CIENA Corporation
920 Elkridge Landing Road
Linthicum, Maryland 21090
410-865-8500
800-921-1144

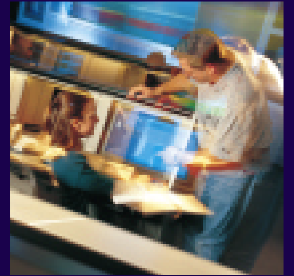
1562-AR-98

1997 Annual Report

What Does CIENA® Mean?

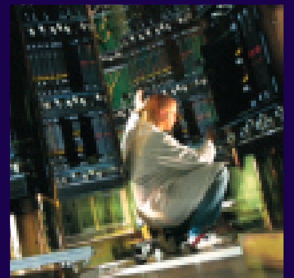
CIENA

MEANS

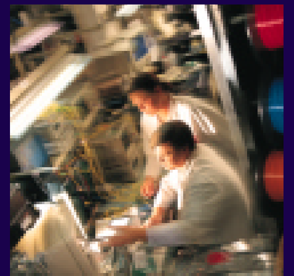


NETWORK BANDWIDTH

CUSTOMER FOCUS



INNOVATIVE TECHNOLOGY



MANUFACTURING EXCELLENCE

COMMITMENT

To Our Shareholders

It is with great pleasure that I report on CIENA's first year as a public company. While we didn't realize it at the time, our Initial Public Offering on February 7, 1997 set the tone for the year at CIENA. Following that first day's trading, CIENA achieved a market capitalization of $3.4 billion – the largest first-day market capitalization of any venture-funded startup company in history.

Like our IPO, our financial results for the year were exceptional. For our fiscal year ending October 31, 1997, we recorded revenue of $373.8 million, an increase of $319 million over the $54.8 million reported for fiscal year 1996. Net income for fiscal year 1997 was $112.9 million, or $1.09 per share. This compares to $14.7 million, or $0.15 per share, in fiscal year 1996.

CIENA's MultiWave® products, utilizing dense wavelength division multiplexing (DWDM) technology, make it possible for service providers like Sprint Corporation and WorldCom, Inc. to expand the capacity of their long-distance networks without the expensive and time-consuming process of laying new fiber optic cable.

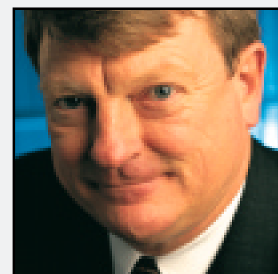
Why do service providers need more capacity in their networks? What is driving this bandwidth demand? The answer is simple: the explosive growth of information exchange.

In the past, telecommunications networks handled voice traffic – the telephone calls from office-to-office and from home-to-home. As a result, the networks grew fairly steadily according to population growth. New applications such as facsimile transmission and cellular service accelerated growth, but not so much that network operators could not plan for anticipated demand.

In recent years, we've begun to see a dramatic departure from past network growth patterns. Two things are causing this change. First, as predicted by Moore's Law, the processing power of personal computers (PCs) has continued to double every 12 to 18 months. At the same time, PC prices have steadily declined. As a result, we have a growing number of PCs in our homes and offices, and these machines "talk" faster every year (that is, the pace at which they are able to exchange information increases rapidly as internal processing power grows). The second contributor to escalating traffic can be described in a word: Internet.

The Internet has emerged as a broadly accepted medium that enables us to connect our homes and businesses to the world. Even more, the Internet allows us to interact with the world. No longer mere word processing and number crunching tools, PCs are fast becoming one

of our primary communication devices. The resulting growth of data traffic – transmissions from computers-to-computers – has been far more rapid than historical voice traffic growth. As if this weren't enough, the Internet also has opened the possibilities for new applications, such as electronic commerce, that will only drive traffic growth faster.



Patrick H. Nettles
President and
Chief Executive Officer

Now service providers are faced with an entirely different challenge. Not only is network traffic growing far more rapidly than historic growth patterns would suggest, but the traffic fueling that growth is different, and it is stressing the networks built to carry telephone traffic in different ways. PCs "talk" faster than humans. Computers also transmit information in larger bursts. Faster traffic in greater bursts requires more network bandwidth. That's where CIENA comes in.

CIENA's timely application of optical technology in products that enable service providers to deploy additional bandwidth – without disrupting existing traffic flows – made it possible for CIENA to enter and impact the telecommunications equipment market in a way usually reserved for much larger and longer-established companies.

While our financial results this first year are notable, they don't tell the whole story. Underlying these results are hard-fought battles to develop robust supply chains, to build scaleable manufacturing facilities, to maintain exceptional quality, and to form enduring customer relationships.

One of the goals we set for ourselves in 1997 was broadening our customer base. Sales to Sprint and WorldCom accounted for the significant majority of our revenues for the year. However, we also were pleased to announce several new customers including Teleway Japan Corporation, Japan Telecom Co., Ltd., Mercury Communications Limited (a subsidiary of Cable & Wireless Communications Group) and Digital Teleport, Inc.

Financial Highlights

(in thousands, except net income per common share)	1997	1996
Revenue	$373,827	$54,838
Gross profit	$237,640	$32,994
Gross margin	63.6%	60.2%
Operating income	$176,702	$16,387
Operating margin	47.3%	29.9%
Net income	$112,945	$14,718
Net income per common share	$ 1.09	$ 0.15
Total assets	$447,228	$67,301
Total stockholders' equity	$363,584	$ 4,970

A significant customer announcement came in June, 1997 when AT&T selected CIENA as one of two DWDM suppliers for its network. Though product shipments to AT&T are dependent upon successful completion of certain test requirements and are not likely to occur until mid-1998, we believe AT&T's selection of CIENA was another important validation of the quality of our products, the robustness of our manufacturing processes and systems, and our ability to execute.

Our product development efforts during the year reflect another important change in the telecommunications equipment industry: shorter product development cycles. Since the advent of the Internet, the telecommunications world has changed and continues to change rapidly. As a supplier to customers in this swiftly moving industry, we too must move quickly. In a single year, we've expanded our long-distance product line to include the next generation of our original 16-channel MultiWave® 1600 system, MultiWave Sentry™, designed to simplify service providers evolving networks, and the higher-capacity 40-channel MultiWave® 4000.

CIENA's future growth will be driven by a combination of our core long-distance products and new products – products that solve different problems for new customers. During the year, we focused a portion of our engineering efforts on diversifying our product line, developing products for short-distance DWDM applications.

In October 1997, we introduced MultiWave® Firefly, a 24-channel, point-to-point system for interoffice applications, and announced the forthcoming MultiWave Metro™, a product designed to enable carriers to meet the challenges of building network capacity in congested and growing metropolitan areas. We expect these products to bring the economies and flexibility of DWDM technology to a broader customer base, addressing the bandwidth constraints faced by regional Bell operating companies and competitive local exchange carriers.

In anticipation of additional customers and new products coming on-line, we also invested in our manufacturing infrastructure during the year. Achieving ISO 9001 certification in July was a significant milestone, but not the end of our efforts by any means. Our "building block" approach to manufacturing and assembly offers inherent scaleability

Common Stock Market Data

	Price Range	
Fiscal Year 1997	High	Low
Period of February 7 to April 30, 1997	$44.00	$22.25
Third Quarter ended July 31, 1997	$57.25	$28.50
Fourth Quarter ended October 31, 1997	$63.62	$43.00

and flexibility that enables us to continuously refine and improve the process, growing and changing as customer and product demands require. However, processes are nothing without skilled people to implement them. As we grow, we also will continue to emphasize the ongoing training and development of our workforce.

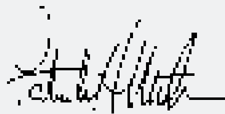
In all, CIENA had a busy year, filled with accomplishments, but what's past is past. What matters now is what we do going forward. We will look to differentiate ourselves through continued technological innovation and a demonstrated top-quality, scaleable manufacturing capability, as well as by maintaining the high level of service our customers have come to expect. In executing this strategy, we will continue to invest in our growing organization, its technology and resources.

As a fellow shareholder, I ask myself, "What makes CIENA different?" "What makes us confident we can succeed?" Success is more than being in the right place at the right time; it is having the forethought to ask, "Where should we be next?" It also is possessing the desire and commitment to take you there. Vision without execution is meaningless. At CIENA, we believe we have both: the vision that enables us to anticipate where our customers will need us to be and the ability to execute to fulfill that vision.

In closing, I extend my thanks to CIENA's employees. Their tireless enthusiasm and unfailing dedication have made this company what it is today, and with them lies the promise of what CIENA can be tomorrow. I believe I speak for them when I also thank our customers, fellow shareholders, suppliers and partners for their support and continued confidence.

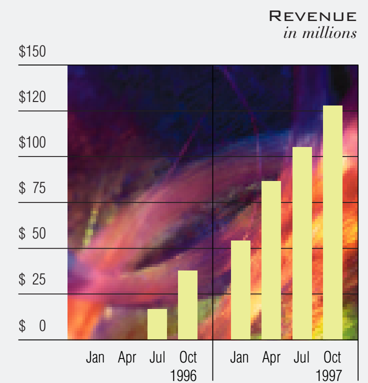
We look forward to 1998 and to the opportunities and challenges we will create.

Sincerely,

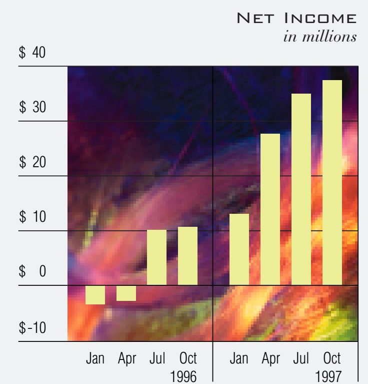


Patrick H. Nettles
President and Chief Executive Officer

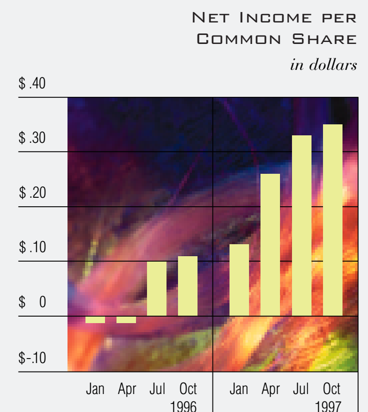
Revenue
in millions



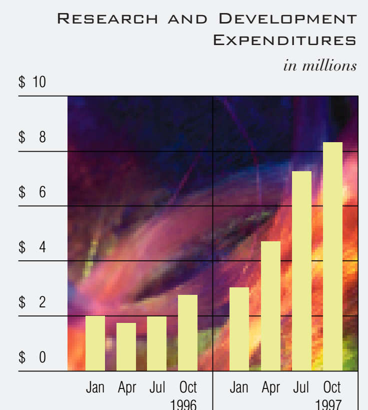
Net Income
in millions



Net Income per Common Share
in dollars

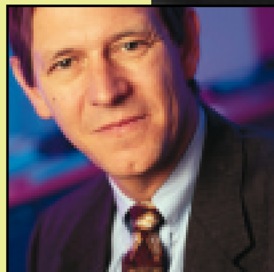


Research and Development Expenditures
in millions



Greater Possibilities

Bandwidth is a critical resource for long-distance carriers like WorldCom. Greater bandwidth opens the door for new applications, and new applications mean revenue opportunities. With the growth we've seen over the last few years, it seems impossible to believe that there will ever be enough network capacity. More and more people are using the Internet. Traffic is no longer simple text messages; it contains high resolution images, full-motion graphics and audio. New technologies make access to the network faster and less expensive. Not so far in the future, it is generally accepted that the Internet will carry traditional services like fax and voice. Increased bandwidth will open possibilities we can only dream of now.



Larry Murphy
Director of Program Management
WorldCom Network Services

Network Bandwidth

Today's business is information driven. Behind what seems to be an ever increasing demand for bandwidth are the applications and services that provide information. As PC processing power and speed escalate, traditional telecommunications carriers are challenged with building the infrastructure required to carry this burgeoning flow of information – the Internet. Once considered a technical curiosity, the Internet today is fueling the communications revolution, changing the way we do business, get news, entertain ourselves.

Networks in Transition

While the bulk of a carrier's traffic continues to be plain old telephone service, the growth rate of data services outpaces voice by four to one. At this rate, data traffic soon will eclipse voice traffic. As traditional capabilities, like fax and voice, migrate to the Internet, the transition will accelerate.

This shift from voice-centric to data-centric traffic impacts carriers fundamentally. Today's networks were built to handle voice traffic. Yet, the changeover in traffic mix is occurring at an unprecedented rate. This shift has a profound impact on network operators' planning cycles, technology choices and capital deployment decisions.

Networks continue to evolve to meet the changing demands of the new information age. At the core of this evolution is a massive increase in network bandwidth required to meet the new data-centric service requirements. Bandwidth is being deployed at an astonishing rate. Still, as bottlenecks are addressed in one portion of the network, new bandwidth constraints appear elsewhere.

New Problems/New Solutions

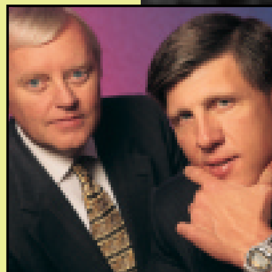
Today, CIENA addresses the demand for bandwidth at the core of the network. As bottlenecks are pushed out into the network, CIENA will look to address those new bottlenecks with products designed specifically to meet the requirements of the application. At CIENA, we continually strive to deliver innovative solutions by working with our customers to gain a better understanding of the problems they face in building their networks. Today, the challenge they face is deploying more bandwidth.

Collaborative Relationships

When Sprint faced the enviable challenge of rapidly growing voice and data traffic on its network, they looked to CIENA's DWDM products to help them meet that demand.

Sprint recognized early on its pending need for more network bandwidth. Projections of Sprint's increasing traffic growth meant either costly fiber construction projects or worse, lost revenues. Both were out of the question.

CIENA responded by delivering a solution, our MultiWave® 1600 DWDM system. We created a best-in-class product that was a price/performance breakthrough. As a result of Sprint's collaboration and feedback throughout the MultiWave 1600's development cycle, CIENA was able to deliver a system to meet Sprint's requirements faster than even Sprint thought possible. With CIENA's bandwidth solutions, Sprint continues to grow its business to meet the market demands of its customers.



Neil Grenfell
Sprint, Vice President of Engineering

Doug McKinley
Sprint, Director of Network Engineering

Customer Focus

CIENA's customers are not only in the communications business; communications is their business. CIENA's bandwidth solutions enable our customers to profit in the highly competitive telecommunications industry. Listening closely to our customers' needs and delivering products to meet those needs have been key factors in CIENA's success.

We Listen

We listen to our customers. It may sound simplistic, but our mission is to provide solutions our customers need to meet the demanding challenges they face. Only by developing a thorough understanding of these challenges can we begin to design products that better allow our customers to succeed. CIENA's products have their genesis in solving practical problems – not solely in the interesting application of technology. As a result, our products are far more likely to meet with early customer acceptance and commercial success.

We Anticipate

We also observe the direction both the industry and our customers' businesses are heading. Watching the environment enables us to anticipate what will be needed next.

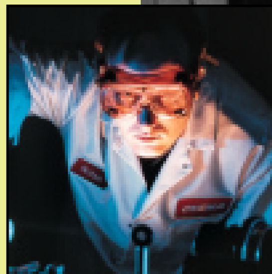
The key to helping our customers maximize their opportunities is being ready to deliver business solutions. By anticipating future requirements, research and design efforts can be launched ahead of market demand, resulting in solutions when customers need them.

We Deliver

Being customer focused means more than listening; it means being responsive without being reactive, enabling our customers to leverage the competitive advantage our products provide. It means working in partnership with our customers to fine-tune solutions and providing quality products and services that help them achieve their business goals.

Making a Difference

A key to CIENA's success has been the Company's ability to bring to market products based on diverse innovative technologies, including erbium-doped fiber amplifiers and in-fiber Bragg gratings. Leading edge technology is critical to our success, as is top-notch optical systems engineering. But innovation *per se* is not the goal. CIENA's research and development efforts focus on creating products to solve customer problems. Our innovative systems combine a wide range of component technologies, yielding the best mix of robust technical performance, economic benefit and timeliness of market availability. Only within the larger context of practical applications can innovation make a difference. Novel technology by itself is not sufficient. At CIENA, our engineers ask themselves every day, "What am I able to do that adds value for our customers?"



CIENA's in-fiber Bragg gratings laboratory

Innovative Technology

Market analysts suggest that the Internet continues to grow at over 75% per year. More and more information is traversing the world at ever increasing speeds. While Internet-based information sources and Internet usage are skyrocketing, carriers' networks struggle to meet current demands. Bandwidth limitations are restricting the development and deployment of services that will enable the Internet to fulfill its potential for global information exchange and commerce.

The First Step

CIENA's MultiWave® 1600 was introduced in 1996 to allow long-distance carriers to expand the capacity of existing fiber optic cable by 16-fold. Employing dense wavelength division multiplexing (DWDM) technology, MultiWave 1600 sends up to 16 independent information streams (channels), each on a different wavelength or color of light, along a single fiber. With this technology, a single strand of fiber can carry the amount of information that used to require 16 separate fibers.

Rapid Product Cycle

In 1997, CIENA introduced MultiWave Sentry™, a second generation 16-channel system offering enhanced transmission, network management and performance monitoring features. With commercial availability anticipated by mid-1998, CIENA's MultiWave® 4000 system will further expand transport capacity up to 40 channels per fiber, a total capacity of 100 gigabits per second.

New Customers/New Applications

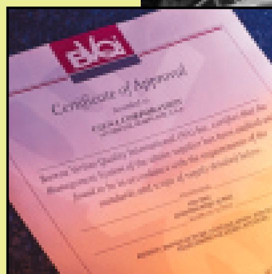
Also during 1997, CIENA introduced a solution optimized for the regional Bell operating companies and competitive local exchange carriers. MultiWave® Firefly offers 24 channels (wavelengths) of capacity at distances of up to 65 kilometers (32 miles). The price/performance of this solution is ideally suited for the high-capacity, short-distance needs of the local exchange carriers.

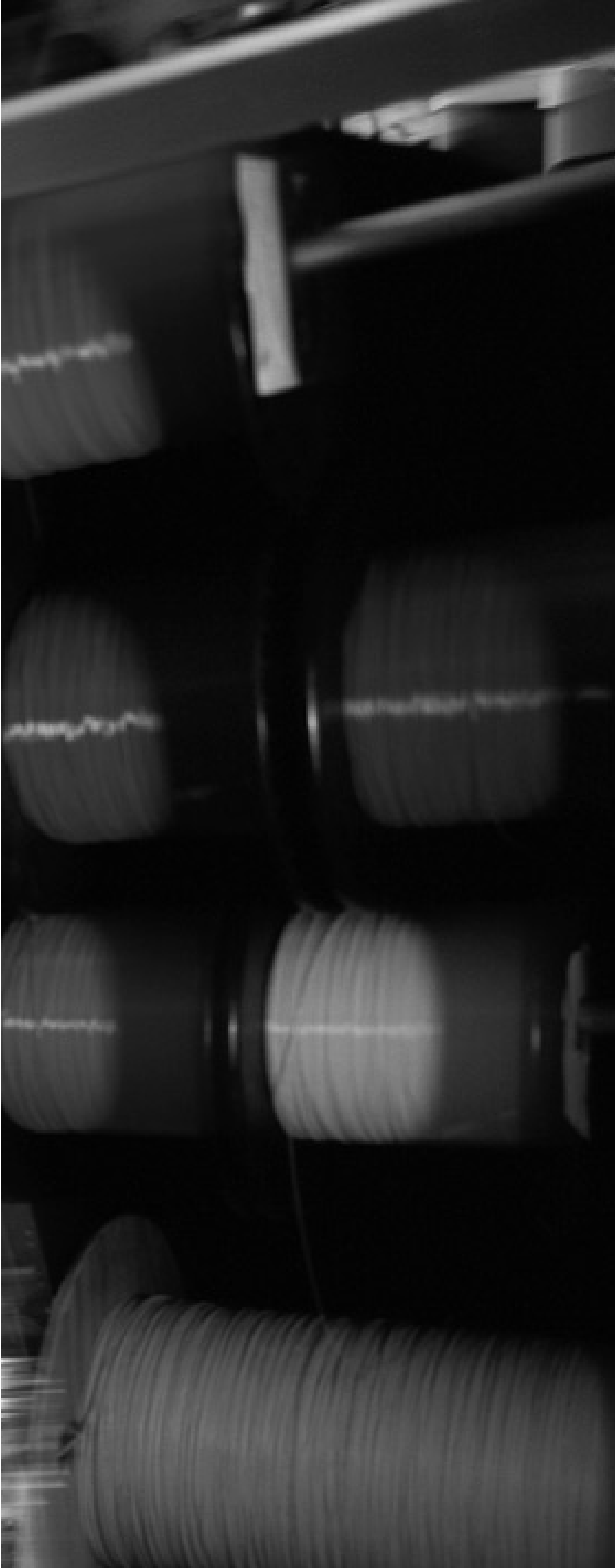
CIENA's MultiWave Metro™ has the potential to change the way service providers build their networks. Currently under development, MultiWave Metro directly addresses the need for flexible provisioning of bandwidth capacity in metropolitan areas. Using DWDM ring technology, CIENA expects MultiWave Metro will offer carriers a significant cost breakthrough in building broadband access networks.

ISO 9001 Certified

ISO 9000 is a series of quality systems standards defined by the International Standards Organization. ISO 9001 applies to all facets of product design, manufacturing, installation, testing and servicing. Increasingly, both domestic and international corporations are relying on ISO 9001 standards to ensure consistent high-quality products and services from their suppliers. Understanding the importance of ISO 9001 certification in the telecommunications market, particularly for large carriers, in the latter part of 1996, CIENA launched efforts to adhere to these standards.

CIENA proudly received its ISO 9001 certification in July, 1997, less than a year after beginning the registration process. The certification assures quality conscious carriers and potential customers that consistent practices are in place and followed throughout CIENA's organization, enabling reliable delivery of high-quality products and services.





Manufacturing Excellence

The manufacturing and assembly of precision DWDM systems demands extremely stringent processes. The unique requirements of major carriers, volume production and CIENA's commitment to unfaltering product quality add to the complexity. Few manufacturing facilities in the world could meet this challenge. At CIENA, we recognized the inherent difficulty of the task we'd undertaken from the onset. The emphasis we place on achieving excellence in manufacturing is reflected in our investment in processes, facilities, new innovations, suppliers and, most importantly, our people.

Process

Building excellence into our manufacturing process begins at the component level. Suppliers are required to measure and record the performance of key components shipped to CIENA. During system assembly, sub-systems undergo automated testing where test data is measured against higher than industry acceptable targets. Entire systems are optimized for performance from the component level up. The result is higher yield, lower deviation, improved performance and consistent quality.

People

Driving this process are CIENA's highly trained production specialists. Each individual receives six weeks of training at CIENA's dedicated training facility where they achieve certification before moving to the manufacturing floor. Supporting the specialist on the production line are workstations with step-by-step graphic work instructions and automated data collection. Continuous training ensures a rigid adherence to quality standards and cross-training enables flexibility.

Results

One of the keys to our continued success is our unwavering commitment to manufacturing excellence. Customers who visit our manufacturing facilities leave with a new standard by which they measure other vendors. Consistent quality throughout the manufacturing process, combined with the personal commitment of each member of the production team, makes a discernible difference... the CIENA difference.

"CIENA Time"

Things tend to move quickly at CIENA – the world of communications is changing faster than it ever has before. The days of multi-year product development cycles are behind us. Today, products are conceived, refined and brought to market in a period of months instead of years. As a supplier to some of the largest service providers in the world, it is not enough to merely keep pace with the change – CIENA must anticipate it, instigate it.

Early on, we recognized that in order to effect change in the outside world, our organization needed the ability to handle change as well. CIENA has grown rapidly, from 225 people at the end of our fiscal year 1996, to more than 900 by the end of December 1997. To accommodate our growth, office and lab expansions are nearly routine. No longer a small company, we've worked hard to build scaleability – the ability to grow larger without adversely affecting critical processes – into our organization. And we are doing it all at the quickening pace of the industry – what we call "CIENA Time."

Commitment

How is it possible that a new company like CIENA, in only a short time, can change the landscape of an industry dominated by large, established players? When we embarked on this endeavor, many counseled us that the task was too difficult, the competitors too strong. Since then, we believe we've proved the nay-sayers wrong.

Indeed, the task proved to be herculean and the competitors remain formidable. Yet, despite conventional wisdom, we have succeeded in establishing a major role for CIENA in the new era of communications. In large measure, we believe this is the result of our commitment to rapid product development cycles, manufacturing excellence and long-term customer relationships.

Entrepreneurial Spirit

The commitment of CIENA's workforce at both the individual and collective level, reflects the organization's core values. We believe these shared values are the true embodiment of the entrepreneurial spirit: taking ownership and responsibility for the goals of the enterprise, and making those goals synonymous with personal objectives. Long hours, late nights, difficult challenges and tight schedules all somehow become more manageable in this context. Behind each achievement, there is undoubtedly a host of extraordinary individual contributions. The commitment and dedication of CIENA's employees is truly one of our most visible and valuable assets.

As CIENA grows, we will strive to maintain our entrepreneurial spirit and an environment that fosters personal growth, encourages independent thinking coupled with cooperative problem solving, and values those that question the status quo.

Commitment Shows

When customers, suppliers or investors visit CIENA, they often comment on the sense of spirit and camaraderie that permeates the environment. Whether it is in a development lab, on the manufacturing floor or at a customer installation site, commitment shows – in everything we do.

Management Team

(left to right) *Michael Kelly, Michael Fagen, Joseph Berthold, Stephen Alexander, Stephen Whitt, Guy Van Buskirk, Jesús León, Daniel McCurdy, Howard Lukens, Eric Georgatos, Steve Chaddick, Joseph Chinnici, Patrick Nettles, Andy Petrik, Rebecca Seidman, Gary Smith, Larry Huang, Mark Cummings*

Stephen B. Alexander
Vice President,
Transport Products

Joseph Berthold
Vice President,
Network Architecture

Steve W. Chaddick
Senior Vice President,
Products and Technologies

Joseph R. Chinnici
Senior Vice President,
Finance and Chief Financial Officer

Mark Cummings
Senior Vice President,
Operations

W. Michael Fagen
Vice President,
New Market Development

G. Eric Georgatos, Esq.
Vice President,
General Counsel and Secretary

Lawrence P. Huang
Senior Vice President,
Sales and Marketing

Michael Kelly
Vice President,
Quality Assurance

Jesús León
Vice President,
Access Products

Howard Lukens
Vice President,
North American Sales

Daniel P. McCurdy
Vice President,
Corporate Development

Patrick H. Nettles, Ph.D.
President and
Chief Executive Officer

Andrew C. Petrik
Vice President,
Finance and Controller

Rebecca K. Seidman
Vice President,
Human Resources

Gary Smith
Vice President,
International Sales

Guy R. Van Buskirk
Vice President,
Customer Service

Stephen Whitt
Vice President,
Intellectual Property

Table of Contents

18 Selected Financial Data

19 Management's Discussion and Analysis of Financial Condition and Results of Operations

25 Consolidated Balance Sheets

26 Consolidated Statements of Operations

27 Consolidated Statements of Changes in Stockholders' Equity (Deficit)

28 Consolidated Statements of Cash Flows

29 Notes to Consolidated Financial Statement

39 Report of Independent Accountants

40 Executive Officers, Outside Board Members

Selected Financial Data

	For the period from inception (November 2, 1992) through October 31,[1]	Year Ended October 31,[1]			
	1993	1994	1995	1996	1997
(in thousands except share and per share data)					
Statement of Operations Data:					
Revenue	$ —	$ —	$ —	$54,838	$373,827
Cost of goods sold	—	—	—	21,844	136,187
Gross Profit	—	—	—	32,994	237,640
Operating expenses					
Research and development	—	1,287	6,361	8,922	23,308
Selling and marketing	—	295	481	3,780	20,899
General and administrative	123	787	896	3,905	16,731
Total operating expenses	123	2,369	7,738	16,607	60,938
Income (loss) from operations	(123)	(2,369)	(7,738)	16,387	176,702
Other income (expense), net	—	(38)	109	581	7,256
Income (loss) before income taxes	(123)	(2,407)	(7,629)	16,968	183,958
Provision for income taxes	—	—	—	2,250	71,013
Net income (loss)	$(123)	$(2,407)	$(7,629)	$14,718	$112,945
Pro forma net income per common and common equivalent share[2]	—	—	—	$ 0.15	$ 1.09

	October 31,[1]				
	1993	1994	1995	1996	1997
(in thousands)					
Balance Sheet Data:					
Cash and cash equivalents	$ 10	$ 1,908	$ 5,032	$22,557	$263,085
Working capital	(35)	932	3,069	35,856	325,050
Total assets	13	2,497	7,383	67,301	447,228
Long-term obligations, excluding current portion	—	392	856	2,673	1,200
Mandatorily redeemable preferred stock	—	3,492	14,454	40,404	—
Stockholders' equity (deficit)	(35)	(2,388)	(9,930)	4,970	363,584

(1) The Company has a 52 or 53 week fiscal year which ends on the Saturday nearest to the last day of October in each year. For purposes of financial statement presentation, each fiscal year is described as having ended on October 31. Fiscal 1994, 1995, and 1997 comprised 52 weeks and fiscal 1996 comprised 53 weeks.

(2) The pro forma weighted average common and common equivalent shares outstanding for year ended October 31, 1996 and 1997 was 99,111,000 and 103,765,000, respectively. Net income per common and common equivalent share is computed using the pro forma weighted average number of common and common equivalent shares outstanding. Pro forma weighted average common and common equivalent shares outstanding include Common Stock, stock options and warrants using the treasury stock method and the assumed conversion of all outstanding shares of Convertible Preferred Stock into Common Stock. See Note 1 of Notes to Consolidated Financial Statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report. The information in the annual report contains certain forward-looking statements that involve risks and uncertainties. The Company's actual results may differ materially from the results discussed in the forward-looking statements due to risk factors discussed briefly in the "Risk Factors" section of this annual report and in detail in the Company's Form 10-K and subsequent Form 8-K, filed with the Securities and Exchange Commission (SEC) on December 10, 1997 and December 29, 1997, respectively.

Overview

CIENA Corporation is a leading supplier of DWDM systems for fiberoptic communications networks. CIENA's DWDM systems alleviate capacity constraints and enable flexible provisioning of additional bandwidth on high-traffic routes in carriers' networks.

The Company completed its initial public offering of 5,750,000 shares, inclusive of 750,000 shares from the exercise of the underwriters' over-allotment option, at a price of $23 per share on February 12, 1997. Net proceeds from the initial public offering were approximately $121.8 million with an additional $0.6 million received from the exercise of certain outstanding warrants. On July 8, 1997 the Company completed a public offering of 10,477,216 shares of which 1,252,060 shares were sold by the Company, inclusive of 252,060 shares from the exercise of the underwriters' over-allotment option, at a price of $44 per share. Net proceeds to the Company from the July public offering were approximately $52.2 million. The Company has added the net proceeds from the public offerings and from the exercise of the warrants to working capital. Pending use of the net proceeds, the Company has invested such funds in short-term, interest bearing investment grade obligations.

The Company recognizes product revenue in accordance with the shipping terms specified. For transactions where the Company has yet to obtain customer acceptance, revenue is deferred until the terms of acceptance are satisfied. Revenue for installation services is recognized as the services are performed unless the terms of the supply contract combine product acceptance with installation, in which case revenues for installation services are recognized when the terms of acceptance are satisfied and installation is completed. Amounts received in excess of revenue recognized are recorded as deferred revenue. For distributor sales where risks of ownership have not transferred, the Company recognizes revenue when the product is shipped through to the end user.

All of the Company's revenue of $54.8 million through October 31, 1996 was derived from MultiWave 1600 system sales to Sprint. Revenue for the fiscal year ended October 31, 1997 was $373.8 million and consisted primarily of MultiWave 1600 systems sales to Sprint, WorldCom, DTI, and through the Company's Japanese distributor Nissho, to Teleway. The DTI installation represented the Company's first deployment of the MultiWave 1600 as part of a newly built long distance fiberoptic route.

In June 1997, the Company signed an agreement to supply MultiWave 1600 systems to Mercury, a U.K. based subsidiary of Cable and Wireless Communications Group. The agreement calls for delivery and installation beginning in August 1997 and continuing through December 1997. The Company also entered into an agreement with BICC Cables, plc, to assist the Company in the delivery of service and support to Mercury in connection with this installation and operation. Revenue recognition for the entirety of the Mercury shipments has been deferred until completion of field testing.

In June 1997, the Company announced a next generation version of the MultiWave 1600 system, the MultiWave Sentry, which includes enhancements that significantly expand the ability of the MultiWave system to interface with data communications equipment in addition to other types of transmission equipment and increase the distance which can be spanned between transmission terminals. The Company also announced a trial evaluation agreement with AT&T, which calls for the Company to supply six 16-channel MultiWave Sentry systems for laboratory interoperability testing. In August 1997, the Company reached agreement on a five-year supply contract with AT&T. The supply agreement does not obligate AT&T to make any minimum purchases from the Company.

In September 1997, the Company signed an agreement through Nissho to supply MultiWave Sentry to Japan Telecom. The agreement calls for delivery and installation over several months beginning in October 1997. Revenue recognition for the Japan Telecom shipments has been deferred until completion of field testing and product acceptance.

The Company is engaged in continuing efforts to expand its manufacturing capabilities. In April 1997 the Company moved its non-manufacturing operating functions to an approximately 96,000 square foot facility near the Baltimore/Washington International Airport in Linthicum, Maryland. During the third quarter ended July 1997, the Company completed the process of renovating the vacated areas of the 50,500 square foot facility in Savage, Maryland for manufacturing capabilities. In March 1997, the Company signed a lease for an additional facility of approximately 57,000 square feet located in Linthicum to be used for manufacturing and support functions.

In September 1997 the Company leased an additional non-manufacturing facility of approximately 68,000 square feet in the Linthicum area, which it will use to transfer its principal executive offices in the second and third quarter of fiscal 1998. The Company's current 96,000 square foot facility would then be converted almost entirely to research and product development functions. The Company added leased non-manufacturing facilities during the fourth quarter of fiscal 1997 in Atlanta, Georgia and in Middletown, New Jersey. These facilities will be used for product development, customer support and other selling and marketing activities. The Company also expects to lease additional manufacturing facilities in the Linthicum area of approximately 50,000 to 100,000 square feet during fiscal 1998.

As of October 31, 1997 the Company and its subsidiaries employed 841 persons, which was an increase of 616 persons over the 225 employed on October 31, 1996.

Results of Operations

Fiscal Years Ended 1995, 1996 and 1997

Revenue. During the fiscal year ended October 31, 1995 the Company was in the development stage and generated no revenue. The Company recognized $373.8 million and $54.8 million in MultiWave 1600 system revenue for the years ended October 31, 1997 and 1996, respectively. Revenue from installation services was $0.3 million for fiscal 1997 compared to no installation service revenue in fiscal 1996. The Company began shipping the MultiWave 1600 system for field testing in May 1996 with customer acceptance by Sprint occurring in July 1996. The MultiWave 1600 system began carrying live traffic in the Sprint network in October 1996. Initial field trials, customer acceptance, and the carrying of live traffic each occurred during fiscal 1997 in the WorldCom, Teleway, and DTI networks.

Sprint and WorldCom accounted for $179.4 million (48.0%) and $184.5 million (49.4%), respectively of the Company's revenue during fiscal 1997. Revenue derived from foreign sales accounted for less than 2% of the Company's revenues during fiscal 1997. The Company expects fiscal 1998 revenue from both Sprint and WorldCom to account for a lower percentage of the Company's total fiscal 1998 revenue and also expects an increase over the fiscal 1997 in the percentage of 1998 revenue derived from foreign sales.

The Company expects a decrease in the amount of revenues from MultiWave 1600 systems in fiscal 1998 as compared to fiscal 1997. The Company expects this decline in MultiWave 1600 revenue will be offset by the initial product acceptance and revenue recognition from system sales of MultiWave Sentry, MultiWave FireFly, MultiWave 4000 and additional installation services but given the recent introduction of these products, there can be no assurance that this will be the case. See "Risk Factors."

Gross Profit. Cost of goods sold consists of component costs, direct compensation costs, warranty and other contractual obligations, royalties, license fees, and overhead related to the Company's manufacturing and installation operations. Gross profit was $237.6 million and $33.0 million for fiscal years 1997 and 1996, respectively, with no comparable gross profit for fiscal 1995. Gross margin was 63.6% and 60.2% for fiscal 1997 and 1996, respectively. The increase in gross margin was affected by fixed overhead costs being allocated over a larger revenue base, an improvement in manufacturing efficiencies, and reductions in component costs.

The Company's gross margins in the future may be under pressure by a number of factors, including competitive market pricing, manufacturing volumes and efficiencies and fluctuations in component costs. See "Risk Factors." During fiscal 1998 the Company expects that future gross margins may be affected by the mix of product features and configurations sold in a period as well as the extent of installation services provided.

Research and Development Expenses. Research and development expenses were $23.3 million, $8.9 million, and $6.4 million for fiscal 1997, 1996, and 1995, respectively. The approximate $14.4 million or 161% increase from fiscal 1996 to 1997 and the approximate $2.6, million or 40% increase from fiscal 1995 to fiscal 1996 in research and development expenses related to increased staffing levels, purchases of materials used in development of new or enhanced product prototypes, and outside consulting services in support of certain developments and design efforts. During fiscal 1997 and 1996 , research and development expenses were 6.2% and 16.3% of revenue, respectively. The Company expects that its research and development expenditures will continue to increase in absolute dollars and perhaps as a percentage of revenue during fiscal 1998 to support the continued development of the various DWDM products, the exploration of new or complementary technologies, and the pursuit of various cost reduction strategies. The Company has expensed research and development costs as incurred.

Selling and Marketing Expenses. Selling and marketing expenses were $20.9 million, $3.8 million, and $0.5 million for fiscal 1997, 1996, and 1995, respectively. The approximate $17.1 million or 453% increase from fiscal 1996 to 1997 and the approximate $3.3 million or 686% increase from fiscal 1995 to fiscal 1996 in selling and marketing expenses was primarily the result of increased staffing levels in the areas of sales, technical assistance and field support, and increases in commissions earned, trade show participation and promotional costs. During fiscal 1997 and 1996, selling and marketing expenses were 5.6% and 6.9% of revenue, respectively. The Company anticipates that its selling and marketing expenses will increase in absolute dollars and perhaps as a percentage of revenue during fiscal 1998 as additional personnel are hired and additional offices are opened to allow the Company to pursue new market opportunities. The Company also expects the portion of selling and marketing expenses attributable to technical assistance and field support will increase as the Company's installed base of operational MultiWave systems increases.

General and Administrative Expenses. General and administrative expenses were $16.7 million, $3.9 million, and $0.9 million for fiscal 1997, 1996, and 1995, respectively. The approximate $12.8 million or 328% increase from fiscal 1996 to 1997 in general and administrative expenses was primarily the result of a $7.5 million charge for actual and estimated legal and related costs associated with ongoing and pending litigation. See Item 3. "Legal Proceedings." The remaining $5.3 million increase was primarily the result of increased staffing levels and outside consulting services. The approximate $3.0 million or 336% increase from fiscal 1995 to 1996 in general and administrative expenses was also the result of increased staffing levels and outside consulting services. During fiscal 1997 and 1996, general and administrative expenses were 4.5% and 7.1% of revenue, respectively. The Company believes that its general and administrative expenses will increase in absolute dollars and perhaps as a percentage of revenue during fiscal 1998 as a result of the expansion of the Company's administrative staff required to support its expanding operations and legal expenses associated with pending litigation.

Operating Profit. During fiscal 1995 the Company was in the development stage and generated no revenue and had a loss from operations of $7.7 million. The Company's operating profit for fiscal 1997 and 1996 was $176.7 million or 47.3% of revenue and $16.4 million or 29.9% of revenue, respectively. The Company expects that its operating profit will decrease as a percentage of revenue as it continues to hire additional personnel and increase operating expenses to support its business.

Other Income (Expense), Net. Other income (expense), net, consists of interest income earned on the Company's cash and cash equivalents, net of interest expense associated with the Company's debt obligations. Other income (expense), net, was $7.3 million, $0.6 million, and $0.1 million for fiscal 1997, 1996, and 1995, respectively. The year to year increase in other income (expense), net, was primarily the result of the investment of the net proceeds of the Company's stock offerings.

Provision (Benefit) For Income Taxes. During fiscal 1995, a valuation allowance had been recorded to offset the Company's net deferred tax assets, including possible future benefit from realization of tax operating loss carryforwards. The recording of such valuation allowance was based upon management's determination that realization of the net deferred tax assets was not "more likely than not" (as defined in Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes"). During fiscal 1996, the Company received product acceptance from its initial customer and started profitable operations, at which time the Company fully reversed its previously established deferred tax valuation allowance. The provision for income taxes for fiscal 1996 of $2.3 million is net of an approximate tax benefit of $4.6 million related to the reversal of the deferred tax valuation allowance. See Note 7 of Notes to Consolidated Financial Statements. The Company's provision for income taxes was 38.6% of pre-tax earnings, or $71.0 million for fiscal 1997.

Quarterly Results of Operations

The tables below set forth the operating results and percentage of revenue represented by certain items in the Company's statements of operations for each of the eight quarters in the period ended October 31, 1997. This information is unaudited, but in the opinion of the Company reflects all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of such information in accordance with generally accepted accounting principles. The results for any quarter are not necessarily indicative of results for any future period. Operating results as a percentage of revenue for the quarters ended January 31 and April 30, 1996 are excluded due to the absence of revenue for those periods:

	Fiscal Quarter Ended							
	Jan. 31, 1996	Apr. 30, 1996	Jul. 31, 1996	Oct. 31, 1996	Jan. 31, 1997	April 30, 1997	Jul. 31, 1997	Oct. 31, 1997
(in thousands, except per share data)								
Revenue	$ —	$ —	$16,923	$37,915	$53,933	$86,669	$112,189	$121,036
Cost of goods sold	—	—	7,346	14,498	20,832	32,008	40,158	43,189
Gross profit	—	—	9,577	23,417	33,101	54,661	72,031	77,847
Operating expenses:								
Research and development	2,473	1,746	1,964	2,739	3,050	4,699	7,245	8,314
Selling and marketing	491	700	1,130	1,459	2,598	4,485	6,315	7,501
General and administrative	499	526	1,064	1,816	6,295	2,106	2,630	5,700
Total operating expenses	3,463	2,972	4,158	6,014	11,943	11,290	16,190	21,515
Income (loss) from operations	(3,463)	(2,972)	5,419	17,403	21,158	43,371	55,841	56,332
Other income (expense), net	129	237	75	140	290	1,877	1,453	3,636
Income (loss) before income taxes	(3,334)	(2,735)	5,494	17,543	21,448	45,248	57,294	59,968
Provision (benefit) for income taxes	—	—	(4,600)	6,850	8,365	17,646	22,345	22,657
Net income (loss)	$(3,334)	$(2,735)	$10,094	$10,693	$13,083	$27,602	$ 34,949	$ 37,311
Pro forma net income (loss) per common and common equivalent share[(1)(2)]	$ (0.03)	$ (0.03)	$ 0.10	$ 0.11	$ 0.13	$ 0.26	$ 0.33	$ 0.35
Pro forma weighted average common and common equivalent shares outstanding[(1)]	99,111	99,111	99,111	99,111	99,425	104,457	105,296	106,308

					Fiscal Quarter Ended			
	Jan. 31, 1996	Apr. 30, 1996	Jul. 31, 1996	Oct. 31, 1996	Jan. 31, 1997	April 30, 1997	Jul. 31, 1997	Oct. 31, 1997
(as a percentage of revenue)								
Revenue	—	—	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	—	—	43.4	38.2	38.6	36.9	35.8	35.7
Gross profit	—	—	56.6	61.8	61.4	63.1	64.2	64.3
Operating expenses:								
Research and development	—	—	11.6	7.2	5.7	5.5	6.5	6.9
Selling and marketing	—	—	6.7	3.8	4.8	5.2	5.6	6.2
General and administrative	—	—	6.3	4.8	11.7	2.4	2.3	4.7
Total operating expenses	—	—	24.6	15.8	22.2	13.1	14.4	17.8
Income (loss) from operations	—	—	32.0	46.0	39.2	50.0	49.8	46.5
Other income (expense), net	—	—	0.4	0.3	0.6	2.2	1.3	3.0
Income (loss) before income taxes	—	—	32.4	46.3	39.8	52.2	51.1	49.5
Provision (benefit) for income taxes	—	—	(27.2)	18.1	15.5	20.3	19.9	18.7
Net income (loss)	—	—	59.6%	28.2%	24.3%	31.9%	31.2%	30.8%

(1) The pro forma net income (loss) per common and common equivalent share are presented on a pro forma basis for all periods stated, except for the quarters ended July 31, 1997 and October 31, 1997, which is presented on a historical basis. Pro forma weighted average common and common equivalent shares outstanding include Common Stock, stock options and warrants using the treasury stock method and the assumed conversion of all outstanding shares of Convertible Preferred Stock into Common Stock. See Note 1 of Notes to Consolidated Financial Statements.

(2) The sum of the quarterly earnings per share for fiscal 1997 does not equal the reported annual earnings per share for fiscal 1997 due to the effect of the Company's stock issuances during the year.

The Company's quarterly operating results have varied and are expected to vary significantly in the future. These fluctuations may be caused by many factors, including, among others, the size and timing of customer orders and the related field testing and product acceptance cycle times; increases in manufacturing and operating expenses in anticipation of expected customer demand; effective transition and market acceptance of new and multiple product lines; competitive pricing pressures; mix of products and services sold; intellectual property litigation; and general economic conditions. As a result of the foregoing and other factors, the Company believes that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

The Company's revenue increased significantly on a quarter-to-quarter basis since the Company's initial customer acceptance during the quarter ended July 31, 1996 to the quarter ended July 31, 1997. The fourth quarter ended October 31, 1997 posted an increase in revenue as compared to the third quarter ended July 31, 1997 with moderating sequential growth in percentage terms as compared to the previous quarters. The moderating revenue growth in the fourth quarter of fiscal 1997 was attributable to a year-end wind-down of the annual capital equipment procurement cycle of one of the two primary customers of the Company.

The Company currently expects revenue for the first quarter of fiscal 1998 to show sequential growth, with the rate to be comparable or perhaps modestly above that experienced between the third and fourth quarters of fiscal 1997. However, due to the evolving nature of the markets for the Company's products and other factors, there can be no assurance that the Company's revenues will increase on a quarter-to-quarter basis or at all in future periods.

Operating expenses have generally increased in absolute dollars over the quarters shown as the Company has increased staffing and related infrastructure costs in its research and development, selling and marketing, and administrative functions. Quarter-to-quarter growth in research and development was primarily attributable to increased staffing levels, purchases of materials used in the development of new or enhanced prototypes,

and outside services in support of certain developments and design efforts. Quarter-to-quarter growth in selling and marketing was primarily the result of increased staffing levels in the areas of sales, technical assistance and field support, and increases in commissions earned, trade show participation and promotional costs. For the quarters ended January 31, 1997 and October 31, 1997, the increases in general and administrative costs were primarily the result of a $5.0 and $2.5 million charge, respectively, to accrue estimated legal and related costs associated with pending litigation. See Note 9 of Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

The Company financed its operations and capital expenditures from inception through fiscal 1996 principally through the sale of Convertible Preferred Stock for proceeds totaling $40.6 million and capital lease financing totaling $4.1 million. The Company completed its initial public offering of Common Stock in February 1997 and realized net proceeds of approximately $121.8 million with an additional $0.6 million received from the exercise of certain outstanding warrants. In July 1997, the Company completed a public offering of Common Stock and realized net proceeds of approximately $52.2 million. During fiscal 1997 the Company also realized approximately $53.1 million in tax benefits from the exercise of stock options and certain stock warrants. As of October 31, 1997, the Company had $263.1 million in cash and cash equivalents.

The Company's operating activities used cash of $6.6 million in fiscal 1995 and provided cash of $80.1 million and $0.6 million for fiscal 1997 and 1996, respectively. The cash used in operations in fiscal 1995 was accounted for primarily by the Company's development stage operating losses. Cash provided by operations in fiscal 1997 and 1996 was principally attributable to net income adjusted for the non-cash charges of depreciation, amortization, provisions for inventory obsolescence and warranty, increases in accounts payable, accrued expenses and income tax payable; offset by increases in accounts receivable and inventories due to increased revenue and to the general increase in business activity.

Cash used in investing activities in fiscal 1995, 1996 and 1997 were $2.0 million, $11.5 million and $66.6 million, respectively. Included in investment activities were capital equipment expenditures in fiscal 1995, 1996 and 1997 of $1.9 million, $9.8 million and $51.7 million, respectively. These capital equipment expenditures were primarily for test, manufacturing and computer equipment. The Company expects additional capital equipment expenditures to be made during fiscal 1998 to support selling and marketing, manufacturing and product development activities. In addition, since its inception the Company's investing activities have included the use of $17.3 million for the construction of leasehold improvements and expects to use an additional $9.9 million of capital in the construction of leasehold improvements for its new facilities. The Company intends to lease additional facilities of 50,000 to 100,000 square feet in mid-1998 and may spend up to $5.0 million to $10.0 million in improving such facilities as and to the extent necessary to meet expansion requirements.

The Company believes that its existing cash balance and cash flows expected from future operations will be sufficient to meet the Company's capital requirements for at least the next 18 to 24 months.

Risk Factors

Investors are reminded that this document contains forward-looking statements that should be considered in the context of the risks described in the Company's Form-10K and subsequent Form 8-K, on file with the SEC as of December 10, 1997 and December 29, 1997 respectively. Risk factors that may cause the Company's results to differ materially from those discussed in forward-looking statements include, but are not limited to: a dependence on major customers, a dependence on an effective transition to multiple product lines, the potential for new product development delays and competitive pressures.

Consolidated Balance Sheets

	October 31, 1996	1997
(in thousands, except share data)		
Assets		
Current assets:		
Cash and cash equivalents	$22,557	$263,085
Accounts receivable (net of allowance of $— and $200)	16,759	63,227
Inventories, net	13,228	41,109
Deferred income taxes	1,834	9,006
Prepaid expenses and other	634	2,220
Total current assets	55,012	378,647
Equipment, furniture and fixtures, net	11,863	67,412
Other assets	426	1,169
Total assets	$67,301	$447,228
Liabilities, Mandatorily Redeemable Preferred Stock and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 6,278	$ 20,373
Accrued liabilities	5,242	31,463
Income taxes payable	3,342	—
Deferred revenue	3,265	776
Other current obligations	1,029	985
Total current liabilities	19,156	53,597
Deferred income taxes	—	28,167
Other long-term obligations	2,771	1,880
Total liabilities	21,927	83,644
Commitments and contingencies	—	—
Mandatorily redeemable preferred stock—par value $.01 16,250,000 shares authorized:		
Series A—4,500,000 shares authorized; 3,590,157 and zero shares issued and outstanding	3,492	—
Series B—8,000,000 shares authorized; 7,354,092 and zero shares issued and outstanding	10,962	—
Series C—3,750,000 shares authorized; 3,718,899 and zero shares issued and outstanding	25,950	—
Stockholders' equity:		
Preferred stock—par value $.01; 20,000,000 shares authorized; zero shares issued and outstanding	—	—
Common stock—par value $.01; 180,000,000 shares authorized; 13,191,585 and 99,287,653 shares issued and outstanding	132	993
Additional paid-in capital	339	245,151
Notes receivable from stockholders	(60)	(64)
Retained earnings	4,559	117,504
Total stockholders' equity	4,970	363,584
Total liabilities, mandatorily redeemable preferred stock and stockholders' equity	$67,301	$447,228

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Operations

	Year Ended October 31,		
	1995	1996	1997
(in thousands, except per share data)			
Revenue	$ —	$54,838	$373,827
Cost of goods sold	—	21,844	136,187
Gross profit	—	32,994	237,640
Operating expenses:			
Research and development	6,361	8,922	23,308
Selling and marketing	481	3,780	20,899
General and administrative	896	3,905	16,731
Total operating expenses	7,738	16,607	60,938
Income (loss) from operations	(7,738)	16,387	176,702
Interest and other income (expense), net	195	877	7,599
Interest expense	(86)	(296)	(343)
Income (loss) before income taxes	(7,629)	16,968	183,958
Provision for income taxes	—	2,250	71,013
Net income (loss)	$(7,629)	$14,718	$112,945
Pro forma net income per common and common equivalent share		$ 0.15	$ 1.09
Pro forma weighted average common and common equivalent shares outstanding		99,111	103,765

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Stockholders' Equity (Deficit)

	Common Stock		Additional	Notes Receivable From	Retained Earnings	Total Stockholders'
	Shares	Amount	Paid-in-Capital	Stockholders	(Deficit)	Equity (Deficit)
(dollars in thousands)						
Balance at October 31, 1994	10,816,665	$108	$ 99	$(65)	$ (2,530)	$ (2,388)
Exercise of warrants	1,075,000	11	11	—	—	22
Exercise of stock options	43,750	—	—	—	—	—
Repayment of receivables from stockholders	—	—	—	65	—	65
Net loss	—	—	—	—	(7,629)	(7,629)
Balance at October 31, 1995	11,935,415	119	110	—	(10,159)	(9,930)
Exercise of warrants	676,425	7	—	—	—	7
Exercise of stock options	579,745	6	71	(60)	—	17
Compensation cost of stock options	—	—	2	—	—	2
Issuance of warrant for settlement of certain equity rights	—	—	156	—	—	156
Net income	—	—	—	—	14,718	14,718
Balance of October 31, 1996	13,191,585	132	339	(60)	4,559	4,970
Issuance of common stock, net of issuance costs	7,002,060	70	173,947	—	—	174,017
Conversion of Preferred Stock	74,815,740	748	40,256	—	—	41,004
Exercise of warrants	666,086	7	—	—	—	7
Exercise of stock options	3,612,182	36	859	(73)	—	822
Tax benefit from the exercise of stock options	—	—	29,709	—	—	29,709
Repayment of receivables from stockholders	—	—	—	69	—	69
Compensation cost of stock options	—	—	41	—	—	41
Net income	—	—	—	—	112,945	112,945
Balance at October 31, 1997	99,287,653	$993	$245,151	$(64)	$117,504	$363,584

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

	Year Ended October 31,		
	1995	1996	1997
(in thousands)			
Cash flows from operating activities:			
Net income (loss)	$ (7,629)	$ 14,718	$112,945
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Non-cash charges from equity transactions	—	158	41
Write down of leasehold improvements and equipment	—	883	923
Depreciation and amortization	355	1,007	10,155
Provision for doubtful accounts	—	—	200
Provision for inventory excess and obsolescence	—	1,937	7,585
Provision for warranty and other contractual obligations	—	1,584	11,866
Changes in assets and liabilities:			
Increase in accounts receivable	(8)	(16,753)	(46,668)
Increase in inventories	—	(15,165)	(35,466)
Increase in deferred income tax assets	—	(1,834)	(7,172)
Increase in prepaid expenses and other assets	(72)	(955)	(2,329)
Increase in accounts payable and accruals	757	8,311	28,450
(Decrease) increase in income taxes payable	—	3,342	(3,342)
Increase in deferred income tax liabilities	—	—	4,793
(Decrease) increase in deferred revenue and other obligations	(11)	3,353	(1,907)
Net cash provided by (used in) operating activities	(6,608)	586	80,074
Cash flows from investing activities:			
Additions to equipment, furniture and fixtures	(2,036)	(11,514)	(66,627)
Net cash used in investing activities	(2,036)	(11,514)	(66,627)
Cash flows from financing activities:			
Net proceeds from (repayment of) other obligations	719	2,479	(1,517)
Net proceeds from issuance of or subscription to mandatorily redeemable preferred stock	10,962	25,950	—
Net proceeds from issuance of common stock	22	24	175,446
Tax benefit related to exercise of stock options and warrants	—	—	53,083
Repayment of notes receivable from stockholders	65	—	69
Net cash provided by financing activities	11,768	28,453	227,081
Net increase in cash and cash equivalents	3,124	17,525	240,528
Cash and cash equivalents at beginning of period	1,908	5,032	22,557
Cash and cash equivalents at end of period	$ 5,032	$ 22,557	$263,085
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Interest	$ 86	$ 296	$ 343
Income taxes	$ —	$ 742	$ 24,825
Supplemental disclosure of non-cash financing activities:			
Issuance of common stock for notes receivable from stockholders	$ —	$ 60	$ 73

The accompanying notes are an integral part of these consolidated financial statements.

(1) The Company and Significant Accounting Policies

Description of Business

CIENA Corporation (the "Company" or "CIENA"), a Delaware corporation, designs, manufactures and sells dense wavelength division multiplexing systems for fiberoptic telecommunications networks. During the period from November 2, 1992 to October 31, 1995, CIENA was a development stage company as defined in Statement of Financial Accounting Standards No. 7, "Development Stage Enterprises." Planned principal operations commenced during fiscal 1996 and, accordingly, CIENA is no longer considered a development stage company.

Principles of Consolidation

During the fiscal year ended October 31, 1997, the Company formed four wholly owned subsidiaries for the purpose of segregating aspects of the Company's business. The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

Fiscal Year

The Company has a 52 or 53 week fiscal year which ends on the Saturday nearest to the last day of October in each year (November 1, 1997; November 2, 1996; and October 28, 1995). For purposes of financial statement presentation, each fiscal year is described as having ended on October 31. Fiscal 1997 and 1995 comprised 52 weeks and fiscal 1996 comprised 53 weeks.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, together with amounts disclosed in the related notes to the financial statements. Particularly sensitive estimates include reserves for warranty and other contractual obligations and for excess and obsolete inventories. Actual results could differ from the recorded estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Inventories

Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out basis. The Company records a provision for excess and obsolete inventory whenever such an impairment has been identified.

Equipment, Furniture and Fixtures

Equipment, furniture and fixtures are recorded at cost. Depreciation and amortization are computed using the straight-line method over useful lives of 2-5 years for equipment, furniture and fixtures and of 6-10 years for leasehold improvements.

Concentrations

Substantially all of the Company's cash and cash equivalents are custodied with four major U.S. financial institutions. The majority of the Company's cash equivalents include U.S. Government Federal Agency Securities and overnight repurchase agreements. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally these deposits may be redeemed upon demand and therefore, bear minimal risk.

Historically, the Company has relied on a limited number of customers for a substantial portion of its revenue. In terms of total revenue, the Company's largest two customers have been Sprint and WorldCom who combined for greater than 90% of the Company's fiscal 1997 revenue. The Company expects that a significant portion of its future revenue will continue to be generated by a limited number of customers. The loss of any of these customers or any substantial reduction in orders by any of these customers could materially adversely affect the Company's operating results. Additionally, the Company's access to certain raw materials is dependent upon single and sole source suppliers. The inability of any supplier to fulfill supply requirements of the Company could impact future results.

The Company performs ongoing credit evaluations of its customers and generally does not require collateral from its customers. The Company maintains allowances for potential losses, and has not incurred any significant losses to date. As of October 31, 1996 all of the Company's trade accounts receivable were derived from Sprint, and both Sprint and WorldCom accounted for more than 90% of the trade accounts receivable as of October 31, 1997.

Revenue Recognition

The Company recognizes product revenue in accordance with the shipping terms specified. For transactions where the Company has yet to obtain customer acceptance, revenue is deferred until the terms of acceptance are satisfied. Revenue for installation services is recognized as the services are performed unless the terms of the supply contract combine product acceptance with installation, in which case revenues for installation services are recognized when the terms of acceptance are satisfied and installation is completed. Amounts received in excess of revenue recognized are recorded as deferred revenue. For distributor sales where risks of ownership have not transferred, the Company recognizes revenue when the product is shipped through to the end user.

Revenue-Related Accruals

The Company provides for the estimated costs to fulfill customer warranty and other contractual obligations upon the recognition of the related revenue. Such reserves are determined based upon actual warranty cost experience, estimates of component failure rates, and management's industry experience. The Company's contractual sales arrangements generally do not permit the right of return of product by the customer after the product has been accepted.

Research and Development

The Company charges all research and development costs to expense as incurred.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109 (SFAS No. 109), "Accounting for Income Taxes." SFAS No. 109 is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases, and for operating loss and tax credit carryforwards. In estimating future tax consequences, SFAS No. 109 generally considers all expected future events other than the enactment of changes in tax laws or rates. Tax savings resulting from deductions associated with stock options and certain stock warrants are credited directly to additional paid in capital when realization of such benefit is fully assured and to deferred tax liabilities prior to such point. See Note 7.

Foreign Currency Translation

The Company's foreign branches and subsidiaries use the U.S. dollar as their functional currency as the U.S. parent exclusively funds the branches and subsidiaries' operations with U.S. dollars. The net gain (loss) on foreign currency remeasurement and exchange rate changes for fiscal 1995 , 1996, and 1997 was immaterial.

Computation of Pro Forma Net Income per Share

Pro forma net income per common and common equivalent share is computed using the pro forma weighted average number of common and common equivalent shares outstanding. Pro forma weighted average common and common equivalent shares include Common Stock, stock options and warrants using the treasury stock method and the assumed conversion of all outstanding shares of Convertible Preferred Stock into Common Stock. Since the conversion of the Convertible Preferred Stock at the initial public offering date had a significant effect on the earnings per share calculation, historical loss per share for the fiscal year ended October 31, 1995 has not been calculated on the basis that it is irrelevant.

Pursuant to the rules and regulations of the Securities and Exchange Commission, Common Stock, stock options, warrants and Convertible Preferred Stock issued by the Company during the twelve months immediately preceding the filing of the initial registration statement and through the effective date of such registration statement have been included in the calculation of the pro forma weighted average shares outstanding using the treasury stock method based on the initial public offering price.

Software Development Costs

Statement of Financial Accounting Standards No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed,” requires the capitalization of certain software development costs incurred subsequent to the date technological feasibility is established and prior to the date the product is generally available for sale. The capitalized cost is then amortized over the estimated product life. The Company defines technological feasibility as being attained at the time a working model is completed. To date, the period between achieving technological feasibility and the general availability of such software has been short and software development costs qualifying for capitalization have been insignificant. Accordingly, the Company has not capitalized any software development costs.

Accounting for Stock Options

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (SFAS No. 123), “Accounting for Stock-Based Compensation,” which is effective for the Company’s consolidated financial statements for fiscal years 1996 and 1997. SFAS No. 123 allows companies to either account for stock-based compensation under the new provision of SFAS No. 123 or using the intrinsic value method provided by Accounting Principles Board Opinion No. 25 (APB No. 25), “Accounting for Stock Issued to Employees,” but requires pro forma disclosure in the footnotes to the financial statements as if the measurement provisions of SFAS No. 123 had been adopted. The Company has elected to continue to account for its stock based compensation in accordance with the provisions of APB No. 25 and present pro forma disclosures required by SFAS No. 123. See Note 6.

Newly Issued Accounting Standards

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, “Earnings per Share” (SFAS No. 128). SFAS No. 128 simplifies the earnings per share (EPS) computation and replaces the presentation of primary EPS with a presentation of basic EPS. This statement also requires dual presentation of basic and diluted EPS on the face of the income statement for entities with a complex capital structure and requires a reconciliation of the numerator and denominator used for the basic and diluted EPS computations. The Company will implement SFAS No. 128 in fiscal 1998, as required. Accordingly, all prior period EPS data will be restated. To illustrate the effect of adoption, the Company has elected to disclose pro forma basic and diluted EPS amounts computed using SFAS No. 128, as permitted by the standard. On a pro forma basis, the weighted average shares outstanding for basic EPS and the resulting EPS would be 12,840,000 and $1.15 for the fiscal year ended October 31, 1996, and 95,357,000 and $1.18 for the fiscal year ended October 31, 1997. Diluted EPS under SFAS No. 128 would be the same as currently presented.

In June 1997, the FASB issued SFAS No. 130, "Comprehensive Income." SFAS No. 130 becomes effective for the Company's fiscal year 1999 and requires reclassification of earlier financial statements for comparative purposes. SFAS No. 130 requires that changes in the amounts of certain items, including foreign currency translation adjustments and gains and losses on certain securities be shown in the financial statements. SFAS No. 130 does not require a specific format for the financial statement in which comprehensive income is reported, but does require that an amount representing total comprehensive income be reported in that statement. The Company believes the adoption of SFAS No. 130 will not have a material effect on the consolidated financial statements.

Also in June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This Statement will change the way public companies report information about segments of their business in annual financial statements and requires them to report selected segment information in their quarterly reports issued to stockholders. It also requires entity-wide disclosures about the products and services an entity provides, the material countries in which it holds assets and reports revenues, and its major customers. The Statement is effective for the Company's fiscal year 1999. The Company believes the adoption of SFAS No. 131 will not have a material effect on the consolidated financial statements.

Reclassification

Certain prior year amounts have been reclassified to conform to current year consolidated financial statement presentation.

(2) Inventories

Inventories are comprised of the following (in thousands):

	October 31,	
	1996	1997
Raw materials	$ 8,585	$27,716
Work-in-process	3,629	5,679
Finished goods	2,951	15,180
	15,165	48,575
Less reserve for excess and obsolescence	(1,937)	(7,466)
	$13,228	$41,109

The following is a table depicting the activity in the Company's reserve for excess and obsolescence (in thousands):

	October 31,	
	1996	1997
Beginning balance	$ —	$ 1,937
Provision charged to operations	1,937	7,585
Amounts written off to reserve	—	(2,056)
Ending balance	$1,937	$ 7,466

(3) Equipment, Furniture and Fixtures

Equipment, furniture and fixtures are comprised of the following (in thousands):

	October 31,	
	1996	1997
Equipment, furniture and fixtures	$11,647	$ 64,502
Leasehold improvements	1,141	13,953
	12,788	78,455
Accumulated depreciation and amortization	(1,388)	(11,543)
Construction-in-progress	463	500
	$11,863	$ 67,412

(4) Accrued Liabilities

Accrued liabilities are comprised of the following (in thousands):

	October 31, 1996	1997
Warranty and other contractual obligations	$1,584	$12,205
Accrued compensation	2,314	7,725
Legal and related costs	300	4,577
Consulting and outside services	—	3,219
Unbilled construction-in-process and leasehold improvements	50	1,427
Other	994	2,310
	$5,242	$31,463

(5) Line of Credit

In November 1996, the Company entered into an unsecured line of credit agreement with a bank, which provided for borrowings of up to $15,000,000. The Company had no borrowings against the line of credit during fiscal 1997. In November 1997, the line of credit agreement expired.

(6) Stockholders' Equity

Changes in and Conversion of Mandatorily Redeemable Convertible Preferred Stock

As a result of the February 1997 initial public offering, all shares of Convertible Preferred Stock converted into 73,315,740 shares of Common Stock and warrants to purchase 300,000 shares of Convertible Preferred Stock were exercised for $600,000 and converted into 1,500,000 shares of Common Stock.

Public Offerings

In February 1997, the Company successfully completed its initial public offering of Common Stock. The Company sold 5,750,000 shares, inclusive of 750,000 shares from the exercise of the underwriters over-allotment option, at a price of $23 per share. Net proceeds from the offering were approximately $121,800,000 with an additional $600,000 received from the exercise of 300,000 shares of outstanding Convertible Preferred Stock warrants.

In July 1997 the Company completed a public offering of 10,477,216 shares of Common Stock of which 1,252,060 shares were sold by the Company inclusive of 252,060 shares from the exercise of the underwriters over-allotment option, at a price of $44 per share. Net proceeds to the Company from the public offering were approximately $52,200,000.

Stock Incentive Plans

The Company has an Amended and Restated 1994 Stock Option Plan (the "1994 Plan"). Under the 1994 Plan, 20,050,000 shares of the Company's authorized but unissued Common Stock are reserved for options issuable to employees. These options are immediately exercisable upon grant, and both the options and the shares issuable upon exercise of the options generally vest to the employee over a four year period. The Company has the right to repurchase any exercised and non-vested shares at the original purchase price from the employees upon termination of employment. In June 1996 the Company approved the 1996 Outside Directors Stock Option Plan (the "1996 Plan"). Under the 1996 Plan, 750,000 shares of the Company's authorized but unissued Common Stock are reserved for options issuable to outside members of the Company's Board of Directors. These options vest to the director over periods from one to three years, depending on the type of option granted, and are exercisable once vested. Under the 1994 Plan and the 1996 Plan, options may be incentive stock options or non-statutory options, and the exercise price for each option shall be established by the Board of Directors provided, however, that the exercise price per share shall not be not less than the fair market value for incentive stock options and not less than 85% of fair market value for non-statutory stock options.

Following is a summary of the Company's stock option activity:

	Shares (in thousands)	Weighted Average Exercise Price
Balance at October 31, 1994	3,560	$ 0.02
Granted	3,856	0.03
Exercised	(44)	0.02
Canceled	(431)	0.02
Balance at October 31, 1995	6,941	0.03
Granted	5,901	1.85
Exercised	(579)	0.14
Canceled	(1,180)	0.18
Balance at October 31, 1996	11,083	0.97
Granted	1,737	32.81
Exercised	(3,612)	0.27
Canceled	(98)	0.52
Balance at October 31, 1997	9,110	$ 7.33

At October 31, 1997 approximately 156,000 shares of Common Stock subject to repurchase by the Company had been issued upon the exercise of options and approximately 1.7 million of the total outstanding options were vested and not subject to repurchase by the Company upon exercise.

The following table summarizes information with respect to stock options outstanding at October 31, 1997:

	Options Outstanding			Options Not Subject to Repurchase Upon Exercise	
Range of Exercise Price	Number Outstanding at Oct. 31, 1997	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number at Oct. 31, 1997	Weighted Average Exercise Price
$ 0.02–$ 0.03	2,586,000	7.14	$ 0.03	1,203,000	$0.03
$ 0.06–$ 0.40	810,000	8.22	$ 0.26	165,000	$0.28
$ 0.52–$ 1.66	983,000	8.53	$ 1.18	152,000	$1.21
$ 2.34–$ 4.34	2,839,000	8.66	$ 2.52	89,000	$3.12
$ 4.44–$18.00	935,000	9.07	$15.52	47,000	$9.17
$23.88–$58.88	957,000	9.71	$45.61	—	$0.00
	9,110,000	8.33	$ 7.33	1,656,000	$0.58

Pro Forma Stock-Based Compensation

The Company has elected to continue to follow the provisions of APB No. 25 for financial reporting purposes and has adopted the disclosure-only provisions of SFAS No. 123. Accordingly, no compensation cost has been recognized for the Company's stock option plans. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards in fiscal years 1996 and 1997 consistent with the provisions of SFAS No. 123, the Company's net income and net income per share for fiscal years 1996 and 1997 would have been decreased to the pro forma amounts indicated below (in thousands, except per share amounts):

	Fiscal Years 1996	1997
Net income applicable to common stockholders—as reported	$14,718	$112,945
Net income applicable to common stockholders—pro forma	$14,225	$107,382
Net income per share—as reported	$ 0.15	$ 1.09
Net income per share—pro forma	$ 0.14	$ 1.03

The above pro forma disclosures are not necessarily representative of the effects on reported net income or loss for future years.

The aggregate fair value and weighted average fair value of each option granted in fiscal years 1996 and 1997 were approximately $6.7 million and $33.6 million, and $1.14 and $19.33, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions for fiscal years 1996 and 1997:

	1996	1997
Expected volatility	60%	60%
Risk-free interest rate	6.1%	5.8%
Expected life	3 yrs.	3 yrs.
Expected dividend yield	—%	—%

(7) Income Taxes

Income before income taxes and the provision for income taxes consists of the following (in thousands):

	October 31,	
	1996	1997
Income before income taxes	$16,968	$183,958
Provision for income taxes:		
Current:		
Federal	$ 3,452	$ 66,154
State	632	7,238
Total current	4,084	73,392
Deferred:		
Federal	(1,690)	(1,882)
State	(144)	(497)
Total deferred	(1,834)	(2,379)
Provision for income taxes	$ 2,250	$ 71,013

In fiscal 1995, the tax provision was comprised primarily of a tax benefit of approximately $3.1 million which was offset by a valuation allowance of the same amount.

In fiscal 1995, the tax provision differed from the expected tax benefit, computed by applying the U.S. federal statutory rate of 35% to the loss before income taxes, principally due to the effect of increases in the valuation allowance. In fiscal 1997 and 1996, the tax provision reconciles to the amount computed by multiplying income before income taxes by the U.S. federal statutory rate of 35% as follows:

	October 31,	
	1996	1997
Provision at statutory rate	35.0%	35.0%
Reversal of valuation allowance	(24.3)	—
State taxes, net of federal benefit	2.9	2.6
Other	(0.3)	1.0
	13.3%	38.6%

The significant components of deferred tax assets and liabilities were as follows (in thousands):

	October 31,	
	1996	1997
Deferred tax assets:		
Reserves and accrued liabilities	$1,452	$ 9,006
Depreciation and other	382	—
Deferred tax assets	$1,834	$ 9,006
Deferred tax liabilities:		
Equipment leases	$ —	$ 3,985
Services	—	19,389
Depreciation and other	—	4,793
Deferred tax liabilities	$ —	$28,167

The income tax provisions do not reflect the tax savings resulting from deductions associated with the Company's stock option plans or the exercise of certain stock warrants. Tax benefits of approximately $29.7 million and $23.4 million from exercises of stock options and certain stock warrants, respectively, were credited directly to additional paid-in-capital and to long-term deferred income taxes for fiscal 1997, respectively.

(8) Employee Benefit Plans

In January 1995, the Company adopted a 401(k) defined contribution profit sharing plan. The plan covers all full-time employees who are at least 21 years of age, have completed three months of service and are not covered by a collective bargaining agreement where retirement benefits are subject to good faith bargaining. Participants may contribute up to 15% of pre-tax compensation, subject to certain limitations. The Company may make discretionary annual profit sharing contributions of up to the lesser of $30,000 or 25% of each participant's compensation. In fiscal 1997 the Company revised the plan to include an employer matching contribution equal to 100% of the first 3% of participating employee contributions, with a five year vesting plan applicable to the Company's contribution. The Company has made no profit sharing contributions to date. During fiscal 1997 the Company made matching contributions of approximately $300,000.

(9) Commitments and Contingencies

Operating Lease Commitments

The Company has certain minimum obligations under noncancelable operating leases expiring on various dates through 2006 for equipment and facilities. Future annual minimum rental commitments under noncancelable operating leases at October 31, 1997 are as follows (in thousands):

Fiscal year ending October 31,	
1998	$ 4,429
1999	4,900
2000	4,805
2001	4,627
2002	4,003
Thereafter	13,015
	$35,779

Rental expense for fiscal 1995, 1996 and 1997 was approximately $111,000, $602,000 and $2,511,000, respectively.

Litigation

Pirelli Litigation. On December 20, 1996, a U.S. affiliate of Pirelli SpA ("Pirelli") filed suit in U.S. District Court in Delaware, alleging willful infringement by the Company of five U.S. patents held by Pirelli. The lawsuit seeks treble damages, attorneys' fees and costs, as well as preliminary and permanent injunctive relief against the alleged infringement. On February 10, 1997, the Company filed its answer denying infringement, alleging inequitable conduct on the part of Pirelli in the prosecution of certain of its patents, and stating a counterclaim against the relevant Pirelli parties for a declaratory judgment finding the Pirelli patents invalid and/or not infringed. Two of the five patents in suit have since been removed from the litigation. Discovery proceedings are ongoing, and are currently expected to be completed by January 31, 1998, with trial expected no earlier than mid 1998.

On March 14, 1997, the Company filed suit against Pirelli in U.S. District Court in the Eastern District of Virginia, alleging willful infringement by Pirelli of three U.S. patents held or co-owned by the Company, one of

which was withdrawn in September 1997. The lawsuit seeks treble damages, attorneys' fees and costs, as well as permanent injunctive relief against the alleged infringement. The patents relate to certain of Pirelli's cable television equipment and fiberoptic communications equipment. Motions for summary judgment by both parties are currently pending on the issue of infringement as it relates to the cable television patent, and Pirelli has also filed a motion for summary judgment of invalidity on this patent. As to the second of the two patents, on December 5, 1997, the court issued an order granting partial summary judgment for Pirelli on the issue of non-infringement, and denying Pirelli's motion for summary judgment of invalidity of this patent. Trial is currently scheduled for January 1998.

In February 1997, the Company filed a complaint against Pirelli with the International Trade Commission ("ITC"), based on the Company's belief that a 32 channel DWDM system announced by Pirelli infringed at least two of the Company's patents. The Company's complaint sought a ban on the importation of this product into the U.S. A formal investigative proceeding was instituted by the ITC on April 3, 1997. On November 24, 1997, the parties settled the matter by entry of a Consent Order. Under the Consent Order, Pirelli has agreed not to import into the United States WDM systems which infringe upon the Company's patented in fiber Bragg gratings-based WDM systems.

The Company has accrued $7.5 million for legal fees associated with their involvement in the above litigation; $4.3 million of that accrual is remaining at October 31, 1997, which the Company considers sufficient to account for all anticipated legal fees. The Company continues to believe its MultiWave systems do not infringe any valid claim of the three remaining Pirelli patents and believes certain Pirelli patents and/or claims are invalid. The Company is defending itself vigorously and is planning on all remaining litigation proceeding through trial.

However, there can be no assurance that the Company will be successful in the Pirelli litigation, and an adverse determination in the Delaware court could result from a finding of infringement of only one claim of a single patent. The Company may consider settlement due to the costs and uncertainties associated with litigation in general and patent infringement litigation in particular and due to the fact that an adverse determination in the litigation could preclude the Company from producing the MultiWave 1600 system until it were able to implement a non-infringing alternative design to any portion of the system to which such determination applied. There can be no assurance that any settlement will be reached by the parties. An adverse determination in, or settlement of, the Pirelli litigation could involve the payment of significant amounts, or could include terms in addition to such payments, which could have a material adverse effect on the Company's business, financial condition and results of operations.

Kimberlin Litigation. On November 20, 1996, a stockholder and entities controlled by that stockholder (the "plaintiffs") who provided initial equity capital during the formation of the Company and participated in the Series C Preferred Stock financing, filed suit in U. S. District Court for the Southern District of New York against the Company and certain directors of the Company (the "defendants"), alleging that the plaintiffs were entitled to purchase additional shares of Series C Preferred Stock at the time of the closing of the Series C Preferred Stock financing, but were denied that opportunity by the defendants. The lawsuit claims breach of contract, breach of fiduciary duty and violation of Securities Commission Rule 10b-5 by the defendant. On January 6, 1997, the Company filed its answer to the plaintiffs' complaint, and filed a counterclaim. The plaintiffs amended their complaint in May 1997 alleging a violation of federal insider trading laws. There has not been a trial date set by the judge.

The Company believes that the Plaintiffs' claims and amended claims are without merit and intends to defend itself vigorously. The Company has moved for summary judgment on the entire matter, but there is no assurance the judgment will be granted.

The Company has agreed to indemnify its customers for liability incurred in connection with the infringement of a third-party's intellectual property rights. Although the Company has not received notice from any customer advising the Company of any alleged infringement of a third-party's intellectual property rights, there can be no assurance that such indemnification of alleged liability will not be required from the Company in the future.

(10) Foreign Sales

The Company has sales and marketing operations located outside the United States in the United Kingdom, Belgium and Japan. The Company has distributor or marketing representative arrangements covering Austria, Germany, Italy and Switzerland in Europe, and the Republic of Korea and Japan in Asia. The Company also has representative support in Brazil. Included in revenues are export sales of approximately $0 and $5.5 million in fiscal years 1996 and 1997, respectively.

(11) Subsequent Events (unaudited)

Acquisitions

The Company has signed a letter of intent to enter into an Agreement and Plan of Merger with Astracom, Inc. ("Astracom"), an early stage telecommunications company which was incorporated on November 20, 1996, and is located in Atlanta, Georgia. The transaction is expected to be completed during the December 1997 period. The purchase price is expected to be approximately $13.1 million and consists of the issuance of 169,754 shares of CIENA common stock, the payment of $2.4 million in cash, and the assumption of certain stock options. Based on preliminary estimates, the Company believes the purchase price represents approximately $11.4 million in goodwill and other intangibles, and approximately $1.7 million in net assets assumed, and that the amortization period for the intangibles, based on management's estimate of the useful life of the acquired technology, is between five to seven years.

The operations of the acquired company are not material to the consolidated financial statements of the Company, and accordingly, separate pro forma financial information has not been presented for fiscal year 1997 as if Astracom had been acquired as of November 20, 1996.

Report of Independent Accountants

To the Board of Directors and
Stockholders of CIENA Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows and of changes in stockholders' equity (deficit) present fairly, in all material respects, the financial position of CIENA Corporation and subsidiaries at October 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 1997, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Falls Church, VA
November 26, 1997

Executive Officers

Patrick H. Nettles, Ph.D.
President, Chief Executive Officer and Director

Steve W. Chaddick
Senior Vice President,
Products and Technologies

Joseph R. Chinnici
Senior Vice President,
Finance and Chief Financial Officer

Lawrence P. Huang
Senior Vice President,
Sales and Marketing

Stephen B. Alexander
Vice President,
Transport Products

Mark Cummings
Senior Vice President,
Operations

G. Eric Georgatos, Esq.
Vice President,
General Counsel and Secretary

Andrew C. Petrik
Vice President,
Finance and Controller

Rebecca K. Seidman
Vice President,
Human Resources

Outside Board Members

Jon W. Bayless, Ph.D.
Chairman of the Board of Directors,
General Partner,
Sevin Rosen Funds

Harvey B. Cash
General Partner,
InterWest Partners

Clifford W. Higgerson
General Partner,
Vanguard Venture Partners

Billy B. Oliver
Communications Consultant

Michael J. Zak
General Partner,
The Charles River Partnerships

Corporate Information

Corporate Headquarters
CIENA Corporation
920 Elkridge Landing Rd.
Linthicum, MD 21090 U.S.A.
Telephone: (800) 921-1144 or (410) 865-8500
Website: http://www.CIENA.com

Annual Meeting
CIENA's first annual shareholder meeting will be held at 3:00 p.m. on Wednesday, March 11 at the Harbor Inn Pier 5, Baltimore, MD.

Independent Certified Public Accountants
Price Waterhouse LLP
Falls Church, VA

General Counsel
Hogan & Hartson
Baltimore, MD

Transfer Agent
First National Bank of Boston
c/o Boston Equiserve LP
Boston, MA

Common Stock Market Data
Since its Initial Public Offering on February 7, 1997, the Company's Common Stock has traded on the Nasdaq Stock Market under the symbol CIEN and appears in most daily newspaper stock tables as Ciena. As of January 12, 1998, there were approximately 561 stockholders of record and 99,982,487 shares of Common Stock outstanding.

Investor Relations
For a copy of the Company's Form 10-K or additional copies of this report or other financial information, contact:

Investor Relations
CIENA Corporation
920 Elkridge Landing Rd.
Linthicum, MD 21090
(888) 243-6223 or (410) 865-8500

Additional information is available on CIENA's Internet website at http://www.CIENA.com

Design: Financial Communications, Inc. Bethesda, MD www.fincominc.com ©1998 CIENA Corporation