FINISAR CORP
Form 10-Q
February 28, 2019
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended January 27, 2019
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 000-27999

Finisar Corporation
(Exact name of Registrant as specified in its charter)

Delaware	94-3038428
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1389 Moffett Park Drive	
Sunnyvale, California	94089
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:
408-548-1000

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 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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting	Emerging growth

company o company o

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

Number of shares of the registrant's common stock, $.001 par value, outstanding as of February 26, 2019: 117,903,352

Table of Contents

INDEX TO QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended January 27, 2019

Table of Contents

FORWARD LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We use words like “anticipates,” “believes,” “plans,” “expects,” “future,” “intends” and similar expressions to identify th forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events; however, our business and operations are subject to a variety of risks and uncertainties, and, consequently, actual results may materially differ from those projected by any forward-looking statements. As a result, you should not place undue reliance on these forward-looking statements since they may not occur.

Certain factors that could cause actual results to differ from those projected are discussed in “Part II. Other Information, Item 1A. Risk Factors.” We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events.

Table of Contents

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
FINISAR CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	January 27, 2019 (Unaudited)	April 29, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$906,854	$312,257
Short-term investments	3,754	884,838
Accounts receivable, net of allowance for doubtful accounts of $378 at January 27, 2019 and $269 at April 29, 2018	263,737	233,529
Inventories	306,864	348,527
Other current assets	44,713	56,001
Total current assets	1,525,922	1,835,152
Property, equipment and improvements, net	622,770	520,849
Purchased intangible assets, net	4,977	7,878
Goodwill	106,736	106,736
Other assets	12,185	31,720
Deferred tax assets	85,372	80,850
Total assets	$2,357,962	$2,583,185
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$128,594	$132,161
Accrued compensation	41,216	32,525
Other accrued liabilities	54,889	32,824
Deferred revenue	—	9,535
Current portion of convertible debt	—	251,278
Total current liabilities	224,699	458,323
Long-term liabilities:		
Convertible debt, net of current portion	506,454	488,877
Other non-current liabilities	11,864	12,368
Total liabilities	743,017	959,568
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000 shares authorized, no shares issued and outstanding at January 27, 2019 and April 29, 2018	—	—
Common stock, $0.001 par value, 750,000 shares authorized, 117,898 shares and 114,813 shares issued and outstanding at January 27, 2019 and April 29, 2018, respectively	118	115
Additional paid-in capital	2,904,016	2,850,195
Accumulated other comprehensive loss	(46,647)	(14,660)
Accumulated deficit	(1,242,542)	(1,212,033)
Total stockholders' equity	1,614,945	1,623,617
Total liabilities and stockholders' equity	$2,357,962	$2,583,185

See accompanying notes.

Table of Contents

FINISAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
Revenues	$327,636	$332,403	$970,395	$1,006,414
Cost of revenues	232,717	243,724	708,117	705,009
Amortization of acquired developed technology	496	611	1,488	1,833
Gross profit	94,423	88,068	260,790	299,572
Operating expenses:				
Research and development	51,274	59,888	167,007	178,488
Sales and marketing	12,170	11,913	37,077	36,494
General and administrative	14,973	19,739	40,448	47,311
Start-up costs	15,136	638	34,108	638
Amortization of purchased intangibles	337	666	1,413	2,038
Impairment of long-lived assets	—	1,353	—	1,353
Total operating expenses	93,890	94,197	280,053	266,322
Income (loss) from operations	533	(6,129)	(19,263)	33,250
Interest income	5,333	3,995	16,469	11,181
Interest expense	(8,167)	(9,192)	(27,043)	(27,336)
Other income (expense), net	(38)	(459)	(1,043)	(2,042)
Income (loss) before income taxes	(2,339)	(11,785)	(30,880)	15,053
Provision for income taxes	12,962	43,874	8,185	44,996
Net loss	$(15,301)	$(55,659)	$(39,065)	$(29,943)
Net loss per share:				
Basic	$(0.13)	$(0.49)	$(0.33)	$(0.26)
Diluted	$(0.13)	$(0.49)	$(0.33)	$(0.26)
Shares used in computing net loss per share:				
Basic	117,608	114,209	116,919	113,571
Diluted	117,608	114,209	116,919	113,571

See accompanying notes.

Table of Contents

FINISAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, in thousands)

	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
Net loss	$(15,301)	$(55,659)	$(39,065)	$(29,943)
Other comprehensive income (loss), net of tax:				
Change in cumulative foreign currency translation adjustment	11,259	35,952	(31,987)	52,152
Total other comprehensive income (loss), net of tax	11,259	35,952	(31,987)	52,152
Total comprehensive income (loss)	$(4,042)	$(19,707)	$(71,052)	$22,209

See accompanying notes.

Table of Contents

FINISAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Nine Months Ended	
	January 27, 2019	January 28, 2018
Operating activities		
Net loss	$(39,065)	$(29,943)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	71,872	73,700
Amortization	3,979	5,025
Stock-based compensation expense	45,307	49,448
Amortization of discount on held-to-maturity investments	(8,115)	(5,637)
Loss on sale or retirement of assets	—	36
Impairment of long-lived assets	341	1,353
Impairment of minority investment	399	2,347
Amortization of discount on convertible debt	22,921	22,971
Deferred income tax (benefit) expense	(6,781)	41,794
Changes in operating assets and liabilities:		
Accounts receivable	(17,239)	28,414
Inventories	27,800	(27,978)
Other assets	14,034	(2,011)
Accounts payable	(4,944)	(13,320)
Accrued compensation	8,691	(14,860)
Other accrued liabilities	12,275	(7,880)
Deferred revenue	—	1,524
Net cash provided by operating activities	131,475	124,983
Investing activities		
Additions to property, equipment and improvements	(176,426)	(156,302)
Purchases of short-term investments	(830,277)	(1,597,163)
Maturities of short-term investments	1,719,275	1,622,524
Net cash provided by (used in) investing activities	712,572	(130,941)
Financing activities		
Repayment of 2033 Notes	(257,696)	—
Proceeds from the issuance of shares under equity plans and employee stock purchase plan	10,998	11,210
Shares repurchased for tax withholdings on vesting of restricted stock units	(2,752)	(6,457)
Net cash provided by (used in) financing activities	(249,450)	4,753
Net increase (decrease) in cash and cash equivalents	594,597	(1,205)
Cash and cash equivalents at beginning of period	312,257	260,228
Cash and cash equivalents at end of period	$906,854	$259,023
Supplemental disclosure of cash flow information		
Cash paid for interest	$4,170	$4,170
Cash paid for taxes	$5,107	$8,863

See accompanying notes.

Table of Contents

FINISAR CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements as of January 27, 2019 and for the three and nine month periods ended January 27, 2019 and January 28, 2018 have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”), and include the accounts of Finisar Corporation and its controlled subsidiaries (collectively, “Finisar” or the “Company”). Intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP and pursuant to the rules and regulations of the SEC have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position as of January 27, 2019, its operating results for the three and nine month periods ended January 27, 2019 and January 28, 2018, and its cash flows for the nine month periods ended January 27, 2019 and January 28, 2018. Operating results for the three and nine month periods ended January 27, 2019 are not necessarily indicative of the results that may be expected for the fiscal year ending April 28, 2019. The condensed consolidated balance sheet as of April 29, 2018 has been derived from the audited consolidated financial statements as of that date, but does not include all the footnotes required by U.S. GAAP for complete financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended April 29, 2018.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Merger Agreement

On November 8, 2018, the Company, II-VI Incorporated, a Pennsylvania corporation (“Parent”) and Mutation Merger Sub Inc., a Delaware corporation and a wholly owned subsidiary of Parent (“Merger Subsidiary”), entered into an Agreement and Plan of Merger (the “Merger Agreement”), pursuant to which, among other things, Merger Subsidiary will be merged with and into the Company (the “Merger”), with the Company surviving the Merger as a wholly owned subsidiary of Parent. The closing of the Merger is subject to, among other things, the adoption of the Merger Agreement by the affirmative vote of the holders of at least a majority of the outstanding shares of Company Stock (the “Company Stockholder Approval”) and the affirmative vote of at least a majority of the votes cast for the proposal on the issuance of the Parent Common Stock and any restricted units of Parent issuable in connection with the Merger (the “Parent Stockholder Approval”). The closing of the Merger is also subject to various other customary conditions.

2. Summary of Significant Accounting Policies

For a description of significant accounting policies, see Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements included in the Company's annual report on Form 10-K for the fiscal year ended April 29, 2018. There have been no material changes to the Company's significant accounting policies since the filing of the annual report on Form 10-K, except for the adoption of a new revenue recognition standard as described below.

Effect of Adoption of New Accounting Standard

In May 2014, the Financial Accounting Standards Board (the "FASB"), jointly with the International Accounting Standards Board, issued a comprehensive new standard on revenue recognition from contracts with customers. The standard's core principle is that a reporting entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying this new guidance to contracts within its scope, an entity will: (1) identify the contract(s) with a customer, (2) identify the performance obligation in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The Company adopted this standard on April 30, 2018, applying it to all contracts, using a modified retrospective approach. Substantially all of the Company's revenues are derived from sales of products to customers. Upon adopting this standard, the Company recognizes revenue when it satisfies performance obligations as evidenced by the transfer of control of its products to customers at the time of product shipment from the Company's facility or delivery to the customer location, as determined by the agreed upon shipping and delivery terms. The Company's assessment has identified a change in revenue recognition timing

Table of Contents

on sales made to distributors. Upon adopting this standard, the Company now recognizes revenue upon delivery of products to the distributor (in accordance with agreed upon shipping and delivery terms) rather than deferring recognition until the distributor sells the product to the end customer. On April 30, 2018, the Company removed the deferred revenue (and corresponding deferred cost of sales) on sales to distributors through a cumulative adjustment to accumulated deficit. This resulted in an approximately net $8.6 million reduction of accumulated deficit with a corresponding approximately $9.5 million reduction of deferred revenue, an approximately $535,000 reduction of other non-current liabilities, an approximately $760,000 increase in other current assets, and an approximately $2.3 million reduction of deferred tax assets. The Company measures revenue based on the amount of consideration it expects to be entitled to in exchange for products, reduced by amount of consideration related to products expected to be returned. Any variable consideration is recognized as a reduction of revenue at the time of revenue recognition. The Company determines variable consideration, which primarily consists of distributor sales price reductions resulting from price protection agreements, by estimating impact of such reductions based on historical analysis of such activity. The Company’s contracts with customers do not typically include extended payment terms and payment terms generally range from 30 to 90 days. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with sales, recorded as a component of cost of revenues. The Company's standard warranty period usually covers 12 months from the date of sale, although it can be for longer periods for certain products. Based on the Company's assessment, only minimal changes were required to the Company's existing policies, processes, and controls to support the standard's measurement and disclosure requirements. During fiscal 2018, the Company and certain licensees agreed to modify specific terms of some of the Company's out-licensing agreements by granting licensees cancellation rights to cease future payments in the event that licensees cease using the licensed technology. These licensing agreements provided for a settlement and release of any prior claims and licensing of the Company’s technology over a future period. Prior to the modification, there were no cancellation rights. In accordance with the new accounting standard, the Company utilized one of the practical expedients for adoption that allowed the Company to reflect the aggregate effect of all modifications that have occurred before the beginning of the earliest period presented in accordance with this new accounting standard. Absent these modifications, the Company would have recognized, in addition to the amounts described above, approximately $24.4 million of cumulative effect of adoption of the new accounting standard in the earliest period presented in accordance with this new accounting standard. The Company may provide similar cancellation rights in comparable licensing agreements that may be executed in the future.

The following table summarizes the impacts of adopting the new revenue recognition standard on the Company's condensed consolidated financial statements for the three and nine month periods ended January 27, 2019:

	Three Months Ended January 27, 2019		
(in thousands)	As reported	Adjustments	Without new revenue standard
Revenues	$327,636	$(1,130)	$326,506
Cost of revenues	232,717	(1,025)	231,692
Gross profit	94,423	(105)	94,318
Net loss	$(15,301)	$(105)	$(15,406)

	Nine Months Ended January 27, 2019		
(in thousands)	As reported	Adjustments	Without new revenue standard
Revenues	$970,395	$(10,021)	$960,374
Cost of revenues	708,117	(5,724)	702,393
Gross profit	260,790	(4,297)	256,493
Net loss	$(39,065)	$(4,297)	$(43,362)

	As of January 27, 2019		
(in thousands)	As reported	Adjustments	Without new revenue standard
Other current assets	$44,713	$ (611)	$44,102
Deferred tax assets	$85,372	$ 2,259	$87,631
Deferred revenue	$—	$ 14,175	$14,175
Other non-current liabilities	$11,864	$ 326	$12,190
Accumulated deficit	$(1,242,542)	$ (12,853)	$(1,255,395)

Table of Contents

The following table presents the Company's revenues disaggregated by geography, based on the location of the entity purchasing the Company's products:

(in thousands)	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
United States	$106,162	$ 120,259	$331,488	$358,512
China	75,688	66,933	238,205	210,964
Malaysia	17,673	41,104	53,256	98,672
Rest of the world	128,113	104,107	347,446	338,266
Totals	$327,636	$ 332,403	$970,395	$1,006,414

The following table presents the Company's revenues disaggregated by market application:

(in thousands)	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
Datacom	$231,695	$ 266,108	$707,889	$781,047
Telecom	95,941	66,295	262,506	225,367
Totals	$327,636	$ 332,403	$970,395	$1,006,414

Income Tax

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted, which contains significant changes to U.S. tax law, including lowering the U.S. corporate income tax rate, implementing a territorial tax system, and imposing a one-time tax on deemed repatriation of earnings of foreign subsidiaries. In fiscal 2018, the Company recorded provisional tax estimates related to TCJA. During the third quarter of fiscal 2019, the Company completed its accounting for the impact of TCJA on its consolidated financial statements and recorded an additional one-time deferred tax expense of approximately $6.4 million related to the remeasurement of deferred taxes.

The Company and its subsidiaries are subject to taxation in various state jurisdictions as well as the U.S. The Company's U.S. federal and state income tax returns are generally not subject to examination by the tax authorities for tax years before fiscal 2009. For all federal and state net operating loss and credit carryovers, the statute of limitations does not begin until the carryover items are utilized. The taxing authorities can examine the validity of the carryover items and if necessary, adjustments may be made to the carryover items. The Company's Malaysia, Singapore, China, Australia, Israel, and Sweden income tax returns are generally not subject to examination by the tax authorities for tax years before 2011, 2012, 2011, 2011, 2005 and 2010, respectively. The Company's Australia subsidiary is under audit for tax year 2011 and after. If the examinations are resolved unfavorably, there is a possibility they may have a material negative impact on the Company's results of operations.

Pending Adoption of New Accounting Standards

In February 2016, the FASB issued an accounting standards update which replaces the current lease accounting standard. The update will require lessees, among other items, to recognize a right-of-use asset and a lease liability for most leases. The update is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain optional practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented, but provides an optional application at the adoption date. The Company expects to adopt this standard in the first quarter of its fiscal 2020. Although the Company is currently evaluating potential effects on its consolidated financial position, results of operations and cash flows from the adoption of this standard, the Company expects that most of its operating lease commitments will be subject to the new standard and will be recognized as operating lease liabilities and right-of-use assets upon adoption of this standard.

From time to time, new accounting pronouncements are issued by the FASB, or other standards setting bodies, that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes the impact of recently issued standards that are not yet effective will not have a material impact on its consolidated financial position, results of operations and cash flows upon adoption.

10

Table of Contents

3. Earnings per Share

Basic net income (loss) per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share has been computed using the weighted-average number of shares of common stock outstanding during the period plus dilutive potential shares of common stock from (1) stock options and restricted stock units (under the treasury stock method) and (2) convertible debt (under the treasury stock method) outstanding during the period.

The following table presents the calculation of basic and diluted net loss per share:

(in thousands, except per share amounts)	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
Numerator:				
Net loss	$(15,301)	$(55,659)	$(39,065)	$(29,943)
Numerator for basic net loss per share	(15,301)	(55,659)	(39,065)	(29,943)
Numerator for diluted net loss per share	$(15,301)	$(55,659)	$(39,065)	$(29,943)
Denominator:				
Denominator for basic net loss per share - weighted average shares	117,608	114,209	116,919	113,571
Denominator for diluted net income loss per share	117,608	114,209	116,919	113,571
Net loss per share:				
Basic	$(0.13)	$(0.49)	$(0.33)	$(0.26)
Diluted	$(0.13)	$(0.49)	$(0.33)	$(0.26)

The following table presents potential shares of common stock excluded from the calculation of diluted net loss per share as their effect would have been anti-dilutive:

(in thousands)	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
Stock options and restricted stock units	4,073	3,987	2,724	4,412

0.50% Convertible Senior Notes due 2033 and 0.50% Convertible Senior Notes due 2036 were excluded from the calculation of diluted earnings per share under the treasury stock method for the periods when the conversion price exceeded the average market price for the Company's common stock.

4. Inventories

Inventories consist of the following:

(in thousands)	As of	
	January 27, 2019	April 29, 2018
Raw materials	$63,011	$84,441
Work-in-process	193,630	186,160
Finished goods	50,223	77,926
Total inventories	$306,864	$348,527

5. Investments

The Company's portfolio of fixed income securities consists of commercial paper notes and term bank certificates of deposit. All of the Company's investments in fixed income securities have original maturity (maturity at the purchase date) of less than 12 months and are reported as short-term investments in the consolidated balance sheets as of January 27, 2019 and April 29, 2018. All of the Company's investments in fixed income securities are classified as held-to-maturity since the Company has the positive intent and ability to hold these investments until maturity. These investments are carried at amortized cost.

Table of Contents

The Company's investments in fixed income securities as of January 27, 2019 and April 29, 2018 were as follows:

(in thousands)	January 27, 2019 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	April 29, 2018 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	$—	$ —	$ —	$—	$548,010	$ —	$ —	$548,010
Certificates of deposit	3,754	—	—	3,754	336,828	—	—	336,828
Total	$3,754	$ —	$ —	$3,754	$884,838	$ —	$ —	$884,838

During the three and nine month periods ended January 27, 2019 and January 28, 2018, there were no gross unrealized gains or losses, no realized gains or losses, and no other-than-temporary impairments.

6. Debt

0.50% Convertible Senior Notes Due 2036

In December 2016, the Company issued and sold $575.0 million in aggregate principal amount of 0.50% Convertible Senior Notes due 2036 (the "2036 Notes") at par. The terms of the notes are governed by an indenture by and between the Company and Wells Fargo Bank, National Association, as Trustee. The notes will mature on December 15, 2036, unless earlier repurchased, redeemed or converted. The notes are senior unsecured and unsubordinated obligations of the Company, and are effectively subordinated to the Company's secured indebtedness and the indebtedness and other liabilities of the Company's subsidiaries. The notes bear interest at a rate of 0.5% per year, payable semi-annually in arrears on June 15 and December 15 each year.

Holders of the notes may convert their notes at their option prior to the close of business on the business day immediately preceding June 15, 2036 only under the following circumstances: (1) during any fiscal quarter commencing after the fiscal quarter ending on January 29, 2017 (and only during such fiscal quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period ("measurement period"), in which the trading price per $1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events, e.g., a merger or an acquisition. On or after June 15, 2036 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of whether any of the foregoing circumstances have occurred. The conversion rate will initially equal 22.6388 shares of common stock per $1,000 principal amount of notes (which is equivalent to an initial conversion price of approximately $44.17 per share of common stock), subject to adjustment. Upon conversion of a note, the Company will pay or deliver, as the case may be, either cash, shares of its common stock or a combination of cash and shares of its common stock, at the Company's election, as provided in the indenture. If holders elect to convert their notes in connection with a "fundamental change" (as defined in the indenture) that occurs on or before December 22, 2021, the Company will, to the extent provided in the indenture, increase the conversion rate applicable to such notes ("make-whole feature").

Holders will have the option to require the Company to redeem for cash any notes held by them in the event of a fundamental change, e.g., a merger or an acquisition, at a purchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest to, but excluding, the redemption date. Holders also have the option to require the Company to redeem for cash any notes held by them on December 15, 2021, December 15, 2026 and December 15, 2031 at a redemption price equal to 100% of the principal amount of the notes plus accrued and unpaid interest to, but excluding, the redemption date. The Company may redeem the notes in whole or in part at any time on or after December 22, 2021 at 100% of the principal amount, plus accrued and unpaid interest to, but excluding, the redemption date.

The Company considered the features embedded in the notes, that is, the conversion feature, the holders' put feature, the Company's call feature, and the make-whole feature, and concluded that they are not required to be bifurcated and accounted for separately from the host debt instrument.

Because of its option to settle conversion of the notes in cash, the Company separated the liability and equity components of the notes. The carrying amount of the liability component at issuance date of $465.1 million was calculated by estimating the fair value of similar liabilities without a conversion feature. The residual principal amount of the notes of $109.9 million was

Table of Contents

allocated to the equity component. The resulting debt discount is amortized as interest expense. As of January 27, 2019, the remaining debt discount amortization period was 35 months.

As of January 27, 2019, the 2036 Notes consisted of the following (in thousands):

Liability component:	
Principal	$575,000
Unamortized debt discount	(66,931)
Unamortized debt issuance costs	(2,669)
Net carrying amount of the liability component	$505,400
Carrying amount of the equity component	$109,881

The Company incurred approximately $5.7 million in transaction costs in connection with the issuance of the notes. These costs were allocated to the liability and equity components in proportion to the allocation of proceeds. Transaction costs of $4.6 million, allocated to the liability component, were recognized as a debt discount and are amortized. Transaction costs of $1.1 million, allocated to the equity component, were recognized as a reduction of additional paid-in capital.

The following table sets forth interest expense information related to the 2036 Notes:

(in thousands, except percentages)	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
Contractual interest expense	$719	$ 719	$2,157	$2,157
Amortization of the debt discount	5,334	5,085	15,833	15,093
Amortization of issuance costs	231	231	693	693
Total interest cost	$6,284	$ 6,035	$18,683	$17,943
Effective interest rate on the liability component	4.85 %	4.85 %	4.85 %	4.85 %

The Company applies the treasury stock method to determine the potential dilutive effect of the 2036 Notes on net income per share as a result of the Company's intent and stated policy to settle the principal amount of the 2036 Notes in cash.

0.50% Convertible Senior Notes Due 2033

In December 2013, the Company issued and sold $258.8 million in aggregate principal amount of 0.50% Convertible Senior Notes due 2033 (the "2033 Notes") at par. The terms of the notes are governed by an indenture by and between the Company and Wells Fargo Bank, National Association, as Trustee. The notes will mature on December 15, 2033, unless earlier repurchased, redeemed or converted. The notes are senior unsecured and unsubordinated obligations of the Company, and are effectively subordinated to the Company's secured indebtedness and the indebtedness and other liabilities of the Company's subsidiaries. The notes bear interest at a rate of 0.5% per year, payable semi-annually in arrears on June 15 and December 15 each year.

Holders of the notes may convert their notes at their option prior to the close of business on the business day immediately preceding June 15, 2033 only under the following circumstances: (1) during any fiscal quarter commencing after the fiscal quarter ending on January 26, 2014 (and only during such fiscal quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period ("measurement period"), in which the trading price per $1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events, e.g., a merger or an acquisition. On or after June 15, 2033 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of whether any of the foregoing circumstances have occurred. The conversion rate will initially equal 33.1301 shares of common stock per $1,000 principal amount of notes (which is equivalent to an initial conversion price of approximately $30.18 per share of common stock), subject to adjustment. Upon conversion of a note, the Company will pay or deliver, as the case may be, either cash, shares of its common stock or a combination of cash and shares of its common stock, at the Company's election, as provided in the indenture. If holders elect to convert their notes in connection with a "fundamental change" (as defined in the indenture) that occurs on or before December

Table of Contents

22, 2018, the Company will, to the extent provided in the indenture, increase the conversion rate applicable to such notes ("make-whole feature").

Holders will have the option to require the Company to redeem for cash any notes held by them in the event of a fundamental change, e.g., a merger or an acquisition, at a purchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest to, but excluding, the redemption date. Holders also have the option to require the Company to redeem for cash any notes held by them on December 15, 2018, December 15, 2023 and December 15, 2028 at a redemption price equal to 100% of the principal amount of the notes plus accrued and unpaid interest to, but excluding, the redemption date. The Company may redeem the notes in whole or in part at any time on or after December 22, 2018 at 100% of the principal amount, plus accrued and unpaid interest to, but excluding, the redemption date.

The Company considered the features embedded in the notes, that is, the conversion feature, the holders' put feature, the Company's call feature, and the make-whole feature, and concluded that they are not required to be bifurcated and accounted for separately from the host debt instrument.

Because of its option to settle conversion of the notes in cash, the Company separated the liability and equity components of the notes. The carrying amount of the liability component at issuance date of $209.1 million was calculated by estimating the fair value of similar liabilities without a conversion feature. The residual principal amount of the notes of $49.6 million was allocated to the equity component. The resulting debt discount was amortized as interest expense and was fully amortized as of January 27, 2019.

In December 2018, the holders of the 2033 Notes representing approximately $257.7 million of the principal amount of the 2033 Notes exercised their rights to redeem their 2033 Notes at a redemption price equal to 100% of the principal amount of the notes. All redemptions were in accordance with the original terms of the 2033 Notes and no gain or loss was recognized as a result of redemption.

As of January 27, 2019, the 2033 Notes consisted of the following (in thousands):

Liability component:	
Principal	$1,054
Unamortized debt discount	—
Unamortized debt issuance costs	—
Net carrying amount of the liability component	$1,054
Carrying amount of the equity component	$49,648

The Company incurred approximately $3.8 million in transaction costs in connection with the issuance of the notes. These costs were allocated to the liability and equity components in proportion to the allocation of proceeds. Transaction costs of $3.1 million, allocated to the liability component, were recognized as a non-current asset and amortized as interest expense and were fully amortized as of January 27, 2019. Transaction costs of $725,000, allocated to the equity component, were recognized as a reduction of additional paid-in capital.

The following table sets forth interest expense information related to the 2033 Notes:

(in thousands, except percentages)	Three Months Ended		Nine Months Ended	
	January 27, 2019	January 28, 2018	January 27, 2019	January 28, 2018
Contractual interest expense	$163	$ 324	$811	$ 972
Amortization of the debt discount	1,606	2,654	7,086	7,878
Amortization of issuance costs	77	154	386	462
Total interest cost	$1,846	$ 3,132	$8,283	$ 9,312

Effective interest rate on the liability component	4.87 %	4.87 %	4.87 %	4.87 %

The Company applies the treasury stock method to determine the potential dilutive effect of the 2033 Notes on net income per share as a result of the Company's intent and stated policy to settle the principal amount of the 2033 Notes in cash.

Table of Contents

7. Fair Value of Financial Instruments

The Company's financial instruments measured at fair value on a recurring basis as of January 27, 2019 and April 29, 2018 were as follows:

	January 27, 2019					April 29, 2018				
	Carrying	Fair Value				Carrying	Fair Value			
(in thousands)	Amount	Level 1	Level 2	Level 3	Total	Amount	Level 1	Level 2	Level 3	Total
Money market funds	$500,000	$500,000	$—	$—	$500,000	$—	$—	$—	$—	$—

The Company's financial instruments not measured at fair value on a recurring basis as of January 27, 2019 and April 29, 2018 were as follows:

	January 27, 2019					April 29, 2018				
	Carrying	Fair Value				Carrying	Fair Value			
(in thousands)	Amount	Level 1	Level 2	Level 3	Total	Amount	Level 1	Level 2	Level 3	Total
Commercial paper	$—	$—	$—	$—	$—	$548,010	$—	$548,010	$—	$548,010
Certificates of deposit	$3,754	$—	$3,754	$—	$3,754	$336,828	$—	$336,828	$—	$336,828
2033 Notes	$1,054	$1,057	$—	$—	$1,057	$251,278	$256,001	$—	$—	$256,001
2036 Notes	$505,400	$553,256	$—	$—	$553,256	$488,877	$520,016	$—	$—	$520,016

The fair values of the Company's investments in commercial papers and certificates of deposit are based on quoted market prices for similar instruments or non-binding market prices that are corroborated by observable market data. The fair values of money market funds, the 2033 Notes, and the 2036 Notes are based on the price in the open market as of or close to the respective balance sheet dates. The difference between the carrying value and the fair value for the convertible notes is primarily due to the spread between the conversion price and the market value of the shares underlying the conversion as of each respective balance sheet date.

8. Legal Matters

The Company accrues a liability for legal contingencies when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. The Company reviews these accruals and adjusts them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel and other relevant information. To the extent new information is obtained and the Company's views on the probable outcomes of claims, suits, assessments, investigations or legal proceedings change, changes in the Company's accrued liabilities would be recorded in the period in which such determination is made. For the matters referenced below, the amount of liability is not probable or the amount cannot be reasonably estimated; and, therefore, accruals have not been made. In addition, in accordance with the relevant authoritative guidance, for matters which the likelihood of material loss is at least reasonably possible, the Company provides disclosure of the possible loss or range of loss; however, if a reasonable estimate cannot be made, the Company will provide disclosure to that effect.

Due to the nature of the Company's business, it is subject to claims alleging infringement by various Company products and services. The Company believes that it has meritorious defenses to the allegations made in its pending cases and intends to vigorously defend these lawsuits; however, it is currently unable to determine the ultimate outcome of these or similar matters. In addition, the Company is a defendant in various litigation matters generally arising out of the normal course of business. Although it is difficult to predict the ultimate outcomes of these cases, the Company believes that it is not reasonably possible that the ultimate outcomes will materially and adversely affect its business, financial position, results of operations or cash flows.

Class Action and Shareholder Derivative Litigation

Several securities class action lawsuits related to the Company's March 8, 2011 earnings announcement alleging claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 have been filed in the United States District Court for the Northern District of California on behalf of a purported class of persons who purchased stock between December 2, 2010 through March 8, 2011. The named defendants are the Company and Jerry Rawls, its former Chief Executive Officer and former Chairman of the Board, and Eitan Gertel, its former Chief Executive Officer. To date, no specific amount of damages has been alleged. The cases were consolidated, a lead plaintiff was appointed and a consolidated complaint was filed. The

Table of Contents

Company filed a motion to dismiss the case. On January 16, 2013, the District Court granted the Company's motion to dismiss and granted the lead plaintiffs leave to amend the consolidated complaint. An amended consolidated complaint was filed on February 6, 2013. Thereafter, the Company filed a renewed motion to dismiss the case. On September 30, 2013, the District Court granted the Company's motion and dismissed the case with prejudice, and plaintiff appealed. On January 8, 2016, the Ninth Circuit Court of Appeals reversed the judgment in part for further proceedings in the District Court. On July 15, 2016, lead plaintiff filed a Second Amended Complaint in the District Court. On August 19, 2016, the Company moved to dismiss. On May 1, 2017, the District Court denied the motion and a case scheduling order has been issued. On December 5, 2017, the District Court issued an order denying class certification. On February 1, 2018, the plaintiff filed a petition with the Ninth Circuit Court of Appeals for permission to appeal the denial of class certification and, on July 13, 2018, the Ninth Circuit Court of Appeals denied the petition for permission to appeal. On October 10, 2018, the plaintiff filed a new motion for class certification, which the Company has opposed and a hearing on the motion is scheduled for May 16, 2019.

In addition, two purported shareholder derivative lawsuits related to the Company's March 8, 2011 earnings announcement have been filed in the California Superior Court for the County of Santa Clara, and a third derivative lawsuit has been filed in the United States District Court for the Northern District of California. The complaints assert claims for alleged breach of fiduciary duty, unjust enrichment, and waste on behalf of the Company. Named as defendants are the members of the Company's board of directors at the time of the claim and certain officers, including Jerry Rawls, the Company's former Chief Executive Officer and former Chairman of the Board, Eitan Gertel, the Company’s former Chief Executive Officer, and Kurt Adzema, the Company’s Chief Financial Officer. No specific amount of damages has been alleged and, by the derivative nature of the lawsuits, no damages will be alleged against the Company. The state court cases were consolidated, a lead plaintiff was appointed to file a consolidated complaint, and the cases were stayed by the agreement of the parties. On August 7, 2017, the plaintiff in the federal case filed an amended complaint. On September 5, 2018, the court granted the motion to dismiss with leave to amend. The parties agreed to settle the federal case and, on February 20, 2019, plaintiff filed an unopposed motion for preliminary approval of the settlement, under which the Company has agreed to implement a series of enhancements to its corporate governance policies and procedures. The motion is scheduled to be heard on April 18, 2019.

Litigation relating to the Merger

As of January 27, 2019, seven lawsuits have been filed by alleged Finisar stockholders challenging the Merger: (i) Hein v. Finisar Corporation, et al., 19CV340510, in the Superior Court of California, County of Santa Clara; (ii) Tenvold v. Finisar Corporation, et al., 1:19-cv-00050, in the United States District Court for the District of Delaware; (iii) Klein v. Finisar Corporation, et al., 3:19-cv-00155, in the United States District Court for the Northern District of California; (iv) Wheby v. Finisar Corporation, et al., 1:19-cv-00064, in the United States District Court for the District of Delaware; (v) Sharma v. Finisar Corporation, et al., 3:19-cv-00220, in the United States District Court for the Northern District of California; (vi) Davis v. Finisar Corporation, et al., 3:19-cv-00271, in the United States District Court for the Northern District of California; and (vii) Buchansky v. Finisar Corporation, et al., 5:19-cv-00446, in the United States District Court for the Northern District of California (collectively, the “Actions”).

Plaintiffs in the Actions name as defendants Finisar and each member of the Finisar Board. In addition, plaintiffs in the Hein, Tenvold, and Klein actions name II-VI and Merger Subsidiary as defendants. Further, plaintiffs in the Hein, Tenvold, Klein, Wheby, Davis, and Buchansky actions seek to recover on behalf of a putative class consisting of all similarly situated Finisar stockholders.

Plaintiff in the Hein action alleges that the Finisar Board breached its fiduciary duties to Finisar stockholders by, among other things, purportedly engaging in an insufficient sales process, obtaining inadequate merger consideration, and filing a materially misleading preliminary proxy statement. The Hein plaintiff further asserts that II-VI and the Merger Subsidiary knowingly aided and abetted the Finisar Board in breaching their fiduciary duties to Finisar stockholders by entering into the Merger. The Hein plaintiff seeks preliminary and permanent injunction of the proposed transaction unless the proxy statement is amended, rescission and unspecified damages if the Merger is consummated, and attorneys' fees and expert fees and costs.

Plaintiffs in the Tenvold, Klein, Wheby, Sharma, Davis, and Buchansky actions purport to state claims for violations of Sections 14(a) and 20(a) of the Exchange Act and Rule 14a-9 and, in the case of the Davis complaint, Regulation G promulgated thereunder. Plaintiffs in these actions generally allege that the preliminary proxy statement omits material information with respect to the Merger, and seek, among other things, an order enjoining the defendants from proceeding with closing the Merger; unspecified damages, attorneys' fees and expert fees, and expenses and costs; and in the event the Merger is consummated before entry of final judgment, rescission of the Merger or rescissory damages. Defendants believe that the complaints are without merit.

Table of Contents

On January 28, 2019, an eighth complaint, captioned Pappey v. Finisar Corporation, et al., 1:19-cv-00167, was filed in the United States District Court for the District of Delaware. In Pappey, plaintiff seeks to recover on behalf of a putative class consisting of all similarly situated Finisar stockholders. As with the plaintiffs in the Tenvold, Klein, Wheby, Sharma, Davis, and Buchansky actions, plaintiff seeks to recover under Sections 14(a) and 20(a) of the Exchange Act and Rule 14a-9 on the grounds that the preliminary proxy statement is false and misleading. Plaintiff also seeks an order enjoining the defendants from proceeding with closing the Merger; unspecified damages, attorneys', and expert fees, and expenses and costs; and in the event the Merger is consummated before entry of final judgment, rescission of the Merger or rescissory damages. The defendants similarly believe this complaint is without merit.

9. Guarantees and Indemnifications

Upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligations it assumes under that guarantee. As permitted under Delaware law and in accordance with the Company's bylaws, the Company indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving in such capacity at the Company's request. The term of the indemnification period is for the officer's or director's lifetime. The Company may terminate the indemnification agreements with its officers and directors upon 90 days written notice, but termination will not affect claims for indemnification relating to events occurring prior to the effective date of termination. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer liability insurance policy that may enable it to recover a portion of any future amounts paid.

The Company enters into indemnification obligations under its agreements with other companies in its ordinary course of business, including agreements with customers, business partners and insurers. Under these provisions, the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities or the use of the Company's products. These indemnification provisions generally survive termination of the underlying agreement. In some cases, the maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited.

The Company believes the fair value of these indemnification obligations is immaterial. Accordingly, the Company has not recorded any liabilities for these agreements as of January 27, 2019. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements.

Table of Contents

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

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We use words like “anticipates,” “believes,” “plans,” “expects,” “future,” “intends” and similar expressions to identify these forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events; however, our business and operations are subject to a variety of risks and uncertainties, and, consequently, actual results may materially differ from those projected by any forward-looking statements. As a result, you should not place undue reliance on these forward-looking statements since they may not occur.

Certain factors that could cause actual results to differ from those projected are discussed in “Part II. Other Information, Item 1A. Risk Factors.” We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events.

The following discussion should be read together with our condensed consolidated financial statements and related notes thereto included elsewhere in this report.

Business Overview

We are a global technology leader in optical communications, providing components and subsystems to networking equipment manufacturers, data center operators, telecom service providers, consumer electronics and automotive companies. We design products that meet the increasing demands for network bandwidth, data storage and 3D sensing subsystems. Our optical subsystems consist primarily of transmitters, receivers, transceivers, transponders and active optical cables, which provide the fundamental optical-electrical, or optoelectronic interface for interconnecting the electronic equipment used in these networks, including the switches, routers, and servers used in wireline networks as well as the antennas and base stations used in wireless networks. These products rely on the use of semiconductor lasers and photodetectors in conjunction with integrated circuits and novel optoelectronic packaging to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable at speeds ranging from less than 1 gigabit per second, or Gbps, to more than 400 Gbps, over distances of less than 10 meters to more than 2,000 kilometers, using a wide range of network protocols and physical configurations.

We also provide products known as wavelength selective switches, or WSS. In long-haul and metro networks, each fiber may carry 50 to more than 100 different high-speed optical wavelengths. WSS are switches that are used to dynamically switch network traffic from one optical fiber to multiple other fibers without first converting to an electronic signal. The wavelength selective feature means that WSS enable any wavelength or combination of wavelengths to be switched from the input fiber to the output fibers. WSS products are sometimes combined with other components and sold as linecards that plug into a system chassis referred to as a reconfigurable optical add/drop multiplexers, or ROADM.

Finally, we have entered the high-growth 3D Sensing market. 3D Sensing enables features such as facial recognition, gaming and virtual reality. In addition, there are applications in the automotive market such as LiDAR and in-cabin recognition. Today, VCSELs (Vertical Cavity Surface Emitting Lasers) are core to 3D Sensing and we are able to leverage multiple years of experience in technology in these emerging applications. We both design and manufacture these lasers and continue to expand our capacity in order to meet demand.

Our line of optical components also includes packaged lasers and photodetectors for data communication and telecommunication applications.

Demand for our products is largely driven by the continually growing need for additional network bandwidth created by the ongoing proliferation of data and video traffic from video downloads, Internet protocol TV, social networking, on-line gaming, file sharing, enterprise IP/Internet traffic, cloud computing, and data center virtualization that must be handled by both wireline and wireless networks. Mobile traffic is increasing as the result of proliferation of smartphones, tablet computers, and other mobile devices.

Our manufacturing operations are vertically integrated and we produce many of the key components used in making our products, including lasers, photodetectors and integrated circuits, or ICs, designed by our internal IC engineering teams. We also have internal assembly and test capabilities that make use of internally designed equipment for the automated testing of our optical subsystems and components.

Table of Contents

We sell our products primarily to manufacturers of storage systems, networking equipment and telecommunication equipment such as Broadcom, Ciena, Cisco Systems, Dell EMC, Ericsson, FiberHome, Fujitsu, Hewlett Packard Enterprise, Huawei, IBM, Juniper, Nokia, QLogic, and ZTE, and to their contract manufacturers. These customers, in turn, sell their systems to businesses and to wireline and wireless telecommunication service providers and cable TV operators, collectively referred to as carriers. We also sell products to end-users.

Our cost of revenues consists of materials, salaries and related expenses for manufacturing personnel, manufacturing overhead, warranty expense, inventory adjustments for obsolete and excess inventory and the amortization of acquired developed technology associated with acquisitions that we have made. As a result of building a vertically integrated business model, our manufacturing cost structure has become more fixed. While this can be beneficial during periods when demand is strong, it can be more difficult to reduce costs during periods when demand for our products is weak, product mix is unfavorable or selling prices are generally lower. While we have undertaken measures to reduce our operating costs, there can be no assurance that we will be able to reduce our cost of revenues sufficiently to achieve or sustain profitability.

Since October 2000, we have completed the acquisition of two publicly-held companies. We have also completed the acquisition of 13 privately-held companies and certain businesses and assets from seven other companies in order to broaden our product offerings and provide new sources of revenue, production capabilities and access to advanced technologies that we believe will enable us to reduce our product costs and develop innovative and more highly integrated product platforms while accelerating the timeframe required to develop such products.

Merger Agreement

On November 8, 2018, the Company, II-VI Incorporated, a Pennsylvania corporation (“Parent” or "II-VI") and Mutation Merger Sub Inc., a Delaware corporation and a wholly owned subsidiary of Parent (“Merger Subsidiary”), entered into an Agreement and Plan of Merger (the “Merger Agreement”), pursuant to which, among other things, Merger Subsidiary will be merged with and into the Company (the “Merger”), with the Company surviving the Merger as a wholly owned subsidiary of Parent.

At the time the Merger becomes effective (the “Effective Time”), each issued and outstanding share of common stock, par value $0.001 per share, of the Company (“Company Stock”) (other than shares of Company Stock owned by Parent or Merger Subsidiary or any direct or indirect wholly owned subsidiary of Parent, which will be cancelled without consideration, and holders of Company Stock, if any, who properly exercise their appraisal rights under the General Corporation Law of the State of Delaware) outstanding immediately prior to the Merger will be automatically cancelled and converted into the right to receive, for each share of Company Stock, at the stockholder’s election and subject to proration in the event the cash consideration or Parent Common Stock (as defined below) consideration is oversubscribed, either (i) $26.00 in cash (the “Cash Election Consideration”), (ii) 0.5546 of a share of common stock, no par value, of Parent (“Parent Common Stock”) (the “Stock Election Consideration”), or (iii) a combination of (A) 0.2218 of a share of Parent Common Stock (the “Exchange Ratio”) and (B) $15.60 in cash, without interest (the “Mixed Election Consideration”). On an average basis across all shares of Company Stock (including the Options (as defined below) and Performance RSUs (as defined below)), at the closing of the Merger, 60% of the aggregate amount of the outstanding shares of Company Stock (including the Options and Performance RSUs) will be converted into the right to receive the Cash Election Consideration, with the remaining 40% converted into the right to receive the Stock Election Consideration.

Pursuant to the Merger Agreement, at the Effective Time, each outstanding and unexercised option to purchase Company Stock (whether vested or unvested) (an “Option”) shall automatically be cancelled and terminated and converted into the right to receive an amount of Mixed Election Consideration equal to the product of (i) the excess, if any, of the Cash Election Consideration over the exercise price per share of such Option multiplied by (ii) the number of shares of Company Stock subject to such Option, payable no later than the Company’s next payroll date after the closing of the Merger. Further, as of the Effective Time, each award of restricted stock units of the Company that is outstanding immediately prior to the Effective Time and is subject to a performance-based vesting condition (a “Performance RSU”) that relates solely to the value of Company Stock will vest as to a number of shares determined under the terms of the award and will be cancelled and extinguished and converted into the right to receive the Cash Election Consideration, the Stock Election Consideration or the Mixed Election Consideration in accordance with the election made by the holder of such Performance RSU. At the Effective Time, each other award of restricted stock units of the Company that is outstanding and unvested will be assumed by Parent and continue to be subject to substantially the same terms and conditions (including vesting requirements) as in effect immediately prior to the Effective Time, except that the number of shares of Parent Common Stock subject to such assumed restricted stock unit awards will be equal to the product of (i) the number of shares of Company Stock underlying such unvested restricted stock unit award as of immediately prior to the Effective Time multiplied by (ii) the sum of the (A) Exchange Ratio plus (B) the quotient obtained by dividing $15.60 by the Equity Award Measurement Price. The “Equity Award Measurement Price” means the

Table of Contents

volume weighted average price per share of Parent Common Stock on NASDAQ for the ten (10) consecutive trading days ending on (and including) the third trading day immediately prior to the Effective Time.

The Merger Agreement also provides, among other things, that the board of directors of Parent (the “Parent Board”) will appoint, at the Effective Time, three members, each of whom are (i) members of the board of directors of the Company (the “Board”) as of the date of the Merger Agreement, (ii) mutually agreed to by the Company and Parent, acting in good faith, and (iii) reasonably approved by the Corporate Governance and Nominating Committee of the Parent Board.

The closing of the Merger is subject to, among other things, the adoption of the Merger Agreement by the affirmative vote of the holders of at least a majority of the outstanding shares of Company Stock (the “Company Stockholder Approval”) and the affirmative vote of at least a majority of the votes cast for the proposal on the issuance of the Parent Common Stock and any restricted units of Parent issuable in connection with the Merger (the “Parent Stockholder Approval”). The closing of the Merger is also subject to various customary conditions, including the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended; receipt of other specified regulatory approvals; the absence of any temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction enjoining or otherwise prohibiting the consummation of the Merger; the SEC having declared effective a Form S-4 with respect to, and the approval of the listing on NASDAQ of, the shares of Parent Common Stock issuable in connection with the Merger; the accuracy of the representations and warranties contained in the Merger Agreement (generally subject to a material adverse effect qualification); compliance with the covenants and agreements in the Merger Agreement in all material respects; and no material adverse effect on either the Company or Parent. The closing of the Merger is also subject to Parent, the Company and Wells Fargo Bank, National Association (the “Trustee”), entering into a supplemental indenture in connection with that certain (i) indenture, dated as of December 16, 2013 (the “2033 Notes Indenture”), by and among the Company and the Trustee governing the Company’s 0.50% Convertible Senior Notes due 2033 (the “2033 Notes”) and (ii) indenture, dated as of December 21, 2016 (the “2036 Notes Indenture” and, together with the 2033 Notes Indentures, the “Indentures”), by and among the Company and the Trustee governing the Company’s 0.50% Convertible Senior Notes due 2036 (the “2036 Notes” and, together with the 2033 Notes, the “Notes”) providing, among other items, (a) at and after the Effective Time, pursuant, and subject to, the terms and conditions of the applicable Indenture, for the change in right to convert each $1,000 principal amount of the 2033 Notes and the 2036 Notes, as applicable, into the amount of shares of Parent Common Stock and cash, or the combination thereof, that a holder of a number of shares of Company Stock equal to the conversion rate of the 2033 Notes and the 2036 Notes immediately prior to the Effective Time would have owned or been entitled to receive upon the Effective Time, and (b) Parent’s full and unconditional guarantee, on a senior unsecured basis, of the 2033 Notes and the 2036 Notes. Though not a condition to Closing, Parent and Merger Subsidiary are also obligated to use its reasonable best efforts to obtain debt financing that, together with the other financial resources of Parent, will be sufficient to satisfy all of Parent’s and Merger Subsidiary’s payment obligations under the Merger Agreement.

Pursuant, and subject, to the terms and conditions of the Indentures, each holder of Notes will have the right, at such holder’s option, to require the Company to repurchase any or all of such holder’s Notes, on the date specified by the Company that is not less than 20 business days and not more than 35 business days after the date of the Company’s notice to holders of the occurrence of the Merger, such notice to be delivered within 20 business days of the Effective Time, at a repurchase price equal to 100% of the principal amount thereof, together with accrued and unpaid interest to, but excluding, the repurchase date (“Merger Repurchase Date”). Further pursuant, and subject, to the terms and conditions of the Indentures, all or any portion of a holder’s Notes may be surrendered for conversion at any time from or after the date that is 25 scheduled trading days prior to the anticipated Effective Time (or, if later, the business day after the Company gives holders notice of the Merger) until the Merger Repurchase Date.

The Company has made customary representations and warranties in the Merger Agreement. The Company is also subject to customary covenants, including, among others, covenants (i) to conduct its business in the ordinary course during the period between the execution of the Merger Agreement and the closing of the Merger, (ii) not to engage in specified types of transactions during this period unless agreed to in writing by Parent, (iii) to convene and hold a meeting of its stockholders for the purpose of obtaining the Company Stockholder Approval and (iv) subject to certain exceptions, not to withdraw, amend or modify in a manner adverse to Parent the recommendation of the Board that the Company's stockholders adopt the Merger Agreement.

Parent has made customary representations and warranties in the Merger Agreement. Parent is also subject to customary covenants, including, among others, (i) to conduct its business in the ordinary course during the period between the execution of the Merger Agreement and the closing of the Merger, (ii) not to engage in specified types of transactions during this period unless agreed to in writing by the Company, (iii) to convene and hold a meeting of its shareholders for the purpose of obtaining the Parent Stockholder Approval and (iv) subject to certain exceptions, not to withdraw, amend or modify in a manner adverse

Table of Contents

to the Company the recommendation of the Parent Board that Parent's shareholders vote in favor of the issuance of the Parent Common Stock issuable in connection with the Merger.

The Merger Agreement contains certain termination rights, including the right of the Company to terminate the Merger Agreement under specified circumstances to accept an unsolicited superior proposal from a third party. The Merger Agreement provides that, upon termination of the Merger Agreement by the Company or Parent under specified circumstances (including termination by the Company to accept a superior proposal), a termination fee of $105,200,000 will be payable by the Company to Parent. The Company termination fee is also payable under certain other specified circumstances set forth in the Merger Agreement. Further, the Company has the right to terminate the Merger Agreement if the Parent Board fails to recommend that the shareholders of Parent vote in favor of the issuance of the Parent Common Stock issuable in connection with the Merger or if the Parent withdraws, amends or modifies such recommendation. If the Company timely exercises its right to terminate the Merger Agreement after it obtains actual knowledge of such failure to recommend, or withdrawal, amendment or modification of such recommendation, a termination fee of $105,200,000 will be payable by Parent to the Company. The Merger Agreement also provides that each party to the Merger Agreement may compel the other party or parties thereto to specifically perform its or their obligations under the Merger Agreement.

The foregoing description of the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the Merger Agreement, which was filed as Exhibit 2.1 to our Current Report on Form 8-K on November 9, 2018 and is incorporated herein by reference.

Critical Accounting Estimates

The preparation of our financial statements and related disclosures requires that we make estimates, assumptions and judgments that can have a significant impact on our revenue and operating results, as well as on the value of certain assets and contingent liabilities on our balance sheet. The methods, assumptions, and estimates that we use in applying our accounting policies may require us to apply judgments regarding matters that are inherently uncertain. We consider an accounting policy to be a critical estimate if: (1) we must make assumptions that were uncertain when the judgment was made, and (2) changes in the estimate assumptions, or the selection of a different estimate methodology, could have a significant impact on our financial position and the results that we report in our consolidated financial statements. While we believe that our estimates, assumptions, and judgments are reasonable, they are based on the information available when the estimate was made. We believe there have been no significant changes in our critical accounting estimates from those described in our Annual Report on Form 10-K for the fiscal year ended April 29, 2018.

Results of Operations

Revenues (by market application)	Three Months Ended			
(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Datacom revenue	$231,695	$266,108	$(34,413)	(13)%
Telecom revenue	95,941	66,295	29,646	45%
Total revenues	$327,636	$332,403	$(4,767)	(1)%
Revenues (by market application)	Nine Months Ended			
(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Datacom revenue	$707,889	$781,047	$(73,158)	(9)%
Telecom revenue	262,506	225,367	37,139	16%
Total revenues	$970,395	$1,006,414	$(36,019)	(4)%

During the fiscal 2019, we recognized revenue based on the ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” but during the fiscal 2018 revenue was recognized based on Topic 605. Therefore, the periods are not directly comparable. For additional information regarding the impact of the new accounting standard on our revenue, please refer to “Part I, Item 1, Financial Statements - Note 2. Summary of Significant Accounting Policies”.

Datacom revenue for the three month period ended January 27, 2019 decreased approximately $34.4 million compared to the three month period ended January 28, 2018 primarily due to an approximately $29.5 million decrease in 100 Gbps datacom transceiver revenue.

Table of Contents

Telecom revenue for the three month period ended January 27, 2019 increased approximately $29.6 million compared to the three month period ended January 28, 2018 primarily due to an approximately $20.2 million increase in WSS products revenue.

Datacom revenue for the nine month period ended January 27, 2019 decreased approximately $73.2 million compared to the nine month period ended January 28, 2018. During the period, 40 Gbps datacom transceiver revenue declined approximately $48.6 million and 100 Gbps datacom transceiver revenue declined approximately $25.9 million.

Telecom revenue for the nine month period ended January 27, 2019 increased approximately $37.1 million compared to the nine month period ended January 28, 2018. During the period, WSS and ROADM line card revenue increased approximately $42.4 million while 100 Gbps telecom transceiver revenue declined approximately $6.9 million.

Amortization of Acquired Developed Technology

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ 496	$ 611	$(115)	(19)%
Nine months ended	$ 1,488	$ 1,833	$(345)	(19)%

Amortization of acquired developed technology for the three and nine month periods ended January 27, 2019 decreased compared to the three and nine month periods ended January 28, 2018 due to the roll-off of amortization of certain intangible assets related to our prior acquisitions.

Gross Profit

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$94,423	$88,068	$6,355	7 %
As a percentage of revenues	29 %	26 %		
Nine months ended	$260,790	$299,572	$(38,782)	(13)%
As a percentage of revenues	27 %	30 %		

Gross profit is calculated as revenues less cost of revenues, amortization of acquired developed technology, and, if applicable, impairment of long-lived assets. The gross profit increase for the three month period ended January 27, 2019, compared to the three month period ended January 28, 2018 was attributable primarily to the increase in gross margin. The gross profit decline for the nine month period ended January 27, 2019, compared to the nine month period ended January 28, 2018 was attributable to the combination of overall lower revenue levels and the decline in gross margin.

Gross margin is gross profit reflected as a percentage of revenues. Our cost of revenues consists of materials, salaries and related expenses for manufacturing personnel, manufacturing overhead, warranty expense, and inventory adjustments for excess and obsolete inventory. Gross margin for the three month period ended January 27, 2019 increased compared to the three month period ended January 28, 2018 mostly due to lower net expenses related to inventory reserves during the third quarter of fiscal 2019. Gross margin for the nine month period ended January 27, 2019 declined compared to the nine month period ended January 28, 2018 mostly due to decreases in the average selling prices for our products.

Our industry is characterized by products with average selling prices that decrease over time and we expect this trend to continue. Future decreases in average selling prices will have an unfavorable impact on our future gross profit, which may be partially or fully offset in any period in the event that we are successful in increasing the number of units sold and/or increasing sales of products with higher gross margins. Future decreases in average selling prices also will have an unfavorable impact on our future gross margin, which may be partially or fully offset in any period in the event that we are successful in decreasing the cost of goods sold of our products and/or increasing sales of products with higher gross margins.

Research and Development Expenses

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ 51,274	$ 59,888	$(8,614)	(14)%
Nine months ended	$ 167,007	$ 178,488	$(11,481)	(6)%

Research and development expenses consist primarily of salaries and related costs of employees engaged in research and design activities, including stock-based compensation charges related to those employees, costs of design tools and computer

22

Table of Contents

hardware, costs related to prototyping, and allocated facilities and IT support costs. Research and development expenses for the three month period ended January 27, 2019 decreased compared to the three month period ended January 28, 2018 primarily due to a decrease in employee compensation related expenses as a result of restructuring activities undertaken during the first quarter of fiscal 2019. Research and development expenses for the nine month period ended January 27, 2019 decreased compared to the nine month period ended January 28, 2018 primarily due to a decrease in employee compensation related expenses as a result of restructuring activities undertaken during the first quarter of fiscal 2019, offset by employee severance compensation and other expenses related to restructuring activities undertaken during the first quarter of fiscal 2019.

Sales and Marketing Expenses

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ 12,170	$ 11,913	$ 257	2 %
Nine months ended	$ 37,077	$ 36,494	$ 583	2 %

Sales and marketing expenses consist primarily of salaries and related costs of employees engaged in sales and marketing functions, including stock-based compensation charges related to those employees, commissions for our external sales representatives, costs related to marketing and promotional activities, and allocated facilities and IT support costs. Sales and marketing expenses for the three month period ended January 27, 2019 increased compared to the three month period ended January 28, 2018 due to an increase in commissions to our external sales representatives. Sales and marketing expenses for the nine month period ended January 27, 2019 increased compared to the nine month period ended January 28, 2018 due to an increase in commissions to our external sales representatives as well as employee compensation expenses related to a reduction in force activities undertaken during the first quarter of fiscal 2019.

General and Administrative Expenses

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ 14,973	$ 19,739	$(4,766)	(24)%
Nine months ended	$ 40,448	$ 47,311	$(6,863)	(15)%

General and administrative expenses consist primarily of salaries and related costs of employees engaged in general and administrative functions, including stock-based compensation charges related to those employees, legal, audit and other professional fees, insurance costs, human resources and other corporate costs, and allocated facilities and IT support costs. General and administrative expenses for the three month period ended January 27, 2019 decreased compared to the three month period ended January 28, 2018 primarily due to approximately $7.5 million of stock-based compensation expense recorded during the third quarter of fiscal 2018 related to the modification of equity awards for our former Chief Executive Officer upon his retirement during the third quarter of fiscal 2018 partially offset by approximately $3.1 million of transaction expenses during the third quarter of fiscal 2019 related to the Merger. General and administrative expenses for the nine month period ended January 27, 2019 decreased compared to the nine month period ended January 28, 2018 primarily due to approximately $7.5 million of stock-based compensation expense recorded during the third quarter of fiscal 2018 related to the modification of equity awards for our former Chief Executive Officer upon his retirement during the third quarter of fiscal 2018 and governmental subsidies received in fiscal 2019 in certain jurisdictions in which we conduct business partially offset by approximately $3.1 million of transaction expenses during the third quarter of fiscal 2019 related to the Merger.

Start-Up Costs

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change

Three months ended	$ 15,136	$ 638	$ 14,498	100 %
Nine months ended	$ 34,108	$ 638	$ 33,470	100 %

Start-up costs consist of operating expenses, including employee compensation, facility maintenance and other expenses, related to our recently purchased 700,000 square foot manufacturing facility in Sherman, Texas during the period while it is being brought to its intended use.

Table of Contents

Interest Income

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ 5,333	$ 3,995	$ 1,338	33 %
Nine months ended	$ 16,469	$ 11,181	$ 5,288	47 %

Interest income for the three and nine month periods ended January 27, 2019 increased compared to the respective three and nine month periods ended January 28, 2018 due to an increase in interest rates.

Interest Expense

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ 8,167	$ 9,192	$ (1,025)	(11)%
Nine months ended	$ 27,043	$ 27,336	$ (293)	(1)%

Interest expense for the three and nine month periods ended January 27, 2019 decreased compared to the respective three and nine month periods ended January 28, 2018 primarily due to the redemption of our 0.50% Convertible Senior Notes due 2033 during the third quarter of fiscal 2019.

Other Income (Expense), Net

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ (38)	$ (459)	$ 421	(92)%
Nine months ended	$ (1,043)	$ (2,042)	$ 999	(49)%

Other expense, net for the three month period ended January 27, 2019 decreased compared to the three month period ended January 28, 2018 primarily due to fluctuations of foreign currency exchange rates. Other expense, net for the nine month period ended January 27, 2019 decreased as compared to the nine month period ended January 28, 2018 primarily due to a $2.4 million impairment of one of our minority investments, recognized during the first quarter of fiscal 2018, due to this investee's prolonged negative results of operations and cash flows, partially offset by fluctuations of foreign currency exchange rates.

Provision for Income Taxes

(in thousands, except percentages)	January 27, 2019	January 28, 2018	Change	% Change
Three months ended	$ 12,962	$ 43,874	$ (30,912)	(70)%
Nine months ended	$ 8,185	$ 44,996	$ (36,811)	(82)%

The provision for income taxes for the three and nine month periods ended January 27, 2019 decreased compared to the three and nine month periods ended January 28, 2018 primarily due to approximately $41.8 million of the deferred tax expense recorded during the third quarter of fiscal 2018 associated with the revaluation of our net deferred tax assets and the inclusion of the one-time deemed repatriation of accumulated foreign earnings, both as the result of the TCJA.

Liquidity and Capital Resources

(in millions)	Nine Months Ended January 27, 2019	January 28, 2018
Net cash provided by operating activities	$ 131.5	$ 125.0

Net cash provided by (used in) investing activities	$712.6	$ (130.9)
Net cash provided by (used in) financing activities	$(249.5)	$ 4.8

Operating Cash Flows

Net cash provided by operating activities in the nine month period ended January 27, 2019 primarily consisted of our net loss, as adjusted to exclude depreciation, amortization and other non-cash items totaling $126.6 million. Net cash provided by operating activities in the nine month period ended January 28, 2018 primarily consisted of our net loss, as adjusted to exclude depreciation, amortization and other non-cash items totaling $191.0 million.

Table of Contents

Investing Cash Flows

Net cash provided by investing activities in the nine month period ended January 27, 2019 primarily consisted of net maturities of short-term investments. Net cash used in investing activities in the nine month period ended January 28, 2018 primarily consisted of expenditures for capital assets.

Financing Cash Flows

Net cash used in financing activities in the nine month period ended January 27, 2019 primarily consisted of the redemption of our 0.50% Convertible Senior Notes due 2033 during the third quarter of fiscal 2019. Net cash provided by financing activities in the nine month period ended January 28, 2018 primarily consisted of proceeds from the issuance of shares under our employee stock option and stock purchase plans, offset by share repurchases for tax withholdings on vesting of restricted stock units.

Contractual Obligations and Commercial Commitments

Our contractual obligations at January 27, 2019 were as follows (in thousands):

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 year	1-3 Years	4-5 Years	After 5 Years
0.5% Convertible Senior Notes due 2033 (a)	$1,054	$—	$—	$1,054	$—
0.5% Convertible Senior Notes due 2036	575,000	—	575,000	—	—
Interest on 2036 Notes (b)	8,266	2,875	5,391	—	—
Operating leases (c)	35,828	10,418	13,501	7,562	4,347
Capital purchase obligations	33,030	33,030	—	—	—
Other purchase obligations	113,670	113,670	—	—	—
Total contractual obligations	$766,848	$159,993	$593,892	$8,616	$4,347

(a) Does not include interest on our 0.50% Convertible Senior Notes due 2033 as we have the right to redeem the notes in whole or in part at any time on or after December 22, 2018.

(b) Includes interest on our 0.50% Convertible Senior Notes due 2036 through December 2021 as we have the right to redeem the notes in whole or in part at any time on or after December 22, 2021.

(c) Includes operating lease obligations that have been accrued as restructuring charges.

Pursuant to the terms of the 2033 Notes and the 2033 Notes Indenture, holders of the 2033 Notes had an option to require the Company to repurchase on December 15, 2018 (the “Repurchase Date”) all or a portion of such holders’ 2033 Notes (the “Put Option”) at a price equal to 100% of the principal amount of such 2033 Notes, plus accrued and unpaid interest to, but excluding, the Repurchase Date. As of the close of business on December 14, 2018, the Company had received valid Put Option exercise notices from holders that required the Company to repurchase approximately $257.7 million aggregate principal amount of 2033 Notes. The Company settled the Put Option on December 17, 2018 and paid an aggregate of approximately $258.3 million to repurchase all of the 2033 Notes for which Put Option exercises notices were validly delivered and not validly withdrawn. Immediately following the settlement of the Put Option, the repurchased 2033 Notes were canceled and approximately $1.1 million principal amount of 2033 Notes remained outstanding.

The 2033 Notes are convertible into shares of our common stock at specified conversion prices by the holders at their option prior to the close of business on the business day immediately preceding June 15, 2033 only under the following circumstances: (1) during any fiscal quarter commencing after the fiscal quarter ending on January 26, 2014 (and only during such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period ("measurement period"), in which the trading price per $1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events. On or after June 15, 2033 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of whether any of the foregoing circumstances have occurred. The outstanding 2033 Notes remain subject to redemption by the holders in December 2023 and 2028. These notes are redeemable by us, in whole or in part, at any time on or after December 22, 2018.

Table of Contents

The 2036 Notes are convertible into shares of our common stock at specified conversion prices by the holders at their option prior to the close of business on the business day immediately preceding June 15, 2036 only under the following circumstances: (1) during any fiscal quarter commencing after the fiscal quarter ending on January 29, 2017 (and only during such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period ("measurement period"), in which the trading price per $1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events. On or after June 15, 2036 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of whether any of the foregoing circumstances have occurred. The 2036 Notes are also subject to redemption by the holders in December 2021, 2026 and 2031. These notes are redeemable by us, in whole or in part, at any time on or after December 22, 2021.
Operating lease obligations consist primarily of base rents for facilities we occupy at various locations.
Capital purchase obligations represent commitments for the construction or purchase of property, equipment and improvements. They were not recorded as liabilities on our consolidated balance sheets as of January 27, 2019, as we had not yet received the related goods or taken title to the property.
Other purchase obligations represent all open purchase orders and contractual obligations in the ordinary course of business for which we have not received the goods or services. Although open purchase orders are considered enforceable and legally binding, their terms generally allow us the option to cancel, reschedule and adjust our requirements based on our business needs prior to the delivery of goods or performance of services.

Sources of Liquidity and Capital Resource Requirements

At January 27, 2019, our principal sources of liquidity consisted of approximately $911 million of cash and cash equivalents and short-term investments, of which approximately $233 million was held by our foreign subsidiaries.

We believe that our existing balances of cash, cash equivalents and short-term investments, together with the cash expected to be generated from future operations, will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may, however, require additional financing to fund our operations in the future, to finance future acquisitions that we may propose to undertake or to repay or otherwise retire all of our outstanding 2033 Notes, in the aggregate principal amount of $1.1 million, which are subject to redemption by the holders in December 2023 and 2028, or our 2036 Notes, in the aggregate principal amount of $575.0 million, which are subject to redemption by the holders in December 2021, 2026 and 2031. A significant contraction in the capital markets, particularly in the technology sector, may make it difficult for us to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, our business, financial condition and results of operations will be adversely affected.

Off-Balance-Sheet Arrangements

At January 27, 2019 and April 29, 2018, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk affecting Finisar, see Item 7A: “Quantitative and Qualitative Disclosures about Market Risk” in our Annual Report on Form 10-K for the fiscal year ended April 29, 2018. Our exposure related to market risk has not changed materially since April 29, 2018.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended January 27, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to “Part I, Item 1, Financial Statements - Note 8. Legal Matters” for a description of pending legal proceedings, including material developments in certain of those proceedings during the quarter ended January 27, 2019.

Item 1A. Risk Factors

OUR FUTURE PERFORMANCE IS SUBJECT TO A VARIETY OF RISKS, INCLUDING THOSE DESCRIBED BELOW. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCUR, OUR BUSINESS COULD BE HARMED AND THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE. YOU SHOULD ALSO REFER TO THE OTHER INFORMATION CONTAINED IN THIS REPORT, INCLUDING OUR CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES. OTHER THAN THE ADDITION OF THE FIRST RISK FACTOR BELOW, THE RISK FACTORS DESCRIBED BELOW DO NOT CONTAIN ANY MATERIAL CHANGES FROM THOSE PREVIOUSLY DISCLOSED IN ITEM 1A OF OUR ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED APRIL 29, 2018.

There are risks and uncertainties associated with the Merger.

The Merger, whether or not consummated, may result in a loss of our key personnel and may disrupt our sales and marketing or other key business activities, including our relationships with customers, suppliers and other third parties, which may have an adverse impact on our financial performance. Our business relationships may be subject to disruption due to uncertainty associated with the Merger, which could have an adverse effect on our results of operations, cash flows and financial condition and, following the completion of the Merger, those of the combined company. Additionally, we have incurred and will continue to incur substantial financial advisory, legal, and other professional fees and expenses in connection with the Merger, which we must pay regardless of whether the Merger is completed. These payments will negatively impact our results of operations, cash flows and financial condition.

Parties with which we do business may be uncertain as to the effects on them from the Merger and the related transactions, including their current or future business relationships with us or the combined company. These relationships may be subject to disruption, as customers, suppliers and other persons with whom we have business relationships may delay or defer certain business decisions or might decide to terminate, change or renegotiate their relationships with us, or consider entering into business relationships with parties other than us or the combined company. Additionally, our current and prospective employees may experience uncertainty about their roles with us or the combined company following the Merger, which may materially adversely affect our ability to attract and retain key personnel during the pendency of the Merger. These disruptions could have an adverse effect on our results of operations, cash flows and financial position or those of the combined company following the completion of the Merger. The risk, and adverse effect, of any disruption could be exacerbated by a delay in completion of the Merger or termination of the Merger Agreement.

The Merger is subject to a number of conditions, some of which are outside of the parties’ control, and, if these conditions are not satisfied, the Merger Agreement may be terminated and the Merger may not be completed. The Merger Agreement contains a number of conditions that must be fulfilled to complete the Merger. These conditions include, among other customary conditions, the affirmative vote of the holders of at least a majority of the outstanding shares of Company Stock and the affirmative vote of at least a majority of the votes cast for the proposal on the issuance of the Parent Common Stock and any restricted units of Parent issuable in connection with the Merger, regulatory approvals, including in China, and that certain supplemental indenture being entered into by Parent, the Company and Trustee with respect to the Notes. These conditions are described in more detail in the Merger Agreement, which is included as Exhibit 2.1 to our Current Report on Form 8-K filed with the SEC on November 9, 2018. The required satisfaction of these conditions could delay the completion of the Merger for a significant period of time or prevent it from occurring. Any delay in completing the Merger could cause us or the combined company not to realize some or all of the benefits that the parties expect us or the combined company to achieve in connection with the Merger. Further, there is no assurance that all of the conditions set forth in the Merger Agreement will be satisfied or waived to the extent permitted by applicable law or that the Merger will occur when or as expected. If the Merger is not completed, the share price of our common stock could decline, for reasons including the loss of the premium over the pre-announcement market price of our common stock that was to be paid upon consummation of the Merger.

Further, until the earlier of the Effective Time and the termination of the Merger Agreement, the Merger Agreement restricts us from taking specified actions without the consent of II-VI, and requires us to generally operate in the ordinary course of business consistent with past practices. These restrictions may prevent us from making appropriate changes to our businesses, retaining its workforce, paying dividends or pursuing attractive business opportunities that may arise prior to the completion of the Merger.

Lawsuits have been filed against us, our Board, II-VI, and Merger Subsidiary, and other lawsuits may be filed against us, II-VI, Merger Subsidiary, and/or their respective boards of directors challenging the Merger. An adverse ruling in any such lawsuit may prevent the Merger from being completed.

As of January 27, 2019, seven lawsuits have been filed by alleged Finisar stockholders challenging the Merger: (i) Hein v. Finisar Corporation, et al., 19CV340510, in the Superior Court of California, County of Santa Clara; (ii) Tenvold v. Finisar Corporation, et al., 1:19-cv-00050, in the United States District Court for the District of Delaware; (iii) Klein v. Finisar Corporation, et al., 3:19-cv-00155, in the United States District Court for the Northern District of California; (iv) Wheby v. Finisar Corporation, et al., 1:19-cv-00064, in the United States District Court for the District of Delaware; (v) Sharma v. Finisar Corporation, et al., 3:19-cv-00220, in the United States District Court for the Northern District of California; (vi) Davis v. Finisar Corporation, et al., 3:19-cv-00271, in the United States District Court for the Northern District of California; and (vii) Buchansky v. Finisar Corporation, et al., 5:19-cv-00446, in the United States District Court for the Northern District of California (collectively, the “Actions”).

Plaintiffs in the Actions name as defendants Finisar and each member of the Finisar Board. In addition, plaintiffs in the Hein, Tenvold, and Klein actions name II-VI and Merger Subsidiary as defendants. Further, plaintiffs in the Hein, Tenvold, Klein, Wheby, Davis, and Buchansky actions seek to recover on behalf of a putative class consisting of all similarly situated Finisar stockholders.

Plaintiff in the Hein action alleges that the Finisar Board breached its fiduciary duties to Finisar stockholders by, among other things, purportedly engaging in an insufficient sales process, obtaining inadequate merger consideration, and filing a materially misleading preliminary proxy statement. The Hein plaintiff further asserts that II-VI and the Merger Subsidiary knowingly aided and abetted the Finisar Board in breaching their fiduciary duties to Finisar stockholders by entering into the Merger. The Hein plaintiff seeks preliminary and permanent injunction of the proposed transaction unless the proxy statement is amended, rescission and unspecified damages if the Merger is consummated, and attorneys’ fees and expert fees and costs.

Plaintiffs in the Tenvold, Klein, Wheby, Sharma, Davis, and Buchansky actions purport to state claims for violations of Sections 14(a) and 20(a) of the Exchange Act and Rule 14a-9 and, in the case of the Davis complaint, Regulation G promulgated thereunder. Plaintiffs in these actions generally allege that the preliminary proxy statement omits material information with respect to the Merger, and seek, among other things, an order enjoining the defendants from proceeding with closing the Merger; unspecified damages, attorneys’ fees and expert fees, and expenses and costs; and in the event the Merger is consummated before entry of final judgment, rescission of the Merger or rescissory damages. Defendants believe that the complaints are without merit.

On January 28, 2019, an eighth complaint, captioned Pappey v. Finisar Corporation, et al., 1:19-cv-00167, was filed in the United States District Court for the District of Delaware. In Pappey, plaintiff seeks to recover on behalf of a putative class consisting of all similarly situated Finisar stockholders. As with the plaintiffs in the Tenvold, Klein, Wheby, Sharma, Davis, and Buchansky actions, plaintiff seeks to recover under Sections 14(a) and 20(a) of the Exchange Act and Rule 14a-9 on the grounds that the preliminary proxy statement is false and misleading. Plaintiff also seeks an order enjoining the defendants from proceeding with closing the Merger; unspecified damages, attorneys’, and expert fees, and expenses and costs; and in the event the Merger is consummated before entry of final judgment, rescission of the Merger or rescissory damages. The defendants similarly believe this complaint is without merit.

The litigation relating to the Merger are discussed in detail in “Part I, Item 1, Financial Statements - Note 8. Legal Matters” in this Form 10-Q. There can be no assurance that additional complaints will not be filed with respect to the Merger. One of the conditions to completion of the Merger is the absence of any applicable law (including any order) being in effect that prohibits completion of the Merger. Accordingly, if a plaintiff is successful in obtaining an order prohibiting completion of the Merger, then such order may prevent the Merger from being completed, or from being completed within the expected timeframe.

Our quarterly revenues and operating results fluctuate due to a variety of factors, which may result in volatility or a decline in the price of our stock.

Our quarterly operating results have varied significantly due to a number of factors, including:

- fluctuation in demand for our products;

29

- the timing of new product introductions or enhancements by us and our competitors;
- the level of market acceptance of new and enhanced versions of our products;
- the timing of acquisitions that we have undertaken;
- the timing or cancellation of large customer orders;
- the timing of capital expenditures associated with our new manufacturing facility in Sherman, Texas;
- changes in levels of our customers' forecasted demand;
- the length and variability of the sales cycle for our products;
- pricing policy changes by us and our competitors and suppliers;
- the availability of development funding;
- changes in the mix of products sold;
- inventory changes;
- increased competition in product lines, and competitive pricing pressures; and
- the evolving and unpredictable nature of the markets for products incorporating our optical components and subsystems.

We expect that our operating results will continue to fluctuate in the future as a result of these factors and a variety of other factors, including:

- fluctuations in manufacturing yields;
- the emergence of new industry standards;
- failure to anticipate changing customer product requirements;
- the loss or gain of important customers;
- product obsolescence; and
- the amount of research and development expenses associated with new product introductions.

Our operating results could also be harmed by:

- adverse changes in economic conditions in various geographic areas where we or our customers do business;
- acts of terrorism and international conflicts or domestic crises;
- other conditions affecting the timing of customer orders or our ability to fill orders of customers subject to export control or U.S. economic sanctions; or
- a downturn in the markets for our customers' products, particularly the data storage and networking and telecommunication components markets.

We may experience a delay in generating or recognizing revenues for a number of reasons. Open orders at the beginning of each quarter are typically lower than expected revenues for that quarter and are generally cancelable with minimal notice. Accordingly, we depend on obtaining orders during each quarter for shipment in that quarter to achieve our revenue objectives. Failure to ship these products by the end of a quarter may adversely affect our operating results. Furthermore, our customer agreements typically provide that the customer may delay scheduled delivery dates and cancel orders within specified timeframes without significant penalty. Because we base our operating expenses on anticipated revenue trends and a high percentage of our expenses are fixed in the short term, any delay in generating or recognizing forecasted revenues or changes in levels of our customers' forecasted demand could significantly harm our business. It is likely that in some future quarters our operating results will again decrease from the previous quarter or fall below the expectations of securities analysts and investors.

As a result of these factors, our operating results may vary significantly from quarter to quarter. Accordingly, we believe that period-to-period comparisons of our results of operations should not be relied upon as indications of future performance. Any shortfall in revenues or net income from the previous quarter or from levels expected by the investment community could cause a decline in the trading price of our stock.

We may lose sales if our suppliers or independent contract manufacturers fail to meet our needs or go out of business.

We currently purchase a number of key components used in the manufacture of our products from single or limited sources, and we rely on several independent contract manufacturers to supply us with certain key components and subassemblies, including lasers, modulators, and printed circuit boards. We depend on these sources to meet our production needs. Moreover, we depend on the quality of the components and subassemblies that they supply to us, over which we have limited control. Several of our suppliers are or may become financially unstable as the result of current global market conditions. In addition, from time to time we have encountered shortages and delays in obtaining components, and we may encounter additional shortages and delays in the future. If we cannot supply products due to a lack of components, or are unable to redesign products with other components in a timely manner, our business will be significantly harmed. We generally have no long-term contracts with any of our component suppliers or contract manufacturers. As a result, a supplier or contract manufacturer can discontinue supplying components or subassemblies to us without penalty. If a supplier were to discontinue supplying a key component or cease operations, the resulting product manufacturing and delivery delays could be lengthy, and our business could be substantially harmed. We are also subject to potential delays in the development by our suppliers of key components which may affect our ability to introduce new products. Similarly, disruptions in the operations of our key suppliers or in the services provided by our contract manufacturers, including disruptions due to natural disasters, or the transition to other suppliers of these key components or services could lead to supply chain problems or delays in the delivery of our products. These problems or delays could damage our relationships with our customers and adversely affect our business.

We use rolling forecasts based on anticipated product orders to determine our component and subassembly requirements. Lead times for materials and components that we order vary significantly and depend on factors such as specific supplier requirements, contract terms and current market demand for particular components. If we overestimate our component requirements, we may have excess inventory, which would increase our costs. If we underestimate our component requirements, we may have inadequate inventory, which could interrupt our manufacturing and delay delivery of our products to our customers. Any of these occurrences could significantly harm our business.

If we are unable to realize anticipated cost savings from the transfer of certain manufacturing operations to our overseas locations and increased use of internally-manufactured components our results of operations could be harmed.

As part of our ongoing initiatives to reduce the cost of revenues, we expect to realize significant cost savings through (i) the transfer of certain product manufacturing operations to lower cost off-shore locations and (ii) product engineering changes to enable the broader use of internally-manufactured components. The transfer of production to overseas locations may be more difficult and costly than we currently anticipate which could result in increased transfer costs and time delays. Further, following transfer, we may experience lower manufacturing yields than those historically achieved in our U.S. manufacturing locations. In addition, the engineering changes required for the use of internally-manufactured components may be more technically-challenging than we anticipate and customer acceptance of such changes could be delayed. Adverse changes in currency exchange rates between the U.S. dollar and the applicable local currency and/or unanticipated increases in labor costs at our lower cost manufacturing locations could limit the anticipated benefits of the transfer of certain product manufacturing operations to such lower cost locations. If we fail to achieve the planned product manufacturing transfer and increase in internally-manufactured component use within our currently anticipated timeframe, or if our manufacturing yields decrease as a result, we may be unsuccessful in achieving cost savings or such savings will be less than anticipated, and our results of operations could be harmed.

Continued competition in our markets may lead to an accelerated reduction in our prices, revenues and market share.

The end markets for optical products have experienced significant industry consolidation during the past few years while the industry that supplies these customers has experienced less consolidation. As a result, the markets for optical subsystems and components are highly competitive. Our current competitors include a number of domestic and international companies, many of which have substantially greater financial, technical, marketing and distribution resources and brand name recognition than we have. Increased consolidation in our industry, should it occur, will reduce the number of our competitors, but would be likely to further strengthen surviving industry participants. We may not be able to compete successfully against either current or future competitors. Companies competing with us may introduce products that are competitively priced, have increased performance or functionality, or incorporate technological advances and may be able to react quicker to changing customer requirements and expectations. There is also the risk that network systems vendors may re-enter the subsystem market and begin to manufacture the optical subsystems incorporated in their network systems. Increased competition could result in significant price erosion, reduced revenue, lower margins or loss of market share, any of which would significantly harm our business. Our principal competitors for data communication applications include Applied Optoelectronics, Foxconn, Innolight, Lumentum, Oclaro (recently acquired by Lumentum), and Sumitomo. Our principal competitors for telecommunication applications include Acacia Communications, Fujitsu Optical Components, Lumentum, Oclaro, and Sumitomo. Our competitors continue to introduce improved products and we will have to do the same to remain competitive.

Decreases in average selling prices of our products may reduce our gross margins.

The market for optical subsystems is characterized by declining average selling prices resulting from factors such as increased competition, overcapacity, the introduction of new products and increased unit volumes as manufacturers continue to deploy network and storage systems. We have in the past experienced, and in the future may experience, substantial period-to-period fluctuations in operating results due to declining average selling prices. We anticipate that average selling prices will

Table of Contents

decrease in the future in response to product introductions by competitors or us, or by other factors, including pricing pressures from significant customers. In particular, we typically conduct pricing negotiations for our existing products with some of our largest telecommunication OEM customers in the last several months of the calendar year. Decreases in our average selling prices resulting from these negotiations typically become effective at the beginning of the next calendar year and generally have an adverse impact on our gross margins in future quarters. This impact is typically most pronounced in our fourth fiscal quarter ending in April, when the impact of the new pricing is first felt over a full quarter. In order to sustain profitable operations, we must continue to develop and introduce on a timely basis new products that incorporate features that can be sold at higher average selling prices. Failure to do so could cause our revenues and gross margins to decline, which would result in additional operating losses and significantly harm our business.

We may be unable to reduce the cost of our products sufficiently to enable us to compete with others. Our cost reduction efforts may not allow us to keep pace with competitive pricing pressures and could adversely affect our margins. In order to remain competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes. We may not be successful in redesigning our products or delivering our products to market in a timely manner. We cannot assure you that any redesign will result in sufficient cost reductions to allow us to reduce the price of our products to remain competitive or improve our gross margins.

Shifts in our product mix may result in declines in gross margins.

Gross margins on individual products fluctuate over the product's life cycle. Our overall gross margins have fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices for older products and our ability to reduce product costs. These fluctuations are expected to continue in the future.

Failure to accurately forecast our revenues could result in additional charges for obsolete or excess inventories or non-cancelable purchase commitments.

We base many of our operating decisions, and enter into purchase commitments, on the basis of anticipated revenue trends which are highly unpredictable. Some of our purchase commitments are not cancelable, and in some cases we are required to recognize a charge representing the amount of material or capital equipment purchased or ordered which exceeds our actual requirements. In the past, we have periodically experienced significant growth followed by a significant decrease in customer demand such as occurred in fiscal 2001, when revenues increased by 181% followed by a decrease of 22% in fiscal 2002. Based on projected revenue trends during these periods, we acquired inventories and entered into purchase commitments in order to meet anticipated increases in demand for our products, which did not materialize. As a result, we recorded significant charges for obsolete and excess inventories and non-cancelable purchase commitments which contributed to substantial operating losses in fiscal 2002. Should revenues in future periods again fall substantially below our expectations, or should we fail again to accurately forecast changes in demand mix, we could again be required to record substantial charges for obsolete or excess inventories or non-cancelable purchase commitments.

If we encounter sustained yield problems or other delays in the production or delivery of our internally-manufactured components or in the final assembly and test of our products, we may lose sales and damage our customer relationships.

Our manufacturing operations are highly vertically integrated. In order to reduce our manufacturing costs, we have acquired a number of companies, and business units of other companies that manufacture optical components incorporated in our optical subsystem products and have developed our own facilities for the final assembly and testing of our products. For example, we design and manufacture many critical components incorporated in transceivers used for data communication and telecommunication applications, including all of the short wavelength VCSEL lasers, at our wafer fabrication facility in Allen, Texas and manufacture a portion of our internal requirements for longer wavelength lasers at our wafer fabrication facility in Fremont, California. We assemble and test most of our transceiver products at our facilities in Ipoh, Malaysia and Wuxi, China. As a result of this vertical integration, we have become increasingly dependent on our internal production capabilities. The manufacture of critical components, including the fabrication of wafers, and the assembly and testing of our products, involve highly complex processes. For example, minute levels of contaminants in the manufacturing environment, difficulties in the fabrication process or other factors can cause a substantial portion of the components on a wafer to be nonfunctional. These problems may be difficult to detect at an early stage of the manufacturing process and often are time-consuming and expensive to correct. From time to time, we have experienced problems achieving acceptable yields at our wafer fabrication facilities, resulting in delays in the availability of components. Moreover, an increase in the rejection rate of products during the quality control process before, during or after manufacture, results in lower yields and margins. In addition, changes in manufacturing processes required as a result of changes in product specifications, changing customer needs and the introduction of new product lines have historically significantly reduced our manufacturing yields, resulting in low or negative margins on those products. Poor manufacturing yields over a prolonged period of time could adversely affect our ability to deliver our subsystem

Table of Contents

products to our customers and could also affect our sale of components to customers in the merchant market. Our inability to supply components to meet our internal needs could harm our relationships with customers and have an adverse effect on our business.

The markets for our products are subject to rapid technological change, and to compete effectively we must continually introduce new products that achieve market acceptance.

The markets for our products are characterized by rapid technological change, frequent new product introductions, substantial capital investment, changes in customer requirements and evolving industry standards with respect to the protocols used in data communication and telecommunication networks. Our future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address these changes as well as current and potential customer requirements. For example, the market for optical subsystems is currently characterized by a trend toward the adoption of “pluggable” modules and subsystems that do not require customized interconnections and by the development of more complex and integrated optical subsystems. We expect that new technologies will emerge as competition and the need for higher and more cost-effective bandwidth increases. The introduction of new and enhanced products may cause our customers to defer or cancel orders for existing products. In addition, a slowdown in demand for existing products ahead of a new product introduction could result in a write-down in the value of inventory on hand related to existing products and/or a charge for the impairment of long-lived assets related to such products. We have in the past experienced a slowdown in demand for existing products and delays in new product development and such slowdown in demand and delays may occur in the future. To the extent customers defer or cancel orders for existing products due to a slowdown in demand or in the expectation of a new product release or if there is any delay in development or introduction of our new products or enhancements of our products, our operating results would be adversely affected. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, or to license these technologies from third parties. Product development delays may result from numerous factors, including:

- changing product specifications and customer requirements;
- unanticipated engineering complexities;
- expense reduction measures we have implemented, and others we may implement, to conserve our cash and attempt to achieve and sustain profitability;
- difficulties in hiring and retaining necessary technical personnel;
- difficulties in reallocating engineering resources and overcoming resource limitations; and
- changing market or competitive product requirements.

The development of new, technologically advanced products is a complex and uncertain process, requiring high levels of innovation and highly skilled engineering and development personnel, as well as the accurate prediction of technological and market trends. The introduction of new products also requires significant investment to ramp up production capacity, for which benefit will not be realized if customer demand does not develop as expected. Ramping of production capacity also entails risks of delays which can limit our ability to realize the full benefit of the new product introduction. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product announcements by competitors, technological changes or emerging industry standards. Many of these factors are beyond our control. Any failure to respond to technological change would significantly harm our business.

In addition, in order to achieve widespread market acceptance, we must differentiate ourselves from our competition through product offerings and brand name recognition. We cannot assure you that we will be successful in making this differentiation or achieving widespread acceptance of our products. Failure of our existing or future products to maintain and achieve widespread levels of market acceptance will significantly impair our revenue growth.

Our entry into the market for components for consumer electronic products, specifically our VCSEL array products for 3D sensing, involves special risks.

We have recently entered into the market for components for consumer electronic products with our VCSEL array products for 3D sensing. We have purchased a facility in Sherman, Texas to expand our production capacity for these products and expect to make significant investments in this expansion during calendar year 2018. We have not previously participated in this market. The market for components for consumer electronics products and our expansion involve additional risks, including:

- We expect our customer base for these products to be highly concentrated. If we are not able to meet the needs of our customers in this area, including with respect to timing and volume of production, performance and quality, we could

Table of Contents

lose business with our customers. Loss of business with any one customer could have a materially negative impact on our revenue and gross margin.

- We are making significant investment in the expansion of our production capacity for our VCSEL arrays for 3D sensing, including the development of a high-volume production facility in Sherman, Texas. If we are unable to complete our production expansion plan and have our new production lines qualified by our customers on a timely basis, we could harm our customer relationships and lose business, which could have a materially negative impact on our revenue and gross margin.
- We expect revenue from our components for consumer electronic products to have significant seasonal variance due to the timing of new customer product introductions and demand.

Our future success ultimately depends on the continued growth of the communications industry and, in particular, the continued expansion of global information networks, particularly those directly or indirectly dependent upon a fiber optics infrastructure.

We are relying on increasing demand for voice, video and other data delivered over high-bandwidth network systems as well as commitments by network systems vendors to invest in the expansion of the global information network. As network usage and bandwidth demand increase, so does the need for advanced optical networks to provide the required bandwidth. Without network and bandwidth growth, the need for optical subsystems and components, and hence our future growth as a manufacturer of these products, will be jeopardized, and our business would be significantly harmed.

We depend on large purchases from a few significant customers, and any loss, cancellation, reduction or delay in purchases by these customers could harm our business.

A small number of customers have consistently accounted for a significant portion of our revenues. Our success will depend on our continued ability to develop and manage relationships with our major customers. Although we are attempting to expand our customer base, we expect that significant customer concentration will continue for the foreseeable future. We may not be able to offset any decline in revenues from our existing major customers with revenues from new customers, and our quarterly results may be volatile because we are dependent on large orders from these customers that may be reduced, delayed, or cancelled.

The markets in which we have historically sold our optical subsystems and components products are dominated by a relatively small number of systems manufacturers, thereby limiting the number of our potential customers. Recent consolidation of portions of our customer base, including telecommunication systems manufacturers, and potential future consolidation, may have a material adverse impact on our business. Our dependence on large orders from a relatively small number of customers makes our relationship with each customer critically important to our business. We cannot assure you that we will be able to retain our major customers, attract additional customers, or that our customers will be successful in selling their products that incorporate our products. We have in the past experienced delays and reductions in orders from some of our major customers. In addition, our customers have in the past sought price concessions from us, and we expect that they will continue to do so in the future. Expense reduction measures that we have implemented over the past several years, and additional action we are taking to reduce costs, may adversely affect our ability to introduce new and improved products which may, in turn, adversely affect our relationships with some of our key customers. Further, some of our customers may in the future shift their purchases of products from us to our competitors or to joint ventures between these customers and our competitors, or may in certain circumstances produce competitive products themselves. The loss of one or more of our major customers, any reduction or delay in sales to these customers, our inability to successfully develop relationships with additional customers, or future price concessions that we may make could significantly harm our business.

Because we do not have long-term contracts with our customers, our customers may cease purchasing our products at any time if we fail to meet our customers' needs.

Typically, we do not have long-term contracts with our customers. As a result, our agreements with our customers do not provide any assurance of future sales. Accordingly:

- our customers can stop purchasing our products at any time without penalty;
- our customers are free to purchase products from our competitors; and
- our customers are not required to make minimum purchases.

Sales are typically made pursuant to inventory hub arrangements under which customers may draw down inventory to satisfy their demand as needed or pursuant to individual purchase orders, often with extremely short lead times. If we are

Table of Contents

unable to fulfill these orders in a timely manner, it is likely that we will lose sales and customers. If our major customers stop purchasing our products for any reason, our business, financial condition, and results of operations would be harmed.

Our customers often evaluate our products for long and variable periods, which causes the timing of our revenues and results of operations to be unpredictable.

The period of time between our initial contact with a customer and the receipt of an actual purchase order typically spans over a year. During this time, customers may perform, or require us to perform, extensive and lengthy evaluation and testing of our products before purchasing and using the products in their equipment. These products often take substantial time to develop because of their complexity and because customer specifications sometimes change during the development cycle. Our customers do not typically share information on the duration or magnitude of these qualification procedures. The length of these qualification processes also may vary substantially by product and customer, and, thus, cause our results of operations to be unpredictable. While our potential customers are qualifying our products and before they place an order with us, we may incur substantial research and development and sales and marketing expenses and expend significant management effort. Even after incurring such costs, we ultimately may not be able to sell any products to such potential customers. In addition, these qualification processes often make it difficult to obtain new customers, as customers are reluctant to expend the resources necessary to qualify a new supplier if they have one or more existing qualified sources. Once our products have been qualified, the agreements that we enter into with our customers typically contain no minimum purchase commitments. Failure of our customers to incorporate our products into their systems would significantly harm our business.

Our products may contain defects that may cause us to incur significant costs, divert our attention from product development efforts and result in a loss of customers.

Our products are complex and defects may be found from time to time. Networking products frequently contain undetected software or hardware defects when first introduced or as new versions are released. In addition, our products are often embedded in or deployed in conjunction with our customers' products, which incorporate a variety of components produced by third parties. As a result, when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relation problems or loss of customers, all of which would harm our business.

We may not be able to obtain additional capital in the future, and failure to do so may harm our business.

We believe that our existing balances of cash and cash equivalents, together with the cash expected to be generated from future operations, will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months. We may, however, require additional financing to fund our operations in the future, to finance future acquisitions that we may propose to undertake or to repay or otherwise retire our outstanding 2033 Notes, in the aggregate principal amount of $1.1 million, which are subject to redemption by the holders in December 2023 and 2028, or our 2036 Notes, in the aggregate principal amount of $575.0 million, which are subject to redemption by the holders in December 2021, 2026 and 2031. Due to the unpredictable nature of the capital markets, particularly in the technology sector, we cannot assure you that we will be able to raise additional capital if and when it is required, especially if we experience disappointing operating results. If adequate capital is not available to us as required, or is not available on favorable terms, we could be required to significantly reduce or restructure our business operations. If we do raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our existing stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders.

Our international business and operations expose us to additional risks.

Products shipped to customers located outside the United States account for a majority of our revenues. In addition, we have significant tangible assets located outside the United States. Our principal manufacturing facilities are located in Malaysia and China. We currently operate smaller facilities in Australia, Korea, Sweden and Germany, and we are further expanding one of our manufacturing facilities in China. We also rely on several contract manufacturers located in Asia for our supply of key subassemblies. Conducting business outside the United States subjects us to a number of additional risks and challenges, including:

- periodic changes in a specific country's or region's economic conditions, such as recession;
- compliance with a wide variety of domestic and foreign laws and regulations (including those of municipalities or provinces where we have operations) and unexpected changes in those laws and regulatory requirements, including

Table of Contents

- uncertainties regarding taxes, social insurance contributions and other payroll taxes and fees to governmental entities, tariffs, quotas, export controls, export licenses and other trade barriers;
- unanticipated restrictions on our ability to sell to foreign customers where sales of products and the provision of services may require export licenses or are prohibited by government action (for example, in early 2018, the U.S. Department of Commerce prohibited the export and sale of a broad category of U.S. products, as well as the provision of services, to ZTE Corporation, one of our customers in China);
- certification requirements;
- environmental regulations;
- fluctuations in foreign currency exchange rates;
- inadequate protection of intellectual property rights in some countries;
- potential political, legal and economic instability, foreign conflicts, and the impact of regional and global infectious illnesses in the countries in which we and our customers, suppliers and contract manufacturers are located;
- preferences of certain customers for locally produced products;
- difficulties and costs of staffing and managing international operations across different geographic areas and cultures, including assuring compliance with the U.S. Foreign Corrupt Practices Act and other U. S. and foreign anticorruption laws;
- seasonal reductions in business activities in certain countries or regions; and
- fluctuations in freight rates and transportation disruptions.

These factors, individually or in combination, could impair our ability to effectively operate one or more of our foreign facilities or deliver our products, result in unexpected and material expenses, or cause an unexpected decline in the demand for our products in certain countries or regions. Our failure to manage the risks and challenges associated with our international business and operations could have a material adverse effect on our business.

Rising threats of international tariffs, including tariffs applied to goods traded between the United States and China, could materially and adversely affect our business and results of operations.

Since the beginning of 2018, there has been increasing rhetoric, in some cases coupled with legislative or executive action, from several U.S. and foreign leaders regarding the possibility of instituting tariffs on the foreign imports of certain materials. More specifically, in March, April and July of 2018, the U.S. and China have applied tariffs or announced tariffs to be applied in the future to certain of each other’s exports. The list of proposed U.S. tariffs on Chinese products released in July 2018 includes transceiver and other products manufactured in our facility in Wuxi, China. If these new tariffs are implemented, sales of our products manufactured in China and shipped to the United States could decrease, which would negatively impact our business. The institution of trade tariffs both globally and between the U.S. and China specifically carries the risk of negatively impacting China’s overall economic condition, which could have negative repercussions for our business. Furthermore, the imposition of tariffs could cause a decrease in the sales of our products to customers located in China or to other customers selling to Chinese end users, which would directly impact our business.

The current U.S. President, members of his administration, and other public officials, including members of the current U.S. Congress, have made public statements indicating possible significant changes in U.S. trade policy and have taken certain actions that may impact U.S. trade policy, including imposing new or increased tariffs on certain goods imported into the United States. Since we manufacture a significant majority of our products outside the United States, such changes, if adopted, could have a disproportionate impact on our business and make our products more expensive and less competitive in domestic markets. Furthermore, changes in U.S. trade policy could trigger retaliatory actions by affected countries, which could impose restrictions on our ability to do business in or with affected countries or prohibit, reduce or discourage purchases of our products by foreign customers, leading to increased costs of components contained in our products, increased costs of manufacturing our products, and higher prices for our products in foreign markets. For example, there are risks that the Chinese government may, among other things, require the use of local suppliers, compel companies that do business in China to partner with local companies to conduct business and provide incentives to government-backed local customers to buy from local suppliers. Changes in, and responses to, U.S. trade policy could reduce the competitiveness of our products and cause our sales and revenues to drop, which could materially and adversely impact our business and results of operations.

Our ability to hire and retain employees may be negatively impacted by changes in immigration laws, regulations and procedures.

Foreign nationals who are not U.S. citizens or permanent residents constitute an important part of our U.S. workforce, particularly in the areas of engineering and product development. Our ability to hire and retain these workers and their ability to remain and work in the United States are impacted by laws and regulations, as well as by procedures and enforcement practices of various government agencies. Changes in immigration laws, regulations or procedures, including those that may be enacted by the new U.S. presidential administration, may adversely affect our ability to hire or retain such workers, increase our operating expenses and negatively impact our ability to deliver our products and services.

Our future operating results may be subject to volatility, as a result of exposure to foreign exchange risks.

We are exposed to foreign exchange risks. Foreign currency fluctuations may affect both our revenues and our costs and expenses, which would significantly affect our operating results. More than 99% of our sales worldwide are denominated in U.S. dollars. If there is a significant devaluation of the currency in a specific country relative to the dollar, the prices of our products will increase relative to that country's currency, our products may be less competitive in that country and our revenues may be adversely affected.

Although we price our products in U.S. dollars, portions of both our cost of revenues and operating expenses are incurred in foreign currencies, principally the Malaysian ringgit, the Chinese yuan, the Australian dollar, the Swedish krona, and the Euro. As a result, we bear the risk that the rate of inflation in one or more countries will exceed the rate of the devaluation of that country's currency in relation to the U.S. dollar, which would increase our costs as expressed in U.S. dollars. To date, we have not engaged in currency hedging transactions to decrease the risk of financial exposure from fluctuations in foreign exchange rates.

Our failure to protect our intellectual property may significantly harm our business.

Our success and ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements to establish and protect our proprietary rights. We license certain of our proprietary technology, including our digital diagnostics technology, to customers who include current and potential competitors, and we rely largely on provisions of our licensing agreements to protect our intellectual property rights in this technology. We have obtained a number of issued patents, acquired certain other patents as a result of our acquisitions, and we have filed applications for additional patents; however, we cannot assure you that any pending patent applications will result in issued patents, any issued patents will include claims that are sufficiently broad to cover our products and technologies or to provide sufficient protection from our competitors, or that our issued patents will be upheld. Additionally, significant technology used in our product lines is not the subject of any patent protection, and we may be unable to obtain patent protection on such technology in the future. Any infringement of our proprietary rights could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, which could result in loss of competitive advantages and decreased revenues to us.

Despite our efforts to protect our proprietary rights, existing patent, copyright, trademark and trade secret laws afford only limited protection. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may not be able to prevent misappropriation of our technology or deter others from developing similar technology. Furthermore, policing the unauthorized use of our products is difficult and expensive. We are currently engaged in pending litigation to enforce certain of our patents, and additional litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. In connection with the pending litigation, substantial management time has been, and will continue to be, expended. In addition, we have incurred, and we expect to continue to incur, substantial legal expenses in connection with these pending lawsuits. These costs and this diversion of resources could significantly harm our business.

Claims that we or any user of our products infringe third-party intellectual property rights could result in significant expenses or restrictions on our ability to sell our products.

Our industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We are currently involved as a defendant in patent infringement litigation and have been involved in the past as a defendant in such lawsuits. From time to time, we have also been accused of patent infringement that is not subject to current lawsuit, some of which accusations are unresolved. In the future, we may be subject to additional litigation alleging infringement of patent, copyright, trademark and other intellectual property rights to technologies and in various jurisdictions that are important to our business. Any claims asserting that our products infringe or may infringe proprietary rights of third parties, if determined adversely to us, could significantly harm our business. Further, claims against a customer and/or end user of our products that the re-sale or use of our products, either alone or in combination with other products, infringes proprietary rights of third parties could cause customers or users to choose to not or be required to not utilize our products alone or in such combination, which could harm our sales of such products. Any claims, against us or any customer or user of our products, with or without merit, could be time-consuming, result in costly litigation, divert the efforts of our technical and management personnel, cause product shipment delays or require us to enter into royalty or licensing agreements, any of which could

Table of Contents

significantly harm our business. In addition, our agreements with our customers typically require us to indemnify our customers from any expense or liability resulting from claimed infringement of third party intellectual property rights. In the event a claim against us was successful and we could not obtain a license to the relevant technology on acceptable terms or license a substitute technology or redesign our products to avoid infringement, our business would be significantly harmed.

Numerous patents in our industry are held by others, including academic institutions, competitors and non-practicing entities. Optical subsystem suppliers may seek to gain a competitive advantage or other third parties may seek an economic return on their intellectual property portfolios by making infringement claims against us. In the future, we may need to obtain license rights to patents or other intellectual property held by others to the extent necessary for our business. Unless we are able to obtain those licenses on commercially reasonable terms, patents or other intellectual property held by others could inhibit our development of new products. Licenses granting us the right to use third party technology may not be available on commercially reasonable terms, if at all. Generally, a license, if granted, would include payments of up-front fees, ongoing royalties or both. These payments or other terms could have a significant adverse impact on our operating results.

If we are unable to retain our key management and technical personnel and attract and retain additional key personnel as required, our business could be significantly harmed.

Our future success is substantially dependent upon the continued contributions of the members of our senior management team, many of whom have years of management, engineering, sales, marketing and manufacturing experience that would be difficult to replace. We also believe our future success will depend in large part upon our ability to attract and retain additional highly skilled managerial, technical, sales and marketing, finance and manufacturing personnel. In particular, we will need to increase the number of our technical staff members with experience in high-speed networking applications as we further develop our product lines. Competition for these highly skilled employees in our industry is intense. In making employment decisions, particularly in the high-technology industries, job candidates often consider the value of the equity they are to receive in connection with their employment. Therefore, significant volatility in the price of our common stock may adversely affect our ability to attract or retain key management and technical personnel. The loss of service of any our key management or technical employees, our inability to attract or retain qualified personnel in the future or delays in hiring key personnel, as required, could significantly harm our business. In addition, employees may leave our company and subsequently compete against us. Moreover, companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices. We have been subject to claims of this type and may be subject to such claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation. We could incur substantial costs in defending ourselves against these claims, regardless of their merits.

Our business and future operating results are subject to a wide range of uncertainties arising out of the continuing threat of terrorist attacks and ongoing military actions in the Middle East.

Like other U.S. companies, our business and operating results are subject to uncertainties arising out of the continuing threat of terrorist attacks on United States' interests, including U.S. companies, in locations worldwide and ongoing military actions in the Middle East, including the economic consequences of the war in Afghanistan or additional terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. In particular, due to these uncertainties we are subject to:

- increased risks related to the operations of our manufacturing facilities in Malaysia;
- greater risks of disruption in the operations of our China and Singapore facilities and our Asian contract manufacturers, including contract manufacturers located in Thailand, and more frequent instances of shipping delays;

and

- the risk that future tightening of immigration controls may adversely affect the residence status of non-U.S. engineers and other key technical employees in our U.S. facilities or our ability to hire new non-U.S. employees in such facilities.

Future acquisitions could be difficult to integrate, disrupt our business, dilute stockholder value and harm our operating results.

In addition to our combination with Optium in August 2008 and our acquisitions of Ignis in May 2011, Red-C in July 2012 and u^{2}t Photonics AG ("u^{2}t") in January 2014, we have completed the acquisition of 11 privately-held companies and certain businesses and assets from seven other companies since October 2000. We continue to review opportunities to acquire other businesses, product lines or technologies that would complement our current products, expand the breadth of our markets or enhance our technical capabilities, or that may otherwise offer growth opportunities, and we from time to time make proposals and offers, and take other steps, to acquire businesses, products and technologies.

Table of Contents

The Optium merger and several of our other past acquisitions have been material, and acquisitions that we may complete in the future may be material. In 13 of our 22 acquisitions, we issued common stock or notes convertible into common stock as all or a portion of the consideration. The issuance of common stock or other equity securities by us in connection with any future acquisition would dilute our stockholders' percentage ownership.

Other risks associated with acquiring the operations of other companies include:

- problems assimilating the purchased operations, technologies or products;
- unanticipated costs associated with the acquisition;
- diversion of management's attention from our core business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience; and
- potential loss of key employees of purchased organizations.

Not all of our past acquisitions have been successful. In the past, we have subsequently sold some of the assets acquired in prior acquisitions, discontinued product lines and closed acquired facilities. As a result of these activities, we incurred significant restructuring charges and charges for the write-down of assets associated with those acquisitions. Through fiscal 2019, we have written off all of the goodwill associated with our past acquisitions with the exception of the more recently completed acquisitions of Ignis, Red-C and u^{2}t. We cannot assure you that we will be successful in overcoming problems encountered in connection with our past acquisitions or potential future acquisitions, and our inability to do so could significantly harm our business. In addition, to the extent that the economic benefits associated with our past acquisitions or any of our future acquisitions diminish in the future, we may be required to record additional write downs of goodwill, intangible assets or other assets associated with such acquisitions, which would adversely affect our operating results.

We have made and may continue to make strategic investments which may not be successful, may result in the loss of all or part of our invested capital and may adversely affect our operating results.

Since inception, we have made minority equity investments in a number of early-stage technology companies, totaling approximately $61.9 million. Our investments in these early stage companies were primarily motivated by our desire to gain early access to new technology. We intend to review additional opportunities to make strategic equity investments in pre-public companies where we believe such investments will provide us with opportunities to gain access to important technologies or otherwise enhance important commercial relationships. We have little or no influence over the early-stage companies in which we have made or may make these strategic, minority equity investments. Each of these investments in pre-public companies involves a high degree of risk. We may not be successful in achieving the financial, technological or commercial advantage upon which any given investment is premised, and failure by the early-stage company to achieve its own business objectives or to raise capital needed on acceptable economic terms could result in a loss of all or part of our invested capital. Between fiscal 2003 and 2019, we wrote off an aggregate of $29.0 million in nine investments which became impaired and reclassified $4.2 million of another investment to goodwill as the investment was deemed to have no value. We may be required to write off all or a portion of the $129,000 of such equity investments remaining on our balance sheet as of January 27, 2019 in future periods.

Our ability to utilize certain net operating loss carryforwards and tax credit carryforwards may be limited under Sections 382 and 383 of the Internal Revenue Code.

As of April 29, 2018, the Company had federal, state and foreign net operating loss carryforwards of approximately $236.5 million, $13.8 million and $22.9 million, respectively, and federal and state tax credit carryforwards of approximately $38.8 million and 31.4 million, respectively. With the exception of California R&D credit, which can be carried forward indefinitely, the net operating loss and tax credit carryforwards will expire at various dates beginning in fiscal 2020 through 2037, if not utilized. $78.0 million of such net operating loss carryforwards and $3.0 million of such tax credit carryforwards will expire in the next five years. Utilization of the Company's U.S. net operating loss and tax credit carryforwards may be subject to a substantial annual limitation due to the ownership change limitations set forth in Internal Revenue Code Section 382 and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss and tax credit carryforwards before utilization.

On December 22, 2017, H.R.1, commonly referred to as the Tax Cuts and Jobs Act ("TCJA"), was signed into law. The TCJA is complex and includes amendments that significantly change the taxation of offshore earnings and the deductibility of interest. The TCJA had a material impact on the value of our deferred tax assets and could increase our future U.S. tax expense. The TCJA implemented a territorial tax system, which includes a mandatory deemed repatriation of all undistributed foreign

Table of Contents

earnings that are subject to a U.S. income tax. The mandatory deemed repatriation of these undistributed earnings has been offset by federal and state net operating loss carryforwards, and state credit carryforwards. Additionally, TCJA introduced new international tax provisions that are effective for our fiscal year 2019, including (i) a new provision designed to currently tax the global low-taxed income of our foreign subsidiaries, together with a deduction of up to 50 percent and a partial credit for foreign taxes incurred by the foreign subsidiaries; (ii) limitations on the deductibility of certain base eroding payments to foreign entities; and (iii) limitations on the use of foreign tax credits to reduce U.S. income tax liability. While each of these provisions will have an impact on our tax expense for fiscal year 2019 and future periods, we expect the minimum tax on certain base erosion payments to have the most significant impact. We have completed our assessment of the effect of the TCJA on our consolidated financial statements. Reference is made to "Part I, Item 1, Financial Statements - Note 2. Summary of Significant Accounting Policies. U.S. Tax Reform" for further discussion of the TCJA.

Changes in the application of tax policies may harm our results of operations.

A number of factors may negatively impact the manner in which our existing NOLs are applied as well as our future effective tax rates including, but not limited to:

- the jurisdictions in which profits are determined to be earned and taxed;
- changes in valuation of our deferred tax assets and liabilities;
- increases in expenses not deductible for tax purposes;
- changes in available tax credits;
- changes in stock-based compensation;
- changes in tax laws or the interpretation of such tax laws, including by authorities in municipalities where we are subject to social insurance and other payroll taxes and fees, and changes in generally accepted accounting principles in the United States or other countries in which we operate; and
- potential changes resulting from the IRS's clarification of the TCJA.

An adverse change that impacts our tax position could negatively impact our operating results. In addition, we are the recipient of tax incentives that provide that certain income earned by our subsidiary in Malaysia is subject to a tax holiday for a limited period of time under the laws of that country. This Malaysian tax holiday is subject to expiration in August 2021. Our ability to realize benefits from tax initiatives could be materially affected if, among other things, applicable requirements are not met, the incentives are substantially modified, or if we incur losses for which we cannot take a deduction. In addition, although we have successfully received tax holiday extensions in the past, there can be no assurance that future extensions will be granted. If we are not able to extend a tax holiday, our total tax paid on a consolidated basis would be materially increased.

We will lose sales if we are unable to obtain government authorization to export certain of our products, and we would be subject to legal and regulatory consequences if we do not comply with applicable export control laws and regulations.

Exports of certain of our products are subject to export controls imposed by the U.S. Government and administered by the United States Departments of State and Commerce. In certain instances, these regulations may require pre-shipment authorization from the administering department. For products subject to the Export Administration Regulations, or EAR, administered by the Department of Commerce's Bureau of Industry and Security, the requirement for a license is dependent on the type and end use of the product, the final destination, the identity of the end user and whether a license exception might apply. Virtually all exports of products subject to the International Traffic in Arms Regulations, or ITAR, administered by the Department of State's Directorate of Defense Trade Controls, require a license. Certain of our fiber optics products are subject to EAR and we historically have sold some products, including certain products developed with government funding, which are subject to ITAR. Products developed and manufactured in our foreign locations are subject to export controls of the applicable foreign nation.

Given the current global political climate, obtaining export licenses can be difficult and time-consuming. Failure to obtain export licenses for these shipments or having one or more of our customers be restricted from receiving exports from us could significantly reduce our revenue and materially adversely affect our business, financial condition and results of operations. Compliance with governmental regulations also subjects us to additional fees and costs. The absence of comparable restrictions on competitors in other countries may adversely affect our competitive position.

We have previously been the subject of inquiries from the Department of State and the Department of Justice regarding compliance with ITAR. Although these inquiries were closed with no action being taken, we expended significant time and resources to resolve them, and future inquiries of this type could also be costly to resolve.

Table of Contents

Privacy concerns and compliance with domestic or foreign privacy laws and regulations may increase our expenses, result in legal or regulatory proceedings against us and may harm our business.

In the ordinary course of our business, we maintain sensitive personal data on our networks, including confidential information relating to our customers, employees and business partners. Global privacy legislation, enforcement, and policy activity are rapidly expanding and are creating a complex compliance regulatory environment regarding the collection, use, storage and disclosure of such information. These laws and regulations are still evolving and are likely to be in flux and subject to uncertain interpretation for the foreseeable future. In particular, the political, legal and economic climate in China, both nationally and regionally, is fluid and unpredictable. Furthermore, personal privacy, cyber security, and data protection are becoming increasingly significant issues in China. To address these issues, the Standing Committee of the National People's Congress promulgated the Cyber Security Law of the People's Republic of China (the "Cyber Security Law"), which took effect on June 1, 2017. The Cyber Security Law sets forth various requirements relating to the collection, use, storage, disclosure and security of data, among other things. Various Chinese agencies are expected to issue additional regulations in the future to define these requirements more precisely. These requirements may increase our costs of compliance.

Additionally, the European Union recently adopted the General Data Protection Regulation (the "GDPR"), which comprehensively reforms the EU's data protection laws and took effect in May 2018. The GDPR imposes strict data protection requirements that may necessitate changes to our business practices to comply with the new requirements or to address the concerns of our customers or business partners relating to the GDPR. The GDPR also includes severe financial penalties for non-compliance. Complying with any new regulatory requirements could force us to incur substantial expenses or require us to change our business practices in a manner that could harm our business. Any non-compliance may result in lawsuits, regulatory fines, or other actions or liability. Our business may also be harmed if these privacy-related laws or any newly adopted privacy-related laws are interpreted or implemented in a manner that is inconsistent from country to country and inconsistent with our current policies and practices, or those of our customers or business partners. Costs to comply with rapidly changing global privacy-related laws and regulations and to implement related data protection measures could be significant. We may also have to change the manner in which we contract with our business partners, store and transfer information and otherwise conduct our business, which could increase our costs and harm our financial results. In addition, even inadvertent failure to comply with federal, state, or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others, resulting in fines, penalties, restrictions on or prohibitions on our operations in certain jurisdictions, increased compliance costs and other adverse effects.

We are subject to pending securities class action and shareholder derivative legal proceedings.

Several purported securities class action lawsuits were filed against us and our Chairman of the Board, Chief Executive Officer and Chief Financial Officer following our March 8, 2011 announcement of unaudited financial results for the third quarter of fiscal 2011 and our financial outlook for the fourth quarter of fiscal 2011. We also have been named as a nominal defendant in several shareholder derivative lawsuits filed in 2011 concerning our March 8, 2011 earnings announcement. No specific amounts of damages have been alleged in the class action lawsuits and, by the nature of the lawsuits, no damages will be alleged against Finisar in the derivative lawsuits.

We will continue to incur legal fees in connection with these pending cases, including expenses for the reimbursement of legal fees of present and former officers and directors under indemnification obligations. The expense of continuing to defend such litigation may be significant. We intend to defend these lawsuits vigorously, however there can be no assurance that we will be successful in any defense. If any of the lawsuits related to our earnings announcement are adversely decided, we may be liable for significant damages directly or under our indemnification obligations, which could adversely affect our business, results of operations and cash flows. Further, the amount of time that will be required to resolve these lawsuits is unpredictable and these actions may divert management's attention from the day-to-day operations of our business, which could adversely affect our business, results of operations and cash flows.

Our business and future operating results may be adversely affected by events outside our control.

Our business and operating results are vulnerable to events outside of our control, such as earthquakes, floods, fire, power loss, telecommunication failures and uncertainties arising out of terrorist attacks in the United States and overseas. Our corporate headquarters and a portion of our manufacturing operations are located in California, and our principal manufacturing operations and those of most of our key suppliers and contract manufacturers are located in Asia. These areas have been vulnerable to natural disasters, such as earthquakes, floods and fires, and other risks which at times have disrupted the local economy and posed physical risks to our property. We are also dependent on communications links with our overseas manufacturing locations and would be significantly harmed if these links were interrupted for any significant length of time.

Table of Contents

We presently do not have adequate redundant, multiple site capacity if any of these events were to occur, nor can we be certain that the insurance we maintain against these events would be adequate.

The conversion of our outstanding convertible notes would result in substantial dilution to our current stockholders.

As of January 27, 2019, we had outstanding an aggregate principal amount of $1.1 million of our 2033 Notes and an aggregate principal amount of $575.0 million of our 2036 Notes. The 2033 Notes are convertible at the option of the holder, under certain circumstances, into shares of our common stock at an initial conversion price of $30.18 per share, subject to adjustments, and the 2036 Notes are convertible at the option of the holder, under certain circumstances, into shares of our common stock at an initial conversion price of $44.17 per share, subject to adjustments. An aggregate of approximately 34,923 and 13,017,885 shares of common stock would be issued upon the conversion of all outstanding 2033 Notes and all outstanding 2036 Notes, respectively, at these conversion prices, which would dilute the voting power and ownership percentage of our existing stockholders. We have previously entered into privately negotiated transactions with certain holders of our convertible notes for the repurchase of notes in exchange for a greater number of shares of our common stock than would have been issued had the principal amount of the notes been converted at the original conversion rate specified in the notes, thus resulting in more dilution. We may enter into similar transactions in the future and, if we do so, there will be additional dilution to the voting power and percentage ownership of our existing stockholders.

Delaware law, our charter documents and our stockholder rights plan contain provisions that could discourage or prevent a potential takeover, even if such a transaction would be beneficial to our stockholders.

Some provisions of our certificate of incorporation and bylaws, as well as provisions of Delaware law, may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable. These include provisions:

- authorizing the board of directors to issue additional preferred stock;
- prohibiting cumulative voting in the election of directors;
- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholder actions by written consent;
- creating a classified board of directors pursuant to which our directors are elected for staggered three-year terms;
- permitting the board of directors to increase the size of the board and to fill vacancies;
- requiring a super-majority vote of our stockholders to amend our bylaws and certain provisions of our certificate of incorporation; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law which limit the right of a corporation to engage in a business combination with a holder of 15% or more of the corporation's outstanding voting securities, or certain affiliated persons.

Although we believe that these charter and bylaw provisions and provisions of Delaware law provide an opportunity for the board to assure that our stockholders realize full value for their investment, they could have the effect of delaying or preventing a change of control, even under circumstances that some stockholders may consider beneficial.

We do not currently intend to pay dividends on Finisar common stock and, consequently, a stockholder's ability to achieve a return on such stockholder's investment will depend on appreciation in the price of the common stock.

We have never declared or paid any cash dividends on Finisar common stock and we do not currently intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. Therefore, a stockholder is not likely to receive any dividends on such stockholder's common stock for the foreseeable future.

Our stock price has been and is likely to continue to be volatile.

The trading price of our common stock has been and is likely to continue to be subject to large fluctuations. Our stock price may increase or decrease in response to a number of events and factors, including:

- trends in our industry and the markets in which we operate;
- changes in the market price of the products we sell;
- changes in financial estimates and recommendations by securities analysts;
- acquisitions and financings;

Table of Contents

- quarterly variations in our operating results;
- the operating and stock price performance of other companies that investors in our common stock may deem comparable; and
- purchases or sales of blocks of our common stock.

Part of this volatility is attributable to the current state of the stock market, in which wide price swings are common. This volatility may adversely affect the prices of our common stock, regardless of our operating performance. If any of the foregoing occurs, our stock price could fall and we may be exposed to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

Our business and operations would be adversely impacted in the event of a failure of our information technology infrastructure.

We rely upon the capacity, reliability and security of our information technology infrastructure and our ability to expand and continually update this infrastructure in response to our changing needs. In some cases, we may rely upon third-party hosting and support services to meet these needs. Any failure to manage, expand and update our information technology infrastructure, including our Enterprise Resource Planning ("ERP") system and other applications, any failure in the extension or operation of this infrastructure, or any failure by our hosting and support partners in the performance of their services could materially and adversely harm our business. Despite our implementation of security measures, our systems are vulnerable to damage from computer viruses, natural disasters, unauthorized access and other similar disruptions. Any system failure, accident or security breach could result in disruptions to our operations. To the extent that any disruption or security breach results in a loss or damage to our data or in inappropriate disclosure of confidential information, it could cause significant damage to our reputation, affect our relationships with our customers, and ultimately harm our business. In addition, we may be required to incur significant costs to protect against or mitigate damage caused by these disruptions or security breaches in the future.

Table of Contents

Item 6. Exhibits

Exhibit Number	Exhibit Description
2.1	Agreement and Plan of Merger, dated as of November 8, 2018, among Finisar Corporation, II-VI Incorporated and Mutation Merger Sub Inc. (1)
3.1	Amendment to the Amended and Restated Bylaws of Finisar Corporation. (2)
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

(1) Incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K filed November 9, 2018.
(2) Incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K filed November 9, 2018.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FINISAR CORPORATION

By:	/s/ MICHAEL E. HURLSTON Michael E. Hurlston Chief Executive Officer (Principal Executive Officer)
By:	/s/ KURT ADZEMA Kurt Adzema Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

Dated: February 28, 2019