering the outstanding claims in connection with its 2011 acquisition of Santur Corporation ("Santur"). Under the terms of the settlement agreement, a net amount of $1.9 million was paid to the Company from the escrow account that was set up under the original merger agreement. This amount comprised of a $3.9 million gain related to indemnification claims by the Company ("Indemnification Amount") which were partially offset by $2.0 million in additional consideration to Santur that was contingent upon Santur's gross profit performance during 2012 ("Contingent Consideration Amount"). The Company had recorded the entire $2.0 million Contingent Consideration Amount as of December 31, 2013. The $3.9 million Indemnification Amount was recognized as settlement gain in the second quarter of 2014.

Penalty Payment Derivative

In connection with a private placement transaction in 2012, the Company agreed to certain performance obligations including establishing a wholly-owned subsidiary in the Russian Federation and making a $30.0 million investment commitment (the "Investment Commitment") towards the Company's Russian operations. The Investment Commitment can be partially satisfied by cash and/or non-cash investment outside of the Russian Federation and/or by way of non-cash asset transfers, including but not limited to capital equipment, small tools, intellectual property, and other intangibles. A minimum of $15.0 million of the Investment Commitment is required to be satisfied by making capital expenditure investments, including those that are non-cash, and the remaining $15.0 million can be satisfied through cash and non-cash general working capital and research and development expenditures. All of the amount for general working capital can be spent either inside or outside of Russia. However, at least 80% of the amount expended for research and development expenditure must be spent inside Russia. General working capital can include acquisition of other businesses or portions thereof to be owned by the Russian subsidiary.

The purchaser of the common stock in the private placement has non-transferable veto rights over the Company's Russian subsidiary's annual budget during the investment period and must approve non-cash asset transfers to be made in satisfaction of the Investment Commitment. Spending and/or commitments to spend for general working capital and research and development do not require approval by the purchaser. There are no legal restrictions on the specific usage of the $39.8 million received in the private placement transaction or on withdrawal from the Company's bank accounts for use in general corporate purposes.

The Company was required to satisfy the Investment Commitment by July 31, 2014, which date has been extended to March 31, 2015 as the Company did not record aggregate revenue from sales of its products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014. The Company intends to meet its Investment Commitment by March 31, 2015. If the Company fails to meet the Investment Commitment by the deadline, including failure to meet the Investment Commitment because the purchaser of the common stock does not approve the transfer of non-cash assets, the Company will be required to pay a $5.0 million penalty (the 'Penalty Payment') as the sole and exclusive remedy for damages and monetary relief available to the purchaser for failure to meet the Investment Commitment.

The Company has accounted for the $5.0 million Penalty Payment as an embedded derivative instrument, with the underlying being the performance or nonperformance of meeting the Investment Commitment by the extended deadline of March 31, 2015. The fair value of the Penalty Payment derivative has been estimated at the date of the original common stock sale (April 27, 2012) and at each subsequent balance sheet date using a probability-weighted discounted future cash flow approach using unobservable inputs, which are classified as Level 3 within the fair value hierarchy. The primary inputs for this approach include the probability of achieving the Investment Commitment and a discount rate that approximates the Company's incremental borrowing rate. After the initial measurement, changes in the fair value of this derivative were recorded in other income (expense), net. The estimated fair value of this derivative was $0.5 million and $0.2 million at September 30, 2014 and December 31, 2013, respectively.

Note 11. Stockholders' equity

Common Stock

As of September 30, 2014, the Company had reserved 6,527,637 common stock shares for issuance under its stock option plans, 600,093 common stock shares for issuance under its stock purchase plan and 4,482 common stock shares to be issued upon exercise of the outstanding warrants.

Accumulated Deficit

Approximately $6.5 million of the Company's accumulated deficit at December 31, 2013 was subject to restriction due to the fact that the Company's subsidiaries in China are required to set aside at least 10% of their respective accumulated profits each year to fund statutory common reserves as well as allocate a discretional portion of their after-tax profits to their staff welfare and bonus fund.

Note 12. Stock-based compensation

The following table summarizes the stock-based compensation expense recognized in the three and nine months ended September 30, 2014 and 2013 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2014	2013	2014	2013
Cost of goods sold	$ 203	$ 471	$ 988	$ 845
Research and development	339	417	1,454	1,435
Sales and marketing	417	253	1,377	835
General and administrative	229	449	993	1,150
	$ 1,188	$ 1,590	$ 4,812	$ 4,265

Determining Fair Value

The Company estimates the fair value of its stock options, stock appreciation units and employee stock purchases related to the Employee Stock Purchase Plan (the "ESPP Purchase Rights") using a Black-Scholes-Merton model or a lattice-binomial option-pricing model (the "Lattice-Binomial Model"). The following assumptions are used in estimating the fair value of stock-based awards in the three and nine months ended September 30, 2014:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Stock options				
Weighted-average expected term (years)	5.78	6.55	5.52	6.48
Weighted-average volatility	66%	71%	68%	72%
Risk-free interest rate	1.62%-1.88%	1.82%	1.62%– 1.88%	1.08%-1.82%
Expected dividends	—%	—%	—%	—%
Stock appreciation units				
Weighted-average expected term (years)	2.47	1.92	2.46	2.29
Weighted-average volatility	54%	52%	56%	57%
Risk-free interest rate	0.47%-0.88%	0.15%-0.66%	0.13%–0.90%	0.14%-0.66%
Expected dividends	—%	—%	—%	—%
ESPP Purchase Rights				
Weighted-average expected term (years)	—	0.73	0.69	0.73
Weighted-average volatility	—	48%	54%	48%
Risk-free interest rate	—	0.09%–0.16%	0.05%–0.13%	0.09%–0.16%
Expected dividends	—	—%	—%	—%

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Stock Options and Restricted Stock Units (RSUs)

The following table summarizes the Company's stock option and RSU activity during the nine months ended September 30, 2014:

	Stock Options		Restricted Stock Units	
	Number of shares	Weighted average exercise price	Number of units	Weighted average grant date fair value
Balance at December 31, 2013	4,103,454	$ 5.92	1,169,649	$ 6.42
Granted	129,444	4.37	72,152	4.82
Exercised/Converted	(173,723)	4.25	(512,807)	6.40
Forfeited and canceled	(323,771)	5.99	(61,469)	6.44
Balance at September 30, 2014	3,735,404	5.94	667,525	6.27

Stock appreciation units ("SAUs")

SAUs are liability classified share-based awards. The Company did not grant any SAUs during the nine months ended September 30, 2014. As of September 30, 2014 and December 31, 2013, there were 388,276 and 420,397 SAUs outstanding. Outstanding SAUs were re-measured each reporting period at fair value.

Employee Stock Purchase Plan ("ESPP")

Due to the delay in filing its Annual Report on Form 10-K, in May 2014 the Compensation Committee of the Company's Board of Directors (the "Committee") rescheduled the May 15 purchase date under the current offering period to June 17, 2014. Additionally, the Committee waived the existing purchase limits for the upcoming purchase date only and created a modification of the purchase price formula for the current offering period. In connection with this modification, the Company recorded an immaterial charge as stock based compensation expense in its condensed consolidated statements of operations in the second quarter of 2014.

Note 13. Income taxes

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2014	2013	2014	2013
Provision for income taxes	$ (902)	$ (777)	$ (1,761)	$ (870)

The Company's income tax provision in the three and nine months ended September 30, 2014 and 2013 was primarily related to income taxes of the Company's non-U.S. operations.

The Company conducts its business globally and its operating income is subject to varying rates of tax in the United States, China and Japan. Consequently, the Company’s effective tax rate is dependent upon the geographic distribution of its earnings or losses and the tax laws and regulations in each geographical region. Historically, the Company has experienced net losses in the United States and in the short term, expects this trend to continue. One of the Company’s subsidiaries in China has historically qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate. In November 2014, the Company received the final approval for the preferential tax rate for 2014 to 2016.

Due to historic losses in the US, the Company has a full valuation allowance on its US federal and state deferred tax assets. Management continues to evaluate the realizability of deferred tax assets and the related valuation allowance. If management's assessment of the deferred tax assets or the corresponding valuation allowance were to change, the Company would record the related adjustment to income during the period in which management makes the determination.

As of September 30, 2014, there were no material changes to either the nature or the amounts of the uncertain tax positions previously determined for the year ended December 31, 2013.

Note 14. Subsequent event

Acquisition

On October 22, 2014, the Company entered into an Asset Purchase Agreement (the "Purchase Agreement"), with EMCORE Corporation, as approved by the Company's Board of Directors. Consummation of this Purchase Agreement is subject to customary closing conditions and is expected to close by early January 2015.

Under the Purchase Agreement, the Company agreed to purchase certain assets and assume certain liabilities of EMCORE's tunable laser and transceiver product lines for $17.5 million in total consideration. Purchase consideration would consist of $1.5 million in cash at closing with the balance to be paid pursuant to a promissory note with a two-year term. The promissory note will bear interest of 5% per annum for the first year and 13% per annum for the second year. The interest will be payable semi-annually in cash, and the promissory note will mature two years from the closing of the transaction. In addition, the promissory note will be subject to prepayment under certain circumstances and will be secured by certain of the assets to be sold pursuant to the Purchase Agreement. Under the Purchase Agreement, the purchase price is subject to certain adjustments for inventory, net accounts receivable, pre-closing revenues and the principal amount due under the promissory note will be increased and decreased, as applicable, by an amount corresponding to any such adjustment. The Company will account for the transaction as a business combination.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q for the period ended September 30, 2014 and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2013 included in our Annual Report on Form 10-K. References to "NeoPhotonics" "we," "our" and "us" are to NeoPhotonics Corporation unless otherwise specified or the context otherwise requires.

This Quarterly Report on Form 10-Q for the period ended September 30, 2014 contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q for the period ended September 30, 2014 that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Terminology such as "believe," "may," "might," "objective," "estimate," "continue," "anticipate," "intend," "should," "plan," "expect," "predict," "potential," or the n terms or other similar expressions is intended to identify forward-looking statements.

We have based these forward-looking statements largely on our current expectations and projections about future events and industry and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in "Part II —Item 1A. Risk Factors" below, and those discussed in the sections titled "Special Note Regarding Forward-Looking Statements" and "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on June 4, 2014. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Business overview

We are a leading designer and manufacturer of photonic integrated circuit, or PIC-based optoelectronic modules and subsystems for bandwidth-intensive, high-speed communications networks.

Our products are designed to enable high-speed transmission rates and efficient allocation of bandwidth over optical networks with high quality and low costs. Our PIC technology utilizes proprietary design elements that provide optical functionality on a silicon or indium phosphide or hybrid chip. PIC devices can integrate many more functional elements than discretely packaged components, enabling increased functionality in a small form factor while reducing packaging and interconnection costs. In addition, the cost advantages of PIC-based components are similar to the economics of semiconductor wafer mass manufacturing, where the marginal cost of producing an incremental chip is much less than that of a discrete component.

We have research and development and wafer fabrication facilities in San Jose and Fremont, California and in Tokyo, Japan which coordinate with our research and development and manufacturing facilities in Shenzhen and Wuhan, China and Ottawa, Canada. We utilize proprietary design tools and design-for-manufacturing techniques to align our design process with our precision nanoscale, vertically integrated manufacturing and testing capabilities. We sell our products to the leading network equipment vendors globally, including ADVA AG Optical Networking Ltd., Alcatel-Lucent SA, Ciena Corporation, Cisco Systems, Inc., Coriant Gmbh & Co. KG (formerly Nokia Siemens Networks B.V.), ECI Telecom, Ltd., FiberHome Technologies Group, Fujitsu Limited, Huawei Technologies Co., Ltd, Juniper Networks, Inc., Mitsubishi Electric Corporation, NEC Corporation, Telefonaktiebolaget LM Ericsson and ZTE Corporation. We refer to these companies as our Tier 1 customers.

On March 29, 2013, we acquired the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd., now known as NeoPhotonics Semiconductor Godo Keisha ("NeoPhotonics Semiconductor"). NeoPhotonics Semiconductor is a leading provider of lasers, drivers, and detectors for high speed 100Gbps applications and is located in Japan. We believe the acquisition of NeoPhotonics Semiconductor enhances our competitive position in 100Gbps products.

In the three months ended September 30, 2014, our revenue growth of 6% over the three months ended September 30, 2013 was primarily due to the demand for our High Speed products, including our 100Gbps Speed products, as carriers continued to accelerate deployments of 100Gpbs high capacity optical transport networks worldwide.

We expect continued volume growth for our 100Gbps products, although quarter-to-quarter results may show considerable variability as is usual in a rapid initial ramp-up for a new technology. Similar to revenue, our gross margins can fluctuate materially depending on a variety of factors including average selling price changes, product mix, volume, manufacturing utilization and ongoing manufacturing process improvements.

In October 2014, we entered into an Asset Purchase Agreement (the “Purchase Agreement”), with EMCORE Corporation (“EMCORE”). Consummation of the Purchase Agreement is subject to customary closing conditions and is expected to close by early January 2015. Under the Purchase Agreement, we agreed to purchase certain assets and assume certain liabilities of EMCORE’s tunable laser and transceiver product lines for $17.5 million in total consideration, which is subject to certain adjustments for inventory, net accounts receivable, pre-closing revenues and the principal amount due under the promissory note will be increased and decreased, as applicable, by an amount corresponding to any such adjustment. Purchase consideration would consist of $1.5 million in cash at closing with the balance to be paid pursuant to a promissory note with a two-year term.

In July 2014, we initiated a restructuring plan (the “2014 Restructuring Plan”) to improve our operating costs, reduce our workforce and to better align our resources for our needs in the changing market. As a result, we have recorded $0.8 million in restructuring expenses in the three and nine months ended September 30, 2014 for severance and related charges. We expect to complete the 2014 Restructuring Plan in the remainder of 2014 as part of our effort to reorganize our business structure to address operational and profitability challenges while continuing our focus on key growth markets.

Critical accounting policies and estimates

In the three and nine months ended September 30, 2014, there have been no material changes to our critical accounting policies and estimates from those disclosed in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2013.

Results of operations

Revenue

We sell substantially all of our products to original equipment manufacturers, or OEMs. Revenue is recognized when title of our products passes to the OEM. We price our products based on market and competitive conditions and may periodically reduce the price of our products as market and competitive conditions change and as manufacturing costs are reduced. Our sales transactions to customers are denominated primarily in Chinese Renminbi (“RMB”), Japanese Yen (“JPY”) or U.S. dollars.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2014	2013	2014	2013
Total revenue	$ 81,576	$ 76,814	$ 227,195	$ 207,867

We have generated most of our revenue from a limited number of customers. Customers accounting for more than 10% of our total revenue and revenue from our top ten customers for the three and nine months ended September 30, 2014 and 2013 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Percent of revenue from customers accounting for 10% or more of total revenue:				
Huawei Technologies Co., Ltd	35 %	23 %	36 %	26 %
Ciena Corporation	17 %	13 %	15 %	16 %
Alcatel-Lucent SA	9 %	17 %	11 %	14 %
Percent of revenue from top ten customers	88 %	85 %	88 %	85 %

As of September 30, 2014, Huawei, ZTE Corporation and Sanmina-SCI Corporation accounted for 39%, 14% and 10% of our total accounts receivable, respectively. As of December 31, 2013, Huawei and ZTE Corporation accounted for 14% and 10% of our total accounts receivable, respectively.

Three Months Ended September 30, 2014 Compared With Three Months Ended September 30, 2013

Our revenue increased $4.8 million, or 6%, in the three months ended September 30, 2014, compared with the three months ended September 30, 2013 due to increases in revenue from our High Speed products, including our 100Gbps Speed products, as carriers continued to accelerate deployments of 100Gbps high capacity optical transport networks worldwide and deployments of 4G-LTE networks.

Nine Months Ended September 30, 2014 Compared With Nine Months Ended September 30, 2013

Our revenue increased $19.3 million, or 9%, in the nine months ended September 30, 2014, compared with the nine months ended September 30, 2013 due to increases in revenue from our High Speed products, including our 100Gbps Speed products and High Speed Transceivers, as carriers continued to accelerate deployments of 100Gbps high capacity optical transport networks worldwide and deployments of 4G-LTE networks in China. NeoPhotonics Semiconductor, many of whose products are 100Gbps and are in our Speed and Agility category, was acquired on March 29, 2013 and only contributed to a portion of the revenue in the nine months ended September 30, 2013.

Cost of goods sold and gross margin

Our cost of goods sold consists primarily of the cost to produce wafers and to manufacture and test our products. Additionally, our cost of goods sold includes stock-based compensation, write-downs of excess and obsolete inventory, royalty payments, amortization of certain purchased intangible assets, depreciation, acquisition-related fair value adjustments, restructuring cost, warranty, shipping and allocated facilities and information technology costs.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014		2013		2014		2013	
(in thousands, except percentages)	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue
Cost of goods sold	$61,512	75 %	$58,635	76 %	$178,763	79 %	$162,330	78 %

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gross margin	25 %	24 %	21 %	22 %

Gross profit as a percentage of total revenue, or gross margin, has been and is expected to continue to be affected by a variety of factors including the introduction of new products, production volume, production volume compared to sales over time, the mix of products sold, inventory changes, changes in the average selling prices of our products, changes in the cost and volumes of materials purchased from our suppliers, changes in labor costs, changes in overhead costs or requirements, revaluation of stock appreciation unit awards that are impacted by our stock price, write-downs of excess and obsolete inventories and warranty costs. In addition, we periodically negotiate pricing with certain customers which can cause our gross margins to fluctuate, particularly in the quarters in which the negotiations occurred.

Three and Nine Months Ended September 30, 2014 Compared With Three and Nine Months Ended September 30, 2013

Gross margin increased one percentage point in the three months ended September 30, 2014 compared with the same period in 2013 primarily due to product mix, lower manufacturing costs and customer mix. Restructuring charges included within cost of goods sold were $0.3 million and $0.6 million in the three months ended September 30, 2014 and 2013, respectively.

Gross margin decreased one percentage point in the nine months ended September 30, 2014 compared with the same period in 2013 primarily due to product mix. Restructuring charges included within cost of goods sold were $0.3 million and $0.6 million in the nine months ended September 30, 2014 and 2013, respectively.

Operating expenses

Personnel costs are the most significant component of operating expenses and consist of costs such as salaries, benefits, bonuses, stock-based compensation and, with regard to sales and marketing expense, sales commissions. Our operating expenses are denominated primarily in RMB, JPY and U.S. dollars.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014		2013		2014		2013	
(in thousands, except percentages)	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue
Research and development	$11,842	15 %	$12,227	16 %	$35,983	16 %	$33,021	16 %
Sales and marketing	3,075	4 %	3,580	5 %	10,057	4 %	10,515	5 %
General and administrative	6,712	8 %	8,905	12 %	23,892	11 %	21,853	10 %
Restructuring charges	504	1 %	450	1 %	504	0 %	775	0 %
Amortization of purchased intangible assets	378	0 %	381	0 %	1,136	1 %	1,128	1 %
Adjustment to fair value of contingent consideration	—	— %	1,026	1 %	—	— %	1,026	0 %
Escrow settlement gain	—	0 %	—	0 %	(3,886)	(2) %	—	0 %
Acquisition-related transaction costs	—	0 %	126	0 %	—	0 %	5,317	3 %
Total operating expenses	$22,511	28 %	$26,695	35 %	$67,686	30 %	$73,635	35 %

Research and development

Research and development expense consists of personnel costs, including stock-based compensation, for our research and development personnel, and product development costs, including engineering services, development software and hardware tools, depreciation of equipment and facility costs. We record all research and development expense as incurred.

Three Months Ended September 30, 2014 Compared With Three Months Ended September 30, 2013

Research and development expense decreased $0.4 million, or 3%, in the three months ended September 30, 2014 compared with the three months ended September 30, 2013 primarily due to a $0.5 million decrease in development expenses and a $0.2 million increase in depreciation expense, partially offset by a $0.2 million increase in bonus accrual.

Nine Months Ended September 30, 2014 Compared With Nine Months Ended September 30, 2013

Research and development expense increased $3.0 million, or 9%, in the nine months ended September 30, 2014, compared with the nine months ended September 30, 2013, primarily attributable to a $1.3 million increase in development expenses for key projects, a $0.9 million increase in facility and equipment depreciation expenses to support our development initiatives and a $0.2 million increase due to the acquisition of NeoPhotonics Semiconductor in March 2013.

We intend to continue to invest in research and development in line with our business strategy. As a percentage of total revenue, our research and development expense may vary with changes in our revenue.

Sales and marketing

Sales and marketing expense consists primarily of personnel costs, including stock-based compensation and sales commissions, costs related to sales and marketing programs, services costs and facility costs.

Three Months Ended September 30, 2014 Compared With Three Months Ended September 30, 2013

Sales and marketing expense decreased $0.5 million, or 14%, in the three months ended September 30, 2014 compared with the three months ended September 30, 2013 primarily due to a $0.4 million decrease in provision for doubtful accounts and a $0.2 million decrease in payroll expense resulting from past restructuring efforts, partially offset by a $0.1 million increase in allocated service costs.

Nine Months Ended September 30, 2014 Compared With Nine Months Ended September 30, 2013

Sales and marketing expense decreased $0.5 million, or 4%, in the nine months ended September 30, 2014 compared with the nine months ended September 30, 2013 primarily attributable to a $0.4 million decrease in payroll expense resulting from past restructuring efforts, a $0.3 million decrease in provision for doubtful accounts and a $0.2 million reduction in commission expense, partially offset by a $0.4 million increase in allocated service costs and a $0.1 million increase in employee related expenses.

General and administrative

General and administrative expense consists primarily of personnel costs, including stock-based compensation, for our finance, legal, human resources and information technology personnel and certain executive officers, as well as professional services costs related to accounting, tax, banking, legal and information technology services, depreciation and facility costs.

Three Months Ended September 30, 2014 Compared With Three Months Ended September 30, 2013

General and administrative expense decreased $2.2 million, or 25%, in the three months ended September 30, 2014 compared with the three months ended September 30, 2013 primarily due to a $1.7 million decrease in consulting services, a $0.3 million decrease in accounting and legal fees, a $0.3 million decrease in maintenance costs, a $0.2 million decrease in equipment expense and a $0.2 million decrease in facility expenses, partially offset by a $0.3 million increase in depreciation expense and a $0.2 million increase in recruiting, bonus and employee related expenses.

Nine Months Ended September 30, 2014 Compared With Nine Months Ended September 30, 2013

General and administrative expense increased $2.0 million, or 9%, in the nine months ended September 30, 2014, compared with the nine months ended September 30, 2013, primarily due to a $1.3 million increase in accounting and consulting fees related to the restatement of our Quarterly Reports on Form 10-Q for the quarters ended March 31 and June 30, 2013 and resources to assist us in the process of strengthening our internal controls. Employee costs increased $0.6 million as NeoPhotonics Semiconductor was acquired on March 29, 2013 and incurred related expenses for only a portion of 2013. In addition, depreciation expense increased $0.6 million due to past capital expenditures, partially offset by a $0.5 million decrease in maintenance costs.

Amortization of purchased intangible assets

Our intangible assets are being amortized over their estimated useful lives. Amortization expense relating to technology, patents and leasehold interests are included within cost of goods sold, and expense from amortization of customer relationships is recorded within operating expenses. Amortization of purchased intangibles included in operating expenses was relatively consistent in the three and nine months ended September 30, 2014 compared to the same periods in 2013.

Escrow Settlement Gain

In May 2014, we entered into a settlement agreement covering the outstanding claims in connection with our 2011 acquisition of Santur Corporation ("Santur"). Under the terms of the settlement agreement, a net amount of $1.9 million was paid to us from the escrow account that was setup under the original merger agreement. This amount comprised of $3.9 million related to indemnification claims by us (the "Indemnification Amount") which was partially offset by a $2.0 million liability related to additional consideration to Santur that was contingent upon Santur's gross profit performance in 2012 (the “Contingent Consideration”). We had recorded the entire Contingent Consideration as of December 31, 2013. The $3.9 million Indemnification Amount was recorded as a settlement gain in the second quarter of 2014.

Restructuring

In the three and nine months ended September 30, 2014, we incurred $0.8 million in severance and related restructuring expenses in connection with our 2014 Restructuring Plan. In the three and nine months ended September 30, 2013, we incurred restructuring charges of $1.1 million and $1.4 million, respectively, to reduce workforce and close certain facilities in the U.S. and in China. Restructuring charges in the 2014 and 2013 periods are included in cost of goods sold and operating expenses.

Acquisition-related transaction costs

In connection with our acquisition of NeoPhotonics Semiconductor in 2013, we incurred $5.3 million in acquisition-related transaction costs during the nine months ended September 30, 2013 related to investment banking, legal, accounting and other professional services and fees as well as transfer and acquisition taxes related to real property acquired.

Interest and other expense, net

Interest income consists of income earned on our cash, cash equivalents, short-term investments as well as restricted cash and investments. Interest expense consists of amounts paid for interest on our bank and other borrowings. Other income (expense), net is primarily made up of government subsidies as well as foreign currency transaction gains and losses. The functional currency of our subsidiaries in China is the RMB and of our subsidiaries in Japan is the JPY. The foreign currency transaction gains and losses of our subsidiaries in China and Japan primarily result from their transactions in U.S. dollars.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2014	2013	2014	2013
Interest income	$ 52	$ 66	$ 155	$ 269
Interest expense	(375)	(251)	(937)	(756)
Other income (expense), net	1,735	115	493	(432)
Total	$ 1,412	$ (70)	$ (289)	$ (919)

Three Months Ended September 30, 2014 Compared With Three Months Ended September 30, 2013

Total interest and other income (expense), net increased by $1.5 million in the three months ended September 30, 2014, compared with the three months ended September 30, 2013, primarily due to a $1.8 million foreign exchange gains mainly attributable to weaker Japanese Yen in the 2014 period.

Nine Months Ended September 30, 2014 Compared With Nine Months Ended September 30, 2013

Total interest and other income (expense), net increased by $0.6 million in the nine months ended September 30, 2014, compared with the nine months ended September 30, 2013, mainly due to $0.9 million increase in other income attributable to foreign exchange gains mainly driven by weaker Japanese Yen, partially offset by a $0.3 million charge to adjust the fair value of our penalty payment derivative in the 2014 period.

Income taxes

We conduct our business globally and our operating income is subject to varying rates of tax in the United States, China, Japan and other various foreign jurisdictions. Consequently, our effective tax rate is dependent upon the geographic distribution of our earnings or losses and the tax laws and regulations in each geographical region. Historically, we have experienced net losses in the U.S. and in the short term, we expect this trend to continue. In China, one of our subsidiaries has historically qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate for 2014 to 2016.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2014	2013	2014	2013
Provision for income taxes	$ (902)	$ (777)	$ (1,761)	$ (870)

Our income tax expense in the three and nine months ended September 30, 2014 was primarily related to income taxes of our non-U.S. operations.

Liquidity and capital resources

At September 30, 2014, we had working capital of $95.2 million and total cash and cash equivalents of $35.3 million, of which 20% was held in accounts by our subsidiaries in China and 20% was held in accounts by our subsidiaries in Japan.

Approximately $6.5 million of our accumulated deficit at December 31, 2013 was subject to restriction due to the fact that our subsidiaries in China are required to set aside at least 10% of their respective accumulated profits each year to fund statutory common reserves as well as allocate a discretional portion of their after-tax profits to their staff welfare and bonus fund. This restricted amount is not distributable as cash dividends except in the event of liquidation.

We have a bank credit agreement with Comerica Bank as the lead bank. As of September 30, 2014, this credit agreement included the following:

A revolving credit facility under which there was no outstanding borrowing at September 30, 2014 or December 31, 2013 and $20.0 million was available for borrowing at September 30, 2014, subject to covenant requirements. Amounts borrowed, if any, are due on or before March 2016 and bear interest at an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of September 30, 2014, the rate on the LIBOR option was 2.90%.

A term loan facility under which $19.3 million was outstanding at September 30, 2014. Interest is payable monthly in arrears and the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan bear interest at an interest rate option of a base rate as defined in the agreement plus 2.0% or LIBOR plus 3.0%. As of September 30, 2014, the rate on the LIBOR option was 3.15%.

Our credit agreement requires the maintenance of specified financial covenants, including a debt to EBITDA ratio and liquidity ratios. The agreement also restricts our ability to incur certain additional debt or to engage in specified transactions, restricts the payment of dividends and is secured by substantially all of our U.S. assets, other than intellectual property assets.

On May 19, 2014, we executed an amendment to the credit agreement that waived the testing of certain covenants for compliance, provided that we maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. We intend to restructure the bank credit agreement, including the compensating balance requirements. In the absence of a restructured agreement, we believe we may need to continue to maintain the compensating balances at least through the end of 2014. As of September 30, 2014, the amount of our cash and investments in these compensating balance accounts, for the term loan with Comerica Bank, was $19.3 million, which is classified as current and non-current restricted cash and investments on our September 30, 2014 condensed consolidated balance sheet.

We regularly issue notes payable to our suppliers in China in exchange for accounts payable. These notes are supported by noninterest bearing bank acceptance drafts and are due three to six months after issuance. As a condition of the notes payable arrangements, we are required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the amounts are settled.

At September 30, 2014, one of our subsidiaries in China had a short-term line of credit facility with a banking institution which expires in June 2015. Under the agreement, RMB 160.0 million ($26.0 million) can be used for bank acceptance drafts (with a 25% to 30% compensating balance requirement) and up to RMB 120.0 million ($19.5 million) can be used for short-term loans, which will bear interest at varying rates. In September 2014, the Company’s China subsidiary renewed its second line of credit facility with a banking institution, under which RMB 150 million ($24.4 million) can be used for bank acceptance draft (with a 30% compensating balance requirement) or short-term loans. This line of credit facility expires in September 2015. As of September 30, 2014, the non-interest bearing bank acceptance drafts issued in connection with our notes payable to our suppliers in China under these line of credit facilities had an outstanding balance of $12.6 million.

In May 2014, one of our subsidiaries in China issued a bank acceptance draft of $8.1 million to its subsidiary. This bank acceptance draft required a compensating balance of RMB 15 million ($2.4 million) prior to its cancellation in August 2014.

As of September 30, 2014 and December 31, 2013, the compensating balance for these bank acceptance drafts totaled $3.4 million and $2.1 million, respectively, and was classified as restricted cash and investments on our condensed consolidated balance sheets.

In May 2014, our subsidiary in China borrowed CNY 50 million ($8.1 million) under a working capital loan agreement with a bank. The loan bears interest at 7% per annum. Interest is payable monthly and the principal is due on November 23, 2014. The loan was repaid in full in November 2014.

In October 2014, our subsidiary in China entered into a short-term advance financing agreement under one of its line of credit facilities to borrow \$5.0 million against export sales to its parent company. The loan bears interest at 4.02% per annum. Interest and the principal are due on April 27, 2015.

In connection with the acquisition of NeoPhotonics Semiconductor on March 29, 2013, we were obligated to pay 1,050 million Japanese Yen in three equal installments on the anniversaries of the closing date for the purchase of the real estate used by NeoPhotonics Semiconductor, of which 700 million Japanese Yen (\$6.4 million) was outstanding at September 30, 2014. The obligation bears interest at 1.5% per year, payable annually, and is secured by the acquired real estate property.

On October 22, 2014, we entered into the Purchase Agreement with EMCORE Corporation to purchase certain assets and assume certain liabilities of EMCORE's tunable laser and transceiver product lines for $17.5 million in total consideration. Purchase consideration would consist of $1.5 million in cash at closing with the balance to be paid pursuant to a promissory note with a two-year term. The promissory note will bear interest of 5% per annum for the first year and 13% per annum for the second year. The interest will be payable semi-annually in cash, and the promissory note will mature two years from the closing of the transaction. In addition, the promissory note will be subject to prepayment under certain circumstances and will be secured by certain of the assets to be sold pursuant to the Purchase Agreement. Under the Purchase Agreement, the purchase price is subject to certain adjustments for inventory, net accounts receivable, pre-closing revenues and the principal amount due under the promissory note will be increased and decreased, as applicable, by an amount corresponding to any such adjustment. Consummation of the Purchase Agreement is subject to customary closing conditions and is expected to close by early January 2015.

From time to time we accept notes receivable in exchange for accounts receivable from certain of our customers in China. These notes receivable are non-interest bearing and are generally due within six months. Historically, we have collected on the notes receivable in full at the time of maturity.

We believe that our existing cash, cash equivalents and expected cash flows from our operating activities will be sufficient to meet our anticipated cash needs for at least the next 12 months, even with the compensating balance requirements discussed above. Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced products, the costs to increase our manufacturing capacity and our foreign operations, the continuing market acceptance of our products and acquisitions of businesses and technology. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition would be adversely affected.

Private placement transaction

In connection with the 2012 private placement transaction, we agreed to certain performance obligations including establishing a wholly-owned subsidiary in Russia and making a $30.0 million investment commitment (the "Investment Commitment") towards our Russian operations. The Investment Commitment can be partially satisfied by cash and/or non-cash investment inside or outside of Russia and/or by way of non-cash asset transfers, including but not limited to capital equipment, small tools, intellectual property, and other intangibles. A minimum of $15.0 million of the Investment Commitment is required to be satisfied by making capital expenditure investments, including those that are non-cash, and we expect that the remaining $15.0 million will be satisfied through cash and non-cash general working capital and research and development expenditures and commitments. All of the amount for general working capital can be spent either inside or outside of Russia. However, at least 80% of the amount expended for research and development must be spent inside Russia. General working capital can include cash or stock acquisition of technology and other businesses or portions thereof to be owned by the Russian subsidiary. Our current plan is to substantially meet the $15.0 million capital expenditure portion of the Investment Commitment by transferring non-cash assets from other entities within the consolidated Company to the Russian subsidiary, subject to the purchaser's approval as required in the rights agreement. We expect that the remaining $15.0 million will be satisfied through some combination of working capital and research and development spending, which may include technology or other acquisitions acquired by cash or stock through March 2015. The exact timing and composition of those expenditures has not yet been determined.

The purchaser of the common stock in the private placement transaction has nontransferable veto rights over our Russian subsidiary's annual budget during the investment period, and non-cash asset transfers to be made in satisfaction of the Investment Commitment requires approval by the purchaser. Spending and/or commitments to spend for general working capital and research and development do not require approval by the purchaser. There are no legal restrictions on the specific usage of amounts received in the private placement transaction or on withdrawal from our bank accounts for use in general corporate purposes.

We were required to satisfy the Investment Commitment by July 31, 2014, which date has been extended to March 31, 2015 as we did not record aggregate revenue from sales of our products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014. We intend to meet the Investment Commitment by March 31, 2015. If we fail to meet the Investment Commitment by the deadline, including failure to meet the Investment Commitment because the purchaser of the common stock does not approve the transfer of non-cash assets, we will be required to pay a $5.0 million penalty as the sole and exclusive remedy for damages and monetary relief available to the purchaser for failure to meet the Investment Commitment.

Cash flow discussion

The table below sets forth selected cash flow data for the periods presented:

	Nine Months Ended September 30,	
(in thousands)	2014	2013
Net cash used in operating activities	$(11,428)	$(5,007)
Net cash (used in) provided by investing activities	(11,939)	10,164
Net cash provided by financing activities	2,062	1,495
Effect of exchange rates on cash and cash equivalents	(527)	64
Net (decrease) increase in cash and cash equivalents	$(21,832)	$6,716

Operating activities

Net cash used in operating activities was $11.4 million in the nine months ended September 30, 2014, which was a $6.4 million increase compared with the nine months ended September 30, 2013. The increase was primarily due to a $17.3 million reduction in cash flows related to accounts payable as well as accrued and other liabilities primarily attributable to timing of payments and a $7.2 million reduction in accounts receivable related cash flows attributable to higher accounts receivable balance driven by increased sales and timing of collections. The increase was partially offset by an $11.4 million decrease in inventories related cash outflows due to inventory reduction measures and an $8.6 million decrease in net loss during the 2014 period.

Investing activities

Net cash used in investing activities increased $22.1 million to $11.9 million in the nine months ended September 30, 2014 as compared with the nine months ended September 30, 2013. The increase was primarily due to a $75.3 million decrease in proceeds from the sale and maturity of marketable securities and a $13.3 million increase in restricted cash pertaining to the compensating balance requirements under our term loan arrangement and our line of credit facilities, partially offset by a $48.2 million decrease in marketable securities purchases, a net cash payment of $13.1 million for the acquisition of NeoPhotonics Semiconductor in 2013 and a $5.2 million decrease in capital equipment purchases.

Financing activities

Net cash provided by financing activities increased $0.6 million to $2.1 million in the nine months ended September 30, 2014 as compared with the nine months ended September 30, 2013. The increase was primarily due to a $13.7 million decrease in bank loan repayments, a $4.7 million increase in proceeds from issuance of notes payable and a $2.6 million decrease in notes payable repayments, partially offset by a $18.3 million decrease in proceeds from bank loans and a $2.0 million payment for the contingent consideration liability related to the Santur acquisition.

Contractual obligations and commitments

As of September 30, 2014, our principal commitments consist of obligations under operating leases, purchase commitments, debt and other contractual obligations. There have been no significant changes to these obligations during the nine months ended September 30, 2014 compared to the contractual obligations disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations, set forth in Part II, Item 7, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, except as follows:

- In May 2014, we executed an amendment to the credit agreement with Comerica Bank that waived the testing of certain covenants for compliance provided that we maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. As of September 30, 2014, our cash and investments in these compensating balance accounts was $19.3 million, which have been classified as current and non-current restricted cash and investments on our September 30, 2014 condensed consolidated balance sheet.
- In May 2014, our subsidiary in China borrowed CNY 50 million ($8.1 million) under a working capital loan agreement with a bank, which was outstanding as of September 30, 2014. The loan bears interest at 7% per annum. Interest is payable monthly and the principal is due on November 23, 2014. The loan was repaid in full in November 2014.
- In June 2014, our subsidiary in China renewed a short-term line of credit facility with a banking institution which expires in June 2015. Under the agreement, RMB 160.0 million ($26.0 million) can be used for bank acceptance drafts (with a 25% to 30% compensating balance requirement) and up to RMB 120.0 million ($19.5 million) can be used for short-term loans, which will bear interest at varying rates. In September 2014, our China subsidiary renewed its second short-term line of credit facility with a banking institution, under which RMB 150.0 million ($24.4 million) can be used for bank acceptance drafts (with a 30% compensating balance requirement) or short-term loans. This line

of credit facility expires in September 2015. As of September 30, 2014, the non-interest bearing bank acceptance drafts issued in connection with the Company's notes payable to its suppliers in China, under these line of credit facilities, was $12.6 million, which has been classified as notes payable on our September 30, 2014 condensed balance sheet.

Off-balance sheet arrangements

During the three and nine months ended September 30, 2014, we did not have any significant off-balance sheet arrangements.

Recent accounting pronouncements

See Note 1 "Basis of presentation and significant accounting policies" in the Notes to Condensed Consolidated Financial Statements on this Quarterly Report on Form 10-Q for a description of recent accounting pronouncements and accounting changes.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposures to market risk have not changed materially since December 31, 2013. For quantitative and qualitative disclosures about market risk, see Item 7A Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2013.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2014. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were not effective as a result of the material weaknesses that existed in our internal control over financial reporting.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

The following material weaknesses in our internal control over financial reporting were identified during 2013 and had not been remediated at September 30, 2014:

Control Environment — We did not maintain an effective control environment, which is the foundation for the discipline and structure necessary for effective internal control over financial reporting, as evidenced by: (i) an insufficient number of personnel appropriately qualified to perform control monitoring activities, including the recognition of the risks and complexities of our transactions and business operations, (ii) an insufficient number of personnel with an appropriate level of GAAP knowledge and experience or ongoing training in the application of GAAP commensurate with our financial reporting requirements, which resulted in erroneous judgments regarding the proper application of GAAP and (iii) insufficient corporate involvement to identify and resolve errors in recording transactions and financial results at our non-US subsidiaries. This control environment material weakness was exacerbated by our acquisition of NeoPhotonics Semiconductor in March 2013 and contributed to the following additional material weaknesses.

Accounting for complex transactions — We did not maintain effective internal controls related to complex transactions, including the acquisition of NeoPhotonics Semiconductor. Our controls over the accounting, process and procedures for the NeoPhotonics Semiconductor acquisition were not effective to provide reasonable assurance that (i) the business combination accounting identified and considered all known acquired liabilities, (ii) the business combination accounting reflected the appropriate application of GAAP and (iii) there was appropriate review of the purchase price allocation entries recorded in the consolidated financial statements. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

Preparation and review of consolidated financial statements — We did not maintain effective internal control over financial reporting related to the preparation and review of our consolidated financial statements. Specifically, we did not execute controls related to the review of transactions and balances for proper classification in our balance sheet, statement of operations and statement of cash flows. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

Remedial Measures

Our management continued significant efforts during 2013 and the first three quarters of 2014 to establish a framework to improve internal controls over financial reporting. We committed considerable resources to the design, implementation, documentation, and testing of our internal controls. Additional efforts were required to remediate and re-test certain internal control deficiencies. Our management believes that these efforts have improved our internal control over financial reporting. With the oversight of senior management and our audit committee, we have taken steps and plan to take additional measures to remediate the underlying causes of the material weaknesses described above. Our management, audit committee and board of directors have taken the following steps as part of our ongoing remediation efforts to address these material weaknesses:

- Hired a new Chief Financial Officer;
- Hired a new World-Wide Corporate Controller;
- Hired a Business Unit Controller;
- Hired a VP Finance and Cost Accounting;
- Hired a Director of Internal Audit;
- Hired a Director of Technical Accounting;
- Implemented enhanced communication and monitoring processes and the appropriate documentation of such to ensure the audit committee's effectiveness in executing its oversight responsibilities; and
- Engaged an external team of experienced senior finance and accounting consultants to review and analyze our consolidated financial statement close and reporting processes.
- Increased management oversight by expanding our disclosure process to include all senior management with responsibility for responding to issues during the financial reporting process and enhanced required certifications from all executive management;

While these steps have helped address some of the root causes of the material weaknesses noted above, they have not fully remediated the material weaknesses that existed as of December 31, 2013. We intend to take the following additional steps to remediate these material weaknesses:

- Add additional key positions to the finance team;
- Continue to increase management oversight through our disclosure process, which includes all senior management with responsibility for responding to issues during the financial reporting process and enhanced required certifications from all executive management;
- Improve the documentation, communication and periodic review of our accounting policies throughout our domestic and international locations for consistency and application with generally accepted accounting principles, and
- Enhance the training and education for our world-wide finance and accounting personnel.

Notwithstanding the identified material weaknesses, management believes that the condensed consolidated financial statements contained in this report present fairly our financial condition, results of operations, and cash flows for the periods covered thereby in all material respects. To address the material weaknesses in our internal control over financial reporting, we also performed additional manual procedures and analysis and other post-closing procedures in order to prepare the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

While management is dedicated to improving our internal controls over financial reporting, the nature and significance of the outstanding material weaknesses may prevent successful remediation of all material weaknesses during 2014.

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Changes in Internal Control over Financial Reporting

Other than the remedial measures described above, there have not been any significant changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934, as amended) as of September 30, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitation on the Effectiveness of Internal Controls

The effectiveness of any system of internal control over financial reporting is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting can only provide reasonable, not absolute assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We intend to continue to monitor and upgrade our internal controls as necessary or appropriate for our business, but cannot assure that such improvements will be sufficient to provide us with effective internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in litigation that we believe is of the type common to companies engaged in our line of business, including commercial disputes and employment issues. As of the date of this Quarterly Report on Form 10-Q, other than as described below, we are not involved in any pending legal proceedings that we believe could have a material adverse effect on our financial condition, results of operations or cash flows. However, as described below, a certain dispute involves a claim by a third party that our activities infringe their intellectual property rights. This and other types of intellectual property rights claims generally involve the demand by a third party that we cease the manufacture, use or sale of the allegedly infringing products, processes or technologies and/or pay substantial damages or royalties for past, present and future use of the allegedly infringing intellectual property. Claims that our products or processes infringe or misappropriate any third-party intellectual property rights (including claims arising through our contractual indemnification of our customers) often involve highly complex, technical issues, the outcome of which is inherently uncertain. Moreover, from time to time, we may pursue litigation to assert our intellectual property rights. Regardless of the merit or resolution of any such litigation, complex intellectual property litigation is generally costly and diverts the efforts and attention of our management and technical personnel which could adversely affect our business.

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and us, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the codefendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. On March 23, 2010, we filed an answer to the complaint and counterclaims, asserting two claims of patent infringement and additional claims asserting that Finisar has violated state and federal competition laws and violated our obligations to license on reasonable and non-discriminatory terms. On May 5, 2010, the court dismissed without prejudice all co-defendants (including us) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against us. On January 18, 2011, we and Finisar agreed to suspend our respective claims and not to refile the originally asserted claims against each other until at least 90 days after one or more specified events occur resulting in the partial or complete resolution of litigation involving the same Finisar patents between Oplink Communications, Inc. and Finisar. This tolling period expired on April 30, 2012. On May 3, 2012, we and Finisar agreed to further toll our respective claims until the refiling of certain of the previously asserted claims from this dispute. As a result, Finisar is permitted to bring a new lawsuit against us if it chooses to do so, and we may bring new claims against Finisar upon seven days written notice prior to filing such claims.

ITEM 1A. RISK FACTORS

The risk factors facing our company have not changed materially from those set forth in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on June 4, 2014, which risk factors are set forth below, except for those risk factors denoted by an asterisk (*).

Risks related to our business

*We have a history of losses which may continue in the future.

We have a history of losses and we may incur additional losses in future periods. As of September 30, 2014, our accumulated deficit was $303.7 million. We also expect to continue to make significant expenditures related to the ongoing operations and development of our business. These include expenditures related to the sales, marketing and development of our products and to maintain our manufacturing facilities and research and development operations.

Customer demand is difficult to accurately forecast and, as a result, we may be unable to optimally match production with customer demand, which could adversely affect our business and financial results.

We make planning and spending decisions, including determining the levels of business that we will seek and accept, production schedules, and inventory levels, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers and the possibility of unexpected changes in demand for their products reduce our ability to accurately estimate future customer requirements. On occasion, customers may require rapid increases in production, which can strain our resources, cause our manufacturing to be negatively impacted by materials shortages, necessitate higher or more restrictive procurement commitments, increase our manufacturing yield loss and scrapping of excess materials, and reduce our gross margin. We may not have sufficient capacity at any given time to meet the volume demands of our customers, or one or more of our suppliers may not have sufficient capacity at any given time to meet our volume demands. Conversely, a downturn in the markets in which our customers compete can cause, and in the past have caused, our customers to significantly reduce or delay the amount of products ordered from us or to cancel existing orders, leading to lower utilization of our facilities. Because many of our costs and operating expenses are relatively fixed, reduction in customer demand due to market downturns or other reasons would have a material adverse effect on our gross margin, operating income and cash flow. For example, in the fourth quarter of 2012, we experienced an increase in manufacturing costs for one of our high speed products and separately, lower utilization of one of our water fabrication facilities, which adversely affected our gross margin in the fourth quarter of 2012 and each quarter of 2013.

Our products are typically sold pursuant to individual purchase orders or by use of a vendor-managed inventory, or VMI, model, which is a process by which we ship agreed quantities of products to a customer-designated location and those products remain our inventory and we retain the title and risk of loss for those products until the customer takes possession of the products. While our customers generally provide us with their demand forecasts and may give us a promised market share award, they are typically not contractually committed to buy any quantity of products beyond firm purchase orders. Many of our customers may increase, decrease, cancel or delay purchase orders already in place. We have experienced and expect to continue to experience wide fluctuations in demand from customers using VMI, particularly Huawei Technologies, even in instances where we have built and shipped products to the customer-designated locations as VMI. In recent periods, there has been an increase in the number of our customers utilizing VMI, which may increase our exposure to risks of wide fluctuations in demand from VMI customer locations. If any of our major customers decrease, stop or delay purchasing our products for any reason, our business and results of operations would be harmed. Cancellation or delays of such orders, as well as fluctuations in VMI utilization by our customers, may cause us to incur an adverse effect on our revenues, as well as adversely affect our overall results of operations.

*We are under continuous pressure to reduce the prices of our products, which has affected, and may continue to, adversely affect our gross margins.

The communications networks industry has been characterized by declining product prices over time. We have reduced the prices of many of our products in the past and we expect to continue to experience pricing pressure for our products in the future, including from our major customers. Price declines have particularly adversely affected our gross margins in the first and second quarters of 2014. When seeking to maintain or increase their market share, our competitors may also reduce the prices of their products. In addition, our customers may have the ability or seek to internally develop and manufacture competing products at a lower cost than we would otherwise charge, which would add additional pressure on us to lower our selling prices. If we are unable to offset any future reductions in our average selling prices by increasing our sales volume, reducing our costs and expenses or introducing new products, our gross margin would continue to be adversely affected.

*We are dependent on Huawei Technologies, Ciena, Alcatel-Lucent SA and our other key customers for a significant portion of our revenue and the loss of, or a significant reduction in orders from, Huawei Technologies or any of our other key customers may reduce our revenue and adversely impact our results of operations.

Historically, we have generated most of our revenue from a limited number of customers. In the nine months ended September 30, 2014, Huawei Technologies, Ciena Corporation and Alcatel-Lucent SA accounted for 36%, 15% and 11% of our revenue, respectively, and our top ten customers represented 88% of our total revenue. In 2013, Huawei Technologies, Alcatel-Lucent SA and Ciena Corporation accounted for 27%, 14% and 16% of our revenue, respectively, and our top ten customers represented 86% of our total revenue. In 2012, Huawei Technologies, Alcatel-Lucent SA and Ciena Corporation accounted for 36%, 16% and 15% of our revenue, respectively and our top ten customers represented 90% of our total revenue. As a result, the loss of, or a significant reduction in orders from Huawei Technologies, Alcatel-Lucent SA, Ciena Corporation or any of our other key customers would materially and adversely affect our revenue and results of operations. Adverse events affecting our customers could also adversely affect our revenue and results of operations.

*We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our stockholders.

We believe that our existing cash and cash equivalents, and cash flows from our operating activities, will be sufficient to meet our anticipated cash needs for at least the next 12 months. We operate in an industry, however, that makes our prospects difficult to evaluate. Our total cash, cash equivalents, short-term investments, restricted cash and restricted investments was $57.9 million and $77.2 million as of September 30, 2014 and December 30, 2013, respectively. Our cash, cash equivalents and short-term investments decreased from $75.0 million as of December 31, 2013 to $35.3 million as of September 30, 2014. This decrease was attributable in part to our agreement with our primary lender in 2014 to restrict some of our cash and cash equivalents in exchange for the lender’s wavier of certain financial covenants. Our restricted cash and investments increased from $2.1 million as of December 31, 2013 to $22.7 million as of September 30, 2014. It is possible that we may not generate sufficient cash flow from operations or otherwise have the capital resources to meet our future capital needs. If this occurs, we may need additional financing to continue operations or execute on our current or future business strategies, including to:

invest in our research and development efforts, including by hiring additional technical and other personnel;
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maintain and expand our operating or manufacturing infrastructure;
acquire complementary businesses, products, services or technologies; or
otherwise pursue our strategic plans and respond to competitive pressures.

If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders, including those acquiring shares in our initial public offering. We cannot assure you that additional financing will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, if and when needed, our ability to fund our operations, take advantage of unanticipated opportunities, develop or enhance our products, or otherwise respond to competitive pressures could be significantly limited. Furthermore, in the event adequate capital is not available to us as required, or is not available on favorable terms, our business, financial condition, results of operations, and cash flows may be materially and adversely affected.

We face intense competition which could negatively impact our results of operations and market share.

The communications networks industry is highly competitive. Our competitors range from large international companies offering a wide range of products to smaller companies specializing in niche markets. In addition, we believe that a number of companies have developed or are developing planar light wave, indium phosphide, high speed drivers or MEMS-based PIC devices and other products that compete directly with our products. Current and potential competitors may have substantially greater financial, marketing, research and manufacturing resources than we possess, and there can be no assurance that our current and future competitors will not be more successful than us in specific product lines or as a whole.

Some of our competitors have substantially greater name recognition, technical, financial, and marketing resources, and greater manufacturing capacity, as well as better-established relationships with customers, than we do. Some of our competitors have more resources to develop or acquire, and more experience in developing or acquiring, new products and technologies and in creating market awareness for these products and technologies. Some of our competitors may be able to develop new products more quickly than us and may be able to develop products that are more reliable or which provide more functionality than ours. In addition, some of our competitors have the financial resources on business strategy to offer competitive products at below-market pricing levels that could prevent us from competing effectively and result in a loss of sales or market share or cause us to lower prices for our products.

In particular we have developed new technologies and products that we believe are key components in our customers' systems for 100Gbps data transmission. The emergence of technologies and products from our competitors and their success in competing against our technologies and products for 100Gbps data transmission could render our existing products uncompetitive from a pricing standpoint, obsolete or otherwise unmarketable.

We also face competition from some of our customers who evaluate our capabilities against the merits of manufacturing products internally, including Huawei Technologies and its affiliate, HiSilicon. Due to the fact that such customers are not seeking to make a comparable profit directly from the manufacture of these products, they may have the ability to provide competitive products at a lower total cost than we would charge such customers. As a result, these customers may purchase less of our products and there would be additional pressure to lower our selling prices which, accordingly, would negatively impact our revenue and gross margin.

Intense competition in our markets could result in aggressive business tactics by our competitors, including aggressively pricing their products or selling older inventory at a discount. If our current or future competitors utilize aggressive business tactics, including those described above, demand for our products could decline, we could experience delays or cancellations of customer orders, or we could be required to reduce our sales prices.

Increasing costs may adversely impact our gross margins.

The rate of increase in our costs and expenses, including as a result of rising labor costs in China, may exceed the rate of increase in our revenue, either of which would materially and adversely affect our business, our results of operations and our financial condition.

Manufacturing problems could result in delays in product shipments to customers and could adversely affect our revenue, competitive position and reputation.

We may experience delays, disruptions or quality control problems in our manufacturing operations. For instance, we could experience a disruption in our fabrication facilities for our PIC products due to any number of reasons, such as equipment failure, contaminated materials or process deviations, which could adversely impact manufacturing yields or delay product shipments. As a result, we could incur additional costs that would adversely affect our gross margin, and product shipments to our customers could be delayed beyond the shipment schedules requested by our customers, which would negatively affect our revenue, competitive position and reputation.

Additionally, manufacturing yields depend on a number of factors, including the stability and manufacturability of the product design, manufacturing improvements gained over cumulative production volumes, the quality and consistency of component parts and the nature and extent of customization requirements by customers. Capacity constraints, raw materials shortages, logistics issues, labor shortages, the introduction of new product lines, rapid increases in production demands and changes in customer requirements, manufacturing facilities or processes, or those of some third party contract manufacturers and suppliers of raw materials and components have historically caused, and may in the future cause, reduced manufacturing yields, negatively impacting the gross margin on, and our production capacity for, those products. Moreover, an increase in the rejection and rework rate of products during the quality control process before, during or after manufacture would result in our experiencing lower yields, gross margin and production capacity. Our ability to maintain sufficient manufacturing yields is particularly challenging with respect to PICs due to the complexity and required precision of a large number of unique manufacturing process steps. Manufacturing yields for PICs can also suffer if contaminated materials or materials that do not meet highly precise composition requirements are inadvertently utilized. Because a large portion of our PIC manufacturing costs are fixed, PIC manufacturing yields have a substantial effect on our gross margin. Lower than expected manufacturing yields could also delay product shipments and decrease our revenue. It can be hard to cost-effectively increase our production output rapidly, and we can experience yield loss and excess material scrap, which can increase our cost of goods sold and harm our profitability. Also, if we do not have sufficient demand for our PIC-based products our cost of goods sold can increase as the fixed costs of our fabrication facilities are spread over lower production. For example, in the fourth quarter of 2012 and in 2013, we experienced such increased costs with one of our high speed products and one of our wafer fabrication facilities. These higher costs have continued in 2014, and could re-occur due to these or other reasons, in the future.

We are subject to the cyclical nature of the markets in which we compete and any future downturn may reduce demand for our products and revenue.

The markets in which we compete are tied to the aggregate capital expenditures of telecommunications service providers as they build out and upgrade their network infrastructure. These markets are highly cyclical and characterized by constant and rapid technological change, price erosion, evolving standards and wide fluctuations in product supply and demand. In the past, including recently to varying degrees in China, the U.S. and Europe, these markets have experienced significant downturns, often connected with, or in anticipation of, the maturation of product cycles—for both manufacturers' and their customers' products—or in response to over or under purchasing of inventory by our customers relative to ultimate carrier demand, and with declining general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices.

Our historical results of operations have been subject to substantial fluctuations, and we may experience substantial period-to-period fluctuations in future results of operations. Any future downturn in the markets in which we compete could significantly reduce the demand for our products and therefore may result in a significant reduction in revenue. It may also increase the volatility of the price of our common stock. Our revenue and results of operations may be materially and adversely affected in the future due to changes in demand from individual customers or cyclical changes in the markets utilizing our products.

In addition, the communications networks industry from time to time has experienced and may again experience a pronounced downturn. To respond to a downturn, many service providers may slow their capital expenditures, cancel or delay new developments, reduce their workforces and inventories and take a cautious approach to acquiring new equipment and technologies from original equipment manufacturers, which would have a negative impact on our business. Weakness in the global economy or a future downturn in the communications networks industry may cause our results of operations to fluctuate from quarter-to-quarter and year-to-year, harm our business, and may increase the volatility of the price of our common stock.

It could be discovered that our products contain defects that may cause us to incur significant costs, divert our attention, result in a loss of customers and result in product liability claims.

Our products are complex and undergo quality testing as well as formal qualification, both by our customers and by us. However, defects may occur from time to time. Our customers' testing procedures are limited to evaluating our products under likely and foreseeable failure scenarios and over varying amounts of time. For various reasons, such as the occurrence of performance problems that are unforeseeable in testing or that are detected only when products age or are operated under peak stress conditions, our products may fail to perform as expected long after customer acceptance. Failures could result from faulty components or design, problems in manufacturing or other unforeseen reasons. As a result, we could incur significant costs to repair or replace defective products under warranty, particularly when such failures occur in installed systems. We have experienced such failures in the past and will continue to face this risk going forward, as our products are widely deployed throughout the world in multiple demanding environments and applications. In addition, we may in certain circumstances honor warranty claims after the warranty has expired or for problems not covered by warranty in order to maintain customer relationships. Any significant product failure could result in lost future sales of the affected product and other products, as well as customer relations problems, litigation and damage to our reputation.

In addition, our products are typically embedded in, or deployed in conjunction with, our customers' products, which incorporate a variety of components, modules and subsystems and may be expected to interoperate with modules produced by third parties. As a result, not all defects are immediately detectable and when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems or loss of customers, all of which would harm our business.

The occurrence of any defects in our products could give rise to liability for damages caused by such defects. They could, moreover, impair our customers' acceptance of our products. Both could have a material adverse effect on our business and financial condition. Although we carry product liability insurance which covers this risk, this insurance may not adequately cover our costs arising from defects in our products or otherwise.

If spending for communications networks does not continue to grow as expected, our business and financial results may suffer.

Our future success as a provider of modules and subsystems to leading network equipment vendors depends on their continued capital spending on global communications networks. Network traffic has experienced rapid growth driven primarily by bandwidth-intensive content, including cloud services, mobile video and data services, wireless 4G/LTE services, social networking, video conferencing and other multimedia. This growth is intensified by the proliferation of fixed and wireless network-attached devices, including smartphones, laptops, netbooks, tablet computers, PCs, e-readers, televisions and gaming devices that are enabling consumers to access content at increasing data rates anytime and anywhere. Our future success depends on continued demand for high-bandwidth, high-speed communications networks and the ability of network equipment vendors to meet this demand. Growth in demand for communications networks is limited by several factors, including an evolving regulatory environment and uncertainty regarding long-term sustainable business models. We cannot be certain that demand for bandwidth-intensive content will continue to grow in the future. If expectations for growth of communications networks and bandwidth consumption are not realized and investment in communications networks does not grow as anticipated, our business could be harmed.

We depend upon outside contract manufacturers for a portion of the manufacturing process for some of our products. Our operations and revenue related to these products could be adversely affected if we encounter problems with this contract manufacturer.

The majority of our products are manufactured internally. However we also rely upon contract manufacturers in China, Japan and other Asia locations to provide back-end manufacturing and produce the finished portion of some of our products. Our reliance on a contract manufacturer for these products makes us vulnerable to possible capacity constraints and reduced control over delivery schedules, manufacturing yields, manufacturing quality/controls and costs. If one of our contract manufacturers is unable to meet all of our customer demand in a timely fashion, this could have a material adverse effect on the revenue from our products. If the contract manufacturer for one of our product were unable or unwilling to manufacture such product in required volumes and at high quality levels or to continue our existing supply arrangement, we would have to identify, qualify and select an acceptable alternative contract manufacturer or move these manufacturing operations to our internal manufacturing facilities. An alternative contract manufacturer may not be available to us when needed or may not be in a position to satisfy our quality or production requirements on commercially reasonable terms, including price. Any significant interruption in manufacturing our products would require us to reduce our supply of products to our customers, which in turn would reduce our revenue, harm our relationships with the customers of these products and cause us to forego potential revenue opportunities.

Our revenues and costs will fluctuate over time, making it difficult to predict our future results of operations.

Our revenue, gross margin and results of operations have varied significantly and are likely to continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. For instance, changes in gross margin may result from various factors, such as changes in pricing, changes in our fixed costs, changes in the cost of labor, changes in the mix of our products sold, changes in the amount of product manufactured versus the amount of product sold over time, and charges for excess and obsolete inventory. It is difficult for us to accurately forecast our future revenue and gross margin and plan expenses accordingly and, therefore, it is difficult for us to predict our future results of operations.

We must continually achieve new design wins and enhance existing products or our business and future revenue may be harmed.

The markets for our products are characterized by frequent new product introductions, changes in customer requirements and evolving industry standards, all with an underlying pressure to reduce cost and meet stringent reliability and qualification requirements. Our future performance will depend on our successful development, introduction and market acceptance of new and enhanced products that address these challenges. The anticipated or actual introduction of new and enhanced products by us and by our competitors may cause our customers to defer or cancel orders for our existing products. In addition, the introduction of new products by us or our competitors could result, and in the past, has resulted, in a slowdown in demand for our existing products and could result, and in the past, has resulted, in a write-down in the value of inventory. We have both recently and in the past experienced a slowdown in demand for existing products and delays in new product development, and such delays may occur in the future. To the extent customers defer or cancel orders for our products for any reason or we fail to achieve new design wins, our competitive position would be adversely affected and our ability to grow revenue would be impaired.

Product development delays may result from numerous factors, including:

- changing product specifications and customer requirements;
- unanticipated engineering complexities;
- difficulties in reallocating engineering resources and overcoming resource limitations; and
- changing market or competitive product capabilities that impact our requirements.

Furthermore, fast time-to-market with new products can be critical to success in our markets. It is difficult to displace an existing supplier for a particular type of product once a network equipment vendor has chosen a supplier, even if a later-to-market product provides superior performance or cost efficiency. If we are unable to make our new or enhanced products commercially available on a timely basis, we may lose existing and potential customers and our financial results would suffer.

The development of new, technologically-advanced products is a complex and uncertain process requiring frequent innovation, highly-skilled engineering and development personnel and significant capital, as well as the accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product introductions by competitors, technological changes or emerging industry standards. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, license these technologies from third parties, or remain competitive in our markets.

Our success will depend on our ability to anticipate and quickly respond to evolving technologies and customer requirements.

The communications networks industry is characterized by substantial investment in new technology and the development of diverse and changing technologies and industry standards. For example, new technologies are required to satisfy the emerging standards for 100Gbps, 400 Gbps and higher data transmission in communications networks.

Our ability to anticipate and respond to evolving technology, industry standards, customer requirements and product offerings, and to develop and introduce new and enhanced products and technologies, will be critical factors in our ability to succeed. If we are unable to anticipate and respond to such changes in the future, our competitive position could be adversely affected. In addition, the introduction of new products by other companies embodying new technologies, or the emergence of new industry standards, could render our existing products uncompetitive from a pricing standpoint, obsolete or otherwise unmarketable.

If our customers do not qualify our products for use, then our results of operations may suffer.

Prior to placing volume purchase orders with us, most of our customers require us to obtain their approval—called qualification in our industry—of our new and existing products, and our customers often audit our manufacturing facilities and perform other vendor evaluations during this process. The qualification process involves product sampling and reliability testing and collaboration with our product management and engineering teams in the design and manufacturing stages. If we are unable to qualify our products with customers, then our revenue would be lower than expected and we may not be able to recover the costs associated with the qualification process which would have an adverse effect on our results of operations.

In addition, due to evolving technological changes in our markets, a customer may cancel or modify a design project before we have qualified our product or begun volume manufacturing of a qualified product. It is unlikely that we would be able to recover the expenses for cancelled or unutilized custom design projects. It is difficult to predict with any certainty whether our customers will delay or terminate product qualification or the frequency with which customers will cancel or modify their projects, but any such delay, cancellation or modification would have a negative effect on our results of operations.

In particular, we have developed new technologies and products that we believe are key components in our customers' systems for 100Gbps data transmission. There are multiple modulation approaches for these systems and not all are likely to be equally successful. While we are shipping certain products for 100Gbps system designs today, many of our products for these systems are currently being qualified for use by our customers. Our ability to successfully qualify and scale capacity for these new technologies and products is important to our ability to grow our business and market presence. If we are unable to qualify and sell any of these products in volume on time, or at all, our results of operations may be adversely affected.

If we fail to retain our key personnel or if we fail to attract additional qualified personnel, we may not be able to achieve our anticipated level of growth and our business could suffer.

Our success and ability to implement our business strategy depends upon the continued contributions of our senior management team and others, including senior management in foreign subsidiaries and our technical and operations employees in all locations. Our future success depends, in part, on our ability to attract and retain key personnel, including our senior management and others, and on the continued contributions of members of our senior management team and key technical and operations personnel, each of whom would be difficult to replace. The loss of services of members of our senior management team or key personnel or the inability to continue to attract and retain qualified personnel could have a material adverse effect on our business. Competition for highly skilled technical and operations people where we operate is extremely intense, and we continue to face challenges identifying, hiring and retaining qualified personnel in many areas of our business. If we fail to retain our senior management and other key personnel or if we fail to attract additional qualified personnel, our business could suffer.

The communications networks industry has long product development cycles requiring us to incur product development costs without assurances of an acceptable investment return.

The communications networks industry is highly capital-intensive. Large volumes of equipment and support structures are installed with considerable expenditures of funds and other resources, and long investment return period expectations. At the component supplier level, these cycles create considerable, typically multi-year, gaps between the commencement of new product development and volume purchases. Accordingly, we and our competitors often incur significant research and development and sales and marketing costs for products that, initially, will be purchased by our customers long after much of the cost is incurred and, in some cases, may never be purchased due to changes in industry or customer requirements in the interim.

Due to changing industry and customer requirements, we are constantly developing new products, including seeking to further integrate functions on PICs and developing and using new technologies in our products. These development activities can and are expected to necessitate significant investment of capital. Our new products often require a long time to develop because of their complexity and rigorous testing and qualification requirements. Additionally, developing a manufacturing approach with an acceptable cost structure and yield for new products can be expensive and time-consuming. Due to the costs and length of research and development and manufacturing process cycles, we may not recognize revenue from new products until long after such expenditures are incurred, if at all, and our gross margin may decrease if our costs are higher than expected.

While we rely on many suppliers, there are a few which, if they stopped, decreased or delayed shipments to us, it could have an adverse effect on our business and financial results.

We depend on a limited number of suppliers for certain components and materials we have qualified to use in the manufacture of certain of our products. Some of these suppliers could disrupt our business if they stop, decrease or delay shipments or if the components they ship have quality, consistency, or business continuity issues. Some of these components and materials are available only from a sole source, or have been qualified only from a single source, although other sources may exist. For example, we use various types of adhesives that are sourced from various manufacturers, which presently are sole sources for these particular adhesives. Furthermore, there are a limited number of entities from which we could obtain certain other components and materials. We may also face component shortages if we experience increased demand for components beyond what our qualified suppliers can deliver. We have experienced component shortages from certain key suppliers, which has resulted and, if this occurs in the future, may result in an inability to meet customer demand, higher purchasing costs, or both. Although we engage in various actions to mitigate the impact of these shortages, any inability on our part to obtain sufficient quantities of critical components at reasonable costs could adversely affect our ability to meet demand for our products, which could cause our revenue, results of operations, or both to suffer.

Our customers generally restrict our ability to change the component parts in our modules without their approval. For more critical components, such as PICs, lasers and photo detectors, any changes may require repeating the entire qualification process. We typically have not entered into long-term or written agreements with our suppliers to guarantee the supply of the key components used in our products, and, therefore, our suppliers could stop supplying materials and equipment at any time or fail to supply adequate quantities of component parts on a timely basis. It is difficult, costly, time consuming and, on short notice, sometimes impossible for us to identify and qualify new component suppliers. The reliance on a sole supplier, single qualified vendor or limited number of suppliers could result in delivery and quality problems, reduced control over product pricing, reliability and performance and an inability to identify and qualify another supplier in a timely manner. We have in the past had to change suppliers, which has, in some instances, resulted in delays in product development and manufacturing and loss of revenue. Any such delays in the future may limit our ability to respond to changes in customer and market demands. Any supply deficiencies relating to the quality, quantities or timeliness of delivery of components that we use to manufacture our products could adversely affect our ability to fulfill our customer orders and our results of operations.

If we fail to protect, or incur significant costs in defending, our intellectual property and other proprietary rights, our business and results of operations could be materially harmed.

Our success depends to a significant degree on our ability to protect our intellectual property and other proprietary rights. We rely on a combination of patent, trademark, copyright, trade secret and unfair competition laws, as well as license agreements and other contractual provisions, to establish and protect our intellectual property and other proprietary rights. We have applied for patent registrations in the U.S. and in other foreign countries, some of which have been issued. In addition, we have registered the trademark “NeoPhotonics” in the U.S. We cannot guarantee that our pending applications will be approved by the applicable governmental authorities. Moreover, our existing and future patents and trademarks may not be sufficiently broad to protect our proprietary rights or may be held invalid or unenforceable in court. A failure to obtain patents or trademark registrations or a successful challenge to our registrations in the U.S. or other foreign countries may limit our ability to protect the intellectual property rights that these applications and registrations intended to cover.

Policing unauthorized use of our technology is difficult and we cannot be certain that the steps we have taken will prevent the misappropriation, unauthorized use or other infringement of our intellectual property rights. Further, we may not be able to effectively protect our intellectual property rights from misappropriation or other infringement in foreign countries where we have not applied for patent protections, and where effective patent, trademark, trade secret and other intellectual property laws may be unavailable, or may not protect our proprietary rights as fully as U.S. or Japan law. Particularly, our U.S. patents do not afford any intellectual property protection in China, Japan, Canada or other Asia locations where we have company operations, or in Russia, where we intend to expand operations. We seek to secure, to the extent possible, comparable intellectual property protections in China and other areas in which we operate. However, while we have issued patents and pending patent applications in China, portions of our intellectual property portfolio are not yet protected by patents in China. Moreover, the level of protection afforded by patent and other laws in countries such as China and Russia may not be comparable to that afforded in the U.S. or Japan.

We attempt to protect our intellectual property, including our trade secrets and know-how, through the use of trade secret and other intellectual property laws, and contractual provisions. We enter into confidentiality and invention assignment agreements with our employees and independent consultants. We also use non-disclosure agreements with other third parties who may have access to our proprietary technologies and information. Such measures, however, provide only limited protection, and there can be no assurance that our confidentiality and non-disclosure agreements will not be breached, especially after our employees or those of our third-party contract manufacturers end their employment or engagement, and that our trade secrets will not otherwise become known by competitors or that we will have adequate remedies in the event of unauthorized use or disclosure of proprietary information. Unauthorized third parties may try to copy or reverse engineer our products or portions of our products, otherwise obtain and use our intellectual property, or may independently develop similar or equivalent trade secrets or know-how. If we fail to protect our intellectual property and other proprietary rights, or if such intellectual property and proprietary rights are infringed or misappropriated, our business, results of operations or financial condition could be materially harmed.

In the future, we may need to take legal actions to prevent third parties from infringing upon or misappropriating our intellectual property or from otherwise gaining access to our technology. Protecting and enforcing our intellectual property rights and determining their validity and scope could result in significant litigation costs and require significant time and attention from our technical and management personnel, which could significantly harm our business. In addition, we may not prevail in such proceedings. An adverse outcome of such proceedings may reduce our competitive advantage or otherwise harm our financial condition and our business.

We may be involved in intellectual property disputes in the future, which could divert management's attention, cause us to incur significant costs and prevent us from selling or using the challenged technology.

Participants in the markets in which we sell our products have experienced frequent litigation regarding patent and other intellectual property rights. Numerous patents in these industries are held by others, including our competitors. In addition, from time to time, we have been notified that we may be infringing certain patents or other intellectual property rights of others. Regardless of their merit, responding to such claims can be time consuming, divert management's attention and resources and may cause us to incur significant expenses. In addition, there can be no assurance that third parties will not assert infringement claims against us. While we believe that our products do not infringe in any material respect upon intellectual property rights of other parties and/or meritorious defense would exist with respect to any assertions to the contrary, we cannot be certain that our products would not be found infringing the intellectual property rights of others. Intellectual property claims against us could invalidate our proprietary rights and force us to do one or more of the following:

- obtain from a third party claiming infringement a license to sell or use the relevant technology, which may not be available on reasonable terms, or at all;
- stop manufacturing, selling, incorporating or using our products that use the challenged intellectual property;
- pay substantial monetary damages; or
- expend significant resources to redesign the products that use the technology and to develop non-infringing technology.

Any of these actions could result in a substantial reduction in our revenue and could result in losses over an extended period of time.

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and us, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the co-defendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products in the U.S. On March 23, 2010, we filed an answer to the complaint and counterclaims, asserting two claims of patent infringement and additional claims asserting that Finisar has violated state and federal competition laws and violated its obligations to license on reasonable and non-discriminatory terms. On May 5, 2010, the court dismissed without prejudice all co-defendants (including us) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each co-defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against us. Since that time, we and Finisar entered into agreements that tolled our respective claims until Finisar resolved its litigation against certain other co-defendants, which litigation subsequently was resolved (commencing the tolling period with us).

On May 3, 2012, we and Finisar agreed to further toll our respective claims until the refiling of certain of the previously asserted claims from this dispute. As a result, Finisar is permitted to bring a new lawsuit against us if it chooses to do so, and we may bring new claims against Finisar upon seven days written notice prior to filing such claims.

If we are unsuccessful in our defense of the Finisar patent infringement claims, a license to use the allegedly infringing technology may not be available to us at all, and if it is, it may not be available on commercially reasonable terms and therefore may limit or preclude us from competing in the market for optical transceivers in the U.S., which may have a material adverse effect on our results of operations and financial condition, and otherwise materially harm our business.

Although we believe that we would have meritorious defenses to the infringement allegations and intend to defend any new similar lawsuit vigorously, there can be no assurance that we will be successful in our defense. Even if we are successful, we may incur substantial legal fees and other costs in defending the lawsuit. Further, a new lawsuit, if brought by either party, would be likely to divert the efforts and attention of our management and technical personnel, which could harm our business.

If we fail to obtain the right to use the intellectual property rights of others which are necessary to operate our business, and to protect their intellectual property, our business and results of operations will be adversely affected.

From time to time we may choose to or be required to license technology or intellectual property from third parties in connection with the development of our products. We cannot assure you that third-party licenses will be available to us on commercially reasonable terms, if at all. Generally, a license, if granted, would include payments of up-front fees, ongoing royalties or both. These payments or other terms could have a significant adverse impact on our results of operations. The inability to obtain a necessary third-party license required for our product offerings or to develop new products and product enhancements could require us to substitute technology of lower quality or performance standards, or of greater cost, either of which could adversely affect our business. If we are not able to obtain licenses from third parties, if necessary, then we may also be subject to litigation to defend against infringement claims from these third parties. Our competitors may be able to obtain licenses or cross-license their technology on better terms than we can, which could put us at a competitive disadvantage. Also, we typically enter into confidentiality agreements with such third parties in which we agree to protect and maintain their proprietary and confidential information, including requiring our employees to enter into agreements protecting such information. There can be no assurance that the confidentiality agreements will not be breached by any of our employees or that such third parties will not make claims that their proprietary information has been disclosed.

Any potential dispute involving our patents or other intellectual property could also include our customers using our products, which could trigger our indemnification obligations to them and result in substantial expenses to us.

In any potential dispute involving our patents or other intellectual property, our customers could also become the target of litigation. Because we often indemnify our customers for intellectual property claims made against them for products incorporating our technology, any claims against our customers could trigger indemnification obligations in some of our supply agreements, which could result in substantial expenses such as increased legal expenses, damages for past infringement or royalties for future use. While we have not incurred any material indemnification expenses to date, any future indemnity claim(s) could adversely affect our relationships with our customers and result in substantial costs to us. Our insurance does not cover intellectual property infringement.

If we fail to adequately manage our long-term growth and expansion requirements, our business and financial results will suffer.

In recent years, we have experienced significant growth through, among other things, internal expansion programs, product development and acquisitions of other businesses and products. Our business has expanded to numerous locations, including foreign locations, and as a result become more complex, more demanding of management's attention and subject to new laws and regulations. If we fail to comply with new laws and regulations related to the expansion of our business, our business could suffer.

We expect to continue to grow, which could require us to expand our manufacturing operations, including hiring new personnel, purchasing additional equipment, leasing or purchasing additional facilities, developing the management infrastructure and developing our suppliers to manage any such expansion. If we fail to secure these expansion requirements or manage our future growth effectively, our business could suffer.

*We have pursued and may continue to pursue acquisitions. Acquisitions could be difficult to integrate, divert the attention of key personnel, disrupt our business, dilute stockholder value and impair our financial results.

As part of our business strategy, we have pursued and intend to continue to pursue acquisitions of complementary businesses, products, services or technologies that we believe could accelerate our ability to compete in our existing markets or allow us to enter new markets. Any of these transactions could be material to our financial condition and results of operations. For instance, in October 2011, we completed the acquisition of Santur Corporation, a designer and manufacturer of InP-based PIC products, and in March 2013 we completed the acquisition of the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd., now known as NeoPhotonics Semiconductor. In October 2014, we entered into an Asset Purchase Agreement to purchase certain assets and assume certain liabilities of the tunable laser and transceiver product lines of EMCORE Corporation, and we expect to complete this acquisition by early January 2015. If we fail to properly evaluate or integrate acquisitions, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate.

Acquisitions involve numerous risks, any of which could harm our business, including:

difficulties in integrating the operations, technologies, products, existing contracts, accounting and personnel of the target company and realizing the anticipated synergies of the combined businesses;

difficulties in realizing our expectations for the financial performance of the target company;
difficulties in supporting and transitioning customers, if any, of the target company;
difficulties in managing and integrating different cultures with respect to our international acquisitions;
dependence or reliance on subcontractors or suppliers to the acquired company that may not have been fully qualified or evaluated for their position in supplying the acquired company previously;
diversion of management time and potential business disruption;
the incurrence of debt to provide capital for any cash-based acquisitions;
the price we pay or other resources that we devote may exceed the value we realize, or the value we could have realized if we had allocated the purchase price or other resources to another opportunity;
risks of entering new markets in which we have limited or no experience;

potential loss of key employees, customers and strategic alliances from either our current business or the target company's business;
assumption of unanticipated problems or latent liabilities, such as problems with the quality of the target company's products;
exposure to environmental liabilities that have not yet been discovered associated with acquired businesses' facilities;
expenses, distractions and actual or threatened claims or litigation resulting from acquisitions, whether or not they are completed;
unexpected capital expenditure requirements
inability to generate sufficient revenue to offset increased expenses association with any acquisition;
issues arising from weaknesses or deficiencies in internal controls over financial reporting for acquired businesses that were not previously subject to internal control requirements of a U.S. public company;
in the event of international acquisitions, risks associated with accounting and business practices that are different from applicable U.S. practices and requirements;
dilutive effect on our stock as a result of any equity-based acquisitions;
incurring potential write-offs, contingent liabilities and amortization expense; and,
opportunity costs of committing capital to such acquisitions.
The failure to successfully evaluate and execute acquisitions or otherwise adequately address these risks could materially harm our business and financial results.

Acquisitions also frequently result in the recording of goodwill and other intangible assets which are subject to potential impairments which have occurred in the past and which, were they to occur in the future, could harm our financial results. As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate. The failure to successfully evaluate and execute acquisitions or investments or otherwise adequately address these risks could materially harm our business and financial results.

*Failure to realize the anticipated benefits from our past and future acquisitions may affect our future results of operations and financial condition.

In connection with our acquisitions of Santur and NeoPhotonics Semiconductor, we have integrated the commercial operations and personnel into our existing infrastructure. If there are unexpected difficulties in our integration of these acquired businesses and/or the product lines we intend to acquire from EMCORE Corporation, the anticipated benefits of these acquisitions may not be realized or may take longer to realize than expected. The anticipated benefits of these acquisitions could be materially reduced by a number of factors, including the following:

the future revenue and gross margins of the acquired products may be materially different from those we originally anticipated;
we could incur material unanticipated expenses;
acquired products may not achieve the performance levels or specifications required by our customers;
claims or lawsuits may arise from the acquisition transaction or from their previous business operations;
we may experience difficulties in managing inventory and other operational processes in facilities that we acquire or lease as a result of the acquisitions;
we may experience difficulties in implementing effective internal controls over financial reporting as part of our integration actions, particularly since neither of these businesses were historically subject as a stand-alone entity to the internal control requirements of a U.S. public company;
potential growth, expected financial results, perceived synergies and anticipated opportunities may not be realized through the ongoing integration actions;
we may face competition from existing customers as well as new competitors;

some existing customers of NeoPhotonics Semiconductor may view our larger company as a competitor, and therefore may reduce or end their purchases of NeoPhotonics Semiconductor products for competitive reasons;

Japanese customers of NeoPhotonics Semiconductor, who had previously been buying from OCU as a Japanese supplier, could choose to find another Japanese supplier rather than buying products from a U.S.-headquartered company;
a potential decline in revenues could occur from NeoPhotonics Semiconductor's legacy products for network applications that are declining within our customer base (such as NeoPhotonics Semiconductor's gallium arsenide integrated circuits for 10G network applications)
we could have difficulty implementing and maintaining financial reporting requirements for NeoPhotonics Semiconductor's previous business operations, which have not been previously audited nor subject to the internal compliance structure of a U.S. public company;
we could have difficulty implementing our existing management, production and accounting software and programs for NeoPhotonics Semiconductor's previous business operations or for the product lines we intend to acquire from EMCORE;
we could incur additional costs associated with known and unknown environmental contamination of the real estate acquired from NeoPhotonics Semiconductor; and
we could incur costs associated with new export or compliance issues associated with NeoPhotonics Semiconductor products.
The occurrence of any or all of these events may have an adverse effect on our business and results of operations.

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

Our worldwide operations could be subject to natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses. For example, our corporate headquarters and wafer fabrication facility in Silicon Valley, California and our Tokyo, Japan facility are located near major earthquake fault lines, and our manufacturing facilities are located in Shenzhen and Dongguan, China, areas that are susceptible to typhoons. Further, a terrorist attack, including one aimed at energy or communications infrastructure suppliers, could hinder or delay the development and sale of our products. In the event that an earthquake, tsunami, typhoon, terrorist attack or other natural or man-made catastrophe were to destroy any part of our facilities, destroy or disrupt vital infrastructure systems or interrupt our operations or the facilities or operations of our suppliers or customers for any extended period of time, our business, financial condition and results of operations would be materially and adversely affected. We are not insured against many natural disasters, including earthquakes.

Similarly, our worldwide operations could be subject to secondary effects of natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses. For instance, natural disasters and other business disruptions have created significant secondary effects in the past (such as the 2011 floods in Thailand and the 2011 earthquakes, tsunami and subsequent crisis relating to nuclear power facilities in Japan). Any of these types of events in the future could result in a slowdown of business or inability to manufacture products by our customers or others in the industry that are located in the affected areas; a disruption to the global supply chain for products manufactured in the affected areas that are included in the products either by us or by our customers; a disruption to manufacturing resulting from power shortages or other rationing of inputs to production; an increase in the cost of products that we purchase due to reduced supply; and other unforeseen impacts. These secondary effects could have a material and adverse effect on our business, financial condition, and results of operations.

Rapidly changing standards and regulations could make our products obsolete, which would cause our revenue and results of operations to suffer.

We design our products to conform to regulations established by governments and to standards set by industry standards bodies worldwide, such as The American National Standards Institute, the European Telecommunications Standards Institute, the International Telecommunications Union and the Institute of Electrical and Electronics

Engineers. Various industry organizations are currently considering whether and to what extent to create standards for elements used in 100Gbps systems. Because certain of our products are designed to conform to current specific industry standards, if competing or new standards emerge that are preferred by our customers, we would have to make significant expenditures to develop new products. If our customers adopt new or competing industry standards with which our products are not compatible, or the industry groups adopt standards or governments issue regulations with which our products are not compatible, our existing products would become less desirable to our customers and our revenue and results of operations would suffer.

Failure to realize the anticipated benefits from our planned expansion in the Russian Federation may affect our future results of operations and financial condition.

In connection with our raising capital in an April 2012 private placement of common stock, we have established a wholly-owned subsidiary and company operations in the Russian Federation. The establishment of successful operations in the Russian Federation will require capital expenditure in 2014 and 2015, and will be in part dependent on the cooperation of Russian entities that could include the Russia government and other third parties. If there are delays in our efforts to establish operations in the Russian Federation, the anticipated benefits of our Russian expansion may not be realized or may take longer to realize than expected. The anticipated benefits of our Russian expansion could be materially reduced by a number of factors, including the following:

- the future revenue and gross margins of products produced in the Russian Federation may be materially different from those we originally anticipated;
- we could incur material unanticipated expenses; and
- we could have difficulty managing a business in the Russian Federation, where we did not previously have a material business presence.

In addition, in connection with the private placement transaction, we entered into a rights agreement with the sponsoring investor. Pursuant to the rights agreement, we have agreed to make a $30.0 million investment towards our Russian operations. We were required to satisfy this investment commitment by July 31, 2015, which date has been extended to March 31, 2015 as we did not record aggregate revenue from sales of our products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014. Pursuant to the rights agreement, failure to perform the investment commitment by the deadline will result in an obligation to pay damages to the investor in the amount of $5.0 million.

In recent years the Russian Federation has undergone substantial political, economic and social change. The business, legal and regulatory infrastructure in the Russian Federation is less well-developed that would generally exist in a more mature free market economy. In addition, the tax, currency and customs legislation within the Russian Federation is subject to varying interpretations and changes, which can occur frequently. The future economic direction of the Russian Federation remains largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory and political developments. Our failure to manage the risks associated with our planned Russian expansion could have a material adverse effect upon our results of operations.

Our planned Russian expansion could also be delayed or adversely affected by direct or indirect events arising out of the recent actions related to Ukraine. For instance, trade restrictions or economic sanctions that may be imposed by the United States or other countries as a consequence of Russia's recent or future involvement in Ukraine could restrict or potentially harm our business in the Russian Federation. Furthermore, we could be adversely affected by any actions taken by Russia in response to U.S. or international sanctions, such as restrictions place by Russia on U.S. companies doing business in Russia.

The occurrence of any or all of these events may have an adverse effect on our business, and results of operations and financial condition.

Potential changes in our effective tax rate could negatively affect our future results.

We are subject to income taxes in the U.S., China, Japan and other various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in differing jurisdictions. Our tax rate is affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses and the valuation of deferred tax assets and liabilities, including our ability to utilize our net operating losses. Increases in our effective tax rate could negatively affect our results of operations.

Our future results of operations may be subject to volatility as a result of exposure to fluctuations in foreign exchange rates, primarily the Chinese Renminbi (RMB) and Japanese Yen (JPY) exchange rates.

We are exposed to foreign exchange risks. Foreign currency fluctuations may adversely affect our revenue and our costs and expenses, and hence our results of operations. A substantial portion of our business is conducted through our subsidiaries based in China, whose functional currency is the RMB and Japan, whose functional currency is the JPY. The value of the RMB against the U.S. dollar and other currencies and the value of the JPY against the U.S. dollar and other currencies fluctuate and are affected by, among other things, changes in political and economic conditions.

The People's Bank of China regularly intervenes in the foreign exchange market to limit fluctuations in RMB exchange rates and achieve policy goals. Since July 21, 2005, the RMB has no longer been pegged solely to the value of the U.S. dollar. Instead, the

RMB is now pegged against a basket of currencies, determined by the People's Bank of China, against which it can rise or fall by as much as 1.0% each day (which may further widen in the future). This change in policy has resulted in approximately 36% appreciation of the RMB against the U.S. dollar between July 21, 2005 and December 31, 2013. In the long term, the RMB may appreciate or depreciate significantly in value against the U.S. dollar, depending upon the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the RMB against the U.S. dollar.

Foreign currency exchange rates are subject to fluctuation and may cause us to recognize transaction gains and losses in our statements of operations. To the extent that transactions by our subsidiaries in China and Japan are denominated in currencies other than the RMB and JPY, we bear the risk that fluctuations in the exchange rates of the RMB and JPY in relation to other currencies could decrease our revenue or increase our costs and expenses, therefore having an adverse effect on our future results of operations.

While we generate a significant portion of our revenue in RMB and JPY, a majority of our operating expenses are in U.S. dollars. Therefore depreciation in RMB or JPY against the U.S. dollar would negatively impact our revenue upon translation to U.S. dollars but the impact on operating expenses would be less. For example, for the year ended December 31, 2013, a 10% depreciation in RMB against the U.S. dollar would have resulted in a $7.8 million decrease in our revenue and a $0.2 million increase in our net loss and a 10% depreciation in JPY would have resulted in a $0.8 million decrease in our revenue and a $0.03 million increase in our net loss. In the nine months ended September 30, 2014, the Japanese yen and the RMB weakened against the U.S dollar.

We also transact in other currencies that have had historical volatility, including Russian Rubles. Fluctuations in the exchange rates of these currencies may cause us to recognize additional transaction gains or losses which could impact our results of operations.

To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedging transactions may be limited and we may not be able to successfully hedge our exposure. In addition, our currency exchange variations may be magnified by Chinese exchange control regulations that restrict our ability to convert RMB into foreign currency.

We face a variety of risks associated with international sales and operations, which if not adequately managed could adversely affect our business and financial results.

We currently derive, and expect to continue to derive, a significant portion of our revenue from international sales in various markets. In addition, a major portion of our operations is based in Shenzhen and Dongguan, China as well as our having additional operations in Japan, Russia and Canada. We are also in the process of establishing manufacturing operations in Russia. Our international revenue and operations are subject to a number of material risks, including, but not limited to:

difficulties in staffing, managing and supporting operations in more than one country;
difficulties in enforcing agreements and collecting receivables through foreign legal systems;
fewer legal protections for intellectual property in foreign jurisdictions;
compliance with local regulations;
foreign and U.S. taxation issues and international trade barriers;
general economic and political conditions in the markets in which we operate;
difficulties in obtaining any necessary governmental authorizations for the export of our products to certain foreign jurisdictions;
fluctuations in foreign economies;

fluctuations in the value of foreign currencies and interest rates;
trade and travel restrictions;
outbreaks of contagious disease;
domestic and international economic or political changes, hostilities and other disruptions in regions where we currently operate or may operate in the future;
difficulties and increased expenses in complying with a variety of U.S. and foreign laws, regulations and trade standards, including the Foreign Corrupt Practices Act; and
different and changing legal and regulatory requirements in the jurisdictions in which we currently operate or may operate in the future.

Negative developments in any of these areas in China, Japan, Russia or other countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, difficulties in producing and delivering our products, threats to our intellectual property, difficulty in collecting receivables, and a higher cost of doing business.

In addition, although we maintain an anti-corruption compliance program throughout our company, violations of our compliance program may result in criminal or civil sanctions, including material monetary fines, penalties and other costs against us or our employees, and may have a material adverse effect on our business.

In making an investment decision relating to our common stock, you should evaluate our business in light of the risks, expenses and difficulties frequently encountered by companies operating on a global platform, particularly companies in the rapidly changing communications networks industry.

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

We are subject to export and import control laws, trade regulations and other trade requirements that limit which products we sell and where and to whom we sell our products, especially laser-dependent products. In some cases, it is possible that export licenses would be required from U.S. government agencies for some of our products in accordance with various statutory authorities, including but not limited to the International Traffic in Arms Regulations, the Export Administration Act of 1979, the International Emergency Economic Powers Act of 1977, the Trading with the Enemy Act of 1917 and the Arms Export Control Act of 1976 and various country-specific trade sanctions legislation. In addition, various countries regulate the import of certain technologies and have enacted laws that could limit our ability to distribute our products. We may not be successful in obtaining the necessary export and import licenses. Failure to comply with these and similar laws on a timely basis, or at all, or any limitation on our ability to export or sell our products or to obtain any required licenses would adversely affect our business, financial condition and results of operations.

Changes in our products or changes in export and import laws and implementing regulations may create delays in the introduction of new products in international markets, prevent our customers from deploying our products internationally or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. In such event, our business and results of operations could be adversely affected.

We have identified material weaknesses in our internal control over financial reporting which could, if not remediated, result in material misstatements in our financial statements.

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended, or the Exchange Act.

The following material weaknesses in our internal control over financial reporting were identified during 2013 and had not been remediated as of September 30, 2014:

Control Environment — We did not maintain an effective control environment, which is the foundation for the discipline and structure necessary for effective internal control over financial reporting, as evidenced by: (i) an insufficient number of personnel appropriately qualified to perform control monitoring activities, including the recognition of the risks and complexities of our transactions and business operations, (ii) an insufficient number of personnel with an appropriate level of GAAP knowledge and experience or ongoing training in the application of GAAP commensurate with our financial reporting requirements, which resulted in erroneous judgments regarding the proper application of GAAP and (iii) insufficient corporate involvement to identify and resolve errors in recording transactions and financial results at our non-US subsidiaries. This control environment material weakness was exacerbated by our acquisition of NeoPhotonics Semiconductor in March 2013 and contributed to the following additional material weaknesses.

Accounting for complex transactions — We did not maintain effective internal controls related to complex transactions, including the acquisition of NeoPhotonics Semiconductor. Our controls over the accounting, process and procedures for the NeoPhotonics Semiconductor acquisition were not effective to provide reasonable assurance that (i) the business combination accounting identified and considered all known acquired liabilities, (ii) the business combination accounting reflected the appropriate application of GAAP and (iii) there was appropriate review of the purchase price allocation entries recorded in the consolidated financial statements. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

Preparation and review of consolidated financial statements — We did not maintain effective internal control over financial reporting related to the preparation and review of our consolidated financial statements. Specifically, we did not execute controls related to the review of transactions and balances for proper classification in our balance sheet, statement of operations and statement of cash flows. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

We have developed remediation plans designed to address these material weaknesses. If our remedial measures are insufficient to address the material weaknesses or if additional material weaknesses in our internal control are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results. For more information see “Item 4. Controls and Procedures”.

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

Preparing our consolidated financial statements involves a number of complex manual and automated processes, which are dependent upon individual data input or review and require significant management judgment. One or more of these elements may result in errors that may not be detected and could result in a material misstatement of our consolidated financial statements. Since the year ended December 31, 2011, we have been required to comply with the internal control requirements of the Sarbanes-Oxley Act of 2002. The original Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 1992 will be superseded by COSO’s Internal Control-Integrated Framework issued in 2013 (the “2013 Framework”) after December 15, 2014 and we are in the process to complete our transition to the 2013 Framework. In addition, we may experience difficulties in implementing effective internal controls over financial reporting as part of our integration of NeoPhotonics Semiconductor. NeoPhotonics Semiconductor was not subject as a stand-alone entity to the internal control requirements of a U.S. public company. We could also experience unanticipated additional operating costs in implementing and managing effective internal controls over financing reporting at the NeoPhotonics Semiconductor facilities and operations, which could adversely affect our financial performance.

If a material misstatement occurs in the future, we may fail to meet our future reporting obligations, we may need to restate our financial results and the price of our common stock may decline. Our internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if we experience difficulties in the implementation, our business and operating results may be harmed and we may fail to meet our financial reporting obligations. Any failure of our internal controls could also adversely affect the results of the periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting that is now applicable to us under the rules of the Securities and Exchange Commission, or the SEC. Effective internal controls are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and results of operations could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.

We may be subject to disruptions or failures in information technology systems and network infrastructures that could have a material adverse effect on our business and financial condition.

We rely on the efficient and uninterrupted operation of complex information technology systems and network infrastructures to operate our business. A disruption, infiltration or failure of our information technology systems as a result of software or hardware malfunctions, system implementations or upgrades, computer viruses, third-party security breaches, employee error, theft or misuse, malfeasance, power disruptions, natural disasters or accidents could cause breaches of data security, loss of intellectual property and critical data and the release and misappropriation of sensitive competitive information and partner, customer and employee personal data. Any of these events could harm our competitive position, result in a loss of customer confidence, cause us to incur significant costs to remedy any damages and ultimately materially adversely affect our business and financial condition.

Covenants in our credit facilities may limit our flexibility in responding to business opportunities and competitive developments and increase our vulnerability to adverse economic or industry conditions.

We have lending arrangements with several financial institutions, including a revolving credit and term loan agreement with Comerica Bank and East-West Bank in the U.S. Our U.S. revolving credit and term loan agreement requires us to maintain certain financial covenants, including a liquidity ratio and a quarterly ratio of funded debt to adjusted EBITDA, and limits our ability to take certain actions such as incurring some kinds of additional debt, paying dividends, or engaging in certain transactions like mergers and acquisitions, investments and asset sales without the lenders' consent. In May 2014, we executed an amendment to the credit agreement that waived testing of certain covenants for compliance, including the debt to EBITDA covenant, provided that we maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. We intend to work with the lenders to restructure the credit agreement, including the covenant requirements. In the absence of a restructured agreement, we believe we will have difficulty complying with the existing debt to EBITDA covenant for at least the next twelve months.

These restrictions may limit our flexibility in responding to business opportunities, competitive developments and adverse economic or industry conditions. In addition, our obligations under our U.S. revolving credit and term loan agreement with Comerica Bank and East-West Bank are secured by substantially all of our assets other than intellectual property assets, which limit our ability to provide collateral for additional financing. A breach of any of these covenants, or a failure to pay interest or indebtedness when due under any of our credit facilities, could result in a variety of adverse consequences, including the acceleration of our indebtedness.

We may be unable to utilize our net operating loss carryforwards to reduce our income taxes, which could adversely affect our future financial results.

As of December 31, 2013, we had net operating loss, or NOL, carryforwards for U.S. federal and state tax purposes of $238.0 million and $155.6 million, respectively. As these net operating losses have not been utilized, a portion will begin to expire in 2014 and will continue to expire further in the current and future years. The utilization of the NOL and tax credit carryforwards are subject to a substantial limitation imposed by Section 382 of the Internal Revenue Code of 1986, as amended, or the Code, and similar state provisions. We recorded deferred tax assets, net of valuation allowance, for the NOL carryforwards currently available after considering the existing Section 382 limitation. If we incur an additional limitation under Section 382, then the NOL carryforwards, as disclosed, could be reduced by the impact of any future limitation that would result in existing NOL carryforwards and tax credit carryforwards expiring unutilized and increases in future tax liabilities.

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

We became a public reporting company in February 2011. As a public company, we incur legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act, as well as rules subsequently implemented by the SEC and the New York Stock Exchange, or NYSE, imposes additional requirements on public companies, including specific corporate governance practices. For example, the listing requirements of the NYSE require that we satisfy certain corporate governance requirements relating to independent directors, audit and compensation committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of conduct. Our management and other personnel need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly. For example, these rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial additional costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

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

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

We may utilize conflict minerals in our production or rely on suppliers who utilize conflict minerals in their production, and the use of such conflict minerals may negatively impact our results of operations.

In August 2012, the U.S. Securities and Exchange Commission (SEC) adopted its final rule to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding reporting obligations for the use of conflict minerals originating in the Democratic Republic of the Congo and adjoining countries, and beginning on January 1, 2013, we became subject to these reporting obligations and filed our first conflict minerals report with the SEC in the second quarter of 2014. In connection with these requirements, we regularly communicate with customers and suppliers regarding the new conflict mineral rules and reporting obligations and continue to work with these customers and suppliers to implement any necessary or requested compliance programs. As a result of these new rules, our results in operations may suffer for a variety of reasons, including:

- difficulty in obtaining supplies that are conflict-free;
- shipping delays or the cancellation of orders for our products;
- costs associated with the implementation of the conflict minerals reporting obligations; and
- reputational damage in the event that we determine our products do incorporate conflict minerals or cannot be verified as not incorporating conflict minerals.

In some instances, we rely on third-party sales representatives to assist in selling our products, and the failure of these representatives to perform as expected could reduce our future revenue.

Although we primarily sell our products through direct sales to systems vendors, we also sell our products to some of our customers through third-party sales representatives. Many of our third-party sales representatives also market and sell competing products from our competitors. Our third-party sales representatives may terminate their relationships with us at any time, or with short notice. Our future performance will also depend, in part, on our ability to attract additional third-party sales representatives that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. If our current third-party sales representatives fail to perform as expected, our revenue and results of operations could be harmed.

We are subject to environmental, health and safety laws and regulations, which could subject us to liabilities, increase our costs, or restrict our business or operations in the future.

Our manufacturing operations and our products are subject to a variety of federal, state, local and international environmental, health and safety laws and regulations in each of the jurisdictions in which we operate or sell our products. These laws and regulations govern, among other things, air emissions, wastewater discharges, the handling and disposal of hazardous substances and wastes, soil and groundwater contamination, employee health and safety, and the use of hazardous materials in, and the recycling of, our products. Our failure to comply with present and future environmental, health or safety requirements, or the identification of contamination, could cause us to incur substantial costs, including cleanup costs, monetary fines, civil or criminal penalties, or curtailment of operations. In addition, the enactment of more stringent laws and regulations, or other unanticipated events could restrict our ability to expand our facilities, require us to install costly pollution control equipment or incur other additional expenses, or require us to modify our manufacturing processes or the contents of our products, which could have a material adverse effect on our business, financial condition and results of operations.

Additionally, increasing efforts to control emissions of greenhouse gases, or GHG, may also impact us. Additional climate change or GHG control requirements are under consideration at the federal level in the U.S. and in China. Additional restrictions, limits, taxes, or other controls on GHG emissions could increase our operating costs and, while it is not possible to estimate the specific impact any final GHG regulations will have on our operations, there can be no assurance that these measures will not have significant additional impact on us.

Our Japan operations are subject to local environmental laws and regulations, and our failure to fully comply with all applicable environmental laws and regulations could negatively affect our operations and our future results.

Following our acquisition of NeoPhotonics Semiconductor, we now own and operate a semiconductor facility in Japan which is subject to local environmental laws and regulations, including the Japanese Environmental Quality Standards (“JEQS”) and the Water Pollution Control Law (“Water Law”), which includes provisions for periodic monitoring of groundwater quality. The JEQS provides guidelines for specified substances in groundwater, primarily including metals and volatile organic compounds, include some that are either used in our operations or have been used in our facilities in prior years. In addition, the Soil Contamination Countermeasures Law includes regulatory standards for many of the same substances regulated under the Water Law, some that are either used in our operations or have been used in our facilities in prior years. Should any of these regulated materials be detected in local water or soil, we could be subject to local law remedies, which could affect our ability to operate or could negatively affect our results of operations.

Risks related to our operations in China

Our business operations conducted in China are critical to our success. A total of $51.0 million, or 22%, of our revenue in the nine months ended September 30, 2014 was recognized from customers for whom we shipped products to a location in China. Additionally, a substantial portion of our property, plant and equipment, 49% as of September 30, 2014, was located in China. We expect to make further investments in China in the foreseeable future. Therefore, our business, financial condition, results of operations and prospects are to a significant degree subject to economic, political, legal, and social events and developments in China.

Adverse changes in economic and political policies in China, or Chinese laws or regulations could have a material adverse effect on business conditions and the overall economic growth of China, which could adversely affect our business.

The Chinese economy differs from the economies of most developed countries in many respects, including the level of government involvement, level of development, growth rate and control of foreign exchange and allocation of resources. The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. Despite reforms, the government continues to exercise significant control over China’s economic growth by way of the allocation of resources, control over foreign currency-denominated obligations and monetary policy and provision of preferential treatment to particular industries or companies. Moreover, the laws, regulations and legal requirements in China, including the laws that apply to foreign-invested enterprises are relatively new and are subject to frequent changes. The interpretation and enforcement of such laws is uncertain. Any adverse changes to these laws, regulations and legal requirements, including tax laws, or their interpretation or enforcement, or the creation of new laws or regulations relating to our business, could have a material adverse effect on our business. For example, the Chinese government’s recent crackdown on alleged price fixing and bribery of local officials by multinational companies could signal a broad trend toward elevated scrutiny of foreign corporations operating in the country.

Furthermore, while China’s economy has experienced rapid growth in the past 20 years, growth has been uneven across different regions, among various economic sectors and over time. China has also in the past and may in the future experience economic downturns due to, for example, government austerity measures, changes in government policies relating to capital spending, limitations placed on the ability of commercial banks to make loans, reduced levels of exports and international trade, inflation, lack of financial liquidity, restrictions on the flow of capital and foreign exchange, stock market volatility and global economic conditions. Any of these developments could contribute to a decline in business and consumer spending in addition to other adverse market conditions, which could adversely affect our business.

Our cost advantage from having our manufacturing and part of our research and development in China may diminish over time due to increasing labor costs, which could materially and adversely affect our operating results.

The labor market in China, particularly in the manufacturing-heavy Southeast region of China where our manufacturing facilities are located, has experienced higher costs due to increased wages. We were required to pay additional employee benefits taxes beginning in late 2010 and were subject to increases in the minimum wage for hourly workers in 2011, 2012 and 2013. We expect that we will be subject to further increases in personnel costs and taxes in the future due to market conditions and/or government mandates. If labor costs in China continue to increase, our gross margins and profit margins and results of operations may be adversely affected. In addition, our competitive advantage against competitors with manufacturing in traditionally higher cost countries would be diminished.

The termination, expiration or unavailability of our preferential income tax treatment in China may have a material adverse effect on our operating results.

Effective January 1, 2008, the China Enterprise Income Tax Law, or the EIT law, imposes a single uniform income tax rate of 25% on all Chinese enterprises, including foreign-invested enterprises, and eliminates or modifies most of the tax exemptions, reductions and preferential treatment available under the previous tax laws and regulations. As a result, our subsidiaries in China may be subject to the uniform income tax rate of 25% unless we are able to qualify for preferential status. Historically, we have qualified for a preferential 15% tax rate that is available for new and high technology enterprises. The preferential tax rate applied to 2013, 2012 and 2011. We realized benefits from this 10% reduction in tax rate of $0.2 million, $0.9 million and $0.5 million for 2013, 2012 and 2011, respectively. We received the final approval for the preferential tax rate for 2014 to 2016. In order to retain the preferential tax rate, we must meet certain operating conditions, satisfy certain product requirements, meet certain headcount requirements and maintain certain levels of research expenditures. The preferential tax rate that we enjoy could be modified or discontinued altogether at any time, which could materially and adversely affect our financial condition and results of operations.

Our subsidiaries in China may be subject to restrictions on dividend payments, on making other payments to us or any other affiliated company, and on borrowing or allocating tax losses among our subsidiaries.

Current Chinese regulations permit our subsidiaries in China to pay dividends only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations, which are different than U.S. accounting standards and regulations. In addition, our subsidiaries in China are required to set aside at least 10% of their respective accumulated profits each year, if any, to fund their statutory common reserves until such reserves have reached at least 50% of their respective registered capital, as well as to allocate a discretional portion of their after-tax profits to their staff welfare and bonus fund. As of December 31, 2013, our Chinese subsidiaries' common reserves had not reached this threshold and, accordingly, these entities are required to continue funding such reserves with accumulated net profits. The statutory common reserves are not distributable as cash dividends except in the event of liquidation. In addition, current Chinese regulations prohibit inter-company borrowings or allocation of tax losses among subsidiaries in China. Further, if our subsidiaries in China incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments to us. Accordingly, we may not be able to move our capital easily, which could harm our business.

Restrictions on currency exchange may limit our ability to receive and use our revenue and cash effectively.

Because a substantial portion of our revenue is denominated in RMB, any restrictions on currency exchange may limit our ability to use revenue generated in RMB to fund any business activities we may have outside China or to make dividend payments in U.S. dollars. Under relevant Chinese rules and regulations, the RMB is currently convertible under the "current account," which includes dividends, trade and service-related foreign exchange transactions, but not under the "capital account," which includes foreign direct investment and loans, without the prior approval of the State Administration of Foreign Exchange, or SAFE. Currently, our subsidiaries in China may purchase foreign exchange for settlement of "current account transactions," including the payment of dividends to us, without the approval of SAFE. Although Chinese government regulations now allow greater convertibility of the RMB for current account transactions, significant restrictions remain. For example, foreign exchange transactions under our primary Chinese subsidiary's capital account, including principal payments in respect of foreign currency-denominated obligations, remain subject to significant foreign exchange controls and the approval of SAFE. These limitations could affect the ability of our subsidiaries in China to obtain foreign exchange for capital expenditures through debt or equity financing, including by means of loans or capital contributions from us. We cannot be certain that Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of the RMB, especially with respect to foreign exchange transactions. If such restrictions are imposed, our ability to adjust our capital structure or engage in foreign exchange transactions may be limited.

In August 2008, SAFE promulgated the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of Payment and Settlement of Foreign Currency Capital of Foreign-invested Enterprises, or Circular 142, a notice regulating the conversion by foreign-invested enterprises or FIE of foreign currency into RMB by restricting how the converted RMB may be used. Circular 142 requires that RMB converted from the foreign currency-dominated capital of a FIE may only be used for purposes within the business scope approved by the applicable government authority and may not be used for equity investments within China unless specifically provided for otherwise. In addition, SAFE strengthened its oversight over the flow and use of RMB funds converted from the foreign currency-dominated capital of a FIE. The use of such RMB may not be changed without approval from SAFE. Violations of Circular 142 may result in severe penalties, including substantial fines set forth in the Foreign Exchange Administration Regulations. As a result of Circular 142, our subsidiaries in China may not be able to convert our capital contributions to them into RMB for equity investments or acquisitions in China.

The Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the M&A Rules, establish complex procedures for some acquisitions of Chinese companies by foreign investors, which could make it more difficult for us to pursue growth through acquisitions in China.

The M&A Rules establish procedures and requirements that could make some acquisitions of Chinese companies by foreign investors more time-consuming and complex, including requirements in some instances that the Ministry of Commerce be notified in advance of any change-of-control transaction in which a foreign investor takes control of a Chinese domestic enterprise. We may seek to expand our business in part by acquiring complementary businesses. Complying with the requirements of the M&A Rules to complete such transactions could be time-consuming, and any required approval processes, including obtaining approval from the Ministry of Commerce, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

Uncertainties with respect to China's legal system could adversely affect the legal protection available to us.

Our operations in China are governed by Chinese laws and regulations. Our subsidiaries in China are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to wholly foreign-owned enterprises. China's legal system is a civil law system based on written statutes. Unlike common law systems, it is a legal system where decided legal cases have limited value as precedents. Since 1979, Chinese legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, China has not developed a fully-integrated legal system, and recently-enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, the interpretation and enforcement of these laws and regulations involve uncertainties, including regional variations within China. For example, we may have to resort to administrative and court proceedings to enforce the legal protection under contracts or law. However, since Chinese administrative and court authorities have significant discretion in interpreting and implementing statutory and contract terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we would receive compared to more developed legal systems. These uncertainties may impede our ability to enforce the contracts we have entered into with our distributors, business partners, customers and suppliers. In addition, protections of intellectual property rights and confidentiality in China may not be as effective as in the U.S. or other countries or regions with more developed legal systems. Furthermore, the legal system in China is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until sometime after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. All the uncertainties described above could limit the legal protections available to us and could materially and adversely affect our business and operations.

Chinese regulations relating to offshore investment activities by Chinese residents and employee stock options granted by overseas-listed companies may increase our administrative burden, restrict our overseas and cross-border investment activity or otherwise adversely affect the implementation of our acquisition strategy. If our stockholders who are Chinese residents, or our Chinese employees who are granted or exercise stock options, fail to make any required registrations or filings under such regulations, we may be unable to distribute profits and may become subject to liability under Chinese laws.

Chinese foreign exchange regulations require Chinese residents and corporate entities to register with local branches of SAFE in connection with their direct or indirect offshore investment activities. These regulations apply to our stockholders who are Chinese residents and may apply to any offshore acquisitions that we make in the future. Pursuant to these foreign exchange regulations, Chinese residents who make, or have previously made, direct or indirect investments in offshore companies, will be required to register those investments. In addition, any Chinese resident who is a direct or indirect stockholder of an offshore company is required to file or update the registration with the local branch of SAFE, with respect to that offshore company, including any material change involving its round-trip investment, capital variation, such as an increase or decrease in capital, transfer or swap of shares, merger, division, long-term equity or debt investment or creation of any security interest. If any Chinese stockholder fails to make the required SAFE registration or file or update the registration, subsidiaries in China of that offshore parent company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation, to their offshore parent company, and the offshore parent company may also be prohibited from injecting additional capital into their subsidiaries in China. Moreover, failure to comply with the various foreign exchange registration requirements described above could result in liability under Chinese laws for evasion of applicable foreign exchange restrictions. We cannot provide any assurances that all of our stockholders who are Chinese residents have made or obtained, or will make or obtain, any applicable registrations or approvals required by these foreign exchange regulations. The failure or inability of our stockholders in China to comply with the required registration procedures may subject us to fines and legal sanctions, restrict our cross-border investment activities, or limit our Chinese subsidiaries' ability to distribute dividends or obtain foreign-exchange-dominated loans. Moreover, because of the uncertainties in the interpretation and implementation of these foreign exchange regulations, we cannot predict how they will affect our business operations or future strategy. For example, we may be subject to a more stringent review and approval process with respect to our foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, which may adversely affect our results of operations and financial condition. In addition, if we decide to acquire a domestic company in China, we cannot assure you that we or the owners of such company, as the case may be, will be able to obtain the necessary approvals or complete the necessary filings and registrations required by these foreign exchange regulations. This may restrict our ability to implement our acquisition strategy and could adversely affect our business and prospects.

On March 28, 2007, SAFE promulgated the Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas-Listed Company, or the Stock Option Rule. Under the Stock Option Rule, Chinese residents who are granted stock options by an overseas publicly-listed company are required, through a Chinese agent or Chinese subsidiary of such overseas publicly-listed company, to register with SAFE and complete certain other procedures. We and our Chinese employees who have been granted stock options are subject to the Stock Option Rule. We have completed the process of registering our stock option and appreciation plans with SAFE. On February 20, 2012, SAFE issued the Circular on Relevant Issues concerning Foreign Exchange Administration for Individuals in PRC Participating in Equity Incentive Plan of Overseas-Listed Companies, or Circular 7, which provides detailed procedures for conducting foreign exchange matters related to domestic individuals' participation in the equity incentive plans of overseas listed companies and supersedes the Stock Option Rule in its entirety. If we or our optionees in China fail to comply with the applicable regulations, we or our optionees in China may be subject to fines and legal sanctions. Several of our employees in China have exercised their stock options prior to our becoming an overseas publicly-listed company. Since there is not yet a clear regulation on how and whether

Chinese employees can exercise their stock options granted by overseas private companies, it is unclear whether such exercises were permitted by Chinese laws and it is uncertain how SAFE or other government authorities will interpret or administer such regulations. Therefore, we cannot predict how such exercises will affect our business or operations. For example, we may be subject to more stringent review and approval processes with respect to our foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, which may affect our results of operations and financial condition.

We may be obligated to withhold and pay individual income tax in China on behalf of our employees who are subject to individual income tax in China arising from the exercise of stock options. If we fail to withhold or pay such individual income tax in accordance with applicable Chinese regulations, we may be subject to certain sanctions and other penalties and may become subject to liability under Chinese laws.

The State Administration of Taxation has issued several circulars concerning employee stock options. Under these circulars, our Chinese employees (which could include both employees in China and expatriate employees subject to individual income tax in China) who exercise stock options will be subject to individual income tax in China. Our subsidiaries in China have obligations to file documents related to employee stock options with relevant tax authorities and withhold and pay individual income taxes for those employees who exercise their stock options. However, since there was not yet a clear regulation on how and whether Chinese employees could exercise stock options granted by overseas private companies and how Chinese employers shall withhold and pay individual taxes, the relevant tax authority verbally advised us that due to the difficulty in determining the fair market value of our shares as a private company, we did not need to withhold and pay the individual income tax for the exercises until after we completed our initial public offering in February 2011. Thus, we have not withheld or paid the individual income tax for the option exercises through the date of our initial public offering. However, we cannot be assured that the Chinese tax authorities will not act otherwise and request us to pay the individual income tax immediately and impose sanctions on us.

If the Chinese government determines that we failed to obtain approvals of, or registrations with, the requisite Chinese regulatory authority with respect to our current and past import and export of technologies, we could be subject to sanctions, which could adversely affect our business.

China imposes controls on technology import and export. The term “technology import and export” is broadly defined to include, without limitation, the transfer or license of patents, software and know-how, and the provision of services in relation to technology. Depending on the nature of the relevant technology, the import and export of technology to or from China requires either approval by, or registration with, the relevant Chinese governmental authorities.

If we are found to be, or to have been, in violation of Chinese laws or regulations, the relevant regulatory authorities have broad discretion in dealing with such violation, including, but not limited to, issuing a warning, levying fines, restricting us from benefiting from these technologies inside or outside of China, confiscating our earnings generated from the import or export of such technology or even restricting our future export and import of any technology. If the Chinese government determines that our past import and export of technology were inconsistent with, or insufficient for, the proper operation of our business, we could be subject to similar sanctions. Any of these or similar sanctions could cause significant disruption to our business operations or render us unable to conduct a substantial portion of our business operations and may adversely affect our business and result of operations.

China regulation of loans and direct investment by offshore holding companies to China entities may delay or prevent us from using the proceeds we received from our initial public offering to make loans or additional capital contributions to our China subsidiaries.

From time to time, we may make loans or additional capital contributions to our China subsidiaries. Any loans to our China subsidiaries are subject to China regulations and approvals. For example, any loans to our China subsidiaries to finance their activities cannot exceed statutory limits, must be registered with SAFE, or its local counterpart, and must be approved by the relevant government authorities. Any capital contributions to our China subsidiaries must be approved by the Ministry of Commerce of China or its local counterpart. In addition, under Circular 142, our China subsidiaries, as FIEs, may not be able to convert our capital contributions to them into RMB for equity investments or acquisitions in China.

We cannot assure you that we will be able to obtain these government registrations or approvals on a timely basis, if at all, with respect to our future loans or capital contributions to our China subsidiaries. If we fail to receive such registrations or approvals, our ability to capitalize our China subsidiaries may be negatively affected, which could materially and adversely affect our liquidity and ability to fund and expand our business.

Dividends paid to us by our Chinese subsidiaries may be subject to Chinese withholding tax.

The EIT Law and the implementation regulations provide that a 10% withholding tax may apply to dividends payable to investors that are “non-resident enterprises,” to the extent such dividends are derived from sources within China and in the absence of any tax treaty that may reduce such withholding tax rate. The comprehensive Double Taxation Arrangement between China and Hong Kong generally reduces the withholding tax on dividends paid from a Chinese company to a Hong Kong company to 5%. Dividends paid to us by our Chinese subsidiaries will be subject to Chinese withholding tax if, as expected, we are considered a “non-resident enterprise” under the EIT Law. If dividends from our Chinese subsidiaries are subject to Chinese withholding tax, our financial condition may be adversely impacted to the extent of such tax.

Our worldwide income may be subject to Chinese tax under the EIT Law.

The EIT Law provides that enterprises established outside of China whose “de facto management bodies” are located in China are considered “resident enterprises” and are generally subject to the uniform 25% enterprise income tax on their worldwide income. Under the implementation regulations for the EIT Law issued by the State Council, a “de facto management body” is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and treasury, and acquisition and disposition of properties and other assets of an enterprise. If we are deemed to be a resident enterprise for Chinese tax purposes, we will be subject to Chinese tax on our worldwide income at the 25% uniform tax rate, which could have an impact on our effective tax rate and an adverse effect on our net income (loss), however, dividends paid to us by our Chinese subsidiaries may not be subject to withholding if we are deemed to be a resident enterprise.

Dividends payable by us to our investors and gains on the sale of our common stock by our foreign investors may be subject to tax under Chinese law.

Under the EIT Law and implementation regulations issued by the State Council, a 10% withholding tax is applicable to dividends payable to investors that are “non-resident enterprises.” Similarly, any gain realized on the transfer of common stock by such investors is also subject to a 10% withholding tax if such gain is regarded as income derived from sources within China. If we are determined to be a “resident enterprise,” dividends and other income we pay on our common stock, or the gain you may realize from the transfer of our common stock, would be treated as income derived from sources within China. If we are required under the EIT Law to withhold tax from dividends payable to investors that are “non-resident enterprises,” or if a gain realized on the transfer of our common stock is subject to withholding, the value of your investment in our common stock may be materially and adversely affected.

Our contractual arrangements with our subsidiaries in China may be subject to audit or challenge by the Chinese tax authorities, and a finding that our subsidiaries in China owe additional taxes could substantially reduce our net income and the value of our stockholders’ investment.

Under the applicable laws and regulations in China, arrangements and transactions among related parties may be subject to audit or challenge by the Chinese tax authorities. We would be subject to adverse tax consequences if the Chinese tax authorities were to determine that the contracts with or between our subsidiaries were not executed on an arm’s length basis, and as a result the Chinese tax authorities could require that our Chinese subsidiaries adjust their taxable income upward for Chinese tax purposes. Such an adjustment could adversely affect us by increasing our tax expenses.

Because a substantial portion of our business is located in China, we may have difficulty maintaining adequate management, legal and financial controls, which we are required to do in order to comply with Section 404 of the Sarbanes-Oxley Act and securities laws, and which could cause a material adverse impact on our consolidated financial statements, the trading price of our common stock and our business.

Chinese companies have historically not adopted a western style of management and financial reporting concepts and practices, which includes strong corporate governance, internal controls and computer, financial and other control systems. Most of our middle management staff and some of our top management staff in China are not educated and trained in the western system, and we may have difficulty hiring new employees in China with experience and expertise relating to accounting principles generally accepted in the U.S. and U.S. public-company reporting requirements. As a result of these factors, we may experience difficulty in maintaining management, legal and financial controls, collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet U.S. public-company reporting requirements. We may, in turn, experience difficulties in maintaining adequate internal controls as required under Section 404 of the Sarbanes-Oxley Act. This may result in material weaknesses in our internal controls which could impact the reliability of our consolidated financial statements and prevent us from complying with SEC rules and regulations and the requirements of the Sarbanes-Oxley Act. Any such material weaknesses or lack of compliance with SEC rules and regulations could result in restatements of our historical consolidated financial statements, cause investors to lose confidence in our reported financial information, have an adverse impact on the trading price of our common stock, adversely affect our ability to access the capital markets and our ability to recruit personnel, lead to the delisting of our securities from the stock exchange on which they are traded. This could lead to litigation claims, thereby diverting management's attention and resources, and which may lead to the payment of damages to the extent such claims are not resolved in our favor, lead to regulatory proceedings, which may result in sanctions, monetary or otherwise, and have a material adverse effect on our reputation and business.

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

Our consolidated affiliated entities in China are audited by auditors who are not inspected by the Public Company Accounting Oversight Board and, as such, you are deprived of the benefits of such inspection.

Publicly traded companies in the United States are audited by independent registered public accounting firms registered with the U.S. Public Company Accounting Oversight Board, or the PCAOB, and are required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. Because the auditors of our consolidated affiliated entities in China are located in China, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the Chinese authorities, such auditors are not currently inspected by the PCAOB. On May 24, 2013, the PCAOB announced that it had entered into a memorandum of understanding on enforcement cooperation with the China Securities Regulatory Commission and the Ministry of Finance of China that establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in the United States and China. However, direct PCAOB inspections of independent registered accounting firms in China are still not permitted by Chinese authorities.

Inspections of auditing firms that the PCAOB has conducted outside China have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our Chinese auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

Proceedings instituted by the SEC against five China-based accounting firms could result in our financial statements being determined to not be in compliance with the requirements of the Exchange Act.

In December 2012, the SEC instituted proceedings under Rule 102(e)(1)(iii) of the SEC's Rules of Practice against five China-based accounting firms, including the China affiliate of our independent registered public accounting firm, alleging that these firms had violated U.S. securities laws and the SEC's rules and regulations thereunder by failing to provide to the SEC the firms' work papers related to their audits of certain China-based companies that are publicly traded in the United States. On January 23, 2014, the administrative law judge presiding over the proceedings issued an initial decision denying the ability of the China affiliates of four accounting firms, including the China affiliate of our independent registered public accounting firm, to practice before the SEC for six months. This initial decision is subject to appeal. While we cannot predict the final outcome of the SEC's proceedings, if the China affiliate of our independent registered public accounting firm were denied, temporarily or permanently, the ability to practice before the SEC, and we are unable to find timely another registered public accounting firm in China which can audit the financial statements of our consolidated affiliated entities in China, our current independent registered public accounting firm may not be able to issue a report on our financial statements and our financial statements could be determined to not be in compliance with the requirements for financial statements of public companies with a class of securities registered under the Exchange Act. Such a determination could ultimately lead to the delisting of our common stock from the NYSE, which event would effectively terminate the trading market for our common stock, and to the SEC's revoking the registration of our common stock pursuant to Section 12(j) of the Exchange Act, in which event broker-dealers thereafter would be prohibited from effecting transactions in, or inducing the purchase or sale of, our common stock.

The turnover of direct labor in manufacturing industries in China is high, which could adversely affect our production, shipments, and results of operations.

Employee turnover of direct labor in the manufacturing sector in China is typically high and retention of such personnel is a challenge to companies located in or with operations in China. Although direct labor cost does not represent a high proportion of our overall manufacturing costs, direct labor is required for the manufacture of our products. If our direct labor turnover rates are higher than we expect, or we otherwise fail to adequately manage our direct labor turnover rates, then our results of operations could be adversely affected.

Our subsidiaries in China are subject to Chinese labor laws and regulations. Recently enacted Chinese labor laws may increase our operating costs in China, which could adversely affect our financial results.

China Labor Contract Law, effective January 1, 2008, together with its implementing rules, effective September 18, 2008, provides more protection to Chinese employees. Under the new rules, the probation period varies depending on contract terms and the employment contract can only be terminated during the probation period for cause upon three days’ notice. Additionally, an employer may not be able to terminate a contract during the probation period on the grounds of a material change of circumstances or a mass layoff. The new law also has specific provisions on conditions when an employer has to sign an employment contract with open-ended terms. If an employer fails to enter into an open-ended contract in certain circumstances, the employer must pay the employee twice their monthly wage beginning from the time the employer should have executed an open-ended contract. Additionally an employer must pay severance for nearly all terminations, including when an employer decides not to renew a fixed-term contract.

On January 1, 2008, the Regulations on Paid Annual Leaves of Staff and Workers also took effect, followed by its implementing measures effective September 18, 2008. These regulations provide that employees who have worked consecutively for one year or more are entitled to paid annual leave. An employer must guarantee that employees receive the same wage income during the annual leave period as that for the normal working period. Where an employer cannot arrange annual leave for an employee due to production needs, upon agreement with the employee, the employer must pay daily wages equal to 300% of the employee’s daily salary for each day of annual leave forfeited by such employee.

The Shenzhen municipal government, effective December 2010, issued a measure to require all government agencies, public institutions, and enterprises in Shenzhen to pay a monthly housing fund. The housing fund is designed to enhance the welfare and increase the funds available to Shenzhen employees when buying, building, renovating, or overhauling owner-occupied houses. Employee and employers are required to make equal contributions to the housing fund, which can range between 5% and 20% of the employees’ average salary of the most recent year and we commenced making these contributions in the fourth quarter of 2010.

From time to time, the Chinese government has implemented requirements to increase the minimum wage for employees in China. These requirements have resulted in the past, and may result in the future, in higher employee costs for our personnel in China. Minimum wage rates generally vary by city and province within China and have historically increased as much as 20% on an annual basis. We were required to increase wages to comply with these requirements and it may be necessary for us to increase wages more than the minimum wage adjustment requires due to market conditions or additional government mandates. If labor costs in China continue to increase, our gross margins, profit margins and results of operations may be adversely affected. In addition, our competitive advantage against competitors with personnel costs or manufacturing in traditionally higher cost countries may be diminished. These newly introduced laws and regulations may materially increase the costs of our operations in China.

Adoption of international labor standards may increase our direct labor costs.

International standards of corporate social responsibility include strict requirements on labor work practices and overtime. As global service providers and their network equipment vendors adopt these standards, we have in the past incurred and may be required in the future to incur additional direct labor costs associated with our compliance with these standards.

If any of our subsidiaries in China becomes the subject of a bankruptcy or liquidation procedures, we may lose the ability to use its assets.

Because a substantial portion of our business and revenue are derived from China, if any of our subsidiaries in China goes bankrupt and all or part of its assets become subject to liens or rights of third-party creditors, we may be unable to continue some or all of our operations in China. Any delay, interruption or cessation of all or a part of our operations in China would negatively impact our ability to generate revenue and otherwise adversely affect our business.

We may be exposed to liabilities under the FCPA and Chinese anti-corruption laws, and any determination that we violated these laws could have a material adverse effect on our business.

We are subject to the Foreign Corrupt Practice Act of 1977, or FCPA, and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by U.S. persons and issuers as defined by the statute, for the purpose of obtaining or retaining business. We have operations, agreements with third parties and we make significant sales in China. China also strictly prohibits bribery of government officials. Our activities in China create the risk of unauthorized payments or offers of payments by our employees, consultants, sales agents or distributors, even though they may not always be subject to our control. Although we have implemented policies and procedures to discourage these practices by our employees, our existing safeguards and any future improvements may prove to be less than effective, and our employees, consultants, sales agents or distributors may engage in conduct for which we might be held responsible. Violations of the FCPA or Chinese anti-corruption laws may result in severe criminal or civil sanctions, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition. In addition, the U.S. government may seek to hold us liable for successor liability FCPA violations committed by companies in which we invest or that we acquire.

Risks related to ownership of our common stock

Our financial results may vary significantly from quarter-to-quarter due to a number of factors, which may lead to volatility in our stock price.

Our quarterly revenue and results of operations have varied in the past and may continue to vary significantly from quarter to quarter. This variability may lead to volatility in our stock price as research analysts and investors respond to these quarterly fluctuations. These fluctuations are due to numerous factors, including:

- fluctuations in demand for our products;
- the timing, size and product mix of sales of our products;
- changes in our pricing and sales policies or the pricing and sales policies of our competitors;
- our ability to design, manufacture and deliver products to our customers in a timely and cost-effective manner and that meet customer requirements;
- quality control or yield problems in our manufacturing operations;
- our ability to timely obtain adequate quantities of the components used in our products;
- length and variability of the sales cycles of our products;
- unanticipated increases in costs or expenses; and
- fluctuations in foreign currency exchange rates.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly and annual results of operations in the future. In addition, a significant amount of our operating expenses is relatively fixed in nature due to our internal manufacturing, research and development, sales and general administrative efforts. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of such revenue shortfall on our results of operations. Moreover, our results of operations may not meet our announced guidance or the expectations of research analysts or investors, in which case the price of our common stock could decrease significantly. There can be no assurance that we will be able to successfully address these risks.

*Our failure to comply with conditions required for our common stock to be listed on the NYSE could result in delisting of our common stock from the NYSE and have a significant negative effect on the value and liquidity of our securities as well as other matters.

As a result of our failure to timely file our Annual Report on Form 10-K for the year ended December 31, 2013, as well as our Quarterly Report on Form 10-Q for the three months ended March 31, 2014, we were not in full compliance with the NYSE Listed Company Manual, Section 802.01E. We have cured this deficiency by our filings of our Annual Report on Form 10-K for the year ended December 31, 2013 and our Quarterly Report on Form 10-Q for the three months ended March 31, 2014. We are required to comply with the NYSE Listed Company Manual as a condition for our common stock to continue to be listed on the NYSE. If we are unable to comply with such conditions, then our shares of common stock are subject to delisting from the NYSE.

If our common stock is delisted from the NYSE, such securities may be traded over-the-counter on the “pink sheets.” The alternative market, however, is generally considered to be less efficient than, and not as broad as, the NYSE. Accordingly, delisting of our common stock from the NYSE could have a significant negative effect on the value and liquidity of our securities. In addition, the delisting of such stock could adversely affect our ability to raise capital on terms acceptable to us or at all. In addition, delisting of our common stock may preclude us from using exemptions from certain state and federal securities regulations.

Our failure to prepare and file timely our periodic reports with the SEC may make it more difficult for us to access the public markets to raise debt or equity capital.

We did not file our 2013 Annual Report within the time frame required by the SEC. As a result of our failure to file our Annual Report on Form 10-K for the year ended December 31, 2013, as well as our Quarterly Report on Form 10-Q for the three months ended March 31, 2014, by the filing dates required by the SEC (including the grace period permitted by Rule 12b-25 under the Exchange Act), we are not eligible to file a Form S-3 registration statement to conduct public offerings until our filings with the SEC have been timely made for a full year. Our ineligibility to use Form S-3 during this time period may have a negative impact on our ability to quickly access the public capital markets because we would be required to file a longer-form registration statement and wait for the SEC to declare such registration statement effective. This may require additional time and resources for us to access the public markets to raise debt or equity capital, which could adversely affect our ability to pursue transactions or implement business strategies that we believe would be beneficial to our business.

Our stock price may be volatile.

The market price of our common stock could be subject to wide fluctuations in response to, among other things, the risk factors described in this section of our Quarterly Report on Form 10-Q, and other factors beyond our control, such as fluctuations in the valuation of companies perceived by investors to be comparable to us.

The stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions, such as recessions, sovereign debt or liquidity issues, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock.

In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may become the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

If research analysts do not publish research about our business or if they issue unfavorable commentary or downgrade our common stock, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that research analysts publish about us and our business. The price of our common stock could decline if one or more research analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business. If one or more of the research analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our common stock could decrease, which could cause our stock price or trading volume to decline.

The concentration of our capital stock ownership with our principal stockholders, executive officers and directors and their affiliates will limit other stockholders' ability to influence corporate matters.

As of December 31, 2013, our executive officers and directors, and entities that are affiliated with them, beneficially own an aggregate of approximately 55% of our outstanding common stock. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. Also, as a result, these stockholders, acting together, will be able to control our management and affairs and matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. Consequently, this concentration of ownership may have the effect of delaying or preventing a change in control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if such a change in control would benefit our other stockholders.

We currently do not intend to pay dividends on our common stock and, consequently, your only opportunity to achieve a return on your investment is if the price of our common stock appreciates.

We currently do not plan to declare dividends on shares of our common stock in the foreseeable future. In addition, the terms of our U.S. revolving credit and term loan agreement with Comerica Bank and East-West Bank restrict our ability to pay dividends. Consequently, your only opportunity to achieve a return on your investment in our company will be if the market price of our common stock appreciates and you sell your shares at a profit. There is no guarantee that the price of our common stock that will prevail in the market after our initial public offering will ever exceed the price that you pay.

Our charter documents and Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could delay or prevent a change in control of our company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include:

providing for a classified board of directors with staggered, three-year terms;

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not providing for cumulative voting in the election of directors;
authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock;
prohibiting stockholder action by written consent;
limiting the persons who may call special meetings of stockholders; and
requiring advance notification of stockholder nominations and proposals.

In addition, we have been governed by the provisions of Section 203 of the Delaware General Corporate Law since the completion of our initial public offering. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding common stock, from engaging in certain business combinations without approval of substantially all of our stockholders for a certain period of time.

These and other provisions in our amended and restated certificate of incorporation, our amended and restated bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay for shares of our common stock in the future and result in the market price being lower than it would be without these provisions.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See Index to Exhibits at the end of this report.

SIGNATURE

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

			NeoPhotonics Corporation
Date:	November 10, 2014	By:	/S/ CLYDE RAYMOND WALLIN
			Clyde Raymond Wallin
			Chief Financial Officer and Senior Vice President
			(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit no.	Description of exhibit	Form	SEC File No.	Exhibit	Filing Date	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation of NeoPhotonics Corporation.	Form 8-K	001-35061	3.1	February 10, 2011	
3.2	Amended and Restated Bylaws of NeoPhotonics Corporation.	Form S-1	333-166096	3.4	November 22, 2010	
4.1	Specimen Common Stock Certificate of NeoPhotonics Corporation.	Form S-1	333-166096	4.1	April 15, 2010	
4.2	2008 Investors' Rights Agreement by and between NeoPhotonics Corporation and the investors listed on Exhibit A thereto, dated May 14, 2008.	Form S-1	333-166096	4.2	April 15, 2010	
4.3	Warrant to Purchase Common Stock by and between NeoPhotonics Corporation and Comerica Bank, dated December 20, 2007.	Form S-1	333-166096	4.3	April 15, 2010	
10.1	Amended and Restated Severance Agreement by and between NeoPhotonics Corporation and Benjamin L. Sitler dated October 8, 2014.					X
10.2	Asset Purchase Agreement by and between NeoPhotonics Corporation and EMCORE Corporation, dated October 22, 2014.	Form 8-K	001-35061	10.1	October 27, 2014	
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a).					X
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a).					X

32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X
101.INS	XBRL Instance Document.	
101.SCH	XBRL Taxonomy Extension Schema Document.	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.	
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.	
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.	