XTERA COMMUNICATIONS, INC.
Form 10-Q
May 16, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-37617

XTERA COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	38-3394611
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
500 W. Bethany Drive, Suite 100	
Allen, Texas	75013

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (972) 649-5000

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (Do not check if a small reporting company)	Small reporting company ¨

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

As of April 30, 2016 the registrant had 17,214,718 shares of common stock, $0.001 par value per share, outstanding.

Table of Contents

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

XTERA COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	March 31, 2016	September 30, 2015
Assets		
Current assets		
Cash and cash equivalents	$2,568	$ 1,753
Restricted cash	328	1,120
Accounts receivable, net	12,718	6,580
Unbilled receivables	10,272	6,119
Inventories, net	13,066	10,540
Deferred cost	3,053	780
Prepaid expenses and other current asset	1,127	1,185
Total current assets	43,132	28,077
Property and equipment, net	3,359	3,399
Restricted cash	3,479	152
Intangible assets, net	7,014	7,554
Other assets	90	90
Total assets	$57,074	$ 39,272
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$14,227	$ 13,589
Accrued compensation and employee benefits	1,137	760
Deferred revenue	1,769	1,058
Warranty reserve	2,158	1,735
Current portion of long-term debt	14,878	10,707
Other accrued liabilities	9,648	4,966
Total current liabilities	43,817	32,815
Long-term debt less current portion	—	2,133
Other long-term liabilities	644	631
Total liabilities	44,461	35,579
Commitments and contingencies		
Stockholders' equity (deficit)		
Series A-3 convertible preferred stock, $0.001 par value, Authorized shares: 0 and 40,500,000	—	40

as of March 31, 2016 and September 30, 2015; Issued and outstanding shares:

0 and 39,663,482 as of March 31, 2016 and September 30, 2015		
Series B-3 convertible preferred stock, $0.001 par value, Authorized shares: 0 and 39,500,000 as of March 31, 2016 and September 30, 2015; Issued and outstanding shares: 0 and 38,589,303 as of March 31, 2016 and September 30, 2015	—	39
Series C-3 convertible preferred stock, $0.001 par value, Authorized shares: 0 and 25,000,000 as of March 31, 2016 and September 30, 2015; Issued and outstanding shares: 0 and 19,081,778 as of March 31, 2016 and September 30, 2015	—	19
Series D-3 convertible preferred stock, $0.001 par value, Authorized shares: 0 and 60,000,000 as of March 31, 2016 and September 30, 2015; Issued and outstanding shares: 0 and 52,509,212 as of March 31, 2016 and September 30, 2015	—	53
Series E-3 convertible preferred stock, $0.001 par value, Authorized shares: 0 and 120,000,000 as of March 31, 2016 and September 30, 2015; Issued and outstanding shares: 0 and 114,679,639 as of March 31, 2016 and September 30, 2015	—	115
Preferred Stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding	—	—
Common Stock, $0.001 par value, Authorized shares: 100,000,000 and 395,000,000 as of March 31, 2016 and September 30, 2015; Issued and outstanding shares: 17,214,718 and 1,936,056 as of March 31, 2016 and September 30, 2015	17	2
Additional paid-in-capital	410,382	388,047
Accumulated deficit	(398,500)	(384,685)
Accumulated other comprehensive income, net	714	63
Total stockholders' equity (deficit)	12,613	3,693
Total liabilities and stockholders' equity	$57,074	$ 39,272

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

XTERA COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share data)

(Unaudited)

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015	Six Months Ended March 31, 2016	Six Months Ended March 31, 2015
Revenue:				
Products	$15,136	$12,776	$25,978	$24,955
Services	1,943	1,341	3,731	2,527
Total revenue	17,079	14,117	29,709	27,482
Cost of revenue:				
Products	15,036	9,141	27,225	18,365
Services	987	662	1,747	1,224
Total cost of revenue	16,023	9,803	28,972	19,589
Gross profit	1,056	4,314	737	7,893
Operating expenses:				
Sales and marketing	1,466	1,056	2,991	2,249
Research and development	3,279	2,675	6,044	5,427
General and administrative	2,269	1,435	4,106	3,051
Total operating expense	7,014	5,166	13,141	10,727
Operating loss	(5,958)	(852)	(12,404)	(2,834)
Other income (expense):				
Interest expense	(357)	(624)	(762)	(1,286)
Interest expense, related party	—	(336)	—	(679)
Foreign exchange loss	(283)	(389)	(645)	(630)
Other loss	(2)	—	(2)	—
Total other expense	(642)	(1,349)	(1,409)	(2,595)
Loss before income taxes	(6,600)	(2,201)	(13,813)	(5,429)
Income tax provision	1	20	2	36
Net loss	$(6,601)	$(2,221)	$(13,815)	$(5,465)
Preferred dividend	—	(3,300)	—	(6,674)
Net loss available to common stockholders	$(6,601)	$(5,521)	$(13,815)	$(12,139)
Loss per common share – basic and diluted	$(0.38)	$(3.04)	$(1.01)	$(6.69)
Weighted average shares – basic and diluted	17,163,070	1,815,695	13,653,983	1,815,157

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

XTERA COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Net loss	$(6,601)	$(2,221)	$(13,815)	$(5,465)
Other comprehensive income (loss), net of tax:				
Foreign currency translation	298	320	651	564
Total comprehensive loss, net of tax	$(6,303)	$(1,901)	$(13,164)	$(4,901)

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

XTERA COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

(Unaudited)

	Six Months Ended March 31,			
	2016		2015	
	Shares Outstanding	Amount	Shares Outstanding	Amount
Series A-3 convertible preferred stock				
Balance as of the beginning of the period	39,663,482	$40	39,663,482	$40
Conversion to common stock	(39,663,482)	(40)	—	—
Balance as of the end of the period	—	$—	39,663,482	$40
Series B-3 convertible preferred stock				
Balance as of the beginning of the period	38,589,303	$39	38,589,303	$39
Conversion to common stock	(38,589,303)	(39)	—	—
Balance as of the end of the period	—	$—	38,589,303	$39
Series C-3 convertible preferred stock				
Balance as of the beginning of the period	19,081,778	$19	19,081,778	$19
Conversion to common stock	(19,081,778)	(19)	—	—
Balance as of the end of the period	—	$—	19,081,778	$19
Series D-3 convertible preferred stock				
Balance as of the beginning of the period	52,509,212	$53	52,509,212	$53
Conversion to common stock	(52,509,212)	(53)	—	—
Balance as of the end of the period	—	$—	52,509,212	$53
Series E-3 convertible preferred stock				
Balance as of the beginning of the period	114,679,639	$—	—	$—
Issuance of preferred stock	—	115	—	—
Conversion to common stock	(114,679,639)	(115)		
Balance as of the end of the period	—	$—	—	$—
Common stock				
Balance as of the beginning of the period	1,936,056	$2	1,814,630	$2
Exercise of stock options	44,580	—	1,402	—
Release of restricted stock units	60,000	—	—	—
Conversion of preferred stock to common stock	10,174,082	10		
Issuance of common stock	5,000,000	5	—	—
Balance as of the end of the period	17,214,718	$17	1,816,032	$2
Additional paid-in-capital				
Balance as of the beginning of the period		$388,047		$350,098
Issuance of common stock		21,785		1
Conversion of preferred stock to common stock		256		—
Issuance of warrants		—		264
Amortization of share-based compensation		294		17

Balance as of the end of the period	$410,382	$350,380
Accumulated deficit		
Balance as of the beginning of the period	$(384,685)	$(368,053)
Net loss	(13,815)	(5,465)
Balance as of the end of the period	$(398,500)	$(373,518)
Accumulated other comprehensive income (loss), net		
Balance as of the beginning of the period	$63	$(401)
Foreign currency translation	651	564
Balance as of the end of the period	$714	$163
Total stockholders' equity (deficit)	$12,613	$(22,822)

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

XTERA COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended March 31,	
	2016	2015
Operating Activities:		
Net loss	$(13,815)	$(5,465)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,472	1,318
Provision for inventory obsolescence	1,768	618
Provision for loss on contracts	1,039	—
Warranty provision	493	436
Share-based compensation	294	17
Warrant amortization expense	77	86
Changes in operating assets and liabilities		
Accounts receivable	(6,148)	(419)
Unbilled accounts receivable	(4,153)	(5,633)
Inventories	(4,296)	(834)
Deferred costs	(2,273)	(3,930)
Prepaid expenses and other assets	49	(6)
Accounts payable	686	6,796
Other accrued liabilities	3,935	134
Deferred revenue	723	3,010
Net cash used in operating activities	(20,149)	(3,872)
Investing Activities:		
Changes in restricted cash	(2,534)	381
Purchases of property and equipment	(907)	(534)
Net cash used in investing activities	(3,441)	(153)
Financing Activities:		
Repayment of debt	(18,431)	(16,506)
Proceeds from debt	20,393	19,646
Payment of capital lease obligations	(46)	—
Proceeds from issuance of common stock	21,790	1
Net cash provided by financing activities	23,706	3,141
Effect of exchange rate changes on cash	699	620
Net increase (decrease) in cash and cash equivalents	815	(264)
Cash and cash equivalents at beginning of period	1,753	1,920
Cash and cash equivalents at end of period	$2,568	$1,656
Supplemental disclosure of cash flow information:		
Cash paid for interest	$560	$644
Cash paid for income taxes	$2	$36

Noncash investing and finance activities:		
Issuance of warrants	$—	$264

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

XTERA COMMUNICATIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1 - NATURE OF BUSINESS

Description of the Company

Xtera Communications, Inc. (“Xtera”), a Delaware Corporation, was founded in January 1998. Xtera is a leading provider of high-capacity, cost-efficient optical transport solutions, supporting the high growth in global demand for bandwidth. Xtera sells its high-capacity optical transport systems to telecommunications service providers, content service providers, enterprises and government entities worldwide to support their deployments of long-haul terrestrial and submarine optical cable networks.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The accompanying consolidated financial statements include the financial position and results of operations of Xtera and its wholly owned subsidiaries (collectively, the “Company”). All intercompany transactions and balances have been eliminated in consolidation.

Interim Consolidated Financial Information

The accompanying interim consolidated financial statements and footnotes have been prepared by the Company, without audit, in accordance with generally accepted accounting principles in the United States of America, or GAAP, as contained in the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or the Codification or ASU, for interim financial information, and with Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of the results of operations, financial position, changes in stockholders’ deficit and cash flows. The results of operations for interim periods are not necessarily indicative of the results for the full year or the results for any future periods. These unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

Use of Estimates

The accompanying consolidated financial statements have been prepared with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the results of operations. Actual results could differ from those estimates. Significant estimates and assumptions relate to the net realizability of accounts receivable, the estimate for future warranty claims, impairments of goodwill, intangible assets and other long-lived assets, share-based compensation and inventory reserves.

Going-Concern

As shown in the accompanying financial statements, the Company has recurring losses and negative cash flows from operations. As of March 31, 2016, the Company's current liabilities exceeded its current assets by $0.7 million. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company has funded its operations through a combination of bank debt, draws on line of credit and sale of common stock. During the three months ended December 31, 2015, the Company closed an initial public offering that raised net proceeds of $21.76 million. Additionally, the Company continues to invest in new product solutions including those that it believes improve its ability to win turnkey projects. The Company's management believes this investment will allow the Company to attract new customers and leverage relationships with existing customers resulting in improved operating margins and cash flows from operations. The Company must restructure its current debt and obtain additional working capital in order to continue to fund operations. The Company is pursuing multiple opportunities to restructure its debt and improve its working capital position. To provide this additional working capital, in addition to refinancing its debt, the Company is pursuing opportunities for potential additional direct investments and strategic partnerships. The Company believes its plans mitigate the substantial doubt about the entity's ability to continue as a going concern as of March 31, 2016. Accordingly, the accompanying financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Continued

Foreign Currency Translation and Transactions

The functional currency for the Company’s foreign subsidiaries is the local currency in which the entity is located. The financial statements of all subsidiaries with a functional currency other than the United States Dollar (“U.S. Dollar”) have been translated into U.S. Dollars. All assets and liabilities of foreign operations are translated into U.S. Dollars using year-end exchange rates, and the statement of operations is translated at average exchange rates during the respective period. The U.S. Dollar results that arise from such translation, as well as exchange gains and losses on intercompany balances of a long-term investment nature, are included in the cumulative currency translation adjustments in accumulated other comprehensive loss in stockholders’ equity.

For all non-functional currency account balances, the re-measurement of such balances to the functional currency will result in either a foreign exchange transaction gain or loss which is recorded in Foreign exchange gain (loss) in the same period that the re-measurement occurred.

Cash and Cash Equivalents

Cash and cash equivalents include cash deposits in banks and highly-liquid investments with original maturities of three months or less. Xtera places its temporary cash investments with high credit quality financial institutions. The majority of cash deposits and temporary cash investments are not covered by available depository insurance. The Company has not experienced any losses in such accounts.

Restricted Cash

Restricted cash represents money market funds held by certain banks. Balances are classified between current and non-current assets based on the expiration dates of the performance bond agreements. At March 31, 2016, restricted cash of $3.8 million is collateral for various performance bonds in various geographical locations. In each case the cash is held in custody by the issuing bank and is restricted to withdrawal or use.

Accounts Receivable

Accounts receivable, representing amounts due from customers, are generally unsecured and are stated at the amount the Company expects to collect. Interest is generally not charged on overdue receivables. Unbilled receivables represent revenue amounts earned for which the appropriate revenue criteria have been met, but have not yet been billed because of contractual payment terms. The Company estimates an allowance for doubtful accounts based on the creditworthiness of its customers as well as general economic considerations. If a customer's financial condition changes, the Company may be required to record an additional allowance for doubtful accounts for that customer, which could negatively affect its results of operations. All receivables recorded for the six months ended March 31, 2016 and 2015 are fully collectible, and accordingly, no allowance has been recorded.

Inventories

Inventories consist of component materials and finished goods, which are valued at the lower of cost or market. The cost of inventories is determined using the first-in, first-out method. Market value is based upon an estimated selling price reduced by the estimated cost of disposal. The determination of market value involves numerous judgments including estimated average selling prices based on recent sales volumes, industry trends, existing customer orders, current contract price, future demand and pricing for its products and technological obsolescence of the Company’s products. Inventory that is obsolete or in excess of the Company’s forecasted demand or is anticipated to be sold at a loss is written down to its estimated net realizable value based on historical usage and expected demand and included in cost of revenues. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. The Company recorded a provision for inventory obsolescence of approximately $1.7 million and $0.6 million for the six months ended March 31, 2016 and 2015, respectively.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Continued

Impairment of Long-Lived Assets Other Than Goodwill

Long-lived assets include property and equipment and intangible assets. The Company evaluates the recoverability of long-lived assets whenever events or changes in circumstances indicate that the asset's carrying amount may not be recoverable. Such circumstances could include, but are not limited to (1) a significant decrease in the market value of an asset, (2) a significant adverse change in the extent or manner in which an asset is used, (3) an accumulation of costs significantly in excess of the amount originally expected for the acquisition of an asset, or (4) current period operating or cash flow loss combined with previous losses or projected future losses. Due to the Company's current period operating and cash flow loss combined with previous losses, the Company believes a triggering event has occurred in the period ended March 31, 2016 that requires the Company to evaluate the recoverability of its long-lived assets. The Company measures the carrying amount of the asset against the estimated undiscounted future cash flows associated with it. Should the sum of the expected future undiscounted net cash flows be less than the carrying value of the asset being evaluated, an impairment loss would be recognized. The impairment loss would be calculated as the amount by which the carrying value of the asset exceeds its fair value. The fair value is measured based on discounted value of estimated future cash flows. The evaluation of asset impairment requires the Company to make assumptions about future cash flows over the life of the asset being evaluated. These assumptions require significant judgment and actual results may differ from assumed and estimated amounts. Upon completion of the Company's analysis of long-lived assets, it was determined there were no impairments of long-lived assets during the six months ended March 31, 2016 and 2015.

Estimated weighted average amortization periods for customer related intangibles and developed technology are 6.4 years and 15.4 years, respectively.

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collection is reasonably assured. Customer purchase agreements and customer purchase orders are generally used to determine the existence of an arrangement. Delivery does not occur until products have been shipped or services have been provided to the customer and title and risk of loss have transferred to the customer. The Company assesses whether the priced is fixed and determinable based on the payment term associated with the transaction and whether the sales price is subject to refund or adjustment. Collectability is assessed primarily on the creditworthiness of the customer as determined by the Company as well as the customer's payment history. Revenue for maintenance services is deferred and recognized ratably over the period during which the services are performed up to three years. Shipping charges billed to customers are included in revenue. The related shipping costs are included in cost of revenue. The Company also provides for estimated costs that may be incurred for product warranties and for sales returns. When other significant obligations or acceptance terms remain after products are delivered, revenue is recognized only after such obligations are fulfilled. Revenue is recognized net of cash discounts and sales tax.

Contracts for optical network solutions often involve multiple deliverables which may include any combination of products or services. A typical optical network solution will include a combination of hardware, software and turnkey solutions as well as installation services and training. Revenue under multiple element arrangements is separated into more than one unit of accounting if all of the following criteria are met:

- The delivered item(s) has value to the client on a stand-alone basis;
- If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the company.

The Company allocates revenue to each element in its multiple element arrangement based upon their relative selling prices. The Company determines the selling prices for each deliverable based on a selling price hierarchy. The selling price for each deliverable is based on vendor-specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if VSOE is not available, or the Company's best estimated selling price ("BESP") if neither VSOE nor TPE are available. The relative selling price method allocates any discount in the arrangement proportionately to each deliverable on the basis of the deliverable's estimated fair value. The Company limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations, or subject to customer-specific return or refund privileges.

VSOE of selling price is used in the selling price allocation where it exists. However, in most instances, VSOE is unavailable for the Company's products because the product solution delivered differs for each customer. Further, a substantial majority of the selling prices of each deliverable in the Company's product solution offerings has not been consistent, and does not fall within a reasonable narrow pricing range.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Continued

The Company's product solutions contain significant elements of proprietary technology and the solution offered differs substantially from that of the competitors. Also, the Company's product offerings contain a significant level of configuration unique to a specific customer installation and network which will not generally be interchangeable with a third party product solution. Furthermore, the Company is unable to legally and reliably determine what similar competitor products' selling prices are on a standalone basis. Therefore, it is typically difficult to obtain the reliable standalone competitive pricing necessary to establish TPE.

In instances where established VSOE or reliable TPE is unavailable for the Company products, the Company uses BESP in its allocation of arrangement consideration. VSOE is unavailable for the Company products because the product solution delivered differs for each customer. In addition, reliable TPE does not exist because the Company's product solution is configured to comply with a pre-defined set of customer specific criteria which largely will not be interchangeable with a third party product solution. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. The Company determines BESP for a product or service by considering multiple factors including, but not limited to, cost of production, market conditions, competitive landscape, gross margin objectives, pricing practices, geographies, customer classes and distribution channels.

The Company applies the percentage-of-completion method to long-term arrangements where it is required to undertake significant production, customization or modification engineering, and reasonable and reliable estimates of revenue and cost are available. Utilizing the percentage-of-completion method, the Company recognizes revenue based on the ratio of actual costs incurred to date to total estimated costs expected to be incurred. In instances that do not meet the percentage-of-completion method criteria, recognition of revenue is deferred until there are no uncertainties regarding customer acceptance. Unbilled percentage-of-completion revenues recognized are included in unbilled receivables. Billings in excess of revenues recognized on these contracts are recorded within deferred revenue. The percentage of revenue recognized using the percentage-of-completion method for the six months ended March 31, 2016 and 2015 were 66.6% and 8.3%, respectively.

The Company's primary service offerings include services, installation and deployment services, on-site hardware replacement services, system maintenance services, extended hardware warranty services and training across a broad spectrum of products within the optical networking industry. These services are provided on a time-and-materials basis or as a fixed-price contract with contract terms ranging up to three years. Revenue from time-and-material contracts is recognized as labor hours are delivered and direct expenses are incurred. Revenue from fixed price system maintenance and extended warranty contracts is recognized on a straight-line basis over the delivery period. Installation revenue is generally recognized once installation is complete.

Deferred revenue is recorded when cash has been received from the customer and the arrangement does not qualify for revenue recognition under the revenue recognition policies described above. Costs incurred for projects not completed are deferred and recorded as a cost upon recognition of the related revenue.

Computation of Net Income (Loss) per Share

The Company calculates basic earnings per share ("EPS") by dividing earnings attributable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted EPS includes other potential dilutive shares that would be outstanding if securities or other contracts to issue common stock were exercised or converted into common stock. A reconciliation of the numerator and denominator used for the basic and diluted EPS computations is set forth in Note 17 below.

Share-Based Compensation

Share-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period (generally the vesting period) under the straight-line amortization method. The Company estimates the fair value of the stock options granted using the Black-Scholes option pricing model which requires a number of estimates and assumptions in determining share-based compensation related to options. Inherent in this model are assumptions related to the fair value of the common stock, stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data, the expected stock-price volatility and option life assumptions require a greater level of judgment.

The Company has not and does not anticipate distributing dividends to stockholders and accordingly uses a 0% dividend yield assumption for all Black-Scholes option pricing calculations.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES — Continued

The Company uses an expected stock-price volatility assumption that is primarily based on comparable stock of public companies. With regard to the weighted-average option life assumption, the Company evaluates the exercise behavior of past grants as a basis to predict future activity. The amount of stock based compensation expense is net of an estimated forfeiture rate, which is also based on historical data.

The Company recognizes the estimated fair value of restricted stock units, net of estimated forfeitures, as share-based expense over the service period. The Company uses the straight-line method to record expense for share-based awards with service-based vesting.

Income Taxes

The Company's income taxes are accounted for in accordance with the asset and liability method of accounting for income taxes. Under the asset and liability method, a deferred tax asset or liability is recognized for estimated future tax effects attributable to temporary differences and carryforwards. The measurement of deferred income tax assets is adjusted by a valuation allowance, if necessary, to recognize future tax benefits only to the extent, based on available evidence, it is more likely than not such benefit will be realized. Income tax expense or benefit is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

The Company considers many factors when evaluating and estimating its tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. Tax positions are recognized only when it is more likely than not (likelihood of greater than 50%), based on technical merits, that the positions will be sustained upon examination. Tax positions that meet the more-likely-than-not threshold are measured using a probability weighted approach as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement. Whether the more-likely-than-not recognition threshold is met for a tax position is a matter of judgment based on the individual facts and circumstances of that position evaluated in light of all available evidence. The Company recognizes interest and penalties related to uncertain tax positions in operating expenses.

Sales Taxes

The Company is required by the applicable governmental authorities to collect and remit sales taxes. Accordingly, such amounts are charged to the customer, collected and remitted directly to the appropriate jurisdictional entity. The Company reports revenue net of any taxes collected from customers and remitted to the relevant government authority.

Warranty Reserve

The Company provides a limited one to five year warranty on its products and accrues for estimated future warranty costs in the period in which revenue is recognized. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

The following table reflects the changes in the Company's warranty reserve:

	Three Months Ended March 31,	Six Months Ended March 31,

	2016	2015	2016	2015
	(In thousands)		(In thousands)	
Warranty reserve, beginning of period	$1,936	$1,119	$1,735	$978
Provision	263	222	493	436
Claims	(41)	(83)	(70)	(156)
Warranty reserve, end of period	$2,158	$1,258	$2,158	$1,258

Fair Value of Financial Instruments

The carrying value of financial instruments reported in the accompanying consolidated balance sheets for cash, cash equivalents, accounts receivable, accounts payable, and accrued expenses payable and other liabilities, approximate fair value due to the immediate or short-term nature or maturity of these financial instruments. The carrying amount for the Company’s credit facility approximates fair value due to the short-term nature of the facilities as well as the use of variable interest rates that adjust periodically.

NOTE 3 - RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers. ASU 2014-09 supersedes the revenue recognition requirements of FASB ASC Topic 605, Revenue Recognition and most industry-specific guidance throughout the Accounting Standards Codification, resulting in the creation of FASB ASC Topic 606, Revenue from Contracts with Customers. ASU 2014-09 requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. This ASU provides alternative methods of adoption and is effective for fiscal years beginning after December 31, 2018, and to interim periods within annual reporting periods beginning after December 15, 2019. Early adoption is permitted under several options. The Company is currently assessing the potential impact of adopting this ASU on its financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (ASC 842). The new guidance established the principles to report transparent and economically neutral information about the assets and liabilities that arise from leases. For leases with a lease term of more than 12 months, the ASU requires organizations that lease assets—referred to as “lessees”—to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The accounting by organizations that own the assets leased by the lessee—also known as lessor accounting—will remain largely unchanged from current GAAP. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company is currently evaluating the impact these amendments will have on its financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting. The ASU includes multiple provisions intended to simplify various aspects of the accounting for share-based payments, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments will be effective for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted in any annual or interim period, although if early adopted in an interim period, any adjustment should be reflected as of the beginning of the fiscal year that include that interim period. The Company does not expect these amendments to have a material effect on its financial statements.

NOTE 4 - INVENTORIES

Inventories consist of the following:

	March 31,	September 30,

	2016	2015
	(In thousands)	
Component materials	$9,169	$ 6,442
Finished goods	15,836	15,062
	25,005	21,504
Inventory reserves	(11,939)	(10,964)
Net inventories	$13,066	$ 10,540

The following table reflects the changes in the Company's inventory reserve:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
	(In thousands)		(In thousands)	
Inventory reserve, beginning of period	$11,305	$10,211	$10,964	$9,857
Provision - continuing operations	634	16	1,768	618
Write-offs	—	(337)	(793)	(585)
Inventory reserve, end of period	$11,939	$9,890	$11,939	$9,890

NOTE 4 - INVENTORIES — Continued

The Company writes down its inventory for estimated obsolescence or unmarketable inventory by an amount equal to the difference between the cost of inventory and the estimated net realizable value based on assumptions about future demand and market conditions. As product moves through its life cycle, the Company anticipates that reserves will be required to reflect estimated net realizable value of the product. The increased provision is primarily related to the Company's older technologies that are no longer being incorporated in new solutions for customers.

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	March 31, 2016	September 30, 2015
	(In thousands)	
Computer software	$2,529	$ 2,509
Fixtures and equipment	26,118	25,575
Leasehold improvements	1,145	1,672
	29,792	29,756
Accumulated depreciation and amortization	(26,433)	(26,357)
Property and equipment, net	$3,359	$ 3,399

Depreciation and amortization expense for the six months ended March 31, 2016 and 2015 totaled approximately $0.9 million and $0.8 million, respectively. Included in fixtures and equipment is property leased under capital leases totaling $0.38 million and $0.38 million at March 31, 2016 and September 30, 2015, respectively. Depreciation expense on property leased under capital leases for the six months ended March 31, 2016 and 2015 totaled approximately $0.05 million and $0.0 million, respectively.

NOTE 6 - INTANGIBLE ASSETS

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

	March 31, 2016			September 30, 2015		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible

Customer related intangible assets	$2,796	$ 2,796	$ —	$2,796	$ 2,796	$ —
Developed technology	15,838	8,824	7,014	15,838	8,284	7,554
Total intangible assets	$18,634	$ 11,620	$ 7,014	$18,634	$ 11,080	$ 7,554

Amortization expense for the six months ended March 31, 2016 and 2015 was approximately $0.5 million and $0.5 million respectively. Expected future amortization of intangible assets for the fiscal years indicated is as follows:

	(In thousands)
Remainder of 2016	$ 539
2017	1,079
2018	1,079
2018	1,079
2019	1,079
Thereafter	2,159
Total	$ 7,014

NOTE 7 - DEBT

Long-term debt consists of the following:

	March 31, 2016	September 30, 2015
	(In thousands)	
Term loan	$4,319	$ 6,129
Line of credit	10,559	6,711
	14,878	12,840
Less current maturities	(14,878)	(10,707)
Total long-term debt	$—	$ 2,133

On May 10, 2011, the Company entered into a venture loan and security agreement with a financial institution that provided for an initial term loan of up to $10.0 million and an option for an additional term loan of up to $2.0 million and issued to the financial institution a warrant to purchase 983,607 shares of the Company's preferred stock. The Company's obligations under the loan and security agreement are secured by a security interest on all of its assets, including its intellectual property. The loan and security agreement contains customary events of default and non-financial covenants, including covenants limiting the Company's ability to incur liens, dispose of assets, pay dividends or make other distributions to holders of its equity securities, merge with or acquire other entities, incur debt, and make investments, in each case subject to certain exceptions. The loan and security agreement does not require the Company to comply with any financial covenants. The initial term loan bore interest at 11.5% per annum, matured on December 1, 2014, and required interest only payments through June 1, 2012 and principal and interest payment thereafter. The warrant expires on November 17, 2020 and upon completion of the Company's initial public offering, is exercisable for 37,832 shares of the Company's common stock. A $2 million outstanding balance due to the financial institution was repaid using a portion of the proceeds from the initial term loan. The Company exercised the option to obtain the additional $2 million loan on December 27, 2011. The additional term loan bears interest at 11.5% per annum, matured on July 1, 2015, and required interest only payments through January 1, 2013 and principal and interest payments thereafter. Based on their relative fair values at issuance, $8.8 million of the proceeds was allocated to the term loan and $1.2 million to warrants. The relative fair value of the warrants which was determined using the Black Scholes Option pricing model, was recorded as additional paid-in-capital and reduced the carrying value of the loan. The warrants are being amortized to interest expense over the term of the loan using the effective interest method.

Effective March 1, 2014, the Company modified the venture loan and security agreement with the above financial institution to combine the two loans, change the interest rate, revise the repayment schedule amount and extend the maturity date. The modified term loan bears interest at 12.5% per annum and matures on December 31, 2016. The modification added additional nominal payment at the end of the debt term. The Company may, at its option, prepay the borrowings by paying a prepayment premium. No other changes were made to the terms of the debt. The fees paid for the modification are being amortized as an adjustment of interest expense using the interest method. At March 31, 2016, the unamortized warrant was $0.0 million, and the outstanding balance of the loan totaled $4.3 million.

In June of 2010, the Company obtained a $7.5 million revolving line of credit facility from a bank. The line of credit expired in October 2011, was modified and reinstated in February of 2012, and renewed in December of 2013. Borrowings under the line of credit bear interest at the greater of (i) 4.25% and (ii) the prime rate plus 3.25%. All borrowings are collateralized by the Company's receivables and inventory. Borrowings under the line of credit are subject to certain restrictions on indebtedness, dividend payments, financial guarantees, business combinations, and other related items. The renewed facility expired on January 1, 2015 and the Company elected to obtain a new line of credit facility from another bank.

NOTE 7 - DEBT — Continued

In January of 2015, the Company obtained a revolving line of credit facility with a bank for $12.5 million, as defined in the loan and security agreement. Borrowings under the line of credit bear interest at the greater of (i) 7.0% and (ii) the prime rate plus 3.5%. The Company's obligations under the loan and security agreement are secured by a security interest on all of its assets. The financial institution described above has agreed to subordinate its obligations to those under the revolving line of credit facility. The outstanding balance on the line of credit was $10.6 million at March 31, 2016. The loan and security agreement contains customary conditions to borrowing, events of default, and covenants, including covenants limiting the Company's ability to merge or consolidate with other entities, acquire or dispose of assets, make investments, incur debt and pay dividends, in each case subject to certain exceptions. One financial covenant required us to maintain a minimum adjusted cash flow. As of January 31, 2016 and February 29, 2016, the Company breached this financial covenant, which caused a cross-default with its subordinated lender. During the period from January through April 2016, the Company was in default under both of its loan agreements. In April of 2016, the Company obtained a waiver from its senior lender for the violations, agreed to modify certain financial covenants, and extended the agreement through July 31, 2016. Despite the breach, the senior lender allowed access to the credit facility during the second quarter and as of March 31, 2016, the Company's borrowing base supported a capacity of $1.9 million thereunder. In addition, in May 2016 the Company defaulted on its payment obligations to its subordinated lender and obtained a limited waiver with respect to such payment default and the above-referenced cross-default. There is no assurance that the Company will be in compliance with the financial covenant of its loan documents in the future. Concurrently with entering into the loan and security agreement, the Company issued to the bank a warrant to purchase 769,231 shares of the Company's preferred stock that expires on the tenth anniversary of its date of issuance. As of the completion of the Company's initial public offering, the warrant became exercisable for 29,586 shares of the Company's common stock. The relative fair value of the warrant was $0.3 million, which was determined using the Black Sholes Option pricing model, was recorded as additional paid-in-capital and reduced the carrying value of the loan. The warrant is being amortized to interest expense over the term of the loan using the effective interest method.

The debt obligations for future fiscal years are as follows:

	March 31, 2016 (In thousands)
Remainder of 2016	$ 12,746
2017	2,132
	14,878
Less current maturities	(14,878)
Total long-term debt	$ —

NOTE 8 - EMPLOYEE BENEFIT PLAN

The Company sponsors a defined contribution 401(k) plan which covers all full-time employees who are at least 18 years of age. Participants may contribute up to 60% of pretax compensation, subject to certain limitations. Employee contributions are invested, at the employees' discretion, among a variety of investment alternatives. Company contributions are discretionary. No contributions were made for the six months ended March 31, 2016 and 2015.

NOTE 9 - FAIR VALUE MEASUREMENTS

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

Level 1:	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. The Company’s Level 1 assets are investments in money market mutual funds, government agency bonds, and United States treasuries.
Level 2:	Quoted prices for similar assets or liabilities in active markets; or observable prices that are based on observable market data, based on directly or indirectly market-corroborated inputs. The Company has no Level 2 inputs.
Level 3:	Unobservable inputs supported by little or no market activity, and are developed based on the best information available given the circumstances. The Company has no Level 3 inputs.

NOTE 9 - FAIR VALUE MEASUREMENTS — Continued

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

The primary objective of the Company's investment activities is to preserve principal while maximizing yields without significantly increasing risk. The investment instruments held by the Company are money market funds and interest bearing deposits for which quoted market prices are readily available. The Company considers these highly liquid investments to be cash equivalents. These investments are classified within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets.

The following table presents financial assets at March 31, 2016 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy (in thousands):

Asset	Level 1	Level 2	Level 3	Total
Money market funds	$3,698	$ —	$ —	$3,698
Government securities	109	—	—	109
Total assets	$3,807	$ —	$ —	$3,807
Amounts included in:				
Restricted cash	$3,807	$ —	$ —	$3,807
Total	$3,807	$ —	$ —	$3,807

The following table presents financial assets at September 30, 2015 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy (in thousands):

Asset	Level 1	Level 2	Level 3	Total
Money market funds	$1,160	$ —	$ —	$1,160
Government securities	112	—	—	112
Total assets	$1,272	$ —	$ —	$1,272
Amounts included in:				
Restricted cash	$1,272	$ —	$ —	$1,272
Total	$1,272	$ —	$ —	$1,272

NOTE 10 - INCOME TAXES

The following is a geographic breakdown of the provision for income taxes (in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Domestic	$ —	$ —	$ —	$ —
Foreign	1	20	2	36
Total	$ 1	$ 20	$ 2	$ 36

The Company had an effective tax rate for the six months ended March 31, 2016 and 2015 of (0.01)% and (0.19)%, respectively. As of March 31, 2016, the Company's deferred tax assets exceeded its deferred tax liabilities. The Company maintains a valuation allowance against the net deferred tax asset. The total income tax provision for the six months ended March 31, 2016 and 2015 differed from amounts computed by applying the U.S. federal statutory tax rate to loss before income taxes primarily due to the recording of the valuation allowance against the net deferred tax assets.

NOTE 10 - INCOME TAXES — Continued

Federal net operating losses may be carried forward for 20 years. The Company has estimated federal net operating loss carryforwards at March 31, 2016 of approximately $214 million which begin to expire in the year 2018. The net operating loss does consider potential limitations under IRC Section 382 which defers or limit the benefit to offset future taxable income. The Company has established a valuation allowance to reserve the net deferred tax asset at March 31, 2016 and September 30, 2015 due to the uncertainty of the timing and amount of future taxable income. The valuation allowance will continue to be recognized until the realization of future deferred tax benefits are more likely than not to become utilized.

NOTE 11 - STOCKHOLDERS' EQUITY

Number of shares issued and outstanding (in whole shares):

	Preferred Shares Convertible Series A-3	Preferred Shares Convertible Series B-3	Preferred Shares Convertible Series C-3	Preferred Shares Convertible Series D-3	Preferred Shares Convertible Series E-3	Common Stock
As of September 30, 2014	39,663,482	38,589,303	19,081,778	52,509,212	—	1,814,630
Issuance of Preferred stock	—	—	—	—	114,679,639	—
Exercise of warrants	—	—	—	—	—	119,881
Exercise of stock options	—	—	—	—	—	1,545
As of September 30, 2015	39,663,482	38,589,303	19,081,778	52,509,212	114,679,639	1,936,056
Conversion of preferred stock to common stock	(39,663,482)	(38,589,303)	(19,081,778)	(52,509,212)	(114,679,639)	10,174,082
Issuance of common stock	—	—	—	—	—	5,000,000
Exercise of stock options	—	—	—	—	—	44,580
Release of restricted stock units	—	—	—	—	—	60,000
As of March 31, 2016	—	—	—	—	—	17,214,718

Convertible Preferred Stock

On September 22, 2011, in connection with the subscription offering of Series D-3 Preferred Stock, the Company amended and restated its certificate of incorporation and designated its preferred stock as Series A-3 Convertible Preferred Stock, Series B-3 Convertible Preferred Stock, Series C-3 Convertible Preferred Stock and Series D-3 Convertible Preferred Stock. The impacts of the amended certificate of incorporation on previously issued preferred stocks are described in detail below.

As a result of the Company's amended and restated certificate of incorporation on September 22, 2011, all outstanding shares of Series A-2, B-2 and C-2 preferred stock owned by stockholders participating in the new preferred equity issuance were exchanged for an equal number of shares of Series A-3, B-3 and C-3 preferred stock, respectively. All outstanding shares of Series A-2, B-2 and C-2 preferred stock owned by stockholders that did not participate in the new preferred equity issuance were automatically converted to an equal number of shares of common stock. As of September 30, 2014, there were no issued and outstanding shares of Series A-2, B-2 and C-2 preferred stock or cumulative but undeclared dividends due thereon.

On October 25, 2015, the Company amended and restated certificate of incorporation and designated its preferred stock as Series A-3 Preferred Stock, Series B-3 Preferred Stock, Series C-3 Preferred Stock, Series D-3 Preferred Stock, and Series E-3 Preferred Stock.

Conversion of Preferred Stock

In connection with the closing of the Company's initial public offering, on November 17, 2015, the outstanding shares of Series A-3 Preferred Stock, Series B-3 Preferred Stock, Series C-3 Preferred Stock, Series D-3 Preferred Stock, and Series E-3 Preferred Stock were converted into 10,174,082 shares of common stock. The Common Stock issued in connection with this conversion is subject to lock-up requirements for periods that expire May 10, 2016.

NOTE 11 - STOCKHOLDERS’ EQUITY — Continued

Reverse Stock Split

On October 26, 2015, the Company effected a 26-for-one reverse stock split of its common stock. Upon the effectiveness of the reverse stock split, (i) every 26 shares of outstanding common stock were reclassified and combined into one share of common stock, (ii) the number of shares of common stock for which each outstanding option and warrant to purchase common stock is exercisable was proportionately decreased and the exercise price of each outstanding option and warrant to purchase common stock was proportionately increased and (iii) the conversion rate at which each share of the Company's convertible preferred stock was convertible into common stock was proportionately decreased. Fractional shares of common stock were rounded up to the nearest whole share. The total number of authorized shares of common stock and the par value per share of common stock did not change as a result of the reverse stock split. Accordingly, all share and per share amounts for all periods presented in these financial statements and notes thereto have been adjusted retroactively, where applicable, to reflect the reverse stock split and adjustment of the preferred share conversion ratios and exercise price of each outstanding option and warrant as if the transaction had occurred as of the beginning of the earliest period presented.

Initial Public Offering

The registration statement on Form S-1 for the Company’s initial public offering was declared effective on November 12, 2015. On November 17, 2015, the Company consummated the public offering of 5,000,000 shares of common stock at $5.00 per share and received from the underwriters net proceeds of $23.23 million (net of underwriters’ discount of $ 1.75 million and underwriter offering expenses of $0.02 million). The Company incurred additional underwriting expenses of approximately $1.46 million, yielding net proceeds from the initial public offering of approximately $21.76 million.

NOTE 12 - STOCK-BASED COMPENSATION

In November 1999, the Company’s Board of Directors approved the adoption of a stock option plan (the “1999 Stock Option Plan”), which, as amended through July 31, 2007, authorized the grant of options to purchase up to 929,750 shares of the Company’s common stock. The 1999 Stock Option Plan expired on December 31, 2010, and options will no longer be granted under the 1999 Stock Option Plan. However, if outstanding options granted under the 1999 Stock Option plan expire or are terminated or canceled without having been exercised, such options shall automatically be placed into the stock option pool under the 2011 Stock Option Plan. Options under the 1999 Stock Option Plan had a ten-year term and generally vested over four years or over various terms based on Board of Directors approval from the date of grant.

In September 2011, the Company’s Board of Directors approved the adoption of a new stock option plan (the “2011 Stock Option Plan”), which, authorized the grant of options to purchase up to 615,385 shares of the Company’s common stock. The 2011 Stock Option Plan provides for the granting of options and issuance of shares to eligible employees, consultants, and members of the Board of Directors to purchase the Company’s common stock at an exercise price not less than the par value, and, in the case of incentive options, not less than 100% of the fair market value per share on the date of grant as determined by the Board of Directors. The plan was terminated on November 17, 2015 and options will no longer be granted under the 2011 Stock option Plan. However, if outstanding options granted under the 1999 Stock Option Plan or the 2011 Stock Option Plan expire or are terminated or canceled without having been exercised, such options shall automatically be placed in the stock option pool under the 2015 Equity Incentive Plan. All options granted to employees under the 2011 Stock Option Plan are exercisable prior to vesting, subject to a right of repurchase by the Company at the original exercise price for all unvested shares. Once the optionee vests in the shares underlying the options and until certain events occur, the Company has a right of first refusal to repurchase these shares at fair value after the individual has received a bona fide third-party offer with respect to those vested shares. Options under the 2011 Stock Option Plan have a ten-year term and generally vest over four years or over various terms based on Board of Directors approval from the date of grant.

In October 2015, the Company's Board of Directors approved the adoption of a new equity incentive plan (the "2015 Equity Incentive Plan"), which authorized the grant of awards for up to 3,000,000 shares of the Company's common stock. The 2015 Equity Incentive Plan provides for the granting of equity awards including options, stock appreciation rights (SAR), restricted stock purchase rights, restricted stock bonuses, restricted stock units, performance shares, performance units, and other stock based awards to eligible employees, consultants and members of the Board of Directors. Subject to certain restrictions, the Compensation Committee of the Board of Directors has broad discretion to establish the terms and conditions for awards under 2015 Equity Incentive Plan, including the number of shares, vesting conditions, and the required service or performance criteria. Options and SARs have a maximum term of ten years, and their exercise price may not be less than 100% of fair market value on the date of grant. Under certain change in control transactions the Compensation Committee has the authority to accelerate vesting of awards.

NOTE 12 - STOCK-BASED COMPENSATION — Continued

The 2015 Equity Incentive Plan has a provision for the annual increase in the maximum number of shares issuable under the plan. On January 1 of each year, the shares available under the plan shall be cumulatively increased by a number of shares equal to the lesser of i) 3.5% of the number of shares of common stock issued and outstanding on the immediately preceding December 31 or ii) an amount determined by the Company's Board of Directors. As of March 31, 2016, the total shares authorized for issuance under the 2015 Plan was 3,693,557.

Stock Options

There were no stock options granted during the six months ended March 31, 2016 and 2015.

A summary of changes in stock options outstanding is as follows:

	Number of Options (In whole shares)	Weighted Average Grant Price in $	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (in $ thousands)
Outstanding at September 30, 2015	836,767	1.82	5.3	$ 2,830
Granted	—	—		
Exercised	(44,580)	0.47		$ 157
Forfeited/cancelled	—	—		
Expired/cancelled	(1,043)	0.13		
Outstanding at March 31, 2016	791,144	1.89	4.7	$ 1,392
Vested options exercisable at March 31, 2016	778,571	1.92	4.7	$ 1,361
Unvested options exercisable at March 31, 2016	12,573	0.44	7.3	$ 31

During the six months ended March 31, 2016 and 2015, the Company recognized compensation expense of $0.01 million and $0.02, respectively, for stock options. At March 31, 2016, there was $0.00 million of unrecognized compensation expense related to stock options, excluding estimated forfeitures, which is expected to be recognized over a weighted-average period of 1.0 years.

Net cash proceeds from the exercise of stock options were $0.02 million and $0.00 million during the six months ended March 31, 2016 and 2015, respectively. The Company realized no tax benefits from those exercises.

Restricted Stock Units

A restricted stock unit is a stock award that entitles the holder to receive shares of the Company's common stock as the unit vests. The Company's outstanding restricted stock unit awards are subject to service-based vesting conditions. Awards subject to service-based vesting conditions typically vest in increments over a three or four year period or on a specific date as determined by the Compensation Committee.

NOTE 12 - STOCK-BASED COMPENSATION — Continued

The following table is a summary of the Company's restricted stock unit activity for the period indicated, with the aggregate fair value of the balance outstanding at the end of each period, based on the Company's closing stock price on the last trading day of the relevant period.

	Restricted Stock Units (In whole shares)	Weighted Average Grant Date Fair Value Per Share	Aggregate Fair Value (in thousands)
Balance at September 30, 2015	—	$ —	$ —
Granted	65,769	$ 4.66	$ 306
Vested	(60,000)	$ 4.66	$ 202
Forfeited or cancelled	(769)	$ 4.66	
Balance at March 31, 2016	5,000	$ 4.66	$ 14

The fair value of each restricted stock unit aware is based on the closing price on the date of grant. Share-based expense for service-based restricted stock unit awards is recognized, net of estimated forfeitures, ratably over the vesting period on a straight-line basis.

During the six months ended March 31, 2016 and 2015, the Company recognized compensation expense of $0.29 million and $0.0 million, respectively, for restricted stock units. At March 31, 2016 there was $0.02 million of unrecognized compensation expense, excluding estimated forfeitures, which is expected to be recognized over a weighted-average period of 0.6 years.

Because share-based compensation expense is recognized only for those awards that are ultimately expected to vest, the amount of share-based compensation recognized reflects a reduction for estimated forfeitures. The Company estimates forfeitures at the time of grant and revises those estimates in subsequent periods based upon new or changed information.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases multiple office spaces under non-cancellable operating leases which escalate annually and expire from fiscal years 2017 to 2022. Rental expense for the six months ended March 2016 and 2015 totaled $0.33 million and $0.33 million, respectively.

Capital leases

The Company leases computer equipment under capital leases that include a $1 purchase option as the end of the lease term. The lease terms range from 36 months to 60 months with interest rates ranging from 6% to 8%. The current and non-current amounts of the present value of net minimum lease payments are $0.1 million and $0.3 million, respectively

Purchase Commitments

The Company purchases components from a variety of suppliers and uses contract manufacturers to provide manufacturing services for its products. During the normal course of business, in order to manage manufacturing lead times and to help assure adequate component supply, the Company enters into agreements with contract manufacturers and suppliers that allow them to produce and procure inventory based upon forecasted requirements provided by the Company. If the Company does not meet these specified purchase commitments, it could be required to purchase the inventory. As of March 31, 2016, the maximum potential payment under these commitments totaled approximately $12.8 million which approximates fair value.

NOTE 14 - CREDIT CONCENTRATION AND SIGNIFICANT CUSTOMERS

At March 31, 2016 and September 30, 2015, three and three customers accounted for 80.6% and 82.6% of total accounts receivable, respectively.

During the six months ended March 2016 and 2015, three and three customers accounted for 76.6% and 70.6% of total revenues, respectively.

A significant portion of the Company’s purchases are from a limited number of suppliers. During the six months ended March 31, 2016 and 2015, material purchases from five and four suppliers accounted for 74.2% and 88.5% of total material purchases, respectively. The Company does not anticipate any changes in the relationship with these suppliers; however, if such a change were to occur, the Company has alternative sources of materials available.

NOTE 15 - LEGAL PROCEEDINGS

In March 2015 Sycamore IP Holdings, LLC, or Sycamore, which the Company believes is a non-practicing entity, filed a lawsuit against us in the United States District Court for the Eastern District of Texas. In the lawsuit, Sycamore alleges the Company's Nu-Wave Optima platform and related products infringe U.S. patent 6,952,405 B2 and is seeking injunctive relief, damages and costs. Sycamore has asserted similar claims against numerous other companies, including Adva Optical Networking Incorporated, Ericsson, EXFO Incorporated, JDS Uniphase Corporation, Menara Networks, Inc. and RAD Data Communications. On February 5, 2016, an order granting joint motion for dismissal without prejudice was issued and the case was dismissed.

The Company is subject to various legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, the Company does not expect that the ultimate costs to resolve these matters will have a material effect on its results of operations, financial position or cash flows.

NOTE 16 - SEGMENT INFORMATION

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the Company's chief executive officer. The Company's chief executive officer reviews financial information presented on a consolidated basis, accompanied by information about project revenue by geographic region for purposes of allocating resources and evaluating financial performance. The Company has one business activity, and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. The Company projects are obtained primarily through a competitive bid or negotiated contract process. These projects have similar cost structures, including labor, equipment and materials. The Company executes its projects in a similar fashion with a centralized estimating, project controls and management group, and the risks and rewards of project performance are not affected by the location of a specific project but on the Company's ability to compete on pricing and execute within its estimated costs. The Company has the same types of customers with similar funding drivers and market demands across its business. The Company's customer base includes telecommunications service providers, content service providers, enterprises and government entities worldwide. The Company considers the funding availability to be similar across its business, which is driven by the demand for bandwidth from its customer base. Accordingly, the Company is considered to be in a single reporting segment and operating unit structure.

Revenue by geographic region is based on the shipping address of the customer. The following table sets forth revenue by geographic region and long-lived assets by geographic region (in thousands):

Revenue by Geographic Region

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Americas	$4,668	$12,774	$13,398	$25,350
Europe Middle East and Africa (EMEA)	12,117	1,262	15,956	1,614
Asia Pacific (APAC)	294	81	355	518
Total revenue	$17,079	$14,117	$29,709	$27,482

Property and equipment, net

	March 31, 2016	September 30, 2015
	(In thousands)	
Americas	$2,951	$ 2,968
EMEA	408	431
APAC	—	—
Total property and equipment, net	$3,359	$ 3,399

NOTE 17 – LOSS PER SHARE

Basic net earnings (loss) per common share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net earnings (loss) per common share is computed using net loss and the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the assumed exercise of outstanding stock options, restricted common stock, warrants to purchase common and convertible preferred stock.

NOTE 17 – LOSS PER SHARE — Continued

The following table sets forth the computation of net income (loss) per common share – basic and diluted (in thousands, except share and per share amounts):

	Three Months Ended March 31, 2016	2015	Six Months Ended March 31, 2016	2015
Numerator				
Net loss	$(6,601)	$(2,221)	$(13,815)	$(5,465)
Undeclared preferred stock dividend	—	(3,300)	—	(6,674)
Loss attributable to common	$(6,601)	$(5,521)	$(13,815)	$(12,139)
Denominator				
Basic weighted average common shares outstanding	17,163,070	1,815,695	13,653,983	1,815,157
Effect of dilutive securities	—	—	—	—
Dilutive weighted average common shares outstanding	17,163,070	1,815,695	13,653,983	1,815,157
Net loss per share				
Basic	$(0.38)	$(3.04)	$(1.01)	$(6.69)
Dilutive	$(0.38)	$(3.04)	$(1.01)	$(6.69)

The number of shares outstanding used in the computation of basic and diluted net loss per share does not include the effect of the potentially outstanding common stock or the conversion of preferred stock and warrants to purchase preferred stock listed in the following table. The effects of these potentially outstanding shares were not included in the calculation of diluted net loss per share because their effect would have been anti-dilutive.

	Three Months Ended March 31, 2016	2015	Six Months Ended March 31, 2016	2015
Stock options outstanding	791,144	841,655	791,144	841,655
Restricted stock units	5,000	—	5,000	—
Warrants to purchase C-3 convertible preferred stock *	983,607	983,607	983,607	983,607
Warrants to purchase D-3 convertible preferred stock *	769,231	769,231	769,231	769,231
Series A-3 convertible preferred stock	—	39,663,482	—	39,663,482
Series B-3 convertible preferred stock	—	38,589,303	—	38,589,303
Series C-3 convertible preferred stock	—	19,081,778	—	19,081,778
Series D-3 convertible preferred stock	—	52,509,212	—	52,509,212

* Upon completion of the Company’s initial public offering in November 2015, warrants to purchase shares of the Company’s C-3 convertible preferred stock and D-3 convertible preferred stock were converted into warrants to purchase shares of the Company’s common stock.

NOTE 18 – RELATED PARTIES

Advance to Officer

The Company had an outstanding advance to an officer of the company in the amount of $0.0 million and $0.099 million as of March 31, 2016 and September 30, 2015, respectively. The advance was not subject to interest, payable on demand and included in accounts receivable. Prior to March 31, 2016, the advance was repaid in full and no balance was outstanding at March 31, 2016.

NOTE 19 - SUBSEQUENT EVENT

On April 27, 2016 the company obtained a waiver for violations of financial covenants, modified the financial covenants and extended the maturity date on the Company's revolving line of credit. On May 12, 2016, the company obtained a waiver of the cross-default and payment default under its venture loan and security agreement. See Note 7 for details.

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

FORWARD-LOOKING STATEMENTS

Except for the historical financial information contained herein, the matters discussed in this Quarterly Report on Form 10-Q (as well as documents incorporated herein by reference) may be considered "forward-looking" statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements convey our current expectations or forecasts of future events. All statements contained in this Quarterly Report on Form 10-Q (as well as documents incorporated herein by reference), other than statements of historical fact, are forward-looking. You can identify forward-looking statements by terminology such as "anticipates," "believes," "can," "continue," "could," "estimates," "expects," "intends," "ma "seeks," "should," "will" or "would" or the negative of these terms or similar expressions. Examples of these forward-looking statements include, but are not limited to, statements regarding the following:

- The advantages of our technology and products as compared to the advantages of others;
- Our ability to grow our revenue and improve our gross margins;
- Our expectations regarding revenue from turnkey solutions;
- Anticipated trends and challenges in our business and the markets in which we operate;
- Our ability to address market needs or develop new or enhanced products to meet those needs;
- Our ability to attract new customers;
- Expected adoption of our optical networking products and services, and our ability to efficiently upgrade such systems;
- Our ability to compete in our industry;
- Our ability to hire and retain necessary employees and appropriately staff our development programs;
- Our research and development activities and projected expenditures, including the number of products we pursue;
- Our estimates regarding anticipated operating performance, future revenue, our capital requirements and our needs for additional financing;
- Our ability to protect our confidential information and intellectual property rights;
- Our ability to expand into new markets;
- Our estimates of future performance;
- Future regulatory changes impacting our industry; and
- Our ability to remediate the reported material weakness in our internal control over financial reporting

There are a number of important factors that could cause our actual results to differ materially from the results anticipated by these forward-looking statements. These important factors include those that we discuss in this Quarterly Report on Form 10-Q (as well as documents incorporated herein by reference), and in particular, the risks discussed under the section titled "Risk Factors" in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended September 30, 2015. You should read these factors and the other cautionary statements made in this Quarterly Report on Form 10-Q (as well as documents incorporated herein by reference), as being applicable to all related forward-looking statements wherever they appear in this Quarterly Report on Form 10-Q (as well as documents incorporated herein by reference). If one or more of these factors materialize, or if any underlying assumptions prove incorrect, our actual results, performance or achievements may vary materially from any future results, performance or achievements expressed or implied by these forward-looking statements. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Unless otherwise indicated, information contained in this Quarterly Report on Form 10-Q (as well as documents incorporated herein by reference) concerning our industry and the markets in which we operate, including our general expectations and market position, market opportunity and market share, is based on information from various sources (including other industry publications, surveys, forecasts and our internal research), and on assumptions that we have made, which we believe are reasonable, based on those data and other similar sources and on our knowledge of the markets for our services. Our internal research has not been verified by any independent source, and we have not independently verified any third-party information and cannot assure you of its accuracy or completeness. While we believe the market position, market opportunity and market share information included in this Quarterly Report on Form 10-Q is generally reliable, such information is inherently imprecise. In addition, projections, assumptions and estimates of our future performance and the future performance of the industry in which we operate are necessarily subject to a high degree of uncertainty and risk due to a variety of factors, including those described in the section titled “Risk Factors” in this Quarterly Report on Form 10-Q (as well as documents incorporated herein by reference) and in our Annual Report on Form 10-K for the year ended September 30, 2015. These and other factors could cause results to differ materially from those expressed in the projections, assumptions and estimates included in this Quarterly Report on Form 10-Q.

Overview

We are a leading provider of high-capacity, cost-effective optical transport solutions, supporting the high growth in global demand for bandwidth. We sell our high-capacity optical transport solutions to telecommunications service providers, content service providers, enterprises and government entities worldwide to support their deployments of long-haul terrestrial and submarine optical cable networks. We believe that our proprietary Wise Raman optical amplification technology allows for capacity and reach performance advantages over competitive products that are based upon conventional EDFA technology.

We believe that we differentiate ourselves from our competitors through our innovative, proprietary products and our industry-leading cost-efficient operating structure. We have developed a portfolio of intellectual property with more than 180 U.S. and foreign patents and patent applications. We have operations in the United States and the United Kingdom, with an engineering team that includes industry-recognized technical experts. Our first commercial deployment was a terrestrial network in May 2004, which at 1,760 kilometers, or km, was the highest capacity and longest all-optical link in Europe at the time. We have deployed our products in 60 countries. Our revenue in a particular period is significantly impacted by several factors, including large purchases by customers and the timing of revenue recognition in relation to the shipment of products. Our focus on operational efficiency allows us to provide global reach to our customers and still maintain cost efficiencies and pricing discipline that we believe provide us with an advantage over our competitors. In particular, we emphasize upfront planning of network design to ensure compatibility with our existing solutions and product management software and to minimize product maintenance costs post-deployment.

Our customer base varies from period to period based on the mixture and timing of the solutions that we sell. Given the scale of the deployments, we typically deploy our solutions with our customers over multiple years. For the six months ended March 31, 2016 and 2015, 92.4% of our revenue was generated by six customers and 94.9% of our revenue was generated by six customers, respectively.

We operate an outsourced manufacturing business model that utilizes third-party, or contract manufacturer, assembly and test capabilities. Our operational efficiency is enhanced through effective supply chain management and our variable-cost outsourced contract manufacturing model. We provide our own engineering design services, design our own test procedures and software and maintain critical optical supply relationships. We maintain a warranty liability for our products but our contract manufacturers provide service support for equipment malfunctions. We purchase substantially all of our products from three contract manufacturers. In addition, in the provision of our turnkey solutions, we purchase cable, marine operations and other ancillary products from third-party partners.

Key Trends

We believe several key trends are currently impacting the optical networking industry and our business. These trends include (1) the growth in bandwidth-intensive data services, (2) price erosion in traditional telecommunications services and (3) initiatives by content service providers, enterprises and government entities to address bandwidth requirements in the current environment. Rapidly growing demand for data traffic, such as on-demand, high definition video is reducing currently available network capacity. According to an analysis published by Cisco titled Visual

Networking Index: Forecast and Methodology, 2014-2019 (May 27, 2015), monthly Internet Protocol, or IP, video traffic is forecast to grow at a compound annual growth rate, or CAGR, of 33% between 2014 and 2019 and to account for 80% of consumer traffic by 2019. As data traffic increases and available network capacity decreases, our customers will need to either add transmission capacity to existing optical networks or purchase and deploy new systems (on new or existing fibers) to keep pace with bandwidth demands. We believe that our ability to sell additional bandwidth capacity into existing networks, existing fiber and newly deployed fiber with our proprietary solutions addresses this trend. Additionally, general conditions in the telecommunications industry have created significant price pressures for telecommunications service providers in recent years. As a result, such providers are looking for ways to effectively compete in the market and maintain quality service without investing significant capital in new or upgraded networks. Our solutions allow telecommunication service providers to substantially improve the capacity of existing fiber in a cost-effective manner. Finally, the increased demand for bandwidth combined with the telecommunications service providers' challenges meeting such increased bandwidth demand has led to non-traditional providers entering the market and developing their own private network infrastructures. We believe that these new market entrants present a growing opportunity for us to deploy what we believe to be our industry-leading reach and capacity solutions into new optical networks.

Components of Operating Results

Revenue

We derive a substantial majority of our revenue from the sale of our products. We also generate revenue from the sales of support services related to our products. Products revenue represents sales of our long-haul products, which include sales of our turnkey solutions. Services revenue consists primarily of pre-and post-implementation services for customer networking needs, including training, network planning and monitoring, on-call support, hardware and software warranties and upgrade planning. We primarily sell our products through our direct sales force, and we expect to continue generating a significant majority of our revenue from direct sales in the future. We typically sell our products through third-party distributors only when logistics or local customs regulations make doing so more efficient. Our revenue may vary significantly from period to period as a result of fluctuations in the timing of customer orders, revenue recognition in relation to the shipment of products and percentage-of-completion of long term arrangements.

We have one business activity, and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Accordingly, we are considered a single reporting segment and operating unit structure.

We expect future products revenue to benefit from increasing network requirements for data capacity and the corresponding demand for customers to transition to more efficient and economical network infrastructures. We anticipate that product revenue from our turnkey solutions will increase in the fiscal years ending September 30, 2016 and 2017, as demand for these tailor-made solutions increases. In addition, we expect an increased need for our service support as certain of our past deployments come off warranty, therefore driving increases in service revenue.

Gross Profit

Our gross profit is affected by a variety of factors, including product mix and the average selling prices of our products. Product gross profit may be affected by increased sales of our lower-margin products; introduction of new products, including products with price-performance advantages; our ability to reduce production costs; entry into new markets, including markets with different pricing structures and cost structures, as a result of internal development or through acquisitions; or changes in distribution channels and price competition. Additionally, gross profit may be affected by the timing of revenue recognition and revenue deferrals; sales discounts; increases in material or labor costs; excess inventory and obsolescence charges; warranty costs; changes in shipment volume; loss of cost savings due to changes in component pricing; and the extent to which we successfully execute on our strategy and operating plans. Our turnkey solutions have lower margins, as we deploy third-party products and services to provide those solutions. We anticipate that turnkey solutions will represent a significant percentage of our product revenue in the fiscal years ending September 30, 2016 and 2017. Service gross profit may be impacted by various factors, such as the change in mix between various technical support services, in addition to the timing of technical support service contract initiations and renewals, including labor and partner costs.

Operating Expenses

Sales and Marketing

Sales and marketing expense primarily consists of salary and related benefit costs, including share-based compensation expense, sales commissions and marketing costs. We expect sales and marketing expense to increase in absolute dollars as we increase our sales, expand our sales resources and increase our marketing efforts. Sales commissions are adjusted based on annual sales forecasts to align commissions to target compensations. Marketing is primarily focused on industry related tradeshows, technical conferences and publications.

Research and Development

To date, research and development expense has been one of the largest components of our operating expense and primarily includes salaries, related benefit costs and share-based compensation expense for employees and consultants on our engineering and technical teams who are responsible for developing new products as well as improving existing products. We expense research and development costs as incurred. We are devoting substantial resources to the continued development of additional functionality for existing products and the development of new products. We intend to continue to invest significantly in our research and development efforts because we believe that they are essential to maintaining our competitive position. We have a baseline cost associated with supporting our product offerings, which we anticipate will increase significantly in absolute dollars in future periods due to development of additional features to improve our existing product platforms and the development of new products. We focus on market and customer requirements to drive research and development programs and thus believe that we can support significant revenue growth without proportional spending.

General and Administrative

General and administrative expense consists primarily of salary and related benefit costs, including share-based compensation expense and facilities costs related to our executive, finance, human resource and information technology organizations, and fees for professional services. Professional services principally consist of outside legal, audit and information technology consulting costs. We expect general and administrative expense to increase in absolute dollars but decrease as a percentage of revenue in the fiscal year ending September 30, 2016. During the fiscal year ending September 30, 2016, we plan to hire additional personnel, make improvements to our accounting, information systems and compliance infrastructure and incur significant additional costs for the compliance requirements of operating as a public company, including costs associated with compliance with regulations governing public companies, increased costs of directors' and officers' liability insurance and higher accounting, legal, insurance and investor relations costs.

Other Income (expense), net

Other income (expense), net includes interest expense on our debt, interest income on our cash balances, and revaluation losses or gains on foreign currency transactions.

Critical Accounting Policies and Estimates

Our unaudited interim consolidated financial statements are based on the selection and application of significant accounting policies. The preparation of unaudited interim consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the unaudited interim consolidated financial statements and the reported amounts of net sales, expenses and allocated charges during the reporting period. Actual results could differ from those estimates. However, we are not currently aware of any reasonably likely events or circumstances that would result in materially different results.

We describe our significant accounting policies in Note 2 - Summary of Accounting Policies, of the Notes to the Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. Management believes there have been no significant changes during the six months ended March 31, 2016 to the items we disclosed in our critical accounting policies and estimates in the MD&A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

Impairment of Long-Lived Assets

We concluded a triggering event occurred during the second quarter of 2016, due to operating losses in 2014 and 2015 and a projected operating loss in 2016, and we tested our long-lived assets for impairment as of March 31, 2016. Our assessment compared the net undiscounted future cash flows that long-lived assets are projected to generate to the carrying value of such long-lived assets. Key assumptions used in our impairment test included future sales of our products and services and future levels of expenses. Our analysis of projected net undiscounted future cash flows significantly exceeded the book value for long-lived assets. Accordingly, we did not record any impairment charge during the quarter ended March 31, 2016.

Results of Operations

Selected Consolidated Statement of Operations Data (Amount in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Total revenue	$17,079	$14,117	$29,709	$27,482
By Type:				
Products	15,136	12,776	25,978	24,955
Services	1,943	1,341	3,731	2,527
By Geography:				
Americas	4,668	12,774	13,398	25,350
EMEA	12,117	1,262	15,956	1,614
APAC	294	81	355	518
Cost of Revenue	16,023	9,803	28,972	19,589
By Type:				
Products	15,036	9,141	27,225	18,365
Services	987	662	1,747	1,224
Gross profit	1,056	4,314	737	7,893
Operating expenses:				
Sales and marketing	1,466	1,056	2,991	2,249
Research and development	3,279	2,675	6,044	5,427
General and administrative	2,269	1,435	4,106	3,051
Total operating expenses:	7,014	5,166	13,141	10,727
Other income (expense), net	(642)	(1,349)	(1,409)	(2,595)

Selected Consolidated Statement of Operations Data, as a Percentage of Total Revenue:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2016	2015	2016	2015
Total revenue	100.0 %	100.0 %	100.0 %	100.0 %
By Type:				
Products	88.6 %	90.5 %	87.4 %	90.8 %
Services	11.4 %	9.5 %	12.6 %	9.2 %
By Geography:				
Americas	27.3 %	90.5 %	45.1 %	92.2 %
EMEA	70.9 %	8.9 %	53.7 %	5.9 %
APAC	1.7 %	0.6 %	1.2 %	1.9 %
Cost of Revenue	93.8 %	69.4 %	97.5 %	71.3 %
By Type:				
Products	88.0 %	64.8 %	91.6 %	66.8 %
Services	5.8 %	4.7 %	5.9 %	4.5 %

Gross profit	6.2	%	30.6	%	2.5	%	28.7	%
Operating expenses:								
Sales and marketing	8.6	%	7.5	%	10.1	%	8.2	%
Research and development	19.2	%	18.9	%	20.3	%	19.7	%
General and administrative	13.3	%	10.2	%	13.8	%	11.1	%
Total operating expenses:	41.1	%	36.6	%	44.2	%	39.0	%
Other income (expense), net	(3.8	)%	(9.6	)%	(4.7	)%	(9.4	)%

Three Months Ended March 31, 2016 Compared with Three Months Ended March 31, 2015

Revenue

Total revenue for the three months ended March 31, 2016 increased by $3.0 million, or 21.0%, to $17.1 million from $14.1 million for the three months ended March 31, 2015. Product revenue for the three months ended March 31, 2016 increased by $2.4 million, or 18.5%, to $15.1 million from $12.8 million for the three months ended March 31, 2015, primarily driven by increased sales of our products and the timing of delivery of our solutions to customers. Of the $15.1 million of product revenue, $11.1 million was attributable to sales of our turnkey solutions compared to $1.4 million for the three months ended March 31, 2015. Service revenue for the three months ended March 31, 2016 increased by $0.6 million, or 44.9%, to $1.9 million from $1.3 million for the three months ended March 31, 2015. The increase in service revenue was driven by increased revenue from project management related to turnkey solutions.

Cost of Revenue

Total cost of revenue for the three months ended March 31, 2016 increased by $6.2 million, or 63.4%, to $16.0 million from $9.8 million for the three months ended March 31, 2015. Product cost of revenue for the three months ended March 31, 2016 increased by $5.9 million, or 64.5%, to $15.0 million from $9.1 million for the three months ended March 31, 2015. Of the $15.0 million in product cost of revenue, $10.6 million was attributable to our turnkey solutions compared to $1.3 million for the three months ended March 31, 2015. The increase in product cost of revenue was primarily driven by the higher concentration of turnkey solutions in our product mix as well as an increase in provision for excess inventory of $0.6 million. We expect continued variability in our inventory reserve as we invest in new product technology and determine how to most efficiently utilize existing inventory. Service cost of revenue for the three months ended March 31, 2016 increased by $0.3 million, or 49.1%, to $1.0 million from $0.7 million for the three months ended March 31, 2015. The increase in service cost of revenue was primarily a result of the increase in delivery of services to customers.

Gross Profit

Gross profit decreased by $3.3 million, or 75.5%, to $1.1 million for the three months ended March 31, 2016 from $4.3 million for the three months ended March 31, 2015. As a percentage of revenue, gross profit was approximately 6.2% and 30.6% for the three months ended March 31, 2016 and 2015, respectively. The decrease in gross profit as a percentage of revenue for the three months ended March 31, 2016 as compared to the three months ended March 31, 2015 was primarily driven by an increase in provision for excess inventory of $0.6 million and an increase in turnkey solution sales, which have a lower gross margin contribution rate than our other product offerings.

Operating Expenses

Research and Development

Research and development expense increased by $0.6 million, or 22.6%, to $3.3 million for the three months ended March 31, 2016 from $2.7 million for the three months ended March 31, 2015. As a percentage of revenue, research and development expense was approximately 19.2% and 18.9% for the three months ended March 31, 2016 and 2015, respectively. The increase in research and development expense was primarily related to development costs associated with our flexrate card and our submarine branching unit.

Sales and Marketing

Sales and marketing expense increased by $0.4 million, or 38.8%, to $1.5 million for the three months ended March 31, 2016 from $1.1 million for the three months ended March 31, 2015. As a percentage of revenue, sales and marketing expense was approximately 8.6% and 7.5% for the three months ended March 31, 2016 and 2015, respectively. The increase in sales and marketing expenses was primarily due to an increase in headcount and commission costs as a result of an increase in new contracts added to backlog during the three months ended March 31, 2016 compared to the three months ended March 31, 2015.

General and Administrative

General and administrative expense for the three months ended March 31, 2016 increased by $0.8 million, or 58.1%, to $2.3 million compared to $1.4 million for the three months ended March 31, 2015. As a percentage of revenue, general and administrative expense was approximately 13.3% and 10.2% for the three months ended March 31, 2016 and 2015, respectively. The increase in general and administrative expenses was primarily due to increased share based compensation, increased headcount and costs associated with becoming a public company.

Other Income (Expense), Net

Other expense, net, decreased by $0.7 million, or 52.4%, to $0.6 million for the three months ended March 31, 2016 from $1.3 million for the three months ended March 31, 2015. The decrease in other expense was driven by a decrease in interest expense as a result of the conversion of related party notes payable into Series E-3 convertible preferred stock which was subsequently converted to common stock upon the completion of our initial public offering in November 2015.

Six Months Ended March 31, 2016 Compared with Six Months Ended March 31, 2015

Revenue

Total revenue for the six months ended March 31, 2016 increased $2.2 million, or 8.1% to $29.7 million from $27.5 million for the six months ended March 31, 2015. Product revenue for the six months ended March 31, 2016 increased by $1.0 million, or 4.1%, to $26.0 million from $25.0 million for the six months ended March 31, 2015 primarily driven by the timing of delivery of our products. Of the $26.0 million of product revenue, $18.1 million was attributable to sales of our turnkey solutions compared to $1.5 for the six months ended March 31, 2015. Service revenue for the six months ended March 31, 2016 increased by $1.2 million, or 47.6%, to $3.7 million from $2.5 million for the six months ended March 31, 2015. The increase in services revenue was driven by increased revenue from project management related to turnkey solutions.

Cost of Revenue

Total cost of revenue for the six months ended March 31, 2016 increased by $9.4 million, or 47.9%, to $29.0 million from $19.6 million for the six months ended March 31, 2015. Product cost of revenue for the six months ended March 31, 2016 increased by $8.9 million, or 48.2%, to $27.2 million from $18.4 million for the six months ended March 31, 2015. Of the $27.2 million in product cost of revenue, $17.1 million was attributable to our turnkey solutions compared to $1.3 million for the six months ended March 31, 2015. The increase in product cost of revenue was primarily driven by the higher concentration of turnkey solutions in our product mix as well as an increase in provision for excess inventory of $1.2 million and a $1.0 million provision for a loss on a contract. We expect continued variability in our inventory reserve as we invest in new product technology and determine how to most efficiently utilize existing inventory. With respect to the $1.0 million loss on a contract we signed in the period, our current estimated cost on the contract exceeds the purchase price resulting in a loss. Based on our experience, we believe this relationship will ultimately prove profitable through additional purchase orders which we anticipate will include higher margin line cards. Service cost of revenue for the six months ended March 31, 2016 increased $0.5 million, or 42.7% to $1.7 million from $1.2 million for the six months ended March 31, 2015. The increase in service cost of revenue was primarily a result of the increase in delivery of services to customers.

Gross Profit

Gross profit decreased by $7.2 million, or 90.7%, to $0.7 million for the six months ended March 31, 2016 from $7.9 million for the six months ended March 31, 2015. As a percentage of revenue, gross profit was approximately 2.5% and 28.7% for the six months ended March 31, 2016 and 2015, respectively. The decrease in gross profit as a percentage of revenue for the six months ended March 31, 2016 as compared to the six months ended March 31, 2015 was primarily driven by a $1.1 million provision for excess inventory, a $1.0 million provision for a loss contract and an increase in turnkey solution sales, which have a lower gross margin contribution rate than our other product offerings.

Operating Expenses

Research and Development

Research and development expense increased by $0.6 million, or 11.4%, to $6.0 million for the six months ended March 31, 2016 from $5.4 million for the six months ended March 31, 2015. As a percentage of revenue, research and development expense was approximately 20.3% and 19.7% for the six months ended March 31, 2016 and 2015, respectively. The increase in research and development expense was primarily related to development costs associated with our flexrate card and our submarine branching unit.

Sales and Marketing

Sales and marketing expense increased by $0.7 million, or 33.0%, to $3.0 million for the six months ended March 31, 2016 from $2.2 million for the six months ended March 31, 2015. As a percentage of revenue, sales and marketing expense was approximately 10.1% and 8.2% for the six months ended March 31, 2016 and 2015, respectively. The increase in sales and marketing expenses was primarily due to an increase in headcount and commission costs as a result of an increase in new contracts added to backlog during the six months ended March 31, 2016 compared to the six months ended March 31, 2015.

General and Administrative

General and administrative expenses for the six months ended March 31, 2016 increased by $1.1 million, or 34.6%, to $4.1 million compared to $3.1 million for the six months ended March 31, 2015. As a percentage of revenue, general and administrative expense was approximately 13.8% and 11.1% for the six months ended March 31, 2016 and 2015, respectively. The increase in general and administrative expenses was primarily due to increased share based compensation, increased headcount and costs associated with becoming a public company.

Other Income (Expense), Net

Other expense, net, decreased by $1.1 million, or 45.7%, to $1.4 million for the six months ended March 31, 2016 from $2.6 million for the six months ended March 31, 2015. The decrease in other expense was driven by a decrease in interest expense as a result of lower debt levels after completing our initial public offering in November 2015.

Variability of Quarterly Results

Our operating results fluctuate from quarter to quarter as a result of a variety of factors, many of which are outside of our control. These factors can include availability of working capital, fluctuations in demand for our solutions, reductions in customers' budgets for purchase and delays in their purchasing cycles, order cancellations, reductions or delays, the timeliness of our customers' payments, and general economic conditions. Fluctuations in our revenue can lead to even greater fluctuations in our operating results. Our budgeted expense levels depend in part on our expectations with respect to long-term future revenue and global customers. As a result, our historical results should not be considered a reliable indicator of our future results of operations. For additional information on matters that may affect our quarterly results, see the section titled "Risk Factors—Our operating results may fluctuate significantly from period to period, which could make our future results difficult to predict and could cause our operating results to fall below investor or analyst expectations" in this Quarterly Report on Form 10-Q.

Liquidity and Capital Resources

We have incurred net losses and negative cash flows from operations since our inception. For the six months ended March 31, 2016 and 2015, we had a net loss of $13.8 million and $5.4 million, respectively. As of March 31, 2016, we had an accumulated deficit of $398.5 million. Due to our growth, footprint expansion with new customers, and operating results to date, the Company needs access to significant amounts of working capital to satisfy these demands. These needs include both short-term and long-term liquidity requirements. In the short-term, we require additional capital to operate our business, fund our operating expenses and purchase inventory to fulfill our current obligations to our customers and suppliers. In the long-term, we require additional capital to support the growth of our business and the acquisition and fulfillment of new customer contracts to generate revenue. Historically, we have managed our working capital needs through a combination of debt and equity, which are not sufficient to fund operations. We must restructure our debt in the short-term. We are actively pursuing multiple paths to mitigate this risk and satisfy our short-term and long-term needs, including debt restructuring, additional direct investment and strategic partnerships.

In November 2015, we completed our initial public offering in which we issued and sold 5,000,000 shares of our common stock at a public offering price of $5.00 per share. We received net proceeds of $21.76 million after deducting underwriting discounts and commissions and other direct offering expenses, which were available for general corporate purposes. Upon completion of the Company's initial public offering we paid down the revolving line of credit facility, capitalized performance bonds on new customer contracts and used the remaining proceeds to fund the working capital requirements of the Company.

We use term loans as a source of funds to facilitate our liquidity needs on a longer term basis. As of March 31, 2016, we had $2.6 million of cash and cash equivalents, excluding $3.8 million of restricted cash, and $14.9 million of debt. Despite the breach described below, our senior lender allowed access to our credit facility during the second quarter and as of March 31, 2016, our borrowing base supported a capacity of $1.9 million thereunder.

In January and February of 2016, we breached a financial covenant with our senior lender, which caused a cross-default with our subordinated lender. During the period from January through April 2016, we were in default under both of our loan agreements. In April of 2016, we amended our loan agreement with our senior lender to provide for a limited waiver of this breach and to replace the existing financial covenant, among other modifications. As amended, our loan agreement includes covenants that we will (i) maintain at least $1.5 million of cash in lender's bank and/or of available borrowing capacity under our credit facility with our lender and (ii) obtain on or before May 31, 2016 a term sheet or letter of intent for additional capital acceptable to our lender which provides for funding of sufficient proceeds to repay our obligations to our lender on or before July 31, 2016. In addition, in May 2016 we defaulted on our payment obligations to our subordinated lender and obtained a limited waiver with respect to the payment default and the above-referenced cross-default. There is no assurance that we will be in compliance with the financial covenants of our loan documents in the future.

We believe we have the available resources to meet our liquidity requirements, including debt service, for the next twelve months, provided we successfully execute our plan to restructure our credit facility with a new lender and obtain additional working capital. We are actively working on solutions to resolve our liquidity shortfall, including an increase to our borrowing availability and restructuring our debt facilities. In addition we are pursuing additional capital through direct investment and strategic partnerships to provide the Company with access to sufficient working capital to continue to operate and grow. There can be no assurance that we will be able to raise additional capital, restructure our debt, or generate sufficient cash flows to meet our liquidity requirements, or that we will be able to maintain our ability to borrow under our revolving credit facility. See the "Risk Factors" section of this Quarterly Report on Form 10-Q.

	Six Months Ended March 31,	
	2016	2015
Cash used in operating activities	$(20,149)	$(3,872)
Cash used in investing activities	(3,441)	(153)
Cash provided by financing activities	23,706	3,141

Cash Flows

Cash and cash equivalents as of March 31, 201 were $2.6 million, which was an increase of $0.8 million from September 30, 2015.

Net Cash Used in Operating Activities

Cash flow used in operating activities increased $16.3 million to a cash outflow of $20.1 million for the six months ended March 31, 2016 compared to a cash outflow of $3.9 million for the six months ended March 31, 2015. The increase in operating cash outflows was primarily due to a larger loss from operations, partially offset by an increase in non-cash expenses of $2.7 million, and an outflow due to the change in operating assets and liabilities of $10.6 million. Net loss increased to $13.8 million during the six months ended March 31, 2016 compared with $5.5 million for the six months ended March 31, 2015.

Net Cash Used in Investing Activities

Net cash used in investing activities increased to a cash outflow of $3.4 million during the six months ended March 31, 2016 compared to $0.2 million during the six months ended March 31, 2015. Net cash used in investing activities increased primarily due to an increase in restricted cash used to collateralize performance bonds on contracts executed during the period.

Our cash outflow for capital expenditures was $0.9 million and $0.5 million for the six months ended March 31, 2016 and 2015, respectively. Capital expenditures were primarily related to major replacements of equipment and various investments to reduce future operating costs.

Net Cash Provided by Financing Activities

Net cash provided by financing activities increased to a cash inflow of $23.7 million for the six months ended March 31, 2016 compared to a cash inflow of $3.1 million during the six months ended March 31, 2015. The increase was primarily due to proceeds received in our initial public offering, net of offering expenses, of $21.8 million offset by $1.2 million of debt repayment, net of borrowing, during the six months ended March 31, 2016.

Debt and Other Obligations

Long-term debt consists of the following:

	March 31, 2016	September 30, 2015
	(In thousands)	
Term loan	4,319	6,129
Line of credit	10,559	6,711
	14,878	12,840
Less current maturities	(14,878)	(10,707)
Total long-term debt	$—	$ 2,133

In May 2011, we entered into a venture loan and security agreement with Horizon Technology Finance Corporation, or Horizon, that provided for an initial term loan of up to $10.0 million, an option for an additional term loan of up to $2.0 million, and our issuance to Horizon of a warrant to purchase shares of our preferred stock, which upon completion of our initial public offering, is now exercisable for 37,832 shares of our common stock. Our obligations under the loan and security agreement are secured by a security interest on all of our assets. The loan and security agreement contains customary events of default and non-financial covenants, including covenants limiting our ability to incur liens, dispose of assets, pay dividends or make other distributions to holders of our equity securities, merge with or acquire other entities, incur debt, and make investments, in each case subject to certain exceptions. The loan and security agreement does not require us to comply with any financial covenants. The initial term loan bore interest at 11.5% per annum, matured on December 1, 2014, and required interest only payments through June 1, 2012 and principal and interest payments thereafter. The warrant expires on November 17, 2020 and upon completion of our initial public offering is exercisable for 37,832 shares of the Company's common stock. A $2.0 million outstanding balance due to Horizon Technology Finance Corporation was repaid using a portion of the proceeds from the initial term loan. We exercised our option to draw down the additional $2.0 million term loan in December 2011. The additional term loan bore interest at 11.5% per annum, matured on July 1, 2015 and required interest-only payments through January 1, 2013 and principal and interest payments thereafter. Based on their relative fair values at issuance, $8.8 million of the proceeds was allocated to the initial term loan and $1.2 million to the warrant. The relative fair value of the warrant, which was determined using the Black Scholes Option pricing model, was recorded as additional paid-in-capital and reduced the carrying value of the loan. The warrant was amortized to interest expense over the term of the loan using the effective interest method.

In March 2014, we modified our agreement with Horizon Technology Finance Corporation to combine the two term loans, change the interest rate, revise the repayment schedule amount and extend the maturity date. The modified term loan bears interest at 12.5% per annum and matures on December 31, 2016. The modification added an additional nominal payment at the end of the debt term. We may, at our option, prepay the borrowings by paying Horizon a prepayment premium. No other changes were made to the terms of the debt. The fees paid for the modification are being amortized as an adjustment of interest expense using the interest method. At March 31, 2016 the unamortized warrants were $0.0 million, and the outstanding balance of the loan totaled $4.3 million.

In June of 2010, we obtained a $7.5 million revolving line of credit facility from a bank. Borrowings under this line of credit bore interest at a per annum rate equal to the greater of (i) 4.25% and (ii) the prime rate plus 3.25%. All borrowings were collateralized by our receivables and inventory. The outstanding balance on the line of credit was $3.1 million at September 30, 2014. The facility expired on January 1, 2015, and we elected to obtain a new line of credit facility from another bank.

In January of 2015, we entered into a loan and security agreement with Square 1 Bank that provides for a line of credit of up to $12.5 million. The line of credit matured on January 15, 2016 and was modified and extended through April 15, 2016. Borrowings under the line of credit bear interest at a per annum rate equal to the greater of (i) 7.0% and (ii) the prime rate plus 3.5%. Our obligations under the loan and security agreement are secured by a security interest on all of our assets. Horizon agreed to subordinate its obligations to those of Square 1 Bank under this facility. The outstanding balance on the line of credit was $10.6 million at March 31, 2016. The loan and security agreement contains customary conditions to borrowing, events of default, and covenants, including covenants limiting our ability to merge or consolidate with other entities, acquire or dispose of assets, make investments, incur debt, and pay dividends, in each case subject to certain exceptions. One financial covenant requires us to maintain a minimum adjusted cash flow. As of January 31, 2016 and February 29, 2016, we breached this financial covenant, which caused a cross-default with our subordinated lender. During the period from January through April 2016, we were in default under both of our loan agreements. In April of 2016, we obtained a waiver for the violations, agreed to modify certain financial covenants, and extended the loan and security agreement through July 31, 2016. Despite the breach, the senior lender allowed access to the credit facility during the second quarter and as of March 31, 2016, our borrowing base supported a capacity of $1.9 million thereunder. In addition, in May 2016 we defaulted on our payment obligations to our subordinated lender and obtained a limited waiver with respect to the payment default and the above-referenced cross-default. There is no assurance that we will be in compliance with the financial covenants of our loan documents in the future. Concurrently with entering into the loan and security agreement, we issued to Square 1 Bank a warrant to purchase shares of our preferred stock, which upon completion of our initial public offering, is now exercisable for 29,586 shares of our common stock. The warrant expires on the tenth anniversary of its date of issuance. The relative fair value of the warrants of $0.3 million, which was determined using the Black Scholes Option pricing model, was recorded as additional paid-in-capital and reduced the carrying value of the line of credit. The warrants are being amortized to interest expense over the term of the line of credit.

Contractual Debt and Cash Obligations

There have been no material changes to our contractual obligations as disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

Off-Balance Sheet Arrangements

During the six months ended March 31, 2016, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance, or special purpose entities, that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Recent Accounting Pronouncements

See Note 3 of Notes to Consolidated Financial Statements for recent accounting pronouncements that could have an effect on us.

JOBS Act

The JOBS Act contains provisions that, among other things, reduce certain reporting requirements for qualifying public companies. As defined in the JOBS Act, a public company whose initial public offering of common equity securities occurred after December 8, 2011 and whose annual gross revenue is less than $1.0 billion will, in general, qualify as an “emerging growth company” until the earliest of:

- the last day of its fiscal year following the fifth anniversary of the date of its initial public offering of common equity securities;
- the last day of its fiscal year in which it has annual gross revenue of $1.0 billion or more;
- the date on which it has, during the previous three-year period, issued more than $1.0 billion in non-convertible debt; and
- the date on which it is deemed to be a “large accelerated filer,” which will occur at such time as the company (a) has an aggregate worldwide market value of common equity securities held by non-affiliates of $700 million or more as of the last business day of its most recently completed second fiscal quarter, and (b) has been required to file annual and quarterly reports under the Securities Exchange Act of 1934 for a period of at least 12 months and (c) has filed at least one annual report pursuant to the Securities Act of 1934.

Under this definition, we are an “emerging growth company” and could remain an emerging growth company until as late as September 30, 2021.

As an “emerging growth company” we have chosen to rely on such exemptions and are therefore not required to, among other things, (i) provide an auditor’s attestation report on our system of internal controls over financial reporting pursuant to Section 404, (ii) provide all of the compensation disclosure that may be required of non-emerging growth public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act, (iii) comply with any requirement that may be adopted by the PCAOB regarding mandatory audit firm rotation or a supplement to the auditor’s report providing additional information about the audit and the financial statements (auditor discussion and analysis) and (iv) disclose certain executive compensation-related items such as the correlation between executive compensation and performance and comparisons of the Chief Executive Officer's compensation to median employee compensation.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Foreign Currency Risk

The substantial majority of our revenue, expense and capital purchasing activities are transacted in U.S. dollars. However, we do incur certain revenue and operating costs in other currencies and are therefore subject to foreign currency risks, particularly fluctuations in exchange rates for the Canadian dollar, British pound and Euro. The effect of an immediate 10% adverse change in exchange rates on foreign denominated transactions as of the six months ended March 31, 2016 and 2015 would have resulted in a total net loss in the period of approximately $14.2 million and $5.7 million, respectively. To date, we have not entered into any hedging contracts although we may do so in the future.

Interest Rate Sensitivity

We had cash and cash equivalents and short and long-term restricted cash totaling $6.4 million and $3.0 million as of March 31, 2016 and September 30, 2015, respectively. These amounts were invested primarily in money market funds. The unrestricted cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income.

Our earnings and cash flows from operations may be exposed to changes in interest rates because of the floating rate of interest in our term loan and line of credit. See footnote 9 to our Consolidated Financial Statements for information relating to the term loan and line of credit. A 100 basis point (1%) increase in interest rates would increase our interest expense by approximately $0.1 million.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act refers to controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to a company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2016, the end of the period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, solely as a result of the material weakness described below, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of March 31, 2016. To address this material weakness, we have implemented certain remedial measures, as described below.

Material Weakness

As of March 31, 2016, management concluded that our internal control over financial reporting was not effective due to the material weakness identified. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

We did not design and maintain effective internal controls surrounding our impairment of long-lived asset testing, such that management failed to initially identify a triggering event. This control deficiency did not result in a material misstatement to our consolidated financial statements for the quarter ended March 31, 2016. However, this control deficiency, if unremediated, could, in another reporting period, result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected by the control. Accordingly, our management has determined that this control deficiency constitutes a material weakness.

Remediation Plan

With oversight from the audit committee, our management has begun to design and implement certain remediation measures to address the above-described material weakness and enhance the Company's internal control over financial reporting. We will take the following actions to improve the design and operating effectiveness of our internal control in order to remediate this material weakness:

- Review the processes related to the impairment assessment of long-lived assets.

- Design, document, and implement additional control procedures related to the identification of triggering events associated with the potential impairment of long-lived assets.

- Test and evaluate the design and operating effectiveness of the control procedures.

- Assess the effectiveness of the remediation plan.

The Company believes the remediation measures will strengthen the Company's internal control over financial reporting and remediate the material weakness identified. We will continue to monitor the effectiveness of these remediation measures and will make any changes and take such other actions that we deem appropriate given the circumstances. We are in the process of implementing our remediation plan and expect to have the material weakness remediated prior to September 30, 2016.

Changes in Internal Control Over Financial Reporting

Except as described above with respect to the material weakness and our remediation plan, there were no changes in our internal control over financial reporting during the quarter ended March 31, 2016, which were identified in connection with management's evaluation required by Rules 13a-15(d) and15d-15(d) under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Controls

Our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company have been detected.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, we may be involved in litigation relating to claims arising in the ordinary course of business. Management believes that there are no claims or actions pending or threatened against the Company, the ultimate disposition of which would have a material impact on our consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors.

Our business, prospects, financial condition or operating results could be materially adversely affected by any of these risks, as well as other risks not currently known to us or that are currently considered immaterial. The trading price of our common stock could decline due to any of the risks and uncertainties described below, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained in this Quarterly Report on Form 10-Q, including our consolidated financial statements and related notes.

Risks Related to Our Business and Industry

We breached our financial covenant with our senior lender in January and February of 2016 and may breach additional covenants if we are not able to achieve certain requirements as agreed in a recent amendment to our credit facility with our lender. In the event that we breach our covenants with our lenders, our debt with such lenders would accelerate and our lenders could demand repayment, which would severely restrict our ability to operate our business.

Our loan and security agreement with Pacific Western Bank (successor in interests to Square 1 Bank) contained several covenants, including a financial covenant requiring the company to achieve a minimum adjusted cash flow for specific periods measured at the end of each calendar month. In January and February of 2016, we failed to achieve the required minimum adjusted cash flow and breached this covenant with our senior lender, which caused a cross-default with our subordinated lender. During the period from January through April 2016, we were in default under both of our loan agreements. In April of 2016, we amended our loan agreement with our senior lender to provide for a limited waiver of this breach and to replace the existing financial covenant, among other modifications. As amended, our loan agreement includes covenants that we will (i) maintain at least $1.5 million of cash in lender's bank and/or of available borrowing capacity under our credit facility with our lender and (ii) obtain on or before May 31, 2016 a term sheet or letter of intent for additional capital acceptable to our lender which provides for funding of sufficient proceeds to repay our obligations to our lender on or before July 31, 2016. In addition, in May of 2016 we defaulted on our payment obligations to our subordinated lender and obtained a limited waiver with respect to the payment default and the above-referenced cross-default. Even though we obtained waivers from our lenders for the periods above, there can be no assurance that in the future we will satisfy such financial or other covenants of the loan agreements, or obtain any required waiver or amendment, in which event of default the lenders could refuse to make further extensions of credit to us, and could require all amounts borrowed, together with accrued interest and other fees, to be immediately due and payable. In such an event, we could lose access to working capital and be unable to operate our business.

We need to restructure our debt and need access to additional capital to operate our business, which may not be available to us on favorable terms, or at all, and may dilute your ownership of our common stock.

We have historically relied on outside financing to fund our operations, capital expenditures and expansion. We have a short term obligation to restructure our debt. We require and are pursuing additional capital from equity and debt financing sources to operate our business. We may not be able to secure timely additional financing on favorable terms, or at all. The terms of any additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, if and when we require it, our ability to operate, grow or support our business and to respond to business challenges could be significantly limited.

We have a history of significant operating losses, anticipate increasing our operating expenses in the future and may not achieve or maintain profitability in the future.

As of March 31, 2016, our accumulated deficit was $398.5 million. We experienced a net loss of $13.8 million for the six months ended March 31, 2016 and $16.6 million for the fiscal year ended September 30, 2015. We expect to continue to make significant expenditures related to the development of our business, including expenditures to hire additional personnel related to the sales, marketing and development of our products and to maintain and expand our research and development operations. In addition, as a public company, we have incurred and will continue to incur additional legal, accounting and other expenses that we did not incur when were a private company. As a result of these increased expenditures, we will have to generate and sustain increased revenue, manage our cost structure and avoid significant liabilities in order to achieve future profitability. We also may incur losses in the future for a number of other unforeseen reasons. Accordingly, we may not be able to achieve or maintain profitability, and we may continue to incur significant losses in the future.

Our operating results may fluctuate significantly from period to period, which could make our future results difficult to predict and could cause our operating results to fall below investor or analyst expectations.

Our operating results may fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indicator of our future performance. Fluctuations in our revenue can lead to even greater fluctuations in our operating results. Our budgeted expense levels depend in part on our expectations with respect to long-term future revenue and global customers. Given relatively fixed operating costs related to our personnel, any substantial adjustment to our expenses to account for lower levels of revenue will be difficult and take time. Consequently, if our revenue does not meet projected levels, our inventory levels and operating expenses would be high relative to revenue, which would impair our operating results.

In addition to other risks discussed in this section, factors that may contribute to fluctuations in our revenue and our operating results include:

- fluctuations in demand, sales cycles, product mix and prices for our solutions and our services;
- reductions in customers' budgets for solutions purchases and delays in their purchasing cycles;
- order cancellations or reductions or delays in delivery schedules by our customers;
- timeliness of our customers' payments for their purchases;
- preparedness of customers for the installation of our solutions;
- the timing of new product announcements or upgrades by us or by our competitors;
- any significant changes in the competitive dynamics of our market, including any new entrants, technological advances or substantial discounting of products;
- purchase or merger of our existing customers by or with a non-customer who is currently supplied by a competitor;
- availability of third-party suppliers to provide products and services for us;
- the timing of recognizing revenue in any given quarter, including the impact of revenue recognition standards in United States generally accepted accounting principles, or U.S. GAAP;
- our ability to control costs, including our operating expenses, the costs of, and the lead times associated with, obtaining the components we purchase and the costs of warranty or repair work; and
- general economic and adverse geopolitical conditions in domestic and international markets.

If our revenue or operating results fall below the expectations of investors or securities analysts or below any guidance we may in the future provide to the market, the price of our common stock may decline substantially.

Our gross margin may fluctuate from period to period and may be adversely affected by a number of factors, some of which are beyond our control.

Our gross margin fluctuates from period to period and varies by product configuration. Our gross margin may continue to be adversely affected by a number of factors, including:

- mix of products and services sold during the period;

- price discounts negotiated by our customers;
- increased price competition, including competition from lower-cost suppliers in China and other markets;
- changes in the price or availability of components for our products;

- charges for excess or obsolete inventory;
- increased warranty or repair costs;
- sales volume from each customer during the period; and
- the period of time over which ratable recognition of revenue occurs.

For example, our gross margin percentage for the six months ended March 31, 2016 was 2.5% as compared to 16.8% for the year ended September 30, 2015 and 33.7% for the year ended September 30, 2014. The decrease in gross margin percentage the six months ended March 31, 2016 and the year ended September 30, 2015 was primarily driven by the mix of products sold during the periods. In particular, our turnkey solutions have lower gross margins than our equipment sales, and to the extent we have a greater proportion of revenue from turnkey solutions in any period, our gross margin percentage will be lower. As a result of our relative size and the often large, complex nature of the projects in which we make product installations, we have limited ability to control the scheduling of the installation of our products and are often requested to reschedule installations. This rescheduling may cause us to redeploy our personnel and could result in us being unable to meet commitments to our other customers, which may negatively impact our gross margins. Further, this rescheduling could cause revenue to be recognized later than forecasted. As a result of our relatively fixed operating costs associated with our personnel, if our revenue does not meet projected levels in a particular quarter, our gross margin for that quarter will be adversely affected. Fluctuations in gross margin may make it difficult to manage our business and achieve or maintain profitability.

We may have difficulty acquiring new customers due to the high up-front costs of switching optical network providers or equipment, and if we are unable to acquire new customers, our business and operating results will be harmed.

Telecommunications service providers typically make substantial investments when deploying an optical network. Once a network operator has deployed an optical network for a particular portion of their network, it is often difficult and costly to switch to another vendor's infrastructure. Unless we are able to persuasively demonstrate that our solutions offer performance, functionality and cost advantages that materially outweigh a customer's expense of switching from a competitor's product, it may be difficult for us to procure new customers and generate sales once that competitor's equipment has been deployed. In addition, many telecommunications service providers base their deployment decisions primarily on price, and if we are unable to establish better pricing terms for our solutions, we may be unable to acquire new customers.

Aggressive business tactics by our competitors may harm our business.

Increased competition in our markets has resulted in our competitors engaging in aggressive business tactics, especially when we compete for large customers. These tactics include:

- selling equipment or inventory at a discount, including at or below cost;
- announcing competing products prior to market availability combined with extensive marketing efforts;
- offering low pricing on products competitive to ours as part of a larger, bundled product offering;
- partnering of multiple competitors to offer a combined bundled offering;
- providing financing, marketing and advertising assistance to customers; and
- asserting intellectual property rights irrespective of the validity of the claims.

If we fail to compete successfully against our current and future competitors, or if our current or future competitors continue or expand aggressive business tactics, including those described above, demand for our solutions could decline, we could experience delays or cancellations of customer orders, we could be required to reduce our prices or we may experience increased expenses.

The markets in which we compete are highly competitive, and we may lack sufficient financial or other resources to compete.

Competition in the optical networking industry is intense, and we expect such competition to increase. A number of very large companies historically have dominated the optical networking industry. Our primary competitors in the submarine market include Alcatel-Lucent Submarine Networks, SAS, Coriant GmbH, Huawei Marine Networks Co., Limited, NEC Corporation and TE Subcom, a TE Connectivity Ltd. company. In the terrestrial market, our primary competitors include Alcatel-Lucent S.A., Ciena Corporation, Huawei Technologies Co. Ltd., Infinera Corporation and Coriant GmbH. Many of our competitors are substantially larger, have greater name recognition, as well as technical, financial and marketing resources, and may have established relationships with our potential customers. Many of our competitors have more resources to develop or acquire, and more experience in developing or acquiring, new products and technologies and in creating market awareness for those products and technologies. In addition, many of our competitors have the financial resources and product portfolios to offer products competitive with ours at below market pricing levels that could prevent us from competing effectively.

In addition, some of our foreign competitors are able to compete more effectively by obtaining financing for their customers from government-sponsored sources. We also compete with low-cost suppliers in China that have the ability to increase pricing pressure on us.

Our ability to compete will depend upon our ability to provide a better solution than our competitors at a competitive price. We may be required to make substantial additional investments in research and development, sales and marketing and customer support in order to respond to competition, and there is no assurance that these investments will achieve any returns for us or that we will be able to compete successfully in the future. Increased competition could lead to fewer customer orders, price reductions, reduced margins and loss of market share, any of which could harm our business, operating results and financial condition.

Demand for our solutions depends in part on the rate that telecommunications service providers expand and enhance their optical networks and the rate that telecommunications service providers and content service providers build out new optical networks. If such service providers do not continue to expand and enhance their networks or build out new networks, it could have a material adverse effect on our business and results of operations.

Our future success as a provider of high-capacity optical transport solutions ultimately depends on the continued growth of the optical networking industry and, in particular, the continued demand for bandwidth. The amount of data transmitted over optical networks will be impacted by the growth of bandwidth demand. Increased demand by subscribers for bandwidth-intensive applications delivered over network systems will be necessary to justify capital expenditure commitments by telecommunications service providers and content service providers to invest in the improvement and expansion of their networks, or alternatively to build out new networks. Demand for improved optical networking infrastructure might not continue to increase if there is limited availability or market acceptance, if the content offered through networks does not attract widespread interest or if the quality of service available through networks does not meet user expectations. If long-term expectations for bandwidth-intensive and cloud-based applications are not realized, these service providers may not commit significant capital expenditures to upgrade their networks to improve capacity or to build out new networks, the demand for our solutions and services will decrease and we may not be able to sustain or increase our levels of revenue or achieve profitability in the future. Broad macroeconomic weakness and market conditions have in the past and could in the future affect spending levels of our customers and demand for our solutions.

Our concentrated customer base increases the potential adverse effect on us from the loss of one or more customers.

We derive a significant portion of our revenue from a limited number of customers. For the six months ended March 31, 2016, Cable & Wireless Communications plc, Defense Information Systems Agency and a consortia led by Oman Telecommunications Company S.A.O.G. accounted for 11.6%, 21.0% and 45.6% of our revenue, respectively and 92.4% of our revenue was generated by six customers. For the year ended September 30, 2015, Cable & Wireless Communications plc, Defense Information Systems Agency and GlobeNet Inc. accounted for 16.2%, 43.8% and 24.9% of our revenue, respectively, and 95.6% of our revenue was generated by six customers, and for the fiscal year ended September 30, 2014, Cable & Wireless Communications plc, Gulf Bridge International, Inc. and OCI Group Inc. accounted for 25.9%, 22.1% and 24.1% of our revenue, respectively, and 88.7% of our revenue was generated by six customers. Our business and financial results are correlated with the spending of a limited number of customers and can be significantly affected by market, industry or competitive dynamics affecting their businesses. The timing of customer purchases and of their requested delivery of purchased product is difficult to predict, and our ability to continue to generate revenue from key customers will depend on our ability to maintain strong relationships with these customers and introduce new products and services that are desirable to these customers at competitive prices. In addition, in certain circumstances our customers can terminate or reduce their contracts for convenience. We expect that sales of our products to a limited number of customers will continue to contribute materially to our revenue for the next few years. The loss of, or a significant delay or reduction in purchases by, a small number of customers could harm our business, operating results and financial condition.

We must respond to technological change and comply with evolving industry standards and requirements for our products to be successful, and if we do not, it could have a material adverse effect on our business and results of operations.

The optical networking industry is characterized by technological change, changes in customer requirements and evolving industry standards. The introduction of new communications technologies and the emergence of new industry standards or requirements could render our products obsolete. Further, in developing our products, we have made, and will continue to make, assumptions with respect to which standards or requirements will be adopted by our customers and competitors. If the standards or requirements adopted by our prospective customers are different from those on which we have focused our efforts, market acceptance of our solutions would be reduced or delayed and our business would be harmed.

In response to market changes, we expect our competitors to continue to improve the performance of their existing products and to introduce new products and technologies. To be competitive, we must continue to invest significant resources in research and development, sales and marketing and customer support. We may not have sufficient resources to make these investments, we may not be able to make the technological advances necessary to be competitive and we may not be able to effectively sell our products to targeted customers who have prior relationships with our competitors.

If we fail to accurately forecast demand for our solutions, we may have excess or insufficient inventory, which may increase our operating costs, decrease our revenue and harm our business.

We are required to generate forecasts of future demand for our solutions several months prior to the scheduled delivery to our prospective customers. This requires us to make significant investments before we know if corresponding revenue will be recognized. Lead times for materials and components that we need to order for the manufacturing of our products vary significantly and depend on factors, such as the specific supplier, contract terms and demand for each component at a given time. In the past, we have experienced lengthening in lead times for certain components. If the lead times for components are lengthened, we may be required to purchase increased levels of such components to satisfy our delivery commitments to our customers. If we overestimate market demand for our solutions and, as a result, increase our inventory in anticipation of customer orders that do not materialize, we will have excess inventory, which could result in increased risk of obsolescence and significant inventory write-downs. Furthermore, this will result in reduced production volumes and our fixed costs will be spread across fewer units, increasing per unit costs. If we underestimate demand for our solutions, we will have inadequate inventory, which could slow down or interrupt the manufacturing of our products and result in delays in shipments and our ability to recognize revenue. In addition, we may be unable to meet our supply commitments to customers, which could result in a loss of certain customer opportunities or a breach of our customer agreements.

We are susceptible to shortages, price fluctuations and quality control risks in our supply chain. Any shortages, price fluctuations or quality concerns in components used in our products could delay shipment of our products, which could materially adversely affect our business.

Shortages in components that we use in our products are possible and our ability to predict the availability of such components may be limited. Furthermore, some of these components are available only from single or limited sources of supply. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in quantity requirements and delivery schedules. Any growth in our business or the economy is likely to create greater pressures on us and our suppliers to project overall component demand accurately and to establish appropriate component inventory levels. In addition, increased demand by third parties for the components we use in our products may lead to decreased availability and higher prices for those components. We generally rely on purchase orders rather than long-term contracts with our suppliers. As a result, even if available, we may not be able to secure sufficient components at reasonable prices or of acceptable quality to build products in a timely manner, which would seriously impact our ability to deliver products to our customers, and our business, operating results and financial condition would be adversely affected. If we are unable to pass component price increases along to our customers or maintain stable pricing for components, our gross margin and operating results could be negatively impacted. Furthermore, poor quality in sole-sourced components or certain other components in our products could also result in lost sales or lost sales opportunities. If the quality of such components does not meet our standards or our customers' requirements, if we are unable to obtain components from our existing suppliers on commercially reasonable terms, or if any of our sole source providers cease to continue to manufacture such components or to remain in business, we could be forced to redesign our products and qualify new components from alternate suppliers. Further, if components we obtain from our suppliers contain technology that infringes on a third party's intellectual property, we could be forced to redesign our products or find alternate sources of such components. The development of alternate sources for those components can be time-consuming, difficult and costly, and we may not be able to develop alternate or second sources in a timely manner. Even if we are able to locate alternate sources of supply, we could be forced to pay for expedited shipments of such components or our products at dramatically increased costs.

We provide turnkey solutions to our customers, which subject us to additional risks inherent with being the prime contractor on a project that, if realized, may adversely affect our operating results.

In addition to providing our hardware and software products to customers, we also provide turnkey solutions for customers. We oversee project planning, partner management and installation of the projects in which our products are utilized. We anticipate turnkey solutions will represent a significant percentage of our product revenue for our fiscal years ending September 30, 2016 and 2017. As the prime contractor, we are ultimately responsible for the project, including any performance issues, damages or cost overruns. Our actual costs and any gross profit realized on a turnkey solution could vary from the estimated amounts on which our bid was originally based. This may occur for various reasons, including errors in estimates or bidding, changes in availability and cost of labor, equipment and materials and unforeseen technical and logistical challenges, including with managing our geographically widespread operations and the performance of third party subcontractors, suppliers and manufacturers. In particular, if the third party subcontractors, suppliers and manufacturers we engage are unable to perform to our requirements, we may be forced to pursue alternative strategies to obtain these goods or services, which could result in delays, interruptions, additional expenses to us and loss of customers. These variations and the risks inherent in our turnkey solutions may result in reduced profitability or losses on these projects. Depending on the size of a project, variations from estimated contract performance could have a material adverse impact on our operating results.

Our sales cycles can be long and unpredictable, and our sales efforts require considerable time and expense, which may cause our revenue and operating results to fluctuate significantly from period to period.

Our sales efforts involve educating our customers about the use and benefit of our solutions, including their technical capabilities and potential cost savings. Customers typically undertake a significant evaluation process before making a purchase, in some cases over six months. We spend substantial time and resources in our sales efforts, and in limited cases, order inventory for potential sales without any assurance that our efforts will produce any sales. In addition, product purchases are frequently subject to budget constraints, multiple approvals and unplanned administrative, processing and other delays. Our long sales cycle may cause our revenue and operating results to fluctuate significantly.

We depend on contract manufacturers and logistics providers to manufacture and deliver a majority of our products, and changes to these relationships or their inability to obtain necessary parts may result in delays or disruptions that could harm our business.

We depend primarily on Foxconn Technology Group, as well as MC Assembly and Surface Technology International Ltd., each an independent contract manufacturer, to manufacture and assemble a majority of our products, and CEVA Logistics, an independent logistics and freight management provider, to coordinate the delivery of a majority of our products. Our reliance on these third parties reduces our control over the manufacturing and logistics processes and exposes us to risks, including reduced control over quality assurance, product costs, and product supply and timing. Our reliance on contract manufacturers could also increase the potential for infringement or misappropriation of our intellectual property rights. While we rely on a combination of purchase orders and supply contracts with these manufacturers, their ability to timely perform under their agreements with us is subject to the performance of third-party suppliers from whom our contract manufacturers order many of the components and parts necessary for the manufacturing of our products. If we are unable to manage our relationships with these third-party suppliers effectively, or if any of these suppliers suffers from increased manufacturing lead times, capacity constraints or quality control problems, work stoppages or any other reduction or disruption in output, they may be unable to meet our customers’ delivery schedules, which would result in lost revenue, additional product costs and deployment delays that could harm our business and customer relationships.

These contract manufacturers typically fulfill our supply requirements on the basis of individual orders. We do not have long-term contracts with our manufacturers that guarantee capacity, the continuation of particular pricing terms, or the extension of credit limits. Accordingly, they are not obligated to continue to fulfill our supply requirements, which could result in supply shortages, and the prices we are charged for manufacturing services could be increased on short notice. In addition, our orders may represent a relatively small percentage of the overall orders received by our contract manufacturers from their customers. As a result, fulfilling our orders may not be considered a priority by one or more of our contract manufacturers in the event the contract manufacture is constrained in its ability to fulfill all of its customer obligations in a timely manner.

It is time consuming and costly to qualify and implement a contract manufacturer relationship. If we are required to change contract manufacturers, whether due to an interruption in their business, quality control problems or otherwise, or if we are required to add additional contract manufacturers, our ability to ship products to our customers could be delayed or otherwise adversely affected, which could cause the loss of sales to existing or potential customers, delayed revenue or an increase in our costs that could adversely affect our gross margin.

Furthermore, if our logistics provider incurs any interruptions, delays or problems in its business, our ability to ship our products in a timely and efficient manner would be impaired, which could harm our business and customer relationships and adversely affect our business, operating results and financial condition.

We may be adversely affected by fluctuations in currency exchange rates.

A portion of our sales are to countries outside of the United States, and are in currencies other than U.S. dollars, and therefore subject to foreign currency fluctuation. Accordingly, fluctuations in foreign currency rates could have a material impact on our revenue in future periods. We also have exposure to currency exchange rates as a result of the growth in our non-U.S. dollar denominated operating expense in Europe, Asia and Canada. We may in the future enter into foreign currency exchange forward contracts to reduce the impact of foreign currency fluctuations. Any such hedging programs, if implemented, would reduce the impact of currency exchange rate movements on certain transactions, but would not cover all foreign-denominated transactions and would not entirely eliminate the impact of fluctuations in exchange rates that could negatively affect our results of operations and financial condition.

Our international sales and operations subject us to additional risks that may adversely affect our operating results.

Over the last several years, we derived a significant portion of our revenue from customers outside the United States, and we continue to expand our international operations. As of September 30, 2015, approximately 41% of our employees were located abroad, and we expect to continue to add personnel internationally. Any continued expansion into international markets will require significant resources and management attention and will subject us to additional regulatory, economic and political risks, and we cannot be sure that any further international expansion will be successful. Furthermore, in some countries, our success in selling our products and growing revenue will depend in part on our ability to form relationships with local partners. Our inability to identify appropriate partners or reach mutually satisfactory arrangements for international sales of our products could impact our ability to maintain or increase international market demand for our products. In addition, many of the companies we compete against internationally have greater name recognition and a more substantial sales and marketing presence. Among the risks we believe are most likely to affect us with respect to our international operations are:

- unexpected changes in regulatory requirements or in foreign policy, including adoption of domestic or foreign laws, regulations and interpretations detrimental to our business;
- difficulties in enforcing contracts and collecting accounts receivable, and longer payment cycles, especially in emerging markets;
- reduced protection for intellectual property rights in some countries;
- new and different sources of competition;
- the difficulty of managing and staffing international offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- increased financial accounting and reporting burdens and complexities;
- fluctuations in exchange rates;
- political, social and economic instability, including wars, terrorism, political unrest, boycotts, curtailment of trade and other business restrictions, and continued economic uncertainty as a result of sovereign debt issues in Europe and Latin America;
- tariffs and trade barriers, import/export controls, and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets;
- certification requirements;
- potentially adverse tax consequences; and
- local laws and practices that favor local companies, including business practices that we are prohibited from engaging in by the Foreign Corrupt Practices Act and other anti-corruption laws and regulations.

Our international operations are subject to increasingly complex foreign and U.S. laws and regulations, including but not limited to anti-corruption laws, such as the Foreign Corrupt Practices Act and the UK Bribery Act and equivalent laws in other jurisdictions, antitrust or competition laws, and data privacy laws, among others. Violations of these laws and regulations could result in fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business and on our ability to offer our products and services in one or more countries, and could also materially affect our reputation, our international expansion efforts, our ability to attract and retain employees, our business, and our operating results. Additionally, the costs of complying with these laws, including the costs of investigations, auditing and monitoring, could also adversely affect our current or future business.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks successfully could harm our international operations and reduce our international sales, adversely affecting our business, operating results and financial condition.

Product performance problems, including undetected errors in our hardware or software, could cause us to incur additional expenses and harm our business and reputation.

Our products are highly technical and complex and when deployed, they are critical to our customers. Our products have contained and may contain undetected errors, defects or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by service providers. In particular, in a submarine cable network, any errors that are detected after deployment can be extremely costly and time consuming to correct. In addition, because we outsource the manufacturing of certain components of our products, we may also be subject to product performance problems as a result of the acts or omissions of third parties. Any errors or defects discovered in our products after commercial release could result in loss of revenue or delay in revenue recognition, loss of customers and increased service and warranty cost, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort or breach of warranty, including claims relating to changes to our products made by our system integrators or distributors. Our contracts with customers generally contain provisions relating to warranty disclaimers and liability limitations, which may be ineffective, and provisions requiring us to indemnify our customers for product failures. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention away from the business and adversely affect the market's perception of us and our solutions. In addition, if our business liability insurance coverage is inadequate or future coverage is unavailable on acceptable terms or at all, our operating results and financial condition could be adversely impacted.

If we fail to adequately expand our direct sales force with qualified and productive personnel, we may not be able to grow our business effectively.

We primarily sell our products through our direct sales force. To grow our business, we intend to focus on growing our customer base for the foreseeable future. Our ability to add customers and to achieve revenue growth in the future will depend upon our ability to grow and develop our direct sales force and on their ability to productively sell our products. Identifying and recruiting qualified personnel and training them in the use of our solutions require significant time, expense and attention. The amount of time it takes for our sales representatives to be fully trained and to become productive varies widely. If our sales organization does not perform as expected, our revenue could suffer. In addition, if we are unable to hire, develop and retain talented sales personnel, if our sales force becomes less efficient as it grows or if new sales representatives are unable to achieve desired productivity levels in a reasonable period of time, we may not be able to grow our customer base and revenue and our sales and marketing expenses may increase.

We might not be able to continue as a going concern absent our ability to raise additional equity or debt capital.

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States, which contemplate that we will continue to operate as a going concern. Our financial statements do not contain any adjustments that might result if we are unable to continue as a going concern. Our ability to continue as a going concern will be determined by our ability to fund our expansion plans and realize our business objectives. We have had recurring operating losses and negative cash flows from operations since inception, and we may continue to generate operating losses and consume cash resources in the future. If we are unable to grow our revenue substantially to achieve and sustain profitability, or if we are unable to obtain adequate funding in the future, we may not be able to continue as a going concern.

Our customers include departments and agencies of the U.S. and international governments. To the extent those relationships are not positively maintained or such contracts are not renewed or extended, it could have a material adverse effect on our business.

We have in the past and may in the future sell our solutions to various departments and agencies of the U.S. and international governments. The revenue associated with these customers may be significant in any given period. Future general political and economic conditions, which cannot be accurately predicted, may directly and indirectly affect the quantity and allocation of expenditures by these federal or international departments and agencies. Any reductions or reallocations in the budgets for these government entities could have a material adverse impact on our results of operations. Obtaining government contracts may also involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development, price negotiations and milestone requirements. If our relationships with these governmental customers deteriorates, if we were to lose one or more of these customers or if we are subject to unanticipated changes or delays in contract performance with these customers, it could have a material adverse effect on our business and results of operations.

We may not be able to attract and retain the highly skilled personnel that we need to support our business.

Our future depends, in part, on our ability to attract and retain key personnel, including the continued contributions of our executive officers and other key technical personnel, each of whom would be difficult to replace. Our industry has experienced periods of intense competition for highly skilled technical personnel. During such periods it may be difficult to identify and hire qualified personnel in many critical areas of our business. Further, we may not be able to hire and retain such personnel at compensation levels consistent with our existing compensation and salary structure. Many of the companies with which we compete for hiring experienced employees have greater resources than we have and may be able to offer more attractive terms of employment. In addition, we invest significant time and expense in training our employees, which increases their value to competitors who may seek to recruit them. If we fail to retain our current management team or our employees, we could incur significant expenses replacing employees and the quality of our products and services and our ability to provide such products and services could be impaired, resulting in a material adverse effect on our business.

If we fail to manage future growth effectively, our business could be harmed.

We have expanded our operations significantly since inception and anticipate that further expansion will be required. The growth of our business has placed significant demands on our management, as well as our financial and operational resources. If we do not effectively manage our future growth, the efficiency of our operations and the quality of our products could suffer, which could adversely affect our business and operating results. To effectively manage this growth, we will need to continue to:

- implement appropriate operational, financial and management controls, systems and procedures, including continued implementation of our enterprise-wide financial system;
- expand our sales, marketing and distribution infrastructure and capabilities; and
- provide adequate training and supervision to maintain high quality standards.

Compliance with environmental matters and worker health and safety laws could be costly, and noncompliance with these laws could have a material adverse effect on our results of operations, expenses and financial condition.

Some of our operations use substances regulated under various federal, state, local and international laws governing the environment and worker health and safety, including those governing the discharge of pollutants into the ground, air and water, the management and disposal of hazardous substances and wastes and the cleanup of contaminated sites. Some of our products are subject to various federal, state, local and international laws governing chemical substances in electronic products. We could be subject to increased costs, fines, civil or criminal sanctions, third-party property damage or personal injury claims if we violate or become liable under environmental or worker health and safety laws.

Examples of these laws and regulations include the European Union, or EU, Restrictions of Hazardous Substances Directive, or the RoHS Directive, and the EU Waste Electrical and Electronic Equipment Directive, or the WEEE Directive, as well as the implementing legislation of the EU member states. Similar laws and regulations have been passed or are pending in China, South Korea, Norway and Japan and may be enacted in other regions, including in the United States. The RoHS Directive and the similar laws of other jurisdictions ban the use of certain hazardous materials such as lead, mercury and cadmium in the manufacture of electrical equipment, including our products. The WEEE Directive requires electronic goods producers to be responsible for the collection, recycling and treatment of such products. If we fail to comply with these directives, we may suffer a loss of revenue, be unable to sell our products in certain markets and countries, be subject to penalties and fines or suffer a competitive disadvantage. In addition, the scope of any new legislation with respect to currently unregulated substances is uncertain. Costs to comply with WEEE or RoHS related legislation or similar future legislation, if applicable, could include costs associated with modifying our products, recycling and other waste processing costs, legal and regulatory costs and insurance costs. The costs to comply with current and future environmental and worker health and safety laws may have a material adverse effect on our results of operations, expenses and financial condition.

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

We are subject to export control laws that limit which products we sell and where and to whom we sell our products. U.S. export control laws also limit our ability to conduct product development activities in certain countries. In addition, various countries regulate the import of certain technologies and have enacted laws that could limit our ability to distribute our products or could limit our customers' ability to implement our products in those countries. Changes in our products or changes in import and export regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the import and export of our products to certain countries altogether. Any change in import and export regulations or related legislation, shift in approach to the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. In addition, our product or manufacturing standards could also be impacted by new or revised environmental rules and regulations or other social initiatives. Failure to comply with these and similar laws on a timely basis, or at all, decreased use of our products or any limitation on our ability to export or sell our products would adversely affect our business, financial condition and operating results.

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

Regulations related to conflict minerals may cause us to incur additional expenses and could limit the supply and increase the costs of certain metals used in the manufacturing of our products.

As a public company, we are subject to requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that require us to diligence, disclose and report whether or not our products contain conflict minerals. The implementation of these requirements could adversely affect the sourcing, availability and pricing of the materials used in our products. In addition, we will incur additional costs to comply with the disclosure requirements, including costs related to conducting diligence procedures to determine the sources of conflict minerals that may be used or necessary to the production of our products and, if applicable, potential changes to products, processes or sources of supply as a consequence of such verification activities. It is also possible that we may face reputational harm if we determine that certain of our products contain minerals not determined to be conflict free or if we are unable to alter our products, processes or sources of supply to avoid such materials. Since our supply chain is complex, we may not be able to sufficiently verify the origins for the minerals and metals used in our products through the due diligence procedures that we implement, which may harm our reputation. If we are unable to satisfy customers who require that all of the components of our products are certified as conflict mineral free, these customers may discontinue or materially reduce purchases of our products, which could harm our business, results of operations and financial condition.

If we are not able to integrate future acquisitions successfully, our operating results and prospects could be harmed.

We have made strategic acquisitions of businesses, technologies and other assets in the past, and may continue to make acquisitions in the future. The success of our acquisitions will depend on our ability to identify, negotiate, complete and integrate acquisitions and, if necessary, to obtain satisfactory debt or equity financing to fund those acquisitions. If we finance an acquisition with debt financing, we will incur interest expense and may have to comply with financing covenants or secure that debt obligation with our assets. Further, mergers and acquisitions are inherently risky, and any mergers and acquisitions we complete may not be successful. Any mergers and acquisitions we do would involve numerous risks, including the following:

- difficulties in integrating and managing the operations, technologies and products of the companies we acquire;
- diversion of our management's attention from normal daily operations of our business;
- our inability to maintain the key business relationships and the reputations of the businesses we acquire;
- uncertainty of entry into markets in which we have limited or no prior experience and in which competitors have stronger market positions;
- our dependence on unfamiliar affiliates and partners of the companies we acquire;
- challenges in integrating and auditing the financial statements of acquired companies that have not historically prepared financial statements in accordance with U.S. generally accepted accounting principles;

- impairment of goodwill or other intangible assets such as trademarks or other intellectual property arising from acquisitions;
- insufficient revenue to offset our increased expenses associated with acquisitions;
- our responsibility for the liabilities of the businesses we acquire;
- failure of the acquired company to achieve anticipated revenue;
- our inability to maintain internal standards, controls, procedures and policies; and
- potential loss of key employees of the companies we acquire.

Security incidents, such as data breaches and cyber-attacks, could compromise our intellectual property and proprietary or confidential information and cause significant damage to our business and reputation.

In the ordinary course of our business, we maintain sensitive data on our networks, including data related to our intellectual property and data related to our business and that of our customers and business partners that is considered proprietary or confidential information. We believe that companies in the technology industry have been increasingly subject to a wide variety of security incidents, cyber-attacks and other attempts to gain unauthorized access. While the secure maintenance of this information is critical to our business and reputation, our network and storage applications may be subject to unauthorized access by hackers or breached due to operator error, malfeasance or other system disruptions. It may be difficult to anticipate or immediately detect such security incidents or data breaches and the damage caused as a result. Accordingly, a data breach, cyber-attack, or unauthorized access or disclosure of our information could compromise our intellectual property and reveal proprietary or confidential business information. In addition, these security incidents could also cause us to incur significant remediation costs and expenses, disrupt key business operations, subject us to liability and divert attention of management and key information technology resources, any of which could cause significant harm to our business and reputation.

Any future litigation against us could be costly and time-consuming to defend.

We may become subject, from time to time, to legal proceedings and claims that arise in the ordinary course of business such as claims brought by our customers in connection with commercial disputes or employment claims made by our current or former employees. Litigation might result in substantial costs and may divert management’s attention and resources, which might seriously harm our business, overall financial condition and operating results. Insurance might not cover such claims, might not provide sufficient payments to cover all the costs to resolve one or more such claims and might not continue to be available on terms acceptable to us. A claim brought against us that is uninsured or underinsured could result in unanticipated costs, thereby harming our operating results and financial condition.

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

A terrorist attack aimed at our nation’s energy or telecommunications infrastructure could hinder or delay the development and sale of our products. In the event that an earthquake, terrorist attack or other man-made or natural catastrophe were to destroy any part of our facilities, or certain of our contract manufacturers’ facilities, destroy or disrupt vital infrastructure systems or interrupt our operations for any extended period of time, our business, financial condition and operating results would be harmed.

Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.

In general, under Section 382 and Section 383 of the U.S. Internal Revenue Code of 1986, as amended, or the Code, a corporation that undergoes an “ownership change” is subject to limitations on its ability to utilize its pre-change net operating losses, or NOLs, to offset future taxable income, and tax credits to offset tax. Future changes in our stock ownership, many of which are outside of our control, could result in an ownership change under Section 382 and Section 383 of the Code, which could limit our ability to utilize our NOLs and tax credits. Our net operating losses and tax credits could also be impaired under state laws. As a result, we might not be able to utilize a material portion of our state NOLs and tax credits.

47

Risks Related to our Intellectual Property

If we fail to protect our intellectual property rights, our competitive position could be harmed or we could incur significant expense to enforce our rights.

We depend on our ability to protect our proprietary technology. We rely on trade secret, patent, copyright and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection. The steps we have taken to protect our proprietary rights may not be adequate to preclude misappropriation of our proprietary information or infringement of our intellectual property rights, and our ability to police such misappropriation or infringement is uncertain, particularly in countries outside of the United States. This is likely to become an increasingly important issue as we expand our operations and product development into countries that provide a lower level of intellectual property protection. In addition, we do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims, and even if patents are issued, they may be contested, circumvented or invalidated. Moreover, the rights granted under any issued patents may not provide us with a competitive advantage, and, as with any technology, competitors may be able to develop similar or superior technologies to our own now or in the future.

Protecting against the unauthorized use of our products, trademarks and other proprietary rights is expensive, difficult, time consuming and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity or scope of the proprietary rights of others. Such litigation, whether or not resolved in our favor, could result in substantial cost and diversion of management resources, either of which could harm our business, financial condition and operating results. Such litigation could also provoke third parties to assert counterclaims against us, which could result in our need to license our intellectual property to competitors. An adverse decision in such litigation could result in the impairment or loss of portions of our intellectual property, and could limit our ability to assert our intellectual property rights, limit the value of our technology or otherwise negatively impact our business. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to enforce their intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property.

Claims by others that we infringe their intellectual property could harm our business.

Our industry is characterized by the existence of a large number of patents. In particular, many leading companies in the optical networking industry, including our competitors, have extensive patent portfolios with respect to optical communications technology. We expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps in patented technology occur. In addition, to the extent that we gain greater visibility and market exposure as a public company, we face a higher risk of being the subject of intellectual property infringement claims. From time to time, third parties may assert exclusive patent, copyright, trademark and other intellectual property rights to technologies and related standards that are important to our business or seek to invalidate the proprietary rights that we hold. Competitors may assert claims or initiate litigation or other proceedings against us or our manufacturers, suppliers or customers alleging infringement of their proprietary rights, or seeking to invalidate our proprietary rights, with respect to our products and technology. In the event that we are unsuccessful in defending against any such claims, or any resulting lawsuit or proceedings, we could incur liability for damages and/or have valuable proprietary rights invalidated.

Any claim of infringement from a third party, even those without merit, could cause us to incur substantial costs defending against such claims, and could distract our management from running our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from offering a particular product. In addition, we might be required to seek a license for the use of such intellectual property, which may not be available on commercially reasonable terms or at all. Alternatively, we may be required to develop non-infringing technology, which would require significant effort and expense and may ultimately not be successful. Any of these events could harm our business, financial condition and operating results. Competitors and other third parties have and may continue to assert infringement claims against our customers and sales partners. Any of these claims would require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims, because we generally indemnify our customers and sales partners from claims of infringement of proprietary rights of third parties. If any of these claims succeed, we may be forced to pay damages on behalf of our customers or sales partners, which could have an adverse effect on our business, financial condition and operating results.

If we are unable to protect the confidentiality of our unpatented proprietary information and know-how, the value of our technology and products could be adversely affected.

In addition to patented technology, we rely upon unpatented proprietary technology, processes and know-how. We generally seek to protect this information in part by confidentiality agreements with our employees, consultants and third parties. These agreements may be breached, and we may not have adequate remedies for any such breach. In addition, our trade secrets may otherwise become known or be independently developed by competitors. If we are unable to protect the confidentiality of our proprietary information and know-how, the value of our technology and products could be adversely affected, which could in turn adversely affect our business, financial condition and results of operations.

We rely on the availability of licenses for intellectual property from third parties, and if these licenses are not available to us on commercially reasonable terms, product sales and development may be delayed.

We depend on an exclusive license to certain patents and patent applications owned by the Regents of the University of Michigan for use in the telecommunications, data communications, computer and data processing industries. This license is revocable in the event that we cease to do business, fail to make the royalty payments due thereunder or commit a material breach of the agreement that is not cured within 60 days of receiving written notice thereof. In such an event, our ability to compete in the market may be diminished.

We also incorporate certain other third-party technologies, including software programs, into our products and may need to utilize additional third-party technologies in the future. However, licenses to relevant third-party technology may not continue to be available to us on commercially reasonable terms, or at all. Therefore, we could face delays in product releases or be unable to make changes to our products until alternative technology can be identified, licensed or developed, and integrated into our current products. These delays or an inability to make changes to our products, if they occur, could materially and adversely affect our business, operating results and financial condition. The inability to obtain certain licenses to third-party technology, or litigation regarding the interpretation or enforcement of license agreements and related intellectual property issues, could harm our business, operating results and financial condition.

Risks Related to Ownership of Our Common Stock

The trading price of our common stock may be volatile.

The trading price of our common stock may be highly volatile and could be subject to wide fluctuations in response to various factors, including the risk factors described in this “Risk Factors” section and elsewhere in this Quarterly Report on Form 10-Q, and other factors beyond our control. Furthermore, our common stock has limited trading history, and the trading prices of the securities of technology companies have been highly volatile. Factors affecting the trading price of our common stock may include:

- variations in our operating results;
- announcements of technological innovations, new services or service enhancements, strategic alliances or agreements by us or by our competitors;
- the gain or loss of customers;
- any major changes in our board of directors or senior management;
- recruitment or departure of key personnel;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- market conditions in our industry, the industries of our customers and the economy as a whole;
-

sales of our common stock by our directors and executive officers or other sales of large blocks of our common stock;

- threatened or actual litigation;
- publication of research reports or news stories about us, our competitors, or our industry, or positive or negative recommendations or withdrawal of research coverage by security analysis;
- the public's reaction to our press releases, our other public announcements and our filings with the SEC; and
- adoption or modification of regulations, policies, procedures or programs applicable to our business.

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or operating results. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. Each of these factors, among others, could harm the value of your investment in our common stock. Some companies that have had volatile market prices for their securities have had securities class action lawsuits filed against them. If a suit were filed against us, regardless of its merits or outcome, it could result in substantial costs and divert management's attention and resources.

Future sales of shares by existing stockholders could cause our stock price to decline.

As of April 30, 2016, we had 17,214,718 shares of common stock outstanding. The 5,000,000 shares sold in our initial public offering were freely tradeable immediately after the offering, subject in certain instances to lock-up agreements executed in connection with the offering. All remaining shares outstanding are currently restricted as a result of lock-up agreements with us or the underwriters of our initial public offering. The shares currently restricted as a result of lock-up agreements will be available for sale into the public market on May 11, 2016, subject in some cases to volume and other limitations. Needham & Company, LLC may, in its sole discretion, permit our officers, directors, employees and current stockholders who are subject to contractual lock-up agreements with the underwriters to sell shares prior to the expiration of such lock-up agreements. If our existing stockholders sell, or indicate an intention to sell, substantial amounts of our common stock in the public market after the contractual lock-up and other legal restrictions on resale lapse, the trading price of our common stock could decline.

Some of our existing stockholders have contractual demand or piggyback rights to require us to register with the SEC shares of our common stock. If we register these shares of common stock following the expiration of the lock-up agreements, the stockholders would be able to sell those shares freely in the public market.

On November 13, 2015, we registered 3,995,085 shares of our common stock that we have issued or may issue under our equity plans. With the registration of these shares, they can be freely sold in the public market upon issuance, subject, if applicable, to the lock-up agreements described above and in some cases, to volume and other limitations. As of March 31, 2016, there were stock options to purchase 791,144 shares of our common stock and unvested restricted stock units representing 5,000 shares of our common stock outstanding, as well as 67,418 shares subject to outstanding warrants, which will be eligible for sale in the public market upon exercise and to the extent permitted by Rules 144 and 701 under the Securities Act. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock.

Insiders continue to have substantial control over us, which may limit our stockholders' ability to influence corporate matters and delay or prevent a third party from acquiring control over us.

As of April 31, 2016, our directors and executive officers and their affiliates beneficially owned, in the aggregate, approximately 30% of our outstanding common stock. As a result, these stockholders will be able to exercise influence over all matters requiring stockholder approval, including the election of directors and approval of corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit your ability to influence corporate matters and delay or prevent a third party from acquiring control over us.

The issuance of additional stock in connection with acquisitions or otherwise will dilute all other stockholdings.

As of April 31, 2016, we had an aggregate of 78,295,581 shares of common stock authorized but unissued and not reserved for issuance under our stock option plans or otherwise. We may issue all of these shares without any action or approval by our stockholders. We intend to continue to actively pursue strategic acquisitions. We may pay for such acquisitions, partly or in full, through the issuance of additional equity or convertible debt securities. Any issuance of shares in connection with our acquisitions or otherwise or the exercise of stock options issued in connection with our acquisitions would dilute the percentage ownership held by current investors.

If securities or industry analysts do not continue to publish research or publish misleading or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who covers us downgrades our stock or publishes misleading or unfavorable research about our business, our stock price would likely decline. In addition, if one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price or trading volume to decline.

We have identified a material weakness in our internal control over financial reporting. If our internal controls over financial reporting are not considered effective, our business, financial condition and market price of our common stock and other securities could be adversely affected.

As a public company, we are required to maintain internal controls over financial reporting and to report any material weaknesses in such internal controls. Section 404 of the Sarbanes-Oxley Act requires that we evaluate and determine the effectiveness of our internal controls over financial reporting and, beginning with our annual report for the fiscal year ending September 30, 2016, provide a management report on our internal controls over financial reporting, which must be attested to by our independent registered public accounting firm to the extent we are no longer an "emerging growth company," as defined by the JOBS Act.

In connection with the review of our financial statements for the quarter ended March 31, 2016, we concluded that there was a material weakness in our internal control over financial reporting. A material weakness is a significant deficiency, or a combination of significant deficiencies, in internal control over financial reporting such that it is reasonably possible that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness we identified related to the controls surrounding our impairment of long-lived asset testing, such that management failed to identify a triggering event. We subsequently tested our long-lived assets for impairment as of March 31, 2016 and did not ultimately record any impairment charge. Nonetheless, as a result of this material weakness, we evaluated our internal control over financial reporting as ineffective.

We are taking steps to remediate the material weakness in our internal control over financial reporting, including designing additional training programs for relevant personnel and developing specific review procedures regarding the review of the impairment of long-lived assets. However, we cannot assure you that these efforts will remediate our material weakness in a timely manner, or at all. If we are unable to successfully remediate our material weakness, or identify any future material weaknesses, the accuracy and timing of our financial reporting may be adversely affected, we may be unable to maintain compliance with securities law requirements regarding timely filing of periodic reports and we may experience a loss of public confidence, which could have an adverse effect on our business, financial condition and the market price of our common stock and other securities.

Anti-takeover provisions in our charter documents and Delaware law could discourage, delay or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law, which apply to us, may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our amended and restated certificate of incorporation and amended and restated bylaws:

- authorize the issuance of "blank check" convertible preferred stock that could be issued by our board of directors to thwart a takeover attempt;
- establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;
- require that directors only be removed from office for cause and only upon a supermajority stockholder vote;
- provide that vacancies on the board of directors, including newly-created directorships, may be filled by a majority vote of directors then in office rather than by stockholders;

- prevent stockholders from calling special meetings; and
- prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders.

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

We currently do not plan to declare cash dividends on shares of our common stock in the foreseeable future. In addition, our credit facilities currently restrict our ability to pay cash dividends while these facilities remain outstanding. For more information, see the section titled "Dividend Policy." Consequently, your only opportunity to achieve a return on your investment in our company will be if the market price of our common stock appreciates and you sell your shares at a profit. There is no guarantee that the price of our common stock will ever exceed the price that you pay.

We have incurred and will continue to incur significant increased costs as a result of operating as a public company, and our management are required to devote substantial time to compliance initiatives.

As a public company, we have incurred and will continue to incur significant legal, accounting and other expenses that we did not incur when were a private company. In addition, the Sarbanes-Oxley Act and rules subsequently implemented by the Securities and Exchange Commission and The NASDAQ Global Market impose additional requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations have increased and we expect, will continue to increase, our legal and financial compliance costs and make some activities more time-consuming and costly. These rules and regulations, and the risks associated with our status as a public company, could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

As an "emerging growth company" under the JOBS Act, we are permitted to, and intend to, rely on exemptions from certain disclosure requirements, which could make our common stock less attractive to investors.

As an "emerging growth company" under the JOBS Act, we are permitted to, and intend to, rely on exemptions from certain disclosure requirements. For example, we will not include all of the executive compensation related information that would be required in our periodic reports and proxy statements if we were not an emerging growth company. In addition, for so long as we are an emerging growth company, we will not be required to:

- have an auditor report on our internal control over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act;
- comply with any requirement that may be adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements (auditor discussion and analysis); and
- submit certain executive compensation matters to stockholder advisory votes, such as "say on pay" and "say on frequency."

Because of these exemptions and the other reduced disclosure obligations for emerging growth companies set forth elsewhere in this Quarterly Report on Form 10-Q, our stock may appear less attractive to investors and could cause our stock price to decline.

Although we intend to rely on certain of the exemptions provided in the JOBS Act, the exact implications of the JOBS Act for us are still subject to interpretations and guidance by the SEC and other regulatory agencies. Also, as our business grows, we may no longer satisfy the conditions of an emerging growth company. We will remain an "emerging growth company" until the earliest of (i) the last day of the fiscal year during which we have total annual gross revenue of $1 billion or more; (ii) the last day of the fiscal year following the fifth anniversary of our initial public offering; (iii) the date on which we have, during the previous three-year period, issued more than $1 billion in non-convertible debt; and (iv) the date on which we are deemed to be a "large accelerated filer" under the Securities Exchange Act of 1934, as amended, or the Exchange Act. We will be deemed a large accelerated filer on the first day of the fiscal year after the market value of our common equity held by non-affiliates exceeds $700 million, measured on March 31. If investors find our common stock less attractive as a result of our reliance on certain of the JOBS Act exemptions, there may be a less active trading market for our common stock, and our stock price may be more volatile.

Under the JOBS Act, an emerging growth company can delay adopting new or revised accounting standards until those standards would otherwise apply to private companies. We are choosing to "opt in" to such extended transition period. Therefore, we are electing to delay adoption of new or revised accounting standards, and as a result, we may choose to not comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. As a result of such election, our financial statements may not be comparable to the financial statements of other public companies.

52

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

(a) Sales of Unregistered Securities

None

(b) Use of Proceeds from Initial Public Offering of Common Stock

On November 17, 2015, we completed our initial public offering of 5,000,000 shares of common stock, at a price of $5.00 per share, before underwriting discounts and commissions. The offer and sale of all of the shares in our initial public offering were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-207288), which was declared effective by the SEC on November 12, 2015. Following the sale of the shares in connection with the closing of our initial public offering, the offering terminated. Needham & Company, LLC, Cowen and Company, LLC and BMO Capital Markets Corp. acted as the underwriters. Our initial public offering generated net proceeds to us of approximately $21.76 million, after deducting underwriting discounts and direct offering expenses. Direct offering expenses incurred by us for our initial public offering were approximately $1.46 million and were recorded against the proceeds received from our initial public offering. No payments were made by us to directors, officers or persons owning ten percent or more of our common stock or to their associates, or to our affiliates, other than payments in the ordinary course of business to officers for salaries and bonuses.

There have been no material changes in the planned use of proceeds from our initial public offering from that described in the final prospectus filed with the SEC pursuant to Rule 424(b) dated as of November 12, 2015.

Item 3. Defaults Upon Senior Securities.

None

Item 4. Mine Safety Disclosures.

Not Applicable

Item 5. Other Information.

None

Item 6. Exhibits.

See the Index to Exhibits immediately following the signature pages of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

SIGNATURES

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

	XTERA COMMUNICATIONS, INC. AND SUBSIDIARIES	
Date: May 16, 2016	By:	/s/ Jon R. Hopper Jon R. Hopper President, Chief Executive Officer and Director (Principal Executive Officer)
Date: May 16, 2016	By:	/s/ Paul J. Colan Paul J. Colan Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT INDEX

		Incorporated by Reference			
Exhibit Number	Description	Form	File No.	Exhibit	Filing Date
3.1	Amended and Restated Certificate of Incorporation, as currently in effect	Form 10-K	001-37617	3.1	December 16, 2015
3.2	Amended and Restated Bylaws of the Registrant	S-1/A	333-207288	3.4	October 26, 2015
10.1*	Limited Waiver and First Amendment to Loan Agreement, dated October 30, 2015, by and among Pacific Western Bank, the Registrant, Azea Networks, Inc., Neovus, Inc. and Xtera Asia Holdings, LLC.				
10.2*	Second Amendment to Loan Agreement, dated January 11, 2016, by and among Pacific Western Bank, the Registrant, Azea Networks, Inc., Neovus, Inc. and Xtera Asia Holdings, LLC.				
10.3	Limited Waiver and Third Amendment to Loan Agreement, dated April 27, 2016, by and among Pacific Western Bank, the Registrant, Azea Networks, Inc., Neovus, Inc. and Xtera Asia Holdings, LLC.	8-K	001-37617	10.1	May 3, 2016
10.4*	Extension to the Master Manufacturing Agreement between the Registrant and NSG Technology, Inc., effective as of January 1, 2016.				
31.1*	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended				
31.2*	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended				
32.1#	Certification of Chief Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. § 1350 as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002				
32.2#	Certification of Chief Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. § 1350 as adopted				

	pursuant to Section 906 of the Sarbanes–Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

*Filed herewith
#Furnished herewith

55