

EXTREME NETWORKS INC  
Form 10-Q  
February 02, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2015

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 000-25711

EXTREME NETWORKS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE  
[State or other jurisdiction

of incorporation or organization]

77-0430270  
[I.R.S Employer

Identification No.]

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145 Rio Robles,

San Jose, California

95134

[Address of principal executive office] [Zip Code]

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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 (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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

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

The number of shares of the Registrant's Common Stock, \$.001 par value, outstanding at January 22, 2016, was 103,319,359

EXTREME NETWORKS, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED December 31,  
2015

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## EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

(Unaudited)

|  | December 31, | June 30,  |
|--|--------------|-----------|
|  | 2015         | 2015      |
| <b>ASSETS</b>  |              |           |
| Current assets:  |              |           |
| Cash and cash equivalents  | \$ 85,865    | \$76,225  |
| Accounts receivable, net of allowances of \$6,464 at December 31, 2015 and \$2,396 at<br>June 30, 2015         | 73,110       | 92,737    |
| Inventories  | 56,601       | 58,014    |
| Deferred income taxes  | 705          | 760       |
| Prepaid expenses and other current assets  | 9,925        | 10,258    |
| Total current assets   | 226,206      | 237,994   |
| Property and equipment, net  | 32,948       | 39,862    |
| Intangible assets, net   | 35,138       | 52,132    |
| Goodwill   | 70,877       | 70,877    |
| Other assets   | 27,618       | 27,795    |
| Total assets   | \$ 392,787   | \$428,660 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |              |           |
| Current liabilities:   |              |           |
| Current portion of long-term debt  | \$ 14,625    | \$11,375  |
| Accounts payable   | 25,536       | 40,135    |
| Accrued compensation and benefits  | 28,995       | 25,195    |
| Accrued warranty   | 10,415       | 8,676     |
| Deferred revenue, net  | 75,548       | 76,551    |
| Deferred distributors revenue, net of cost of sales to distributors  | 31,677       | 40,875    |
| Other accrued liabilities  | 29,968       | 32,623    |
| Total current liabilities  | 216,764      | 235,430   |
| Deferred revenue, less current portion   | 21,505       | 23,231    |
| Long-term debt, less current portion   | 47,375       | 55,500    |
| Deferred income taxes  | 3,471        | 2,979     |
| Other long-term liabilities  | 8,536        | 7,285     |
| Commitments and contingencies (Note 8)   |              |           |
| Stockholders' equity:  |              |           |
| Convertible preferred stock, \$.001 par value, issuable in series, 2,000,000 shares<br>authorized; none issued | —            | —         |
| Common stock, \$.001 par value, 750,000,000 shares authorized; 103,229,140 shares                              | 103          | 100       |

|   |            |            |
|---|------------|------------|
| issued and outstanding at December 31, 2015 and 100,284,106 shares issued and |            |            |
| outstanding at June 30, 2015  |            |            |
| Additional paid-in-capital  | 876,225    | 865,282    |
| Accumulated other comprehensive loss  | (2,576 )   | (1,291 )   |
| Accumulated deficit   | (778,616 ) | (759,856)  |
| Total stockholders' equity  | 95,136     | 104,235    |
| Total liabilities and stockholders' equity                                    | \$ 392,787 | \$ 428,660 |

See accompanying notes to condensed consolidated financial statements.

## EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

|  | Three Months Ended |                   | Six Months Ended  |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | December 31, 2015  | December 31, 2014 | December 31, 2015 | December 31, 2014 |
| <b>Net revenues:</b>                           |                    |                   |                   |                   |
| Product  | \$105,355          | \$112,501         | \$196,736         | \$215,173         |
| Service  | 33,950             | 34,707            | 67,150            | 68,309            |
| Total net revenues                             | 139,305            | 147,208           | 263,886           | 283,482           |
| <b>Cost of revenues:</b>                       |                    |                   |                   |                   |
| Product  | 57,103             | 60,496            | 104,037           | 114,521           |
| Service  | 11,927             | 11,550            | 24,456            | 23,272            |
| Total cost of revenues                         | 69,030             | 72,046            | 128,493           | 137,793           |
| <b>Gross profit:</b>                           |                    |                   |                   |                   |
| Product  | 48,252             | 52,005            | 92,699            | 100,652           |
| Service  | 22,023             | 23,157            | 42,694            | 45,037            |
| Total gross profit                             | 70,275             | 75,162            | 135,393           | 145,689           |
| <b>Operating expenses:</b>                     |                    |                   |                   |                   |
| Research and development                       | 20,716             | 24,000            | 40,984            | 47,347            |
| Sales and marketing                            | 37,058             | 43,971            | 73,120            | 88,750            |
| General and administrative                     | 9,775              | 10,306            | 18,951            | 21,380            |
| Acquisition and integration costs              | 807                | 3,500             | 1,145             | 7,558             |
| Restructuring charge, net of reversals         | 3,031              | —                 | 8,634             | —                 |
| Amortization of intangibles                    | 4,251              | 4,467             | 8,718             | 8,934             |
| Total operating expenses                       | 75,638             | 86,244            | 151,552           | 173,969           |
| Operating loss                                 | (5,363 )           | (11,082 )         | (16,159 )         | (28,280 )         |
| Interest income                                | 29                 | 196               | 56                | 342               |
| Interest expense                               | (809 )             | (825 )            | (1,635 )          | (1,661 )          |
| Other income (expense), net                    | 112                | (64 )             | 1,079             | (498 )            |
| Loss before income taxes                       | (6,031 )           | (11,775 )         | (16,659 )         | (30,097 )         |
| Provision for income taxes                     | 1,203              | 1,330             | 2,101             | 2,338             |
| Net loss                                       | \$(7,234 )         | \$(13,105 )       | \$(18,760 )       | \$(32,435 )       |
| <b>Basic and diluted net loss per share:</b>   |                    |                   |                   |                   |
| Net loss per share - basic                     | \$(0.07 )          | \$(0.13 )         | \$(0.18 )         | \$(0.33 )         |
| Net loss per share - diluted                   | \$(0.07 )          | \$(0.13 )         | \$(0.18 )         | \$(0.33 )         |
| Shares used in per share calculation - basic   | 102,369            | 98,677            | 101,677           | 97,996            |
| Shares used in per share calculation - diluted | 102,369            | 98,677            | 101,677           | 97,996            |

See accompanying notes to condensed consolidated financial statements.





EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

|   | Three Months Ended<br>December 31, |            | Six Months Ended<br>December 31, |            |
|---|------------------------------------|------------|----------------------------------|------------|
|   | 2015                               | 2014       | 2015                             | 2014       |
| Net loss:   | \$(7,234)                          | \$(13,105) | \$(18,760)                       | \$(32,435) |
| Other comprehensive loss, net of tax:                     |                                    |            |                                  |            |
| Available for sale securities:                            |                                    |            |                                  |            |
| Change in unrealized gains (losses) on available for sale |                                    |            |                                  |            |
| securities, net of taxes                                  | —                                  | 32         | —                                | (25)       |
| Net change in unrealized gains (losses) on available      |                                    |            |                                  |            |
| for sale securities, net of taxes                         | —                                  | 32         | —                                | (25)       |
| Net change in foreign currency translation adjustments    | (421)                              | (654)      | (1,285)                          | (1,420)    |
| Other comprehensive loss                                  | (421)                              | (622)      | (1,285)                          | (1,445)    |
| Total comprehensive loss                                  | \$(7,655)                          | \$(13,727) | \$(20,045)                       | \$(33,880) |

See accompanying notes to condensed consolidated financial statements.

EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Six Months Ended |              |
|---|------------------|--------------|
|   | December 31,     | December 31, |
|   | 2015             | 2014         |
| Cash flows from operating activities:   |                  |              |
| Net loss  | \$(18,760)       | \$ (32,435 ) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                  |              |
| Depreciation  | 5,366            | 6,406        |
| Amortization of intangible assets   | 16,994           | 17,997       |
| Provision for doubtful accounts and allowance for sales returns                 | 2,122            | 2,520        |
| Stock-based compensation  | 8,616            | 9,563        |
| Non-cash restructuring charges  | 3,220            | —            |
| Other non-cash charges  | (275 )           | 512          |
| Changes in operating assets and liabilities, net                                |                  |              |
| Accounts receivable   | 15,180           | 28,624       |
| Inventories   | 1,413            | 2,679        |
| Prepaid expenses and other assets   | 277              | (8 )         |
| Accounts payable  | (14,628)         | 8,196        |
| Accrued compensation and benefits   | 3,800            | (4,202 )     |
| Deferred revenue  | (2,729 )         | 608          |
| Deferred distributor revenue, net of cost of sales to distributors              | (6,874 )         | (811 )       |
| Other current and long term liabilities   | 245              | 1,804        |
| Net cash provided by operating activities                                       | 13,967           | 41,453       |
| Cash flows from investing activities:   |                  |              |
| Capital expenditures  | (1,409 )         | (3,962 )     |
| Proceeds from maturities of investments and marketable securities               | —                | 3,000        |
| Proceeds from sales of investments and marketable securities                    | —                | 9,051        |
| Purchases of intangible assets  | —                | (419 )       |
| Net cash (used in) provided by investing activities                             | (1,409 )         | 7,670        |
| Cash flows from financing activities:   |                  |              |
| Borrowings under Revolving Facility   | 15,000           | 24,000       |
| Repayment of debt   | (19,875)         | (56,438 )    |
| Proceeds from issuance of common stock  | 2,330            | 1,722        |
| Net cash used in financing activities   | (2,545 )         | (30,716 )    |
| Foreign currency effect on cash   | (373 )           | (2,625 )     |
| Net increase in cash and cash equivalents                                       | 9,640            | 15,782       |

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|  |          |           |
|--|----------|-----------|
| Cash and cash equivalents at beginning of period | 76,225   | 73,190    |
| Cash and cash equivalents at end of period       | \$85,865 | \$ 88,972 |

See accompanying notes to the condensed consolidated financial statements.

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Basis of Presentation

Extreme Networks, Inc. ("Extreme Networks" or the "Company") is a leading provider of network infrastructure equipment and markets its products primarily to business, governmental, health care, service provider, and educational customers with a focus on large corporate enterprises and metropolitan service providers on a global basis. The Company conducts its sales and marketing activities on a worldwide basis through distributors, resellers and the Company's field sales organization. Extreme Networks was incorporated in California in 1996 and reincorporated in Delaware in 1999.

The unaudited condensed consolidated financial statements of Extreme Networks included herein have been prepared under the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted under such rules and regulations. The condensed consolidated balance sheet at June 30, 2015 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2015.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme Networks at December 31, 2015. The results of operations for the three and six months ended December 31, 2015 are not necessarily indicative of the results that may be expected for fiscal 2016 or any future periods.

Fiscal Year

The Company uses a fiscal calendar year ending on June 30. All references herein to "fiscal 2016" or "2016" represent the fiscal year ending June 30, 2016.

Principles of Consolidation

The consolidated financial statements include the accounts of Extreme Networks and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated.

Accounting Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates are used for, but are not limited to, the accounting for the allowances for doubtful accounts and sales returns, determining the fair value of acquired assets and assumed liabilities, estimated selling prices, inventory valuation and purchase commitments, depreciation and amortization, impairment of long-lived assets including goodwill, warranty accruals, restructuring liabilities, measurement of share-based compensation costs and income taxes. Actual results could differ materially from these

estimates.

The Company predominantly uses the United States Dollar as its functional currency. The functional currency for certain of its foreign subsidiaries is the local currency. For those subsidiaries that operate in a local currency functional environment, all assets and liabilities are translated to United States Dollars at current month end rates of exchange; and revenue and expenses are translated using the monthly average rate.

Certain balances included in the condensed consolidated statements of cash flows related to restructuring liabilities for prior periods have been reclassified to conform to the current period presentation. In the condensed consolidated statement of cash flows, the changes in operating assets and liabilities for Other long-term liabilities includes the changes in restructuring liabilities and other accrued liabilities which were previously disclosed separately.

## 2. Summary of Significant Accounting Policies

For a description of significant accounting policies, see Note 3, Summary of Significant Accounting Policies, to the consolidated financial statements included in the Company's Annual report on Form 10-K for the fiscal year ended June 30, 2015. There have been no material changes to the Company's significant accounting policies since the filing of the Annual report on Form 10-K.

## 3. Recently Issued Accounting Pronouncements

For a description of recently issued accounting pronouncements, see Note 4, Recently Issued Accounting Pronouncements, to the consolidated financial statements included in the Company's Annual report on Form 10-K for the fiscal year ended June 30, 2015. The following are accounting pronouncements issued that may materially affect the Company's financial statements since the filing of the Annual report on Form 10-K.

In November 2015, the FASB issued Accounting Standards Update No. 2015-17 ("ASU 2015-17"), Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. Current GAAP requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. To simplify the presentation of deferred income taxes, ASU 2015-17 requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this Update. The amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period and the amendments for ASU-2015-17 can be applied retrospectively or prospectively. The adoption of this guidance is not expected to have a material impact upon our financial condition or results of operations.

## 4. Balance Sheet Accounts

### Cash and Cash Equivalents

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

|  | December 31, | June 30, |
|--|--------------|----------|
|  | 2015         | 2015     |
| Cash   | \$ 81,096    | \$71,455 |
| Cash equivalents   | \$ 4,769     | \$4,770  |
| Total available-for-sale                                       | \$ 4,769     | \$4,770  |
| Total cash, cash equivalents and available for sale securities | \$ 85,865    | \$76,225 |

The Company considers highly liquid investments with maturities of three months or less at the date of purchase to be cash equivalents. Investments with original maturities of greater than three months, but less than one year at the balance sheet date are classified as short-term investments.

#### Inventory Valuation

The Company's inventory balances as of December 31 and June 30, 2015 were \$56.6 million and \$58.0 million, respectively. The Company values its inventory at lower of cost or market. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. The Company has established inventory allowances primarily determined by the age of inventory or when conditions exist that suggest that inventory may be in excess of anticipated demand or is obsolete based upon assumptions about future demand. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. Any written down or obsolete inventory subsequently sold has not had a material impact on gross margin for any of the periods disclosed.

The following is a summary of our inventory by category (in thousands):

|                 | December 31, June 30, |          |
|-----------------|-----------------------|----------|
|                 | 2015                  | 2015     |
| Finished goods  | \$ 52,640             | \$55,301 |
| Raw materials   | 3,961                 | 2,713    |
| Total Inventory | \$ 56,601             | \$58,014 |

#### Property and Equipment, Net

Property and equipment consist of the following (in thousands):

|   | December 31, June 30, |          |
|---|-----------------------|----------|
|   | 2015                  | 2015     |
| Computer equipment                              | \$ 33,943             | \$32,753 |
| Purchased software                              | 5,671                 | 5,425    |
| Office equipment, furniture and fixtures        | 11,113                | 10,908   |
| Leasehold improvements                          | 20,682                | 24,293   |
| Total property and equipment                    | 71,409                | 73,379   |
| Less: accumulated depreciation and amortization | (38,461)              | (33,517) |
| Property and equipment, net                     | \$ 32,948             | \$39,862 |

#### Intangibles

The following tables summarize the components of gross and net intangible asset balances (in thousands):

|                        | Weighted Average<br>Remaining Amortization<br>Period | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
|------------------------|--|--------------------------|-----------------------------|---------------------------|
| December 31,           |  |                          |                             |                           |
| 2015                   |  |                          |                             |                           |
| Developed technology   | 0.65 years   | \$ 48,000                | \$ 36,194                   | \$ 11,806                 |
| Customer relationships | 0.75 years   | 37,000                   | 26,722                      | 10,278                    |
| Maintenance contracts  | 2.75 years   | 17,000                   | 7,367                       | 9,633                     |
| Trademarks             | 0.75 years   | 2,500                    | 1,805                       | 695                       |
| Order backlog          | 0.00 years   | 7,400                    | 7,400                       | —                         |
| License agreements     | 9.90 years   | 3,596                    | 1,494                       | 2,102                     |



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|                               |            |                   |                  |                  |
|-------------------------------|------------|-------------------|------------------|------------------|
| Other intangibles             | 4.20 years | 1,426             | 802              | 624              |
| <b>Total intangibles, net</b> |            | <b>\$ 116,922</b> | <b>\$ 81,784</b> | <b>\$ 35,138</b> |

|                               | Weighted Average<br>Remaining Amortization<br>Period | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
|-------------------------------|--|--------------------------|-----------------------------|---------------------------|
| <b>June 30, 2015</b>          |  |                          |                             |                           |
| Developed technology          | 1.20 years   | \$ 48,000                | \$ 28,194                   | \$ 19,806                 |
| Customer relationships        | 1.30 years   | 37,000                   | 20,556                      | 16,444                    |
| Maintenance contracts         | 3.30 years   | 17,000                   | 5,667                       | 11,333                    |
| Trademarks                    | 1.30 years   | 2,500                    | 1,389                       | 1,111                     |
| Order backlog                 | 0.30 years   | 7,400                    | 6,967                       | 433                       |
| License agreements            | 10.20 years  | 10,924                   | 8,620                       | 2,304                     |
| Other intangibles             | 3.80 years   | 2,684                    | 1,983                       | 701                       |
| <b>Total intangibles, net</b> |  | <b>\$ 125,508</b>        | <b>\$ 73,376</b>            | <b>\$ 52,132</b>          |

Amortization expense for the three months ended December 31, 2015 and 2014, was \$8.1 million and \$9.0 million, respectively. For the three months ended December 31, 2015 and 2014 amortization expense of \$3.8 million and \$4.5 million, respectively, is included in "Cost of revenues for products" on the condensed consolidated statements of operations. Amortization expense for the six months ended December 31, 2015 and 2014, was \$17.0 million and \$18.0 million, respectively. For the six months ended

December 31, 2015 and 2014 amortization expense of \$8.3 million and \$9.1 million, respectively, is included in “Cost of revenues for products” on the condensed consolidated statements of operations. The remainder of the amortization expense is included in “Amortization of intangibles” on the condensed consolidated statement of operations for all periods. The amortization expense that is recognized in “Cost of revenues for products” is comprised of amortization for developed technology, license agreements and other intangibles.

#### Other Accrued Liabilities

The following are the components of other accrued liabilities (in thousands):

|  | December 31, June 30, |          |
|--|-----------------------|----------|
|  | 2015                  | 2015     |
| Accrued general and administrative costs | \$ 4,383              | \$1,204  |
| Restructuring                            | 2,588                 | 5,854    |
| Other accrued liabilities                | 22,997                | 25,565   |
| Total other accrued liabilities          | \$ 29,968             | \$32,623 |

#### Deferred Revenue, Net

Deferred revenue, net represents amounts for (i) deferred services revenue (support arrangements, professional services and training), and (ii) deferred product revenue net of the related cost of revenue when the revenue recognition criteria have not been met.

The following table summarizes deferred revenue, net (in thousands):

|                                    | December 31, June 30, |          |
|------------------------------------|-----------------------|----------|
|                                    | 2015                  | 2015     |
| Deferred services                  | \$ 84,706             | \$87,441 |
| Deferred product and other revenue | 12,347                | 12,341   |
| Total deferred revenue             | 97,053                | 99,782   |
| Less: current portion              | 75,548                | 76,551   |
| Non-current deferred revenue, net  | \$ 21,505             | \$23,231 |

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

|                    |                  |
|--------------------|------------------|
| Three Months Ended | Six Months Ended |
| December 31,       | December 31,     |

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|                                | 2015     | 2014      | 2015     | 2014      |
|--------------------------------|----------|-----------|----------|-----------|
| Balance beginning of period    | \$85,255 | \$ 87,012 | \$87,441 | \$ 89,657 |
| New support arrangements       | 29,773   | 35,517    | 56,819   | 64,056    |
| Recognition of support revenue | (30,322) | (31,156)  | (59,554) | (62,340)  |
| Balance end of period          | 84,706   | 91,373    | 84,706   | 91,373    |
| Less: current portion          | 63,201   | 67,433    | 63,201   | 67,433    |
| Non-current deferred revenue   | \$21,505 | \$ 23,940 | \$21,505 | \$ 23,940 |

Deferred Distributors Revenue, Net of Cost of Sales to Distributors

The Company records revenue from its distributors on a sell-through basis, recording deferred revenue and deferred cost of sales associated with all sales transactions to its distributors in “Deferred distributors revenue, net of cost of sales to distributors” in the liability section of its condensed consolidated balance sheet. The amount shown as “Deferred distributors revenue, net of cost of sales to distributors” represents the deferred gross profit on sales to distributors based on contractual pricing.

The following table summarizes deferred distributors revenue, net of cost of sales to distributors (in thousands):

|   | December 31, June 30, |          |
|---|-----------------------|----------|
|   | 2015                  | 2015     |
| Deferred distributors revenue                                       | \$ 41,653             | \$53,366 |
| Deferred cost of sales to distributors                              | (9,976 )              | (12,491) |
| Deferred distributors revenue, net of cost of sales to distributors | \$ 31,677             | \$40,875 |

## Debt

The Company's debt is comprised of the following:

|  | December 31, June 30, |          |
|--|-----------------------|----------|
|  | 2015                  | 2015     |
| Current portion of long-term debt:         |                       |          |
| Term Loan                                  | \$ 14,625             | \$11,375 |
| Current portion of long-term debt          | \$ 14,625             | \$11,375 |
| Long-term debt, less current portion:      |                       |          |
| Term Loan                                  | \$ 37,375             | \$45,500 |
| Revolving Facility                         | 10,000                | 10,000   |
| Total long-term debt, less current portion | 47,375                | 55,500   |
| Total debt                                 | \$ 62,000             | \$66,875 |

During fiscal 2015, the Company amended its credit agreement which provides for a five-year revolving credit facility for up to \$50.0 million (the "Revolving Facility") and a \$65.0 million five-year term loan (the "Term Loan") and together with the Revolving Facility the ("Senior Secured Credit Facilities, as amended").

The Senior Secured Credit Facilities, as amended contains, among others, certain financial covenants that require the Company to maintain defined minimum financial ratios which may limit the Company's availability to borrowings under the Revolving Facility. As of December 31, 2015, the Company had \$32.2 million of availability under the Revolving Facility and is in compliance with its covenants.

The Company had \$1.0 million of outstanding letters of credit as of December 31, 2015.

## Guarantees and Product Warranties

Networking products may contain undetected hardware or software errors when new products or new versions or updates of existing products are released to the marketplace. In the past, we had experienced such errors in connection with products and product updates. The Company's standard hardware warranty period is typically 12 months from the date of shipment to end-users and 90 days for software. For certain access products, the Company offers a limited

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

Upon issuance of a standard product warranty, the Company discloses and recognizes a liability for the obligations it assumes under the product warranty. The following table summarizes the activity related to the Company's product warranty liability during the three and six months ended December 31, 2015 and 2014:

|                             | Three Months Ended<br>December 31, |          | Six Months Ended<br>December 31, |          |
|-----------------------------|------------------------------------|----------|----------------------------------|----------|
|                             | 2015                               | 2014     | 2015                             | 2014     |
| Balance beginning of period | \$9,244                            | \$ 7,889 | \$8,676                          | \$ 7,551 |
| New warranties issued       | 2,956                              | 1,683    | 5,520                            | 3,948    |
| Warranty expenditures       | (1,785 )                           | (1,727 ) | (3,781 )                         | (3,654 ) |
| Balance end of period       | \$10,415                           | \$ 7,845 | \$10,415                         | \$ 7,845 |

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

#### Advertising

Cooperative advertising expenses are recorded as marketing expenses to the extent that an advertising benefit separate from the revenue transaction can be identified and the cash paid does not exceed the fair value of that advertising benefit received. Cooperative advertising obligations with customers are accrued and the costs expensed at the time the related revenue is recognized. If the Company does not meet the criteria for recognizing such cooperative advertising obligations as marketing expense, the costs are recorded as a reduction of revenue. All other advertising costs are expensed as incurred. Advertising expenses for three and six months ended December 31, 2015 and 2014, were immaterial.

#### Concentrations

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

The Company performs ongoing credit evaluations of its customers and generally does not require collateral in exchange for credit.

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

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|                       | Three Months Ended<br>December 31, |      | Six Months Ended<br>December 31, |      |
|-----------------------|------------------------------------|------|----------------------------------|------|
|                       | 2015                               | 2014 | 2015                             | 2014 |
| Tech Data Corporation | 19%                                | 15%  | 16%                              | 15%  |
| Westcon Group Inc.    | 14%                                | 13%  | 15%                              | 13%  |
| Jenne                 | 12%                                | *    | 11%                              | *    |

\*Less than 10% of net revenue

### 5. Fair Value Measurements

A three-tier fair value hierarchy is utilized to prioritize the inputs used in measuring fair value. The hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels are defined as follows:

- Level 1 Inputs - unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 Inputs - quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument; and
- Level 3 Inputs - unobservable inputs reflecting the Company's own assumptions in measuring the asset or liability at fair value.

The Company did not hold any financial liabilities that required measurement at fair value on a recurring basis. The following table presents the Company's fair value hierarchy for its financial assets measured at fair value on a recurring basis (in thousands):

| December 31,       |         |       |       |         |
|--------------------|---------|-------|-------|---------|
|                    | Level   | Level | Level |         |
| 2015               | 1       | 2     | 3     | Total   |
| (In thousands)     |         |       |       |         |
| <b>Assets</b>      |         |       |       |         |
| Investments:       |         |       |       |         |
| Money market funds | \$4,769 | \$ —  | \$ —  | \$4,769 |
| Total              | \$4,769 | \$ —  | \$ —  | \$4,769 |
|                    |         |       |       |         |
| June 30,           |         |       |       |         |
|                    | Level   | Level | Level |         |
| 2015               | 1       | 2     | 3     | Total   |
| (In thousands)     |         |       |       |         |
| <b>Assets</b>      |         |       |       |         |
| Investments:       |         |       |       |         |
| Money market funds | \$4,770 | \$ —  | \$ —  | \$4,770 |
| Total              | \$4,770 | \$ —  | \$ —  | \$4,770 |

Level 2 investments: the Company includes U.S. government and sovereign obligations, most government agency securities, investment-grade corporate bonds, and state, municipal and provincial obligations for which quoted prices are available as Level 2. There were no transfers of assets or liabilities between Level 1 and Level 2 for the periods presented.

The fair value of the borrowings under the Senior Secured Credit Facility, as amended is estimated based on valuations provided by alternative pricing sources supported by observable inputs which is considered Level 2. Due to the short duration until maturity of the credit facility, the fair value approximates the carrying amount of the Company's total long-term indebtedness, including current portion of \$62.0 million and \$66.9 million as of December 31 and June 30, 2015, respectively.

Level 3 investments: The Company does not hold any level 3 investments.



Certain of the Company's assets, including intangible assets and goodwill are measured at fair value on a non-recurring basis if impairment is indicated. There were no impairments recorded for the three and six months ended December 31, 2015 or 2014.

## 6. Share-based Compensation

### Shares reserved for issuance

As of December 31, 2015, the Company had reserved for issuance (in thousands):

|   | December 31, | June 30, |
|---|--------------|----------|
|   | 2015         | 2015     |
| 2014 Employee Stock Purchase Plan                     | 11,000       | 12,000   |
| Employee stock options and awards outstanding         | 12,485       | 15,273   |
| Employee stock options and awards available for grant | 4,768        | 5,450    |
| Total shares reserved for issuance                    | 28,253       | 32,723   |

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

|  | Three Months Ended<br>December 31, |          | Six Months Ended<br>December 31, |          |
|--|------------------------------------|----------|----------------------------------|----------|
|  | 2015                               | 2014     | 2015                             | 2014     |
| Cost of product revenue                | \$277                              | \$ 275   | \$572                            | \$ 558   |
| Cost of service revenue                | 277                                | 272      | 644                              | 563      |
| Research and development               | 1,165                              | 1,544    | 2,795                            | 3,188    |
| Sales and marketing                    | 1,291                              | 1,566    | 2,719                            | 3,123    |
| General and administrative             | 935                                | 1,092    | 1,886                            | 2,131    |
| Total share-based compensation expense | \$3,945                            | \$ 4,749 | \$8,616                          | \$ 9,563 |

During the three and six months ended December 31, 2015 and 2014, the Company did not capitalize any share-based compensation expense in inventory, as the amounts were immaterial.

#### Stock Awards

Stock awards may be granted under the 2013 Equity Incentive Plan (the "2013 Plan") on terms approved by the Compensation Committee of the Board of Directors. Stock awards generally provide for the issuance of restricted stock units (including performance or market-based restricted stock units) which vest over a fixed period.

The following table summarizes stock award activity for the six months ended December 31, 2015 (in thousands, except grant date fair value):

|  | Number<br>of<br>Shares<br>(000's) | Weighted-<br>Average Grant-<br>Date Fair Value | Aggregate Fair<br>Market Value (\$000's) |
|--|-----------------------------------|--|--|
| Non-vested stock awards outstanding at June 30, 2015     | 4,597                             | \$ 3.82  |  |
| Granted  | 2,889                             | \$ 3.14  |  |
| Vested   | (1,729 )                          | \$ 4.68  |  |
| Cancelled  | (582 )                            | \$ 3.77  |  |
| Non-vested stock awards outstanding at December 31, 2015 | 5,175                             | \$ 3.16  | \$ 21,113                                |

The following table summarizes stock option activity under all plans for the six months ended December 31, 2015 (in thousands, except per share and contractual term):

| Weighted-<br>Average | Weighted-<br>Average | Aggregate |
|----------------------|----------------------|-----------|
|----------------------|----------------------|-----------|

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|  | Number<br>of<br>Shares | Exercise<br>Price | Remaining<br>Contractual<br>Term | Intrinsic<br>Value |
|--|------------------------|-------------------|----------------------------------|--------------------|
|  | (000's)                | Per Share         | (years)                          | (000's)            |
| Options outstanding at June 30, 2015             | 10,604                 | \$ 4.03           | 3.79                             | 410                |
| Granted  | 5                      | \$ 3.79           |                                  |                    |
| Exercised  | (240 )                 | \$ 3.23           |                                  |                    |
| Cancelled  | (3,059 )               | \$ 3.83           |                                  |                    |
| Options outstanding at December 31, 2015         | 7,310                  | \$ 4.13           | 4.32                             | \$ 3,632           |
| Exercisable at December 31, 2015                 | 4,908                  | \$ 4.14           | 3.39                             | \$ 2,174           |
| Vested and expected to vest at December 31, 2015 | 6,984                  | \$ 4.12           | 4.25                             | \$ 3,476           |

The weighted-average grant-date fair value of options granted during the three and six months ended December 31, 2015 was \$1.59. The weighted-average grant-date fair value of options granted during the three and six months ended December 31, 2014 was \$1.66 and \$1.96, respectively.

The weighted-average fair value of shares granted under the Company's 2014 ESPP during the six months ended December 31, 2015, was \$1.97. The weighted-average fair value of shares granted under the Company's 1999 ESPP during the three and six months ended December 31, 2014, was \$1.17 and \$1.33, respectively.

The Company uses the straight-line method for expense attribution, and the Company estimates forfeitures and only recognizes expense for those shares expected to vest. The Company's estimated forfeiture rate for fiscal 2016 is based on the Company's historical forfeiture experience and is 13% for non-executives and 19% for executives.

The fair value of each stock option grant under the Company's 2013 Plan and 2005 Equity Incentive Plan is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the following table. The Company uses the Monte-Carlo simulation model to determine the fair value and the derived service period of stock awards with market conditions, on the date of the grant. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate is based upon the estimated life of the option and is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatility is based on a blended rate of the implied volatilities from traded options on the Company's stock and historical volatility on the Company's stock.

The fair value of each share purchase option under the Company's 2014 ESPP and 1999 ESPP is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the following table. The expected term of the 2014 ESPP and the 1999 ESPP represents the term of the offering period of each option. The risk-free rate is based upon the estimated life and is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatility is based on a blended rate of the implied volatilities from traded options and historical volatility on the Company's stock.

|                            | Stock Option Plan<br>Three Months<br>Ended<br>December 31, |              | Employee Stock Purchase Plan<br>Three Months Ended<br>December 31, |               | Stock Option Plan<br>Six Months Ended<br>December 31, |              | Employee Stock Purchase Plan<br>Six Months Ended<br>December 31, |               |
|----------------------------|--|--------------|--|---------------|---|--------------|--|---------------|
|                            | 2015   | 2014         | 2015   | 2014          | 2015  | 2014         | 2015   | 2014          |
| Expected life              | 4.0<br>years   | 4.8<br>years | —  | 0.25<br>years | 4.0<br>years  | 4.7<br>years | 1.25<br>years  | 0.25<br>years |
| Risk-free interest<br>rate | 1.78%  | 1.67%        | —%   | 0.03%         | 1.78%   | 1.61%        | 0.29%  | 0.02%         |
| Volatility                 | 52%  | 54%          | —%   | 63%           | 52%   | 54%          | 58%  | 57%           |
| Dividend yield             | —%   | —%           | —%   | —%            | —%  | —%           | —%   | —%            |

#### 7. Restructuring Charges

As of December 31, 2015, restructuring liabilities were \$4.7 million and consisted of obligations for severance benefits, contract termination and other expenses. The short-term restructuring liability is recorded in "Other accrued liabilities" and the long-term restructuring liability is recorded in "Other long-term liabilities" in the condensed consolidated balance sheets. During the three and six months ended December 31, 2015, the Company recorded restructuring charges of \$3.0 million and \$8.6 million, respectively. Included in the restructuring charges were offsets for future sub-leasing income. The Company has estimated the sub-lease income based on its existing leases agreement, as well the real estate market conditions at the respective locations. The Company also factored into its estimate the time for a sub-lease tenant to enter into an agreement and complete any improvements. The Company will reevaluate any sub-lease income on a regular basis and adjust the accrual as necessary if and when facts should change.

## Fiscal 2015 Restructuring

During the fourth quarter of fiscal 2015, we reduced costs through targeted restructuring activities intended to reduce operating costs and realign our organization in the current competitive environment. We initiated a plan to reduce our worldwide headcount by more than 225 employees, primarily in sales and marketing, as well as research and development, consolidate specific global administrative functions, and shift certain operating costs to lower cost regions, among other actions.

## Phase Two

During the first half of fiscal 2016, we continued our initiative to realign our operations with a second phase by abandoning excess facilities, primarily in San Jose, California; Salem, New Hampshire; Research Triangle Park, North Carolina and Shannon, Ireland. The abandoned facilities represented approximately 29% of the floor space at these locations and included general office and warehouse space. There may be additional abandonments of excess facilities in future periods as we further align our organization to our business and operational needs.

During the first quarter fiscal of 2016, in conjunction with the exiting of facilities noted above, the Company recorded restructuring charges of \$5.6 million including \$5.4 million for excess facility charges and adjustments to service benefits of \$0.2 million. Excess facilities charges included \$4.1 million of accrued lease costs pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities and accelerated depreciation of leasehold improvements in the amount of \$1.3 million. This charge is reflected in "Restructuring charge, net of reversals" in the condensed consolidated statements of operations.

During the second quarter fiscal of 2016, in conjunction with the exiting of the facilities noted above, the Company incurred restructuring charges of \$3.0 million including \$2.9 million in excess facilities charges related to amending its lease in North Carolina, thereby reducing its floor space by 36%, and adjustments to severance benefits of \$0.2 million. Excess facilities charges included accelerated depreciation of leasehold improvements in the amount of \$1.9 million and contract termination charges and professional fees of \$1.0 million. This charge is reflected in "Restructuring charge, net of reversals" in the condensed consolidated statements of operations.

As of December 31, 2015, the Company had restructuring liabilities of \$4.7 million. The severance benefits accrual is expected to be paid by the end of the third quarter of fiscal 2016. The excess facilities accrual payments will continue through fiscal year 2023, due to the length of the agreements.

Restructuring liabilities consist of (in thousands):

|   | Excess     | Severance |       |         |
|---|------------|-----------|-------|---------|
|   | Facilities | Benefits  | Other | Total   |
| Balance as of June 30, 2015                                   | \$—        | \$ 5,737  | \$117 | \$5,854 |
| Period charges  | 5,409      | 321       | 178   | 5,908   |
| Period reversals  | —          | (235 )    | (70 ) | (305 )  |
| Non cash adjustments  | (1,344 )   | —         | —     | (1,344) |
| Period payments   | (42 )      | (4,207 )  | (125) | (4,374) |
| Balance as of September 30, 2015                              | 4,023      | 1,616     | 100   | 5,739   |
| Period charges  | 2,874      | 347       | 53    | 3,274   |
| Period reversals  | (14 )      | (209 )    | (20 ) | (243 )  |
| Non cash adjustments  | (1,876 )   | —         | —     | (1,876) |
| Period payments   | (653 )     | (1,365 )  | (133) | (2,151) |
| Balance as of December 31, 2015                               | \$ 4,354   | \$ 389    | \$—   | \$4,743 |
| Less: current portion recorded in Other accrued liabilities   |            |           |       | (2,588) |
| Restructuring accrual included in Other long-term liabilities |            |           |       | \$2,155 |

## 8. Commitments and Contingencies

### Purchase Commitments

The Company currently has arrangements with contract manufacturers and suppliers for the manufacture of its products. The arrangements allow them to procure long lead-time component inventory based upon a rolling production forecast provided by the Company. The Company is obligated to purchase long lead-time component inventory that its contract manufacturer procures in accordance with the Company's forecast, unless the Company gives notice of order cancellation outside of applicable component lead-times. As of December 31, 2015, the Company had non-cancelable commitments to purchase \$64.3 million of such inventory.

### Legal Proceedings

The Company may from time to time be party to litigation arising in the course of its business, including, without limitation, allegations relating to commercial transactions, business relationships or intellectual property rights. Such

claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Litigation in general and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict.

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

cases, there is considerable uncertainty regarding the ultimate resolution of such matters, including the amount of any possible loss, fine or penalty. Accordingly, for current proceedings, except as noted below, the Company is currently unable to estimate any reasonably possible loss or range of possible loss. However, an adverse resolution of one or more of such matters could have a material adverse effect on the Company's results of operations in a particular quarter or fiscal year.

#### Brazilian Tax Assessment Matters

Certain Brazilian tax authorities have made tax assessments against our Brazilian subsidiary, Enterasys Networks do Brazil Ltda., based on an alleged underpayment of taxes. The tax authorities are also seeking interest and penalties with respect to such claims (collectively, the "ICMS Tax Assessments"). The State of Sao Paulo, Brazil denied Enterasys Networks do Brazil Ltda. the use of certain tax credits granted by the State of Espirito Santo, Brazil under the terms of the FUNDAP program for the tax years of 2002 through 2009. The Company's application to resolve the ICMS Tax Assessments at the administrative level of the Sao Paulo Tax Department under the amnesty relief program (Reference No 3.056.963-1) was denied in March, 2014, by the Sao Paulo Tax Administration. The value of the ICMS tax credits that were disallowed by the Sao Paulo Tax Administration is BR 3.4 million (US \$0.9 million), plus interest and penalties BR 16.6 million (US \$4.3 million). Possible court fees are estimated to be BR 4.0 million (US \$1.0 million). On January 10, 2014, the Company filed a lawsuit to overturn or reduce the ICMS Assessments, which lawsuit remains on-going. As part of this lawsuit, the Company made a request for a stay of execution, so that no tax foreclosure can be filed until a final ruling is made and no guarantee needs to be presented. On or about October 6, 2014, the preliminary injunction was granted with regard to the stay of execution, and in response to an appeal on the guarantee requirement, the appellant court further ruled on or about January 28, 2015 that no cash deposit (or guarantee) need be made by the Company.

On or about June 18, 2014, the State of San Paolo notified Enterasys Networks do Brazil Ltda. that it intends to audit the records of such entity for tax years 2012 and 2013. In addition, the Company received a similar notice in December 2015 with respect to an audit by the State of San Paolo of tax years 2011-2014. The audits are expected to cover the same or very similar issues as the ICMS Tax Assessments for tax years 2002-2009, however, the Company changed their ICMS procedures effective May 2009 and a similar tax assessment is not anticipated. The Company has provided the requested information for these tax years to the Brazilian tax authorities, but has received no further response from the Brazilian tax authorities.

Based on the currently available information, the Company believes the ultimate outcome of the above audits and assessments will not have a material adverse effect on the Company's financial position or overall results of operations. The Company believes that the ICMS Tax Assessments against our Brazilian subsidiary are without merit and we are defending the claims vigorously. While the Company believes there is no legal basis for the alleged liability, due to the complexities and uncertainty surrounding the judicial process in Brazil and the nature of the claims asserted, we are unable to determine the likelihood of an unfavorable outcome against our Brazilian subsidiary and estimate the potential tax liability related to the ICMS Tax Assessments, if any, may be up to BR23.4 million (US \$6.0 million). We do not expect a final judicial determination for several years. The Company believes BR 9.4 million (US \$2.4 million) is the best estimate within the range and has recorded an accrual as of the Acquisition Date of Enterasys as such matter relates to the period before the acquisition.

The Company made a demand on April 11, 2014 for a defense from, and indemnification by, the former equity holder of Enterasys Networks ("Seller") of the ICMS Tax Assessments. Seller agreed to assume the defense of the ICMS Tax Assessments on May 20, 2014. In addition, through the settlement of the Unify Indemnification Suit on June 18, 2015, Seller has agreed to continue to defend the Company with respect to the ICMS Tax Assessments and to indemnify the Company for losses related thereto subject to certain conditions. In addition, the Seller has agreed to indemnify the Company in connection with tax assessments up to a specified cap related to the 2012 and 2013 tax years subject to



certain conditions. These conditions include the offsetting of foreign income tax benefits realized by the Company in the connection with the acquisition of Enterasys. Based upon current projections of the foreign income tax benefits to be realized, the Company does not anticipate that any amounts under the indemnification will be due from Seller in connection with either the ICMS Tax Assessments or any potential tax assessments for tax years 2012 and 2013.

In re Extreme Networks, Inc. Securities Litigation

On October 23 and 29, 2015, complaints were filed for violations of securities laws in the U.S. District Court for the Northern District of California against the Company and three of its current or former officers (Charles W. Berger, Kenneth B. Arola, and John T. Kurtzweil). Subsequently, the cases were consolidated. Plaintiffs allege that defendants violated the securities laws by disseminating materially false and misleading statements and concealing material adverse facts regarding Extreme Networks' current financial condition and growth prospects. Plaintiffs seek damages of an unspecified amount on behalf of a purported class of investors who purchased the Company's common stock from November 4, 2013 through April 9, 2015. Motions for appointment of lead plaintiff have been filed, and are scheduled to be heard on May 5, 2016. The Company believes the claims are without merit and intends to vigorously defend the claims.

## Indemnification Obligations

Subject to certain limitations, the Company may be obligated to indemnify its current and former directors, officers and employees. These obligations arise under the terms of its certificate of incorporation, its bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify, where applicable, generally means that the Company is required to pay or reimburse, and in certain circumstances the Company has paid or reimbursed, the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of these claims. The cost to defend the Company and the named individuals could have a material adverse effect on its consolidated financial position, results of operations and cash flows in the future. Recovery of such costs under its director and officers' insurance coverage is uncertain. As of December 31, 2015, the Company had no outstanding indemnification claims.

## 9. Income Taxes

For the three and six months ended December 31, 2015, the Company recorded an income tax provision of \$1.2 million and \$2.1 million, respectively. For the three and six months ended December 31, 2014, the Company recorded an income tax provision of \$1.3 million and \$2.3 million, respectively.

The income tax provisions for the three and six months ended December 31, 2015 and 2014, consisted primarily of taxes on the income of our foreign subsidiaries as well as tax expense associated with the establishment of a U.S. deferred tax liability for amortizable goodwill resulting from the acquisition of Enterasys Networks, Inc. The income tax provisions for both fiscal years were calculated based on the actual results of operations for the three and six months ended December 31, 2015 and 2014, and therefore may not reflect the annual effective tax rate.

The Company has provided a full valuation allowance against all of its U.S. federal and state deferred tax assets as well as the deferred tax assets in Australia, Brazil, Japan and Singapore. A valuation allowance is determined by assessing both negative and positive evidence to determine whether it is "more likely than not" that the deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. The Company's inconsistent earnings in recent periods, including a cumulative loss over the last three years, coupled with its difficulty in forecasting future revenue trends as well as the cyclical nature of its business represent sufficient negative evidence to require a full valuation allowance against its U.S. federal and state net deferred tax assets as well as the above mentioned foreign jurisdictions. This valuation allowance will be evaluated periodically and can be reversed partially or in whole if business results and the economic environment have sufficiently improved to support realization of some or all of the Company's deferred tax assets.

During 2015, Congress passed legislation that would make the R&D Tax Credit permanent and on December 18, 2015, President Obama signed the Protecting Americans from Tax Hikes ("PATH") Act of 2015, which includes a provision making permanent the R&D tax credit under Section 41 of the Code. This credit previously expired on December 31, 2014. The Company's balance sheet at December 31, 2015, reflects this retroactive reinstatement of the credit to January 1, 2015 offset in full by a valuation allowance.

The acquisition of Enterasys included a U.S. parent company as well as its wholly-owned domestic and foreign subsidiaries. The Company has elected to treat this stock acquisition as an asset purchase by filing the required election forms under IRC Sec 338(h)(10). The Company has estimated the value of the intangible assets from this transaction and is amortizing the amount over 15 years for tax purposes. During the three and six months ended

December 31, 2015, the Company deducted \$1.1 million and \$2.2 million of tax amortization expense, respectively related to capitalized goodwill. As of December 31, 2015, the Company recorded a deferred tax liability of \$3.6 million related to this amortization which is not considered a future source of taxable income in evaluating the need for a valuation allowance against our deferred tax assets.

The Company had \$11.5 million of unrecognized tax benefits as of December 31, 2015. The future impact of the unrecognized tax benefit of \$11.5 million, if recognized, would result in adjustments to deferred tax assets and corresponding adjustments to the valuation allowance. The Company does not anticipate any events to occur during the next twelve months that would reduce the unrealized tax benefit as currently stated in the Company's balance sheet.

The Company's policy is to accrue interest and penalties related to the underpayment of income taxes as a component of tax expense in the condensed consolidated statements of operations.

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

### 10. Net Loss Per Share

Basic earnings per share is calculated by dividing net earnings by the weighted average number of common shares outstanding during the period. Dilutive earnings per share is calculated by dividing net earnings by the weighted average number of common shares used in the basic earnings per share calculation plus the dilutive effect of shares subject to repurchase, options, warrants and unvested restricted stock units.

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share data):

|   | Three Months Ended<br>December 31, |             | Six Months Ended<br>December 31, |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | 2015                               | 2014        | 2015                             | 2014        |
| Net loss  | \$(7,234 )                         | \$(13,105 ) | \$(18,760 )                      | \$(32,435 ) |
| Weighted-average shares used in per share calculation - basic and diluted | 102,369                            | 98,677      | 101,677                          | 97,996      |
| Net loss per share - basic and diluted                                    | \$(0.07 )                          | \$(0.13 )   | \$(0.18 )                        | \$(0.33 )   |

The following securities were excluded from the computation of diluted net loss per share of common stock for the periods presented as their effect would have been anti-dilutive (in thousands):

|                                     | December 31, | December 31, |
|-------------------------------------|--------------|--------------|
|                                     | 2015         | 2014         |
| Options to purchase common stock    | 5,280        | 9,203        |
| Restricted stock units              | 1,895        | 1,369        |
| Employee Stock Purchase Plan shares | 449          | 563          |

### 11. Foreign Exchange Forward Contracts

The Company from time to time enters into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the foreign currency forecasted transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities. At December 31, 2015, we did not have any forward foreign currency contracts.

Foreign currency transaction gains and losses from operations was a gain of \$0.2 million and \$1.3 million for the three and six months ended December 31, 2015, respectively. Foreign currency transaction gains and losses from operations was a gain of less than \$0.1 million and a loss of \$0.3 million for the three and six months ended December 31, 2014,

respectively.

#### 12. Disclosure about Segments of an Enterprise and Geographic Areas

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

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

|                    | Three Months Ended<br>December 31, |            | Six Months Ended<br>December 31, |            |
|--------------------|------------------------------------|------------|----------------------------------|------------|
| Net Revenues:      | 2015                               | 2014       | 2015                             | 2014       |
| Americas:          |                                    |            |                                  |            |
| United States      | \$58,749                           | \$ 58,160  | \$115,093                        | \$ 116,648 |
| Other              | 7,743                              | 12,576     | 13,585                           | 19,917     |
| Total Americas     | 66,492                             | 70,736     | 128,678                          | 136,565    |
| EMEA               | 60,102                             | 62,574     | 111,128                          | 116,509    |
| APAC               | 12,711                             | 13,898     | 24,080                           | 30,408     |
| Total net revenues | \$139,305                          | \$ 147,208 | \$263,886                        | \$ 283,482 |

|                         | December 31, June 30, |           |
|-------------------------|-----------------------|-----------|
| Long Lived Assets:      | 2015                  | 2015      |
| Americas                | \$ 72,674             | \$87,071  |
| EMEA                    | 20,498                | 29,610    |
| APAC                    | 2,532                 | 3,108     |
| Total long lived assets | \$ 95,704             | \$119,789 |

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

This quarterly report on Form 10-Q, including the following sections, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including in particular, our expectations regarding market demands, customer requirements and the general economic environment, future results of operations, and other statements that include words such as “may,” “will,” “should,” “expect,” “plan,” “intend,” “anticipate,” “believe,” “estimate,” “potential,” “continue” and similar expressions. These forward-looking statements involve risks and uncertainties. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in the section entitled “Risk Factors” in this Quarterly Report on Form 10-Q for the second quarter of fiscal 2016, our Annual Report on Form 10-K for the fiscal year ended June 30, 2015, and other filings we have made with the Securities and Exchange Commission. These risk factors, include, but are not limited to: fluctuations in demand for our products and services; a highly competitive business environment for network switching equipment; our effectiveness in controlling expenses; the possibility that we might experience delays in the development or introduction of new technology and products; customer response to our new technology and products; the timing of any recovery in the global economy; risks related to pending or future litigation; a dependency on third parties for certain components and for the manufacturing of our products; and our ability to receive the anticipated benefits of the acquisition of Enterasys.

### Business Overview

We believe that understanding the following key developments is helpful to an understanding of our operating results for the fiscal quarter ended December 31, 2015.

We are a leading provider of network infrastructure equipment and offer related services contracts for extended warranty and maintenance to our enterprise, data center and service provider customers. We are a networking industry leader with more than 20,000 customers. We were incorporated in California in May 1996, and reincorporated in Delaware in March 1999. Our corporate headquarters are located in San Jose, California. Substantially all of our revenue is derived from the sale of our networking equipment and related service contracts.

We believe we will set the standard for the networking industry with a strategic focus on three principles:

- Highly scaled and differentiated products and solutions: Our combined product portfolio spans data center networking, switching and routing, Software-Defined Networking (“SDN”), wired and wireless LAN access, network management with analytics and integrated security features. This broader solutions portfolio can be leveraged to better serve existing and new customers. We intend to increase research and development to accelerate our vision for high-performance, modular, open networking.
- Leading customer service and support: We are working to augment our current outsourced support model by integrating Enterasys’ in-sourced expertise, building on Enterasys’ award-winning heritage and strong commitment to exceptional customer experience. The Company’s expanded global network of channel partners and distributors will benefit from expanded services and support capabilities.
- Strong Channels and Strategic Partners: Our focus is to leverage the capabilities of the combined Company and expand existing partnerships with Ericsson, as well as continue to add new strategic partnerships in the future. Additionally, we will increase our focus on partnering with distributors and channel partners globally. The goal is to develop and enhance relationships that grow revenue and profits for the Company and our alliance and channel partners. At the same time, we are investing in infrastructure to make doing business with the Company easier and more efficient.

### Impact of the Global Economic Developments

We operate in three regions: Americas, which includes the United States, Canada, Mexico, Central America and South America; EMEA, which includes Europe, Middle East, and Africa; and APAC which includes Asia Pacific, South Asia, Japan and Australia. Sales in APAC and some European countries have continued to be impacted as a result of the soft global economy. We believe that conservative purchasing patterns and delays or cancellation of IT infrastructure plans in the face of continued uncertainty regarding the global economy, may continue to negatively impact overall demand for networking solutions, including Ethernet equipment. Additionally, the continuation of the strong U.S. Dollar compared to most other currency, particularly on a year over year basis, has contributed to the conservative purchasing trends in many international locations.



We have taken, and plan to continue to take, other steps to manage our business in the current economic environment. For example, we have managed from time to time our contingent work force, consolidation of office locations, reduced travel and other discretionary spending, realigned our product portfolio and organization to grow revenue and operating income, and controlled all hiring activities.

#### Increasing Demand for Bandwidth

We believe that the continued increase in demand for bandwidth will, over time, drive future demand for high performance Ethernet solutions. Wide-spread adoption of electronic communications in all aspects of our lives, proliferation of next generation converged mobile devices and deployment of triple-play services to residences and businesses alike, continues to generate demand for greater network performance across broader geographic locations. In parallel to these transformational forces within society and the community at large, the accelerating adoption of internet and intranet “cloud” solutions within business enterprises is enabling organizations to offer greater business scalability to improve efficiency and through more effective operations, improve profitability. In order to realize the benefits of these developments, customers require additional bandwidth and high performance from their network infrastructure at affordable prices. We are seeing the initial indications that the Ethernet segment of the networking equipment market will return to growth as enterprise, data center and carrier customers continue to recognize the performance and operating cost benefits of Ethernet technology.

#### Expanding Product Portfolio

We believe that continued success in our marketplace is dependent upon a variety of factors that includes, but is not limited to, our ability to design, develop and distribute new and enhanced products employing leading-edge technology. New software and hardware introductions during fiscal 2015 included a Summit X770 switch supporting industry’s highest density performing top of rack switching, Purview - a network-powered application analytics and optimization solution, identiFi 38xx WiFi Access Points supporting 802.11ac, SDN 2.0 - an open, standards-based (based on OpenDaylight) and comprehensive SDN solution, 100GbE support for the BDX8 and NetSight 6.0 a consolidated management across the expanded portfolio.

#### Industry Developments

The market for network infrastructure equipment is highly competitive and dominated by a few large companies. The current economic climate has further driven consolidation of vendors within the Ethernet networking market and with vendors from adjacent markets, including storage, security, wireless and voice applications. We believe that the underpinning technology for all of these adjacent markets is Ethernet. As a result, independent Ethernet switch vendors are being acquired or merged with larger, adjacent market vendors to enable them to deliver complete and broad solutions. As an independent Ethernet switch vendor, we must provide products that, when combined with the products of our large strategic partners, create compelling solutions for end-user customers. Our acquisition of Enterasys gives us a larger market share and presence and an opportunity to create complementary solutions for our customers. Our approach is to focus on the intelligence and automation layer that spans our hardware products and that facilitates end-to-end solutions, as opposed to positioning ourselves as a low-cost-vendor with point products. Lower overall market growth has also created an environment of declining margins due to increased competition between the remaining vendors in this space. During the last year, overall Ethernet port counts have grown, while industry revenues have decreased, signaling a decline in average selling price per port. Our product life cycle and operational cost reduction efforts are therefore even more critical for margin preservation.

## Results of Operations

During the second quarter of fiscal 2016, we achieved the following results:

- Net revenues of \$139.3 million compared to \$147.2 million in the second quarter of fiscal 2015.
- Product revenues of \$105.4 million compared to \$112.5 million in the second quarter of fiscal 2015.
- Service revenues of \$34.0 million compared to \$34.7 million in the second quarter of fiscal 2015.
- Total gross margin of 50% of net revenues compared to 51% of net revenues in the second quarter of fiscal 2015.
- Operating loss of \$5.4 million compared to \$11.1 million in the second quarter of fiscal 2015.
- Net loss of \$7.2 million compared to \$13.1 million in the second quarter of fiscal 2015.
- Cash flow provided by operating activities of \$14.0 million in the six months ended December 31, 2015 compared to cash flow provided by operating activities of \$41.5 million in the six months ended December 31, 2014.
- Cash and cash equivalents of \$85.9 million as of December 31, 2015 compared to \$76.2 million as of June 30, 2015.

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We operate in three regions: Americas, which includes the United States, Canada, Mexico, Central America and South America; EMEA, which includes Europe, Russia, Middle East, and Africa; and APAC which includes Asia Pacific, South Asia, India, and Australia.

The following table presents the total net revenue geographically for the three and six months ended December 31, 2015 and 2014 (dollars in thousands):

|                           | Three Months Ended |            |              |          | Six Months Ended |            |              |          |
|---------------------------|--------------------|------------|--------------|----------|------------------|------------|--------------|----------|
|                           | December 31,       |            | December 31, |          | December 31,     |            | December 31, |          |
|                           | \$                 | %          | \$           | %        | \$               | %          | \$           | %        |
| Net Revenues              | 2015               | 2014       | Change       | Change   | 2015             | 2014       | Change       | Change   |
| Americas:                 |                    |            |              |          |                  |            |              |          |
| United States             | \$58,749           | \$ 58,160  | \$589        | 1.0 %    | \$115,093        | \$ 116,648 | \$(1,555 )   | (1.3 )%  |
| Other                     | 7,743              | 12,576     | (4,833)      | (38.4 )% | 13,585           | 19,917     | (6,332 )     | (31.8 )% |
| Total Americas            | 66,492             | 70,736     | (4,244)      | (6.0 )%  | 128,678          | 136,565    | (7,887 )     | (5.8 )%  |
| Percentage of net revenue | 47.7 %             | 48.1 %     |              |          | 48.8 %           | 48.2 %     |              |          |
| EMEA                      | 60,102             | 62,574     | (2,472)      | (4.0 )%  | 111,128          | 116,509    | (5,381 )     | (4.6 )%  |
| Percentage of net revenue | 43.1 %             | 42.5 %     |              |          | 42.1 %           | 41.1 %     |              |          |
| APAC                      | 12,711             | 13,898     | (1,187)      | (8.5 )%  | 24,080           | 30,408     | (6,328 )     | (20.8 )% |
| Percentage of net revenue | 9.1 %              | 9.4 %      |              |          | 9.1 %            | 10.7 %     |              |          |
| Total net revenues        | \$139,305          | \$ 147,208 | \$(7,903)    | (5.4 )%  | \$263,886        | \$ 283,482 | \$(19,596)   | (6.9 )%  |

Net Revenues

The following table presents net product and service revenue for the three and six months ended December 31, 2015 and 2014 (dollars in thousands):

|                           | Three Months Ended |            |              |         | Six Months Ended |            |              |         |
|---------------------------|--------------------|------------|--------------|---------|------------------|------------|--------------|---------|
|                           | December 31,       |            | December 31, |         | December 31,     |            | December 31, |         |
|                           | \$                 | %          | \$           | %       | \$               | %          | \$           | %       |
| Net Revenues:             | 2015               | 2014       | Change       | Change  | 2015             | 2014       | Change       | Change  |
| Product                   | \$105,355          | \$ 112,501 | \$(7,146)    | (6.4 )% | \$196,736        | \$ 215,173 | \$(18,437)   | (8.6 )% |
| Percentage of net revenue | 75.6 %             | 76.4 %     |              |         | 74.6 %           | 75.9 %     |              |         |
| Service                   | 33,950             | 34,707     | (757 )       | (2.2 )% | 67,150           | 68,309     | (1,159 )     | (1.7 )% |
| Percentage of net revenue | 24.4 %             | 23.6 %     |              |         | 25.4 %           | 24.1 %     |              |         |
| Total net revenues        | \$139,305          | \$ 147,208 | \$(7,903)    | (5.4 )% | \$263,886        | \$ 283,482 | \$(19,596)   | (6.9 )% |

Product revenue decreased by \$6.0 million or 5.3% and decreased \$17.3 million or 8.0% for the three and six-month periods ended December 31, 2015, respectively, as compared to the corresponding periods of fiscal 2015. The decline in product revenues was due to the continuing strong U.S. Dollar and increased price competition.

Service revenue decreased \$1.1 million or 3.1% in the second quarter of fiscal 2016, compared to the corresponding period of fiscal 2015. Customer service revenue declined \$1.5 million due to lower maintenance revenues partially offset by lower purchase accounting charges related to deferred service revenues of \$0.4 million in second quarter of fiscal 2016 as compared to \$0.8 million in the second quarter of fiscal 2015.

Service revenue decreased \$1.5 million or 2.2% in the six months ended December 31, 2015, compared to the corresponding period of fiscal 2015. Customer service revenue declined \$2.3 million due to lower maintenance revenues partially offset by lower purchase accounting charges related to deferred service revenues of \$0.8 million in the first half of fiscal 2016 as compared to \$1.6 million in the first half of fiscal 2015.

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The following table presents the product and service revenue gross profit and the respective gross profit percentages for the three and six months ended December 31, 2015 and 2014 (dollars in thousands):

|                               | Three Months Ended |          |           |        | Six Months Ended |           |            |        |
|-------------------------------|--------------------|----------|-----------|--------|------------------|-----------|------------|--------|
|                               | December 31,       |          | %         |        | December 31,     |           | %          |        |
|                               | 2015               | 2014     | Change    | Change | 2015             | 2014      | Change     | Change |
| <b>Gross profit:</b>          |                    |          |           |        |                  |           |            |        |
| Product                       | \$48,252           | \$52,005 | \$(3,753) | (7.2)% | \$92,699         | \$100,652 | \$(7,953)  | (7.9)% |
| Percentage of product revenue | 45.8 %             | 46.2 %   |           |        | 47.1 %           | 46.8 %    |            |        |
| Service                       | 22,023             | 23,157   | (1,134)   | (4.9)% | 42,694           | 45,037    | (2,343)    | (5.2)% |
| Percentage of service revenue | 64.9 %             | 66.7 %   |           |        | 63.6 %           | 65.9 %    |            |        |
| Total gross profit            | \$70,275           | \$75,162 | \$(4,887) | (6.5)% | \$135,393        | \$145,689 | \$(10,296) | (7.1)% |
| Percentage of net revenue     | 50.4 %             | 51.1 %   |           |        | 51.3 %           | 51.4 %    |            |        |

Product gross profit decreased \$2.6 million or 5.0% in the second quarter of fiscal 2016 as compared to the corresponding period in fiscal 2015. Gross profit was impacted during the second quarter of fiscal 2016 by a decrease in product revenue of \$6.0 million and higher excess inventory charges of \$1.0 million and warranty charges of \$1.3 million as compared to the corresponding period of fiscal 2015 offset by lower overhead costs of \$0.6 million due in part to the reduction in force ("RIF") during the fourth quarter of fiscal 2015, lower royalties on older products which have been discontinued of \$0.7 million and distribution expenses of \$0.7 million.

Product gross profit decreased \$6.8 million or 6.7% in the six months ended December 31, 2015 as compared to the corresponding period in fiscal 2015. Gross profit was impacted during the second quarter of fiscal 2016 by a decrease in product revenue of \$17.3 million and higher excess inventory charges of \$0.7 million and warranty charges of \$1.4 million as compared to the corresponding period of fiscal 2015 offset by lower overhead costs of \$1.3 million due in part to the RIF during the fourth quarter of fiscal 2015, lower royalties of \$1.4 million on older products which have been discontinued and distribution expenses of \$0.5 million.

Service gross profit decreased \$1.5 million or 6.4% to \$21.7 million in the second quarter of fiscal 2016 from \$23.2 million in the second quarter of fiscal 2015. The decrease was due to lower service revenues of \$1.1 million and higher professional fees of \$0.4 million to service maintenance contracts as compared to the second quarter of fiscal 2015.

Service gross profit decreased \$2.7 million or 6.0% to \$42.3 million for the six months ended December 31, 2015 from \$45.0 million. The decrease was due to lower service revenues of \$1.5 million and excess inventory charges of \$1.2 million for the first six months of fiscal 2016.

#### Operating Expenses

The following table presents operating expenses and operating income (dollars in thousands):

|  | Three Months Ended |              | % | Six Months Ended |              | % |
|--|--------------------|--------------|---|------------------|--------------|---|
|  | December 31,       | December 31, |   | December 31,     | December 31, |   |

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|  | 2015       | 2014        | Change     | Change   | 2015        | 2014        | Change     | Change   |
|--|------------|-------------|------------|----------|-------------|-------------|------------|----------|
| Research and development               | \$20,716   | \$ 24,000   | \$(3,284 ) | (13.7 )% | \$40,984    | \$ 47,347   | \$(6,363 ) | (13.4 )% |
| Sales and marketing                    | 37,058     | 43,971      | (6,913 )   | (15.7 )% | 73,120      | 88,750      | (15,630)   | (17.6 )% |
| General and administrative             | 9,775      | 10,306      | (531 )     | (5.2 )%  | 18,951      | 21,380      | (2,429 )   | (11.4 )% |
| Acquisition and integration costs      | 807        | 3,500       | (2,693 )   | (76.9 )% | 1,145       | 7,558       | (6,413 )   | (84.9 )% |
| Restructuring charge, net of reversals | 3,031      | —           | 3,031      | 100.0 %  | 8,634       | —           | 8,634      | 100.0 %  |
| Amortization of intangibles            | 4,251      | 4,467       | (216 )     | (4.8 )%  | 8,718       | 8,934       | (216 )     | (2.4 )%  |
| Total operating expenses               | \$75,638   | \$ 86,244   | \$(10,606) | (12.3 )% | \$151,552   | \$ 173,969  | \$(22,417) | (12.9 )% |
| Operating loss                         | \$(5,363 ) | \$(11,082 ) | \$5,719    | 51.6 %   | \$(16,159 ) | \$(28,280 ) | \$12,121   | 42.9 %   |

#### Research and Development Expenses

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

Research and development expenses decreased by \$3.3 million, or 13.7% for the three months ended December 31, 2015 as compared to the corresponding periods of fiscal 2015. The decreases in research and development expenses were due to lower personnel costs of \$2.0 million primarily driven by the RIF during the fourth quarter of fiscal 2015 and reduced software tools and maintenance of \$0.5 million.

Research and development expenses decreased by \$6.4 million, or 13.4% for the six months ended December 31, 2015 as compared to the corresponding period of fiscal 2015. The decreases in research and development expenses were due to lower personnel costs of \$4.3 million primarily driven by the RIF during the fourth quarter of fiscal 2015, reduced software tools and maintenance of \$1.0 million.

#### Sales and Marketing Expenses

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

Sales and marketing expenses decreased by \$6.9 million, or 15.7% for the three months ended December 31, 2015 as compared to the corresponding periods of fiscal 2015. The decreases in sales and marketing expenses were primarily due to lower personnel costs (which includes benefits and stock based compensation) of \$6.5 million as a result of the RIF during the fourth quarter of fiscal 2015.

Sales and marketing expenses decreased by \$15.6 million, or 17.6% for the six months ended December 31, 2015 as compared to the corresponding period of fiscal 2015. The decreases in sales and marketing expenses were primarily due to lower personnel costs of \$12.3 million as a result of the RIF during the fourth quarter of fiscal 2015 and a corresponding reduction of \$2.3 million in travel and entertainment related expense.

#### General and Administrative Expenses

General and administrative expense consists primarily of personnel costs, legal and professional service costs, share-based compensation, travel and facilities and information technology costs.

General and administrative expenses decreased by \$0.5 million, or 5.2% for the three months ended December 31, 2015 as compared to the corresponding period of fiscal 2015. The decrease in general and administrative expenses was due to lower personnel costs of \$0.7 million as a result of the RIF during the fourth quarter of fiscal 2015, partially offset by higher bad debt expense of \$0.2 million.

General and administrative expenses decreased by \$2.4 million, or 11.4% for the six months ended December 31, 2015 as compared to the corresponding period of fiscal 2015. The decrease in general and administrative expenses was due to lower personnel costs (which includes benefits and stock based compensation) of \$0.3 million as a result of the RIF during the fourth quarter of fiscal 2015 and professional services of \$1.2 million.

#### Acquisition and Integration Costs

Acquisition and integration costs include those costs that we have incurred only as result of the acquisition of Enterasys and related subsequent integration of the two companies. We expect that any future integration costs will be immaterial.

During the three months ended December 31, 2015 and 2014, we recorded \$0.8 million and \$3.5 million, respectively of integration costs primarily for IT and sales integration costs.

During the six months ended December 31, 2015 and 2014, we recorded \$1.1 million and \$7.6 million, respectively of integration costs primarily for IT, warehouse, and sales integration and severance costs.

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### Restructuring Charges

During the three and six months ended December 31, 2015, we recorded \$3.0 million and \$8.6 million in restructuring charges, respectively, primarily for excess facilities, net of future sub-lease income. There were no restructuring charges during the corresponding periods in fiscal 2015. During the first half of fiscal 2016, we continued our initiative begun in the fourth quarter of fiscal 2015 to realign our operations by abandoning excess facilities, primarily in San Jose California; Salem, New Hampshire; Research Triangle Park, North Carolina and Shannon, Ireland. The abandoned facilities represented approximately 29% of our original space, and included general office and warehouse space. There may be additional activities in abandonments of excess facilities in future periods as we further align our organization to our business and operational needs.

During the second quarter of fiscal 2016, in conjunction with the exiting of the facilities noted above, we incurred \$2.9 million in charges related to amending our facility lease in North Carolina and \$0.2 million of adjustments to severance benefits. Excess facilities charges included the acceleration of depreciation of leasehold improvements in the amount of \$1.9 million, and contract termination charges and professional fees of \$1.0 million.

During the six months ended December 31, 2015, in conjunction with the exiting of the facilities noted above, we incurred \$8.3 million in excess facilities charges and \$0.4 million of adjustments to severance benefits. Excess facilities charges included \$4.1 million of accrued lease costs pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities, acceleration of depreciation of leasehold improvements of \$3.2 million and contract termination charges and professional fees of \$1.0 million.

### Amortization of Intangibles

During the three months ended December 31, 2015 and 2014, we recorded \$4.3 million and \$4.5 million, respectively of amortization expense recorded in operating expenses in the condensed consolidated statements of operations.

During the six months ended December 31, 2015 and 2014, we recorded \$8.7 million and \$8.9 million, respectively of amortization expense recorded in operating expenses in the condensed consolidated statements of operations.

### Interest Expense

During the three and six months ended December 31, 2015 and 2014 we recorded \$0.8 million, \$1.6 million, \$0.8 million and \$1.6 million respectively in interest expense.

### Other Income (Expense), Net

During the three months ended December 31, 2015 and 2014 we recorded \$0.1 million of gains and \$0.1 million of losses, respectively, in other income (expense), net. The increase was primarily due to foreign exchange gains from the revaluation of certain assets and liabilities denominated in foreign currencies into U.S. Dollars.

During the six months ended December 31, 2015 and 2014 we recorded \$1.1 million of gains and \$0.5 million of losses, respectively, in other income (expense), net. The increase was primarily due to foreign exchange gains from the revaluation of certain assets and liabilities denominated in foreign currencies into U.S. Dollars.

### Provision for Income Taxes

For the three months ended December 31, 2015 and 2014, we recorded an income tax provision of \$1.2 million and \$1.3 million, respectively. For the six months ended December 31, 2015 and 2014, we recorded an income tax

provision of \$2.1 million and \$2.3 million, respectively.

The income tax provisions for the three and six months ended December 31, 2015 and 2014 consisted primarily of taxes on the income of our foreign subsidiaries as well as tax expense associated with the establishment of a U.S. deferred tax liability for amortizable goodwill resulting from the acquisition of Enterasys.

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### Critical Accounting Policies and Estimates

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

As discussed in Part II, Item 7, “Management's Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the year ended June 30, 2015, we consider the following accounting policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements:

- Revenue Recognition
- Goodwill
- Share-based Payments
- Restructuring Charges

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

### New Accounting Pronouncements

See Note 3 of the accompanying condensed consolidated financial statements for a full description of new accounting pronouncements, including the respective expected dates of adoption and effects on results of operations and financial condition.

### Liquidity and Capital Resources

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

|                            | December 31, June 30, |          |
|----------------------------|-----------------------|----------|
|                            | 2015                  | 2015     |
| Cash and cash equivalent   | \$ 85,865             | \$76,225 |
| Total cash and investments | \$ 85,865             | \$76,225 |
| Working capital            | \$ 9,442              | \$2,564  |

As of December 31, 2015, our principal sources of liquidity consisted of cash and cash equivalents of \$85.9 million, accounts receivable, net of \$73.1 million and availability of borrowings from the Revolving Facility of \$32.2 million. Our principal uses of cash will include repayments of debt and related interest, purchase of finished goods inventory from our contract manufacturers, payroll, restructuring expenses and other operating expenses related to the development, marketing of our products and purchases of property and equipment. We believe that our \$85.9 million of cash and cash equivalents at December 31, 2015, cash flows from operations along with the availability of borrowings from the Revolving Facility will be sufficient to fund our principal uses of cash for at least the next 12 months.

The Senior Secured Credit Facilities, as amended, contain financial covenants that require us to maintain a minimum Consolidated Fixed Charge Coverage Ratio and Consolidated Quick Ratio and a maximum Consolidated Leverage Ratio and other financial and non-financial covenants and restrictions that limit our ability to incur additional indebtedness, create liens upon any of our property, merge, consolidate or sell all or substantially all of our assets, etc.

The Senior Secured Credit Facilities, as amended, also include customary events of default, including failure to pay principal, interest or fees when due, failure to comply with covenants, if any representation or warranty made by us is false or misleading in any material respect, certain insolvency or receivership events affecting Extreme and its subsidiaries, the occurrence of certain material judgments, the occurrence of certain ERISA events, the invalidity of the loan documents or a change in control of our Company. The amounts outstanding under the Senior Secured Credit Facilities, as amended, may be accelerated upon certain events of default. At December 31, 2015, we are in compliance and expect to remain in compliance with the covenants of the Senior Secured Credit Facilities, as amended, and they are not expected to impact our liquidity or capital resources.

#### Key Components of Cash Flows and Liquidity

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

|   | Six Months Ended |              |
|---|------------------|--------------|
|   | December 31,     | December 31, |
|   | 2015             | 2014         |
| Net cash provided by operating activities           | \$ 13,967        | \$ 41,453    |
| Net cash (used in) provided by investing activities | (1,409 )         | 7,670        |
| Net cash used in financing activities               | (2,545 )         | (30,716 )    |
| Foreign currency effect on cash                     | (373 )           | (2,625 )     |
| Net increase in cash and cash equivalents           | \$ 9,640         | \$ 15,782    |

#### Net Cash Provided By Operating Activities

Cash flows provided by operations in the six months ended December 31, 2015 was \$14.0 million and was generated from non-cash expenses of \$36.0 million such as amortization of intangibles, stock-based compensation expense and depreciation as well as decreases in accounts receivables and was partially offset by the current period's net loss of \$18.8 million along with increases in inventories and decreases in accounts payable, accrued compensation and deferred revenues.

Cash flows provided by operations in the six months ending December 31, 2014 was \$41.5 million. The prior year's net loss of \$32.4 million was primarily offset by non-cash expenses of \$37.0 million such as amortization of intangibles, stock-based compensation expense and depreciation. Accounts receivables decreased due to lower revenue during the quarter combined with higher collections. Inventories decreased due to the timing of inventory receipts to bring inventory levels in line with the near term demand. Such increases in cash inflows were offset by decreases in accounts payables primarily due to the timing of payments.

#### Net Cash (Used In) Provided By Investing Activities

Cash flows used in investing activities in the six months ended December 31, 2015 was \$1.4 million and was comprised of purchases of property and equipment.

Cash flows provided by investing activities in the six months ending December 31, 2014 was \$7.7 million and was comprised of proceeds of \$12.1 million from the maturities and sales of investments offset by \$4.0 million of purchases of property and equipment.

### Net Cash Used In Financing Activities

Cash flows used in financing activities in the six months ended December 31, 2015 was \$2.5 million which was comprised of \$2.3 million proceeds from the issuance of shares of our common stock under the ESPP and the exercise of stock options, net of taxes paid on vested and released stock awards, offset by a net repayment of debt of \$4.9 million.

Cash flows used in financing activities in the six months ending December 31, 2014 was \$30.7 million which was comprised of a \$24.0 million draw on the Revolving Facility, \$1.7 million of proceeds from the exercise of stock options and issuance of shares of our common stock under the ESPP, net of taxes paid on vested and released stock awards, offset by \$56.4 million of cash used for repayment of debt.

### Foreign currency effect on cash

Foreign currency effect on cash increased in the six months ended December 31, 2015, primarily due to changes in foreign currency exchange rates between US Dollar and particularly the Brazilian Real, British Pound, Indian Rupee and the EURO.

## Contractual Obligations

The following summarizes our contractual obligations at six months ended December 31, 2015, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

|  | Total            | Less than<br>1 Year | 1-3 years        | 3-5 years        | More than<br>5 years |
|--|------------------|---------------------|------------------|------------------|----------------------|
| <b>Contractual Obligations:</b>                |                  |                     |                  |                  |                      |
| Debt obligations                               | \$62,000         | \$ 14,625           | \$47,375         | \$—              | \$—                  |
| Interest on debt obligations                   | 4,184            | 2,073               | 2,111            | —                | —                    |
| Non-cancellable inventory purchase commitments | 64,284           | 64,284              | —                | —                | —                    |
| Non-cancellable operating lease obligations    | 58,324           | 9,795               | 16,408           | 11,658           | 20,463               |
| Other liabilities                              | 5,056            | 4,698               | 358              | —                | —                    |
| <b>Total contractual cash obligations</b>      | <b>\$193,848</b> | <b>\$ 95,475</b>    | <b>\$ 66,252</b> | <b>\$ 11,658</b> | <b>\$ 20,463</b>     |

Non-cancelable inventory purchase commitments represent the purchase of long lead-time component inventory that our contract manufacturers procure in accordance with our forecast. Inventory purchase commitments were \$64.3 million as of six months ended December 31, 2015. We expect to honor the inventory purchase commitments within the next 12 months.

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

Other liabilities include the Company's commitments towards debt related fees and specific arrangements other than inventory.

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

We did not have any material commitments for capital expenditures as of December 31, 2015.

## Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of December 31, 2015.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

## Interest Rate Sensitivity

The following table presents the amounts of our cash equivalents that are subject to market risk by range of expected maturity and weighted-average interest rates as of December 31, 2015 (dollars in thousands).

|                                | Maturing in<br>Three<br>months<br>or less<br>(In thousands) | Three<br>months<br>to<br>one<br>year | Greater<br>than<br>one<br>year | Total   | Fair<br>Value |
|--------------------------------|---|--------------------------------------|--------------------------------|---------|---------------|
| December 31, 2015              |   |                                      |                                |         |               |
| Included in cash equivalents   | \$4,769   | \$ —                                 | \$ —                           | \$4,769 | \$4,769       |
| Weighted average interest rate | 0.10 %  | —%                                   | —%                             |         |               |

The following tables present hypothetical changes in fair value of the financial instruments held at December 31, 2015 that are sensitive to changes in interest rates (in thousands):

|                | Fair value as<br>of<br>December 31,<br>2015 | Unrealized<br>gain<br>given a<br>decrease<br>in<br>interest<br>rate of<br>X bps |             | Unrealized<br>loss given<br>an increase<br>in interest<br>rate of X<br>bps |           |
|----------------|---|---|-------------|--|-----------|
|                |   | (100<br>bps)  | (50<br>bps) | 100<br>bps   | 50<br>bps |
| (In thousands) | \$ —  | \$ —  | \$ 4,769    | \$ —   | \$ —      |



## Debt

At certain points in time we are exposed to the impact of interest rate fluctuations, primarily in the form of variable rate borrowings from our credit facility.

The following table presents hypothetical changes in interest expense for the quarter ended December 31, 2015, on outstanding credit facility borrowings as of December 31, 2015, that are sensitive to changes in interest rates (in thousands):

| Change in interest expense given a decrease in   |           | Change in interest expense given an increase in |        |
|--|-----------|---|--------|
| interest rate of X bps                           |           | interest rate of X bps                          |        |
| Average outstanding debt as of December 31, 2015 |           |   |        |
| (100 bps)  | (50 bps)  | 100 bps   | 50 bps |
| (In thousands)                                   |           |   |        |
| \$ (155)   | \$ (78)   | \$ 155  | \$ 78  |
|  | \$ 62,000 |   |        |

\*Underlying interest rate was 0.15% during the quarter. The table above assumed the underlying interest rate did not decrease below 0%.

## Exchange Rate Sensitivity

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

## Foreign Exchange Forward Contracts

We record all derivatives on the balance sheet at fair value. Changes in the fair value of derivatives are recognized in earnings as Other expense, net. From time to time, we enter into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the foreign currency forecast transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities. At December 31, 2015, we did not have any forward foreign currency contracts.

Foreign currency transaction gains and losses from operations was a gain of \$0.2 million and \$1.3 million for the three and six months ended December 31, 2015, respectively. Foreign currency transaction gains and losses from operations was a gain of less than \$0.1 million and a loss of \$0.3 million for the three and six months ended December 31, 2014, respectively.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

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

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

##### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### Inherent Limitations on Effectiveness of Controls

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

## PART II. Other Information

### Item 1. Legal Proceedings

For information regarding litigation matters that we deem significant, refer to Part I, Item 3, Legal Proceedings of our Annual Report on Form 10-K for the fiscal year ended June 30, 2015 and Note 8 to our Notes to Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report which are incorporated herein by reference.

### Item 1A. Risk Factors

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

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

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

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

- we are dependent upon obtaining orders during a quarter and shipping those orders in the same quarter to achieve our revenue objectives;
- decreases in the prices of the products that we sell;
- the mix of products sold and the mix of distribution channels through which products are sold;
- acceptance provisions in customer contracts;
- our ability to deliver installation or inspection services by the end of the quarter;
- changes in general and/or specific economic conditions in the networking industry;
- seasonal fluctuations in demand for our products and services;
- a disproportionate percentage of our sales occurring in the last month of the quarter;
- our ability to ship products by the end of a quarter;
- reduced visibility into the implementation cycles for our products and our customers' spending plans;
- our ability to forecast demand for our products, which in the case of lower-than-expected sales, may result in excess or obsolete inventory in addition to non-cancelable purchase commitments for component parts;

- sales to the telecommunications service provider market, which represent a significant source of large product orders, are especially volatile and difficult to forecast;
- product returns or the cancellation or rescheduling of orders;
- announcements and new product introductions by our competitors;
- our ability to develop and support relationships with enterprise customers, service providers and other potential large customers;
- our ability to achieve targeted cost reductions;
- fluctuations in warranty or other service expenses actually incurred;

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- our ability to obtain sufficient supplies of sole- or limited-source components for our products on a timely basis; and
- increases in the price of the components that we purchase.

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

We have yet to realize the anticipated benefits of the acquisition of Enterasys.

We made certain assumptions relating to the forecast level of cost savings, synergies and associated costs of the acquisition of Enterasys. We have faced and will continue to face significant challenges in combining Enterasys' operations into our historical operations in an efficient manner. Continued challenges to integrate successfully and to manage successfully the integration process may ultimately result in us not achieving the anticipated benefits of the acquisition.

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

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

- customers may delay or cancel plans to purchase our products and services;
- customers may not be able to pay, or may delay payment of, the amounts that they owe us which may adversely affect our cash flow, the timing of our revenue recognition and the amount of revenue;
- increased pricing pressure may result from our competitors aggressively discounting their products;
- accurate budgeting and planning will be difficult due to low visibility into future sales;
- forecasting customer demand will be more difficult, increasing the risk of either excess and obsolete inventory if our forecast is too high or insufficient inventory to meet customer demand if our forecast is too low; and
- our component suppliers and contract manufacturers have been negatively affected by the economy which may result in product delays and changes in pricing and service levels.

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

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

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

- longer accounts receivable collection cycles;
- difficulties in managing operations across disparate geographic areas;
- difficulties associated with enforcing agreements through foreign legal systems;
- higher credit risks requiring cash in advance or letters of credit;
- political and economic turbulence;
- terrorism, war or other armed conflict;
- natural disasters and epidemics;
- potential adverse tax consequences;
- compliance with regulatory requirements of foreign countries, including compliance with rapidly evolving environmental regulations;



- compliance with U.S. laws and regulations pertaining to the sale and distribution of products to customers in foreign countries, including export controls and the Foreign Corrupt Practices Act; and
- the payment of operating expenses in local currencies, which exposes us to risks of currency fluctuations.

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

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

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

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

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

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

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

These actions could have a material adverse effect on our operating results or the price of our common stock.

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

- difficulties in the assimilation of acquired operations, technologies and/or products;
- unanticipated costs associated with the acquisition or investment transaction;
- the diversion of management's attention from other business concerns;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience;
- the potential loss of key employees of acquired organizations; and



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

We may not be able to successfully integrate any businesses, products, technologies, or personnel that we might acquire in the future, and our failure to do so could have a material adverse effect on our business, operating results and financial condition.

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Our credit facilities impose financial and operating restrictions on us.

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

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

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

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

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

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

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

- ASICs;
- Merchant silicon;

- microprocessors;
- programmable integrated circuits;
- selected other integrated circuits;

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- custom power supplies; and
- custom-tooled sheet metal.

Our principal limited-source components include:

- flash memory;
- DRAMs and SRAMs;
- printed circuit boards;
- CAMs;
- Connectors; and
- Timing circuits (crystals & clocks).

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

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

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

The market for network switching solutions is intensely competitive and dominated primarily by Brocade Communications Systems, Inc., Cisco Systems Inc., Dell, Hewlett-Packard Company, Huawei Technologies Co. Ltd., and Juniper Networks, Inc. Most of our competitors have longer operating histories, greater name recognition, larger customer bases, broader product lines and substantially greater financial, technical, sales, marketing and other resources. As a result, these competitors are able to devote greater resources to the development, promotion, sale and support of their products. In addition, they have larger distribution channels, stronger brand names, access to more customers, a larger installed customer base and a greater ability to make attractive offers to channel partners and customers than we do. Some of our customers may question whether we have the financial resources to complete their projects and future service commitments.

For example, we have encountered, and expect to continue to encounter, many potential customers who are confident in and committed to the product offerings of our principal competitors. Accordingly, these potential customers may not consider or evaluate our products. When such potential customers have considered or evaluated our products, we have in the past lost, and expect in the future to lose, sales to some of these customers as large competitors have offered significant price discounts to secure these sales.

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

operating efficiencies, our revenue and gross margins will be adversely affected.

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

We have undertaken restructuring efforts in the past to streamline operations and reduce operating expenses. Our ability to achieve the anticipated cost savings and other benefits from our restructuring efforts within expected time frames is subject to many estimates and assumptions, and may vary materially based on factors such as market conditions and the effect of our restructuring efforts on our work force. These estimates and assumptions are subject to significant economic, competitive and other uncertainties, some of which are beyond our control. There can be no assurance that we will fully realize the anticipated positive impacts to future financial results from our current or future restructuring efforts. If our estimates and assumptions are incorrect or if other unforeseen events occur, we may not achieve the cost savings expected from such restructurings, and our business and results of operations could be adversely affected.

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

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

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

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

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

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

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

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

If we do not successfully anticipate technological shifts, market needs and opportunities, and develop products and product enhancements that meet those technological shifts, needs and opportunities, or if those products are not made available in a timely manner or do not gain market acceptance, we may not be able to compete effectively and our ability to generate revenues will suffer.

We cannot guarantee that we will be able to anticipate future technological shifts, market needs and opportunities or be able to develop new products or product enhancements to meet such technological shifts, needs or opportunities in a timely manner or at all. For example, the move from traditional network infrastructures towards SDN has been receiving considerable attention. In our view, it will take several years to see the full impact of SDN, and we believe the successful products and solutions in this market will combine hardware and software elements together. If we fail to anticipate market requirements or fail to develop and introduce new products or product enhancements to meet those needs in a timely manner, it could cause us to lose customers, and such failure could substantially decrease or delay market acceptance and sales of our present and future products, which would significantly harm our business, financial condition, and results of operations. Even if we are able to anticipate, develop, and commercially introduce new products and enhancements, there can be no assurance that new products or enhancements will achieve widespread market acceptance.

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

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

Litigation resulting from claims that we are infringing the proprietary rights of others has resulted and could in the future result in substantial costs and a diversion of resources, and could have a material adverse effect on our business, financial condition and results of operations. We previously received notices from entities alleging that we were infringing their patents, and have been party to patent litigation in the past.

Without regard to the merits of these or any other claims, an adverse court order or a settlement could require us, among other actions, to:

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

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



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

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

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

We have in the past, currently are and will likely in the future pursue or be subject to claims or lawsuits in the normal course of our business. In addition to the intellectual property lawsuits described above, we are currently parties to other litigation as described in Part II, Item 1. Legal Proceedings. Regardless of the result, litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a lawsuit in which we are a defendant could result in a court order against us or payments to other parties that would have an adverse effect on our business, results of operations, or financial condition. Even if we are successful in prosecuting claims and lawsuits, we may not recover damages sufficient to cover our expenses incurred to manage, investigate and pursue the litigation. In addition, subject to certain limitations, we may be obligated to indemnify our current and former directors, officers and employees in certain lawsuits. We do not maintain adequate insurance coverage to cover all of our litigation costs and liabilities.

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

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

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

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

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

Our dependence on a few manufacturers for our manufacturing requirements could harm our operating results.

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

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

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

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

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

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

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

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

Our revenues may decline as a result of changes in public funding of educational institutions.

A portion of our revenues comes from sales to both public and private K-12 educational institutions. Public schools receive funding from local tax revenue, and from state and federal governments through a variety of programs, many of which seek to assist schools located in underprivileged or rural areas. The funding for a portion of our sales to educational institutions comes from a federal funding program known as the E-Rate program. E-Rate is a program of

the Federal Communications Commission that subsidizes the purchase of approved telecommunications, Internet access, and internal connection costs for eligible public educational institutions. The E-Rate program, its eligibility criteria, the timing and specific amount of federal funding actually available and which Wi-Fi infrastructure and product sectors will benefit, are uncertain and subject to final federal program approval and funding appropriation continues to be under review by the Federal Communications Commission and there can be no assurance that this program or its equivalent will continue, and as a result, our business may be harmed. Furthermore, if state or local funding of public education is significantly reduced because of legislative or policy changes or by reductions in tax revenues due to changing economic conditions, our sales to educational institutions may be negatively impacted by these changed conditions. Any reduction in spending on information technology systems by educational institutions would likely materially and adversely affect our business and results of operations. This is a specific example of the many factors which add additional uncertainty to our future revenue from our education end-customers.

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

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

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

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

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

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

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

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

- the timely adoption and market acceptance of industry standards, and timely resolution of conflicting U.S. and international industry standards; and
- our ability to influence the development of emerging industry standards and to introduce new and enhanced products that are compatible with such standards.

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

Our products must also comply with various U.S. federal government regulations and standards defined by agencies such as the Federal Communications Commission, standards established by governmental authorities in various

foreign countries and recommendations of the International Telecommunication Union. In some circumstances, we must obtain regulatory approvals or certificates of compliance before we can offer or distribute our products in certain jurisdictions or to certain customers. Complying with new regulations or obtaining certifications can be costly and disruptive to our business.

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

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

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

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

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

Our future effective tax rate in particular could be adversely affected by a change in ownership pursuant to U.S. Internal Revenue Code Section 382. If a change in ownership occurs, it may limit our ability to utilize our net operating losses to offset our U.S. taxable income. If U.S. taxable income is greater than the change in ownership limitation, we will pay a higher rate of tax with respect to the amount of taxable income that exceeds the limitation. This could have a material adverse impact on our results of operations. On April 26, 2012, we adopted an Amended and Restated Rights Agreement to help protect our assets (the "Rights Agreement"). In general, this does not allow a stockholder to acquire more than 4.95% of our outstanding common stock without a waiver from our board of directors, who must take into account the relevant tax analysis relating to potential limitation of our net operating losses. The Rights Agreement is effective through May 31, 2016.

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

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

Our Rights Agreement provides that if a single stockholder (or group) acquires more than 4.95% of our outstanding common stock without a waiver from our Board of Directors, each holder of one share of our common stock (other than the stockholder or group who acquired in excess of 4.95% of our common stock) may purchase a fractional share



of our preferred stock that would result in substantial dilution to the triggering stockholder or group. Accordingly, although this plan is designed to prevent any limitation on the utilization of our net operating losses by avoiding issues raised under Section 382 of the U.S. Internal Revenue Code, the Rights Agreement could also serve as a deterrent to stockholders wishing to effect a change of control.

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

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

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

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

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

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

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

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

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

We rely on the availability of third-party licenses.

Some of our products are designed to include software or other intellectual property, including open source software, licensed from third parties. It may be necessary in the future to seek or renew licenses relating to various aspects of these products. There can be no assurance that the necessary licenses would be available on acceptable terms, if at all. The inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could have a material adverse effect on our business, operating results, and financial condition. Moreover, the inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability to protect our proprietary rights in our products. Further, the failure to comply with the terms of any license, including free open source software, may result in our inability to continue to use such license. Our inability to maintain or re-license any third-party licenses required in our products or our inability to obtain third-party licenses necessary to develop new products and product enhancements, could require us, if possible, to develop substitute technology or obtain substitute technology of lower quality or performance standards or at a greater cost, any of which could delay or prevent product shipment and harm our business, financial condition, and results of operations.

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

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

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

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

In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as inventory and technology-related write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Although in certain instances, our supply agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed, our loss contingencies may include liabilities for contracts that we cannot cancel with contract manufacturers and suppliers. Further, our estimates relating to the liabilities for excess facilities are affected by changes in real estate market conditions.

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

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

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

We had authority granted by our Board of Directors to repurchase up to \$75 million in common stock over a three year period starting October 1, 2012. Since the inception of the program, 4.1 million shares have been repurchased for a total purchase price of \$14.5 million. For the six month period ended December 31, 2015, the Company did not

repurchase any shares of its common stock. As of December 31, 2015, the repurchase period has ended.

Item 3. Defaults Upon Senior Securities - Not applicable

Item 4. Mine Safety Disclosure - Not Applicable

Item 5. Other Information

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## Item 6. Exhibits

## (a) Exhibits:

| Exhibit<br>Number | Description of Document   | Incorporated by<br>Reference |      | Filed<br>Number | Herewith |
|-------------------|---|------------------------------|------|-----------------|----------|
|                   |   | Form                         | Date |                 |          |
| 10.1              | Second Amendment to the Lease Agreement by and between RDU Center III LLC and Extreme Networks, Inc. dated December 17, 2015. |                              |      |                 | X        |
| 31.1              | Section 302 Certification of Chief Executive Officer.   |                              |      |                 | X        |
| 31.2              | Section 302 Certification of Chief Financial Officer.   |                              |      |                 | X        |
| 32.1              | Section 906 Certification of Chief Executive Officer.   |                              |      |                 | X        |
| 32.2              | Section 906 Certification of Chief Financial Officer.   |                              |      |                 | X        |
| 101.INS           | XBRL Instance Document.   |                              |      |                 | X        |
| 101.SCH           | XBRL Taxonomy Extension Schema Document.  |                              |      |                 | X        |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase Document.  |                              |      |                 | X        |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase Document.  |                              |      |                 | X        |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase Document.   |                              |      |                 | X        |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase Document  |                              |      |                 | X        |

SIGNATURES

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

EXTREME NETWORKS, INC.

(Registrant)

/ S / KENNETH AROLA  
KENNETH AROLA  
Executive Vice President, Chief Financial Officer

(Principal Accounting Officer)  
February 2, 2016