NEOPHOTONICS CORP
Form 10-Q/A
August 08, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _________ to _________

Commission File Number: 001-35061

NeoPhotonics Corporation

(Exact name of registrant as specified in its charter)

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

2911 Zanker Road

San Jose, California 95134

(Address of principal executive offices, zip code)

(408) 232-9200

(Registrant s telephone number, including area code)

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

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

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

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

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

As of April 30, 2013, there were 30,611,417 shares of the registrant s Common Stock outstanding.

Table of Contents

Explanatory Note

Overview

NeoPhotonics Corporation (the Company), is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q (this Amendment) to restate and amend the Company s previously issued and unaudited interim financial statements and related financial information as of March 31, 2013 and for the three months ended March 31, 2013, which was originally filed with the Securities and Exchange Commission on May 15, 2013. As described below and in Note 2, the restatement adjusts the Company s consolidated statement of cash flows for the three months ended March 31, 2013 to adjust for amounts related to purchases of property and equipment that were inadvertently overstated resulting in the overstatement of net cash used in investing activities by $1.1 million and the overstatement of net cash provided by operating activities by the same amount. The restatement has no impact on the Company s previously reported total cash and cash equivalents, condensed consolidated balance sheet or condensed consolidated statement of operations.

Background

On August 7, 2013, the audit committee of the board of directors of the Company and management concluded, after discussion with the Company s independent registered public accounting firm, PricewaterhouseCoopers LLP, that the consolidated financial statements included in the Company s Quarterly Report on Form 10-Q for the period ended March 31, 2013 should no longer be relied upon as a result of an error in the presentation of non-cash capital expenditures included in the Company s consolidated statement of cash flows. In the previously issued consolidated statement of cash flows for the interim period ended March 31, 2013, amounts related to purchases of property and equipment were overstated.

Effects of Restatement

The table below presents the effect of the restatement on the following consolidated cash flow line items for the three months ended March 31, 2013:

	Three months ended March 31, 2013		
(in thousands)	As previously reported	Adjustment	As restated
Cash Flows From Operating Activities			
Accounts payable	$ 5,098	$ (1,084)	$ 4,014
Net cash provided by operating activities	2,787	(1,084)	1,703
Cash Flows From Investing Activities			
Purchase of property, plant and equipment	(6,218)	1,084	(5,134)
Net cash used in investing activities	(4,706)	1,084	(3,622)

Consistent with the information above, the Company has revised the following items in this Form 10-Q/A:

Part I

Item 1- Financial Statements (Unaudited) including Note 2 to the condensed consolidated financial statements

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

Item 4 Controls and Procedures

Part II

Item 1A- Risk Factors

Additionally, in this Amendment, the Company is including currently dated certifications from the Company s Principal Executive officer and Principal Financial officer as required by Section 302 of the Sarbanes-Oxley Act of 2002 in Exhibits 31.1 and 31.2 and a currently dated certification from the Company s Principal Executive Officer and Principal Financial Officer as required by Section 906 of the Sarbanes-Oxley

Act of 2002 in Exhibit 32.1.

Except to the extent described above and set forth herein, the financial statements and other disclosures in the Form 10-Q initially filed on May 15, 2013 (the initial Form 10-Q) are unchanged and this Amendment does not reflect any events that have occurred after the initial Form 10-Q was filed. Accordingly, this Amendment should be read in conjunction with the Company s initial Form 10-Q and the Company s subsequent filings with the United States Securities and Exchange Commission.

In light of the restatement, readers should not rely on the Company s previously filed financial statements as of and for the three month period ended March 31, 2013.

Table of Contents

NEOPHOTONICS CORPORATION

For the Quarter Ended March 31, 2013

Table of Contents

		Page
	Part I. Financial Information	
Item 1.	Condensed Consolidated Financial Statements (Unaudited)	4
	Condensed Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012 (Unaudited)	4
	Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2013 and 2012 (Unaudited)	5
	Condensed Consolidated Statements of Comprehensive Income (loss) for the Three Months Ended March 31, 2013 and 2012 (Unaudited)	6
	Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2013 and 2012 (Unaudited)	7
	Notes to Condensed Consolidated Financial Statements (Unaudited)	8
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	25
Item 4.	Controls and Procedures	36
	Part II. Other Information	
Item 1A.	Risk Factors	38
Item 6.	Exhibits	67
	Signatures	68

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	As of	
(In thousands, except share and per share data)	**March 31, 2013**	**December 31, 2012**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 51,404	$ 36,940
Short-term investments	48,356	64,301
Restricted cash	2,108	2,626
Accounts receivable, net of allowance for doubtful accounts	63,267	70,354
Inventories	68,818	43,793
Prepaid expenses and other current assets	8,053	7,630
Total current assets	242,006	225,644
Long-term investments	331	188
Property, plant and equipment, net	65,079	54,440
Goodwill	2,188	
Other intangible assets, net	17,176	14,213
Other long-term assets	4,206	1,147
Total assets	$ 330,986	$ 295,632
LIABILITIES, REDEEMABLE COMMON STOCK AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 40,963	$ 36,308
Notes payable	10,431	12,003
Current portion of long-term debt	10,710	5,000
Accrued and other current liabilities	23,520	19,959
Total current liabilities	85,624	73,270
Long-term debt, net of current portion	40,420	17,167
Deferred income tax liabilities	655	653
Other noncurrent liabilities	10,506	1,724
Total liabilities	137,205	92,814
Commitments and contingencies (Note 9)		
Redeemable common stock	5,000	5,000
Stockholders equity:		
Preferred stock, $0.0025 par value		
At March 31, 2013: 10,000,000 shares authorized, no shares issued or outstanding;		
At December 31, 2012: 10,000,000 shares authorized, no shares issued or outstanding		

Common stock, $0.0025 par value		
At March 31, 2013: 100,000,000 shares authorized, 30,604,293 shares issued and outstanding;		
At December 31, 2012: 100,000,000 shares authorized, 30,546,155 shares issued and outstanding	76	76
Additional paid-in capital	435,282	433,996
Accumulated other comprehensive income	11,970	11,829
Accumulated deficit	(258,547)	(248,083)
Total stockholders equity	188,781	197,818
Total liabilities, redeemable common stock and stockholders equity	$ 330,986	$ 295,632

See accompanying Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except share and per share data)	**Three Months Ended March 31, 2013**	**Three Months Ended March 31, 2012**
Revenue	$ 56,063	$ 54,223
Cost of goods sold	44,333	42,817
Gross profit	11,730	11,406
Operating expenses:		
Research and development	9,707	10,538
Sales and marketing	3,586	3,023
General and administrative	8,545	6,995
Amortization of purchased intangible assets	321	354
Adjustment to fair value of contingent consideration	0	1,907
Restructuring charges	325	130
Total operating expenses	22,484	22,947
Loss from operations	(10,754)	(11,541)
Interest income	131	132
Interest expense	(163)	(154)
Other expense, net	(274)	(275)
Total interest and other expense, net	(306)	(297)
Loss before income taxes	(11,060)	(11,838)
Income tax benefit	596	60
Loss from continuing operations	(10,464)	(11,778)
Income from discontinued operations, net of tax (including gain on disposal of $636, net of tax, for the three months ended March 31, 2012)		170
Net loss	$ (10,464)	$ (11,608)
Basic and diluted net income (loss) per share:		
Continuing operations	$ (0.34)	$ (0.47)
Discontinued operations	$ 0.00	$ 0.01
Net loss	$ (0.34)	$ (0.46)
Weighted average shares used to compute basic and diluted net income (loss) per share:	30,574,032	24,870,684

See accompanying Notes to Condensed Consolidated Financial Statements.

5

Table of Contents

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

(In thousands, except share and per share data)	Three months ended March 31, 2013	Three months ended March 31, 2012
Net loss	$ (10,464)	$ (11,608)
Foreign currency translation adjustments	160	125
Unrealized gain (loss) on investments, net of tax of $0	(19)	296
Comprehensive loss	$ (10,323)	$ (11,187)

See accompanying Notes to Condensed Consolidated Financial Statements.

6

Table of Contents

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	**Three Months Ended March 31, 2013 (restated)**	**Three Months Ended March 31, 2012**
Cash flows from operating activities		
Net loss	$ (10,464)	$ (11,608)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,590	5,353
Asset impairment charges	34	14
Stock-based compensation expense	1,202	1,144
Deferred taxes	(781)	387
Loss on disposal of property and equipment	111	18
Gain on sale of discontinued operations		(750)
Allowance for doubtful accounts	22	8
Provision for inventories	30	721
Change in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	7,155	9,155
Inventories	(4,682)	(4,680)
Prepaid expenses and other current assets	(1,256)	(1,800)
Accounts payable	4,014	584
Acquisition-related costs	3,190	
Accrued and other liabilities	(1,462)	(184)
Net cash provided by (used in) operating activities	1,703	(1,638)
Cash flows from investing activities		
Purchase of property, plant and equipment	(5,134)	(2,019)
Purchase of marketable securities	(29,030)	(12,964)
Proceeds from sale of marketable securities	23,747	5,139
Proceeds from maturity of securities	20,900	15,100
Decrease in restricted cash	524	68
Acquisition of OCU, net of notes payable	(14,629)	
Proceeds received on sale of discontinued operations, net of tax		1,825
Net cash provided by (used in) investing activities	(3,622)	7,149
Cash flows from financing activities		
Proceeds from exercise of stock options and warrants	79	64
Proceeds from bank loans	40,000	
Repayment of bank loans	(22,167)	(1,250)
Proceeds from issuance of notes payable	4,881	7,738
Repayment of notes payable	(6,482)	(7,867)
Net cash provided by (used in) financing activities	16,311	(1,315)
Effect of exchange rates on cash and cash equivalents	72	209

Net increase in cash and cash equivalents	14,464	4,405
Cash and cash equivalents at the beginning of the period	36,940	32,485
Cash and cash equivalents at the end of the period	$ 51,404	$ 36,890

Supplemental disclosure of noncash investing and financing activities:

Fair value of the assets acquired and the liabilities assumed are related to OCU acquisition. See Note 6 for details.

See accompanying Notes to Condensed Consolidated Financial Statements.

The Company acquired certain assets and assumed certain liabilities of OCU. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired including goodwill	$ 35,466
Cash paid upon closing	(14,629)
Liabilities assumed	$ 20,837

NeoPhotonics Corporation

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Basis of presentation

The condensed consolidated financial statements of NeoPhotonics Corporation (NeoPhotonics or the Company) as of March 31, 2013 and December 31, 2012 and for the three months ended March 31, 2013 and 2012, have been prepared in accordance with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In accordance with those rules and regulations, the Company has omitted certain information and notes normally provided in the Company s annual consolidated financial statements. In the opinion of management, the condensed consolidated financial statements contain all adjustments, consisting only of normal recurring items, except as otherwise noted, necessary for the fair presentation of the Company s financial position and results of operations for the interim periods. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles (U.S. GAAP). These condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2012. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated.

Due to rounding, numbers presented in this document may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures.

Consolidation

The condensed consolidated financial statements are prepared in accordance with U.S. GAAP and include the consolidated accounts of the Company and its majority owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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

Business Combinations Acquisition Accounting

Under the acquisition method of accounting, the Company allocates the purchase price of acquired companies to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The Company records the excess of purchase price over the aggregate fair values of the tangible and identifiable intangible assets as goodwill. The Company determines the fair values of assets acquired and liabilities assumed. To establish fair value, the Company measures the price that would be received to sell an asset or paid to transfer a liability in an ordinary transaction between market participants. The measurement assumes the highest and best use of the asset by the market participants that would maximize the value of the asset or the group of assets within which the asset would be used at the measurement date, even if the intended use of the asset is different.

Table of Contents

The Company estimates the economic lives of certain acquired assets and these lives are used to calculate depreciation and amortization expenses. The Company estimates the future cash flows to be derived from such assets, and these estimates are used to determine the fair value of the assets. If any of these estimates change, depreciation or amortization expenses could be changed and/or the value of our intangible assets could be impaired.

Acquisition related costs, including finder s fees, advisory, legal, accounting, valuation and other professional or consulting fees are accounted for as expenses in the periods in which the costs are incurred or the services are received.

Note 2. Restatement of unaudited condensed consolidated financial statements

On August 7, 2013, the Company concluded that the condensed consolidated financial statements for the quarter ended March 31, 2013 that the Company previously included in its Quarterly Report on Form 10-Q filed initially filed on May 15, 2013 should be restated. In the previously issued consolidated statement of cash flows for the interim period ended March 31, 2013, amounts related to purchases of property and equipment were inadvertently overstated resulting in the overstatement of cash flows used in investing activities by $1.1 million and the overstatement of cash flows provided by operating activities by the same amount.

The restatement results in a decrease in cash flows used in investing activities and a corresponding decrease in cash flows provided by operating activities. This restatement has no impact on the Company s previously reported total cash and cash equivalents, condensed consolidated balance sheet or condensed consolidated statement of operations.

As detailed in the table below, this restatement impacts the following consolidated cash flow line items:

	Three months ended March 31, 2013		
(in thousands)	As previously reported	Adjustment	As restated
Cash Flows From Operating Activities			
Accounts payable	$ 5,098	$ (1,084)	$ 4,014
Net cash provided by operating activities	2,787	(1,084)	1,703
Cash Flows From Investing Activities			
Purchase of property, plant and equipment	(6,218)	1,084	(5,134)
Net cash used in investing activities	(4,706)	1,084	(3,622)

Note 3. Significant accounting policies

There have been no changes in the Company s significant accounting policies for the three months ended March 31, 2013, as compared to the significant accounting policies described in its Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Recent accounting pronouncements

In February 2013, the Financial Accounting Standard Board (FASB) issued amendments to the FASB Accounting Standard Codification to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments require new disclosures for items reclassified out of accumulated other comprehensive income (AOCI), including (1) changes in AOCI balances by component and (2) significant items reclassified out of AOCI. The guidance does not amend any existing requirements for reporting net income or OCI in the financial statements. The standards update was effective for reporting periods beginning after December 15, 2012, to be applied prospectively. Early adoption is permitted. As this guidance only requires expanded disclosures, the adoption of this guidance did not have a material effect on the Company s consolidated financial statements.

In March 2013, the FASB issued amendments to the FASB Accounting Standard Codification, which indicates that the entire amount of a cumulative translation adjustment related to an entity s investment in a foreign entity should be released when there has been a (i) sale of a subsidiary or group of net assets within a foreign entity and the sale represents the substantially complete liquidation of the investment in the foreign entity, (ii) loss of a controlling financial interest in an investment in a foreign entity, or (iii) step acquisition for a foreign entity. The amendments are effective prospectively for fiscal years beginning after December 15, 2013. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact to the Company s consolidated financial statements.

Note 4. Discontinued operations

In the fourth quarter of 2011, the Company initiated a plan to sell a component of its business, Broadband, a subsidiary in China. The Company decided to sell Broadband because the nature of its operations was different than the core technology and strategy of the Company. On January 11, 2012, the Company entered into a purchase agreement with Guangdong Rainbow Electronic Ltd. (Rainbow) to dispose of its 100% equity interest in Broadband for a total cash consideration of RMB 13.0 million ($2.1 million). The transaction closed on March 13, 2012. The Company recognized a gain of $0.6 million on the sale of Broadband, representing the difference between the consideration received and the net assets transferred to Rainbow, net of tax. The gain was included in income from discontinued operations, net of tax in the statement of operations for the three months ended March 31, 2012.

The results of operations associated with Broadband are presented as discontinued operations in the Company s consolidated statements of operations for the three months ended March 31, 2013 and 2012. Revenue and the components of net income related to the discontinued operations for all periods were as follows (in thousands):

	Three months ended March 31,	
	2013	2012
Revenue	$	$ 590
Income from discontinued operations before income taxes		284
Provision for income taxes		(114)
Net income from discontinued operations	$	$ 170
Basic and diluted net income per share on discontinued operations	$	$ 0.01

Note 5. Cash equivalents and investments

The following table sets forth the fair value of the Company s financial assets as of the date presented (in thousands):

	As of March 31, 2013				As of December 31, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Money market funds	$ 4,869	$ 0	$ 0	$ 4,869	$ 7,270	$ 0	$ 0	$ 7,270
Marketable securities								
Corporate bonds	0	27,454	0	27,454	0	23,193	0	23,193
U.S. federal agencies	0	14,143	0	14,143	0	27,251	0	27,251
Foreign bonds and notes	0	0	0	0	0	4,696	0	4,696
Municipal obligations	0	1,901	0	1,901	0	1,902	0	1,902
	$ 4,869	$ 43,498	$ 0	$ 48,367	$ 7,270	$ 57,042	$ 0	$ 64,312

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

	As of March 31, 2013				As of December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents								
Money market funds	$ 11	$ 0	$ 0	$ 11	$ 11	$ 0	$ 0	$ 11
Short-term investments								
Money market funds	4,858	0	0	4,858	7,259	0	0	7,259
Corporate bonds	27,411	49	(6)	27,454	23,151	43	(1)	23,193
U.S. federal agencies	14,138	5	0	14,143	27,241	10	0	27,251
Foreign bonds and notes	0	0	0	0	4,682	14	0	4,696
Municipal obligations	1,901		0	1,901	1,902	0	0	1,902
Total investments in short-term investments	48,308	54	(6)	48,356	64,235	67	(1)	64,301

Total investments	$ 48,319	$ 54	$ (6)	$ 48,367	$ 64,246	$ 67	$ (1)	$ 64,312

Table of Contents

As of March 31, 2013 and December 31, 2012, maturities of short-term investments are as follows (in thousands):

	March 31, 2013	December 31, 2012
Less than 1 year	$ 39,647	$ 51,861
Due in 1 to 2 years	4,811	10,550
Due in 2 to 5 years	2,008	
Due after 5 years	1,901	1,901
Total	$ 48,367	$ 64,312

The Company may sell its security investments in the future to fund future operation needs. As a result, the Company recorded all its marketable securities in short-term investment as of March 31, 2013 and December 31, 2012, regardless of the contractual maturity date of the securities.

Realized gains and losses on the sale of marketable securities during the three months ended March 31, 2013 and 2012 were immaterial. The Company did not recognize any impairment losses on its marketable securities during the three months ended March 31, 2013 and 2012. As of March 31, 2013, the Company did not have any investments in marketable securities that were in an unrealized loss position for a period in excess of 12 months.

Note 6. Net income (loss) per share attributable to NeoPhotonics Corporation common stockholders

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

	Three months ended March 31,	
	2013	2012
Numerator:		
Loss from continuing operations	$ (10,464)	$ (11,778)
Income from discontinued operations, net of tax	0	170
Net loss	$ (10,464)	$ (11,608)
Denominator:		
Weighted average shares used to compute basic and diluted net income (loss) per share	30,574,032	24,870,684
Basic and diluted net income (loss) per share:		
Continuing operations	$ (0.34)	$ (0.47)
Discontinued operations	$ 0.00	$ 0.01
Net loss	$ (0.34)	$ (0.46)

Shares of common stock subject to repurchase resulting from the early exercise of employee stock options are not considered participating securities and are therefore excluded from the basic weighted average common shares outstanding.

The following potentially dilutive securities were excluded from the computation of diluted net loss per share attributable to NeoPhotonics Corporation common stockholders, as their effect would have been antidilutive:

	Three months ended March 31,	
	2013	2012
Employee stock options	1,499,393	1,353,444
Common stock warrants	4,482	4,482
Employee stock purchase plan	241,582	61,068
Restricted stock units	1,222	587,271
	1,746,679	2,006,265

Note 7. Business Combination

Optical Components Business Unit (OCU)

On March 29, 2013 (the closing date) the Company acquired certain assets and assumed certain liabilities related to the Optical Components Business Unit (the OCU) of Lapis Semiconductor Co., Ltd., a wholly owned subsidiary of Rohm Co., Ltd (Lapis) of Japan with the intention of operating the OCU as an ongoing business.

The OCU is a leader in high speed semiconductor and high speed laser and photodetector devices for communications networks. The Company believes the acquisition will expand the Company s solutions for high speed telecom and datacom applications and strengthen the Company s customer base in Japan.

The total consideration paid by the Company for the OCU was approximately $35.5 million, consisting of cash of $14.6 million, notes payable of $11.1 million and assumed liabilities of $9.7 million. The cash of $14.6 million includes $2.0 million that was withheld and placed into escrow to cover certain indemnity obligations from the closing date through March 29, 2014. The notes payable of $11.1 million are to be paid in three equal installments on the first, second and third anniversaries of the closing date. Each year an additional amount calculated as 1.5% per year of the unpaid balance of the notes becomes due. Lapis retains a lien on the land and building sold until the third payment is paid. The purchase price consideration and payment of notes payable are denominated in Japanese Yen.

In connection with the acquisition, the Company incurred approximately $3.2 million in acquisition-related costs related primarily to investment banking, legal, accounting and other professional services. The acquisition costs were expensed as incurred and were included in general and administrative expenses in the Company s consolidated statement of operations in the first quarter of 2013.

The OCU s results of operations between the closing date of March 29, 2013 and the Company s quarter end date of March 31, 2013 were immaterial.

Purchase Price Allocation

The Company accounted for its acquisition of the OCU assets and assumed liabilities using the acquisition method of accounting for business combinations. The OCU s tangible and identifiable intangible assets acquired and liabilities assumed were recorded based upon their estimated fair values as of the closing date of the acquisition. The excess of purchase price over the value of the net assets acquired was recorded as goodwill. The Company s purchase price allocation is preliminary. The fair values of acquired assets and liabilities may be further adjusted as additional information becomes available during the allocation period. Additional information that may become available subsequently and may result in changes in the values allocated to various assets and liabilities includes, but is not limited to, pension and retirement liabilities, asset retirement obligations, inventory fair value and the working capital adjustments to be agreed with Lapis. Any changes in the values allocated to tangible and identified intangible assets acquired and liabilities assumed during the allocation period may result in material adjustments to goodwill. The following table summarizes the preliminary acquisition accounting and the tangible and intangible assets acquired as of the date of acquisition (in thousands):

Total purchase consideration:	
Cash paid upon closing	$ 14,629
Notes payable	11,130
Liabilities assumed	9,707
	$ 35,466
Less the fair value of assets acquired:	
Inventory	20,286
Land, property, plant and equipment	9,282
Intangible assets acquired:	
Developed technology	2,120
Customer relationships	1,590
	33,278
Goodwill	2,188

Details of liabilities assumed are as follows (in thousands of dollars):	
Pension and retirement obligations	$ 6,471
Other compensation-related liabilities	1,083
Other current liabilities	2,153
Total liabilities assumed	$ 9,707

The adjustments to measure the assets acquired and liabilities assumed at the preliminary fair value are described below:

Net Tangible Assets

The OCU s tangible assets acquired and liabilities assumed as of March 29, 2013 were reviewed and adjusted to their preliminary fair value. The Company adjusted the OCU s historical value of property, plant and equipment to an estimate of depreciated replacement cost, adjusted for economic obsolescence. The Company amortizes property, plant and equipment over estimates lives of 2 to 10 years, and amortizes the expense to cost of goods sold and operating expense. The fair value of inventory acquired was determined using a net realizable value approach based upon the expected sales value of the inventory, less any costs to complete and selling costs along with a reasonable profit margin based on historical and expected results.

Intangible Assets

Developed technology represents products that have reached technological feasibility. The OCU s current product offerings include high speed semiconductor and high speed laser and photodetector devices for communication networks. The fair value of developed technology intangibles acquired was determined by using a royalty-avoidance method. The share of future revenue relating to current technology was forecasted, using an estimate for obsolescence such that the share declines over time. A royalty rate of two percent was used to calculate royalty savings on that revenue that are avoided since the Company owns the technology and does not need to license it from other parties. The after-tax royalty savings was then discounted to present value using the Company s discount rate. The Company amortizes the developed technology intangible assets over estimated lives of 4 to 5 years, and amortization expense is recorded to cost of goods sold.

The customer relationships asset represents the value of the ability to sell existing, in-process, and future versions of the technology to the OCU existing customer base. The Company utilized the excess earnings method, estimating future cash flows that will result from existing customers given assumed retention rates, and then discounting those flows to their present value using the Company s discount rate. The Company amortizes the customer relationships intangible asset over an average estimated life of 6 years, and amortization expense is recorded to operating expenses.

The weighted average amortization period for the total amount of intangible assets acquired is 5.1 years.

Table of Contents

Goodwill

Goodwill is the excess of the purchase price over the preliminary fair value of the underlying net tangible and identifiable intangible assets. In accordance with applicable accounting standards, goodwill is not amortized but instead is tested for impairment at least annually or more frequently if certain indicators are present. The Company expects that goodwill of $2.2 million will be deductible for tax purposes.

Pro Forma Financial Information (unaudited)

The unaudited financial information in the table below summarizes the combined results of operations of the Company with the results of OCU prior to the acquisition, on a pro forma basis, as though the companies had been combined as of the beginning of the period presented. The pro forma financial information for the period presented includes the business combination accounting effects on adjustments related to the fair value of acquired inventory and fixed assets, amortization charges from acquired intangible assets and related tax effects of these adjustments, where applicable. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved had the acquisition taken place at the beginning of the period presented, nor does it intend to be a projection of future results.

	For the 3 months ended March 31,	
	2013	2012
Revenue	$ 68,435	$ 67,544
Net loss	$ (8,296)	$ (9,036)
Basic and diluted net loss per share	$ (0.27)	$ (0.35)

Note 8. Balance sheet components

Accounts receivable, net

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

	March 31, 2013	December 31, 2012
Accounts receivable	$ 58,878	$ 66,338
Trade notes receivable	5,375	4,979
Allowance for doubtful accounts	(986)	(963)
	$ 63,267	$ 70,354

Inventories

Inventories consist of the following (in thousands):

	March 31, 2012	December 31, 2012
Raw materials	$ 28,056	$ 20,520
Work in process	25,312	8,603
Finished goods (1)	15,450	14,670
	$ 68,818	$ 43,793

(1) Finished goods inventory at vendor managed inventory locations were $4.8 million and $4.5 million as of March 31, 2013 and December 31, 2012, respectively.

Table of Contents

Purchased intangible assets

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

	March 31, 2013			December 31, 2012		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Technology and patents	$ 34,295	$ (23,405)	$ 10,890	$ 32,176	$ (22,869)	$ 9,307
Customer relationships	13,538	(8,392)	5,146	11,898	(8,148)	3,750
Leasehold interest	1,358	(234)	1,124	1,355	(241)	1,114
Noncompete agreements	950	(934)	16	950	(908)	42
	$ 50,141	$ (32,965)	$ 17,176	$ 46,379	$ (32,166)	$ 14,213

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

	Three months ended March 31,	
	2013	2012
Cost of goods sold	$ 428	$ 598
Operating expenses	321	354
Total	$ 749	$ 952

The estimated future amortization expense of purchased intangible assets as of March 31, 2013, is as follows (in thousands):

2013 (remaining 9 months)	$ 3,418
2014	4,240
2015	4,225
2016	3,478
2017	549
Thereafter	1,266
	$ 17,176

Accrued and other current liabilities

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

	March 31, 2013	December 31, 2012
Employee-related	$ 9,731	$ 12,293
Other	13,789	7,666
	$ 23,520	$ 19,959

15

Table of Contents

Warranty Accrual

The Company provides warranties to cover defects in workmanship, materials and manufacturing for a period of one to two years to meet the stated functionality as agreed to in each sales arrangement. Products are tested against specified functionality requirements prior to delivery, but the Company nevertheless from time to time experiences claims under its warranty guarantees. The Company accrues for estimated warranty costs under those guarantees based upon historical experience, and for specific items, at the time their existence is known and the amounts are determinable.

The table below summarizes the movement in the warranty accrual (in thousands):

	Three months ended March 31,	
	2013	2012
Beginning balance	$ 1,072	$ 1,443
Warranty accruals	26	19
Settlements and adjustments	(49)	(247)
Ending balance	$ 1,049	$ 1,215

Note 9. Debt

The Company records debt at its carrying amount. The Company uses a market approach to determine fair value, which results in a Level 2 fair value measurement. The following table provides the components of debt, obligations, weighted average interest rate and additional fair value information relating to the Company s outstanding debt instruments (in thousands, except percentages):

	March 31, 2013			December 31, 2012		
	Carrying Amount	Fair Value	Weighted Average Interest Rate	Carrying Amount	Fair Value	Weighted Average Interest Rate
Notes payable	$ 10,431	$ 10,431		$ 12,003	$ 12,003	
Notes payable related to OCU acquisition	3,710	3,710	1.50%	0	0	
Short-term debt	7,000	7,000	5.00%	5,000	4,892	2.20%
Total short-term debt	$ 10,710	$ 10,710		$ 5,000	$ 4,892	
Long-term notes payable related to OCU acquisition	7,420	7,420	1.50%	0	0	
Long-term debt	33,000	33,000	4.91%	17,167	16,336	2.20%
Total long-term debt	$ 40,420	$ 40,420		$ 17,167	$ 16,336	

Notes payable

The Company frequently directs its banking partners to issue notes payable to its suppliers in China in exchange for accounts payable. These banks issue notes to vendors and issue payment to the vendors upon redemption. The Company owes the payable balance to the issuing bank. These notes are unsecured, noninterest bearing and are due approximately six months after issuance.

Notes payable for OCU acquisition

In connection with acquisition of OCU on March 29, 2013, the Company is obligated to pay $11.1 million in three equal installments on the first, second and third anniversaries of the closing date for the purchase of the real estate used by the OCU. The payment is denominated in Japanese Yen. The amount presented in the table is the short-term portion of $3.7 million and the long-term portion of $7.4 million. The obligation bear interest at 1.5% per year and the real property is security for the loan.

Table of Contents

Long-term debt

The Company has lending arrangements with several financial institutions, including a loan and security agreement with Comerica Bank in the U.S., which has been amended several times. As of December 31, 2012, the Company s loan and security agreement in the U.S. included the following components:

As of December 31, 2012, $8.0 million was outstanding under the revolving line of credit agreement and $0.0 million was available for borrowing. Borrowings under this facility bear interest at a rate of LIBOR plus 2%.

As of December 31, 2012, no amounts were outstanding under the equipment advance line advance and all $7.0 million was available for borrowing. Borrowings under this facility would bear interest at a rate of LIBOR plus 2%.

As of December 31, 2012, $14.2 million was outstanding under the acquisition advance and $5.8 million was available for borrowing. The advances bear interest at a rate of LIBOR plus 2%.

On March 21, 2013, the Company amended and restated in its entirety Loan and Security Agreement with the same bank and added East-West Bank as a lender. The components of the available credit facilities as of March 31, 2013 as follows:

As of March 31, 2013, $12.0 million was outstanding under the revolving line of credit agreement and $8.0 million was available for borrowing. Amounts are due on or before March 2016 and borrowings under this revolving line of credit include an interest rate option of the Prime rate plus 4.75% or LIBOR plus 2.5%. Until March 31, 2013, the Prime option was used, and in April 2013, the LIBOR option was selected.

As of March 31, 2013, $28.0 million was outstanding under the term loan of the credit facility and interest is payable quarterly in arrears; the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan include an interest rate option of the Prime rate plus 5.0% or LIBOR plus 2.75%. Until March 31, 2013, the Prime option was used, and in April 2013, the LIBOR option was selected.

The Company s U.S. loan and security agreement requires us to maintain specified financial covenants, including a liquidity ratio, restricts its ability to incur additional debt or to engage in specified transactions and is secured by substantially all of its U.S. assets, other than intellectual property assets. As of March 31, 2013 and December 31, 2012, the Company was in compliance with the covenants contained in this agreement.

In connection with the original loan and security agreement, the Company issued a warrant on December 20, 2007 to Comerica Bank to purchase 4,482 shares of common stock at an exercise price of $29.00 per share. As of March 31, 2013 and 2012, the warrant had not been exercised.

Note 10. Commitments and contingencies

Leases

The Company leases various facilities under noncancelable operating leases. As of March 31, 2013, the future minimum commitments under all operating leases are as follows (in thousands):

2013 (remaining 9 months)	$ 1,593
2014	1,385
2015	1,188
2016	666

2017	500
Thereafter	968
	$ 6,300

Rent expense under the Company s operating leases was $0.6 million and $0.5 million for both the three months ended March 31, 2013 and 2012, respectively.

Litigation

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

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and the Company, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the codefendants respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. Finisar sought to recover unspecified damages, up to treble the amount of actual damages, together with attorneys fees, interest and costs. Finisar alleged that at least some of the patents asserted are a part of certain digital diagnostic standards for optoelectronics transceivers, and, therefore, are being utilized in such digital diagnostic standards. On March 23, 2010, the Company filed an answer to the complaint and counterclaims, asserting two claims of patent infringement and additional claims asserting that Finisar has violated state and federal competition laws and violated its obligations to license on reasonable and non-discriminatory terms. On May 5, 2010, the court dismissed without prejudice all co-defendants (including the Company) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against the Company. The Company and Finisar had agreed to suspend their respective claims for a 90 day period and not to refile the originally asserted claims against each other until one or more specified events occur resulting in the partial or complete resolution of the litigation between Source Photonics and Finisar. On September 10, 2010, Source Photonics and Finisar settled their lawsuit, commencing the suspension period, which ended in December 2010. On January 18, 2011, the Company and Finisar again agreed to suspend their respective claims and not to refile the originally asserted claims against each other until at least 90 days after one or more specified events occur resulting in the partial or complete resolution of litigation involving the same Finisar patents between Oplink Communications, Inc. and Finisar. This tolling period expired on April 30, 2012. On May 3, 2012 the Company and Finisar agreed to further toll their respective claims until the refiling of certain of the previously asserted claims from this dispute. As a result, Finisar is permitted to bring a new lawsuit against the Company if it chooses to do so, and the Company may bring new claims against Finisar upon seven days written notice prior to filing such claims. The Company is currently unable to predict the outcome of this dispute and therefore cannot determine the likelihood of loss nor estimate a range of possible loss.

Indemnifications

In the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and provide for general indemnification. The Company s exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations. As of March 31, 2013, the Company does not have any material indemnification claims that were probable or reasonably possible.

Table of Contents

Purchase obligations

The Company has purchase obligations with certain suppliers for the purchase of goods and services entered in the ordinary course of business. As of March 31, 2013, total outstanding purchase obligations were $26.2 million, primarily due within the next 12 months.

Other contingencies

In connection with the Company s acquisition of Santur that the Company completed in October 2011, the Company may be required to pay up to an additional $7.5 million in cash as further consideration for the business acquisition, contingent upon Santur s gross profit performance during 2012. The fair value of the contingent consideration is re-measured each reporting period and any changes in the fair value of the contingent consideration are recognized as a gain or loss in the consolidated statements of operations. As of March 31, 2013 and December 31, 2012, the Company estimate the fair value of the contingent consideration was $1.0 million and $1.0 million, respectively. Although the Company believes the fair value of the contingent consideration is in accordance with the terms of the Santur acquisition agreements, the selling parties dispute the final amount to be paid. Any adjustment to the fair value of the contingent consideration may impact the results of operations in the period the adjustment is made.

Note 11. Stockholder s equity

Common Stock

As of March 31, 2013, the Company had reserved the following shares of authorized but unissued common stock:

	Common Stock
Stock option plans	5,088,612
Stock purchase plan	257,734
Warrants	4,482
	5,350,828

Private Sale of Common Stock

On April 27, 2012, the Company issued and sold approximately 4.97 million shares of its common stock in a private placement transaction at a price of $8.00 per share for proceeds, net of offering costs of approximately $39.6 million. The shares of common stock are restricted from transfer pursuant to a lockup agreement for up to two years, at the end of which the Company is obligated to file one or more registration statements covering the potential resale of the shares of common stock. In connection with the private placement transactions, the Company agreed to use at least $30.0 million of the proceeds received to establish a wholly-owned subsidiary and facility in the Russian Federation for the benefit of the Company s global organization. The Company has agreed to satisfy the performance obligations by July 31, 2014. In the event the Company has not recorded aggregate revenue from sales of its products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014, then the date to achieve the performance obligations shall be extended from July 31, 2014 to March 31, 2015. If the Company fails to meet these performance obligations by the deadline, the Company will be required to pay $5.0 million.

The private placement transaction was recorded as an equity transaction. Of the common stock, $5.0 million is considered redeemable, as the Company may be required to pay this amount if it is unable to achieve its performance obligations by the date specified. While the Company intends to comply with its performance obligations, it has determined that some of these obligations are contingent upon government approval and maybe outside of the Company s control. Therefore, the redeemable common stock is classified outside of equity on the Company s consolidated balance sheet.

Equity Incentive Programs

The Company grants stock options, restricted stock units, stock appreciation units and stock purchase rights pursuant to stockholder and board approved equity incentive plans. These equity incentive plans are described in further detail in Note 12 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

19

Table of Contents

Stock options and restricted stock units

The following table summarizes the Company s stock option activity during the three months ended March 31, 2013:

		Stock Options		Restricted Stock Units	
	Shares available for grant	Number of shares	Weighted average exercise price	Number of units	Weighted average grant date fair value
Balance at December 31, 2012	382,668	2,773,887	$ 5.87	924,823	$ 5.84
Authorized for issuance	1,069,115	0	0.00	0	0.00
Granted	(30,000)	17,800	5.60	12,200	5.74
Exercised/Converted	0	(18,251)	4.32	(51,634)	6.12
Forfeited	58,998	(14,472)	8.43	(36,522)	5.84
Balance at March 31, 2013	1,480,781	2,758,964	5.86	848,867	5.82

The following table summarizes information about stock options outstanding as of March 31, 2013:

	Options Outstanding			
	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value (in thousands)
Vested and expected to vest	2,700,303	$ 5.87	6.39	$ 1,228
Exercisable	1,902,220	$ 5.67	5.50	$ 1,143

The intrinsic value of options vested and expected to vest and exercisable as of March 31, 2013 is calculated based on the difference between the exercise price and the fair value of the Company s common stock as of March 31, 2013. The intrinsic value of options exercised during the three months ended March 31, 2013 and 2012 was $16,000 and $14,000, respectively.

The following table summarizes information about restricted stock units outstanding as of March 31, 2013:

	Restricted Stock Units Outstanding			
	Number of shares	Weighted average grant date fair value	Weighted average remaining contractual term (years)	Aggregate intrinsic value (in thousands)
Vested and expected to vest	782,071	$ 5.82	1.15	$ 3,996

The intrinsic value of restricted stock units vested and expected to vest as of March 31, 2013 is calculated based on the fair value of the Company s common stock as of March 31, 2013. The intrinsic value of restricted stock units converted during the three months ended March 31, 2013 and 2012 was $301,000 and $0, respectively.

Table of Contents

Stock appreciation units

The following table summarizes the Company s stock appreciation unit activity during the three months ended March 31, 2013:

	Stock Appreciation Units	Weighted average exercise price
Stock appreciation units outstanding as of December 31, 2012	212,534	$ 7.07
Stock appreciation units cancelled	(4,423)	8.93
Stock appreciation units exercised	(316)	4.25
Stock appreciation units outstanding as of March 31, 2013	207,795	7.04

The following table summarizes information about stock appreciation units outstanding as of March 31, 2013:

	Stock Appreciation Units Outstanding			
	Number of units	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value (in thousands)
Vested and expected to vest	207,396	$ 7.03	5.86	$ 101
Exercisable	181,913	$ 6.71	5.69	$ 98

The intrinsic value of stock appreciation units vested and expected to vest and exercisable as of March 31, 2013 is calculated based on the difference between the exercise price and the fair value of the Company s common stock as of March 31, 2013. The intrinsic value of stock appreciation units exercised during the three months ended March 31, 2013 and 2012 was $0 and $6,000, respectively.

Note 12. Stock-based compensation

Stock-based compensation expense

The Company s stock-based compensation expense was recorded as follows:

	Three months ended March 31,	
(in thousands)	2013	2012
Cost of goods sold	$ 243	$ 188
Research and development	418	469
Sales and marketing	238	209
General and administrative	303	278
	$ 1,202	$ 1,144

Table of Contents

Stock options

The following tables summarize the components of stock-based compensation expense for stock options for the three months ended March 31, 2013 and 2012, respectively (in thousands):

	Three months ended March 31,	
	2013	2012
Cost of goods sold	$ 79	$ 61
Research and development	174	209
Sales and marketing	78	94
General and administrative	173	174
	$ 504	$ 538

The weighted-average fair value of options granted was $3.80 and $4.33 per share for the three months ended March 31, 2013 and 2012, respectively. At March 31, 2013, there was $3.1 million of unrecognized stock-based compensation expense that will be recognized over the remaining weighted-average period of 2.41 years.

The Company estimated the fair value of all employee stock options using a Black-Scholes valuation model with the following assumptions:

	Three months ended March 31,	
Stock Options	**2013**	**2012**
Weighted-average expected term (years)	6.55	6.71
Weighted-average volatility	76%	71%
Risk-free interest rate	1.08%	1.81%
Expected dividends	0%	0%

Expected term. The expected term was estimated using the Company s historical and expected future exercise behavior.

Volatility. Due to the limited history of the trading of the Company s common stock since the initial public offering in February 2011, the expected volatility used by the Company is based on the actual volatility of similar entities. In evaluating similarity, factors such as industry, stage of life cycle, size, and financial leverage are taken into consideration. The term over which volatility was measured was commensurate with the expected term.

Risk-free interest rate. The risk-free rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term.

Expected dividends. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

Table of Contents

Stock appreciation units

Stock appreciation units are remeasured each period at fair value. The following table summarizes the expense (credit) recognized for stock appreciation units for the three months ended March 31, 2013 (in thousands):

	Three months ended March 31,	
	2013	**2012**
Cost of goods sold	$ (24)	$ (5)
Research and development	(32)	(9)
Sales and marketing	(13)	(4)
General and administrative	(9)	(3)
	$ (78)	$ (21)

As of March 31, 2013 and December 31, 2012, the liabilities for the settlement of the stock appreciation units were $0.3 million and $0.4 million, respectively and were included in accrued and other current liabilities on the condensed consolidated balance sheet.

Based on the fair value of the stock appreciation units as of March 31, 2013, the Company had $0.05 million of unrecognized stock-based compensation expense that would be recognized over the remaining weighted-average period of 1.10 years. The Company estimated the fair value of all employee stock appreciation units using a Black-Scholes valuation model with the following assumptions:

	Three months ended March 31,	
Stock appreciation units	**2013**	**2012**
Weighted-average expected term (years)	2.61	3.39
Weighted-average volatility	63%	69%
Risk-free interest rate	0.20 - 0.46%	0.42 - 1.04%
Expected dividends	0%	0%

Expected term. Vested stock appreciation units first become exercisable upon the expiration of the lock-up period associated with the initial public offering. Therefore, the Company estimated the term of the award based on an average of the weighted-average exercise period and the remaining contractual term.

Volatility. Due to the limited history of the trading of the Company s common stock since the initial public offering in February 2011, the expected volatility used by the Company is based on the actual volatility of similar entities. In evaluating similarity, factors such as industry, stage of life cycle, size, and financial leverage are taken into consideration. The term over which volatility was measured was commensurate with the expected term.

Risk-free interest rate. The risk-free rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term.

Expected dividends. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

Table of Contents

Employee stock purchase plan (ESPP)

The following tables summarize the components of ESPP expense for the three months ended March 31, 2013 and 2012, respectively (in thousands):

	Three months ended March 31,	
	2013	2012
Cost of goods sold	$ 80	$ 67
Research and development	120	176
Sales and marketing	38	40
General and administrative	40	37
	$ 278	$ 320

As of March 31, 2013 there was $0.4 million of unrecognized stock-based compensation expense for stock purchase rights that will be recognized over the remaining offering period, through November 2013.

The value of the stock purchase right consists of: (1) the 15% discount on the purchase of the stock, (2) 85% of the call option and (3) 15% of the put option. The call option and put option were valued using the Black-Scholes option pricing model with the following assumptions:

	Three months ended March 31,	
Stock purchase rights	**2013**	**2012**
Weighted-average expected term (years)	0.74	0.72
Weighted-average volatility	48%	71%
Risk-free interest rate	0.13 - 0.16%	0.04 - 0.11%
Expected dividends	0%	0%

Expected term. The expected term represents the period of time from the beginning of the offering period to the purchase date.

Volatility. Due to the limited history of the trading of the Company s common stock since the initial public offering in February 2011, the expected volatility used by the Company is based on the actual volatility of similar entities. In evaluating similarity, factors such as industry, stage of life cycle, size, and financial leverage are taken into consideration. The term over which volatility was measured was commensurate with the expected term.

Risk-free interest rate. The risk-free rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term.

Expected dividends. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

Restricted stock units

The following table summarizes the stock-based compensation expense recognized for restricted stock units for the three months ended March 31, 2013 (in thousands):

	Three months ended March 31,

	2013	2012
Cost of goods sold	$ 108	$ 65
Research and development	156	93
Sales and marketing	135	79
General and administrative	99	70
	$ 498	$ 307

Table of Contents

The weighted-average fair value of restricted stock units granted was $5.74 and $6.10 per share for the three months ended March 31, 2013 and 2012, respectively. At March 31, 2013, the Company has $3.3 million of unrecognized stock-based compensation expense that will be recognized over the remaining weighted-average period of 1.92 years.

Note 13. Income taxes

The Company s income tax expense for the three months ended March 31, 2013 is primarily related to income taxes of the Company s non-U.S. operations. The Company recorded an income tax benefit of $596,000 and $60,000 for the three months ended March 31, 2013 and 2012, respectively.

	Three months ended March 31,	
(in thousands, except percentages)	**2013**	**2012**
Income tax benefit	$ 596	$ 60
Effective tax rate	6%	1%

The Company had an effective tax benefit rate of 6% in the three months ended March 31, 2013, compared with an effective tax benefit rate of 1% in the three months ended March 31, 2012. The Company s income tax benefit was primarily due to recording a deferred tax asset arising from transaction costs related to the Company s acquisition of OCU, partially offset by the operating profit realized in the Company s foreign subsidiaries, and a loss before income taxes during the three months ended March 31, 2013. The Company s income tax benefit incurred was primarily due to the loss before income taxes realized in the Company s foreign subsidiaries during the three months ended March 31, 2012.

The Company conducts its business globally. However, operating income is subject to varying rates of tax in the United States, China and Japan. Consequently, the Company s effective tax rate is dependent upon the geographic distribution of earnings or losses and the tax laws and regulations in each geographical region. The Company expects that its income taxes will vary in relation to the Company s profitability and the geographic distribution of its profits. Historically, the Company has experienced net losses in the United States and in the short term, the Company expects this trend to continue. One of the Company s subsidiaries in China generates a cash tax liability. The subsidiary has qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities in the financial statements and their respective tax bases using tax rates expected to be in effect during the years in which the basis differences reverse.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of a deferred tax asset will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. A valuation allowance is recorded for loss carryforwards and other deferred tax assets where it is more likely than not that such deferred tax assets will not be realized. Due to historic losses in the U.S., the Company has a full valuation allowance on the U.S. federal and state deferred tax assets.

As of March 31, 2013, there were no material changes to either the nature or the amounts of the uncertain tax positions previously determined for the year ended December 31, 2012.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q for the period ended March 31, 2013 and the audited consolidated financial statements and notes thereto and management s discussion and analysis of financial condition and results of operations for the fiscal year ended December 31, 2012 included in our Annual Report on Form 10-K. References to NeoPhotonics we, our and us are to NeoPhotonics Corporation unless otherwise specified or the context otherwise requires.

This Quarterly Report on Form 10-Q for the period ended March 31, 2013 contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q for the period ended

March 31, 2013 that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Terminology such as believe, may, might, objective, estimate, continue, anticipate, intend, should, plan, expect, predict, potential, or the negative of these terms or other similar expressions is intended to identify forward-looking statements.

We have based these forward-looking statements largely on our current expectations and projections about future events and industry and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in Part II Item 1A. Risk Factors below, and those discussed in the sections titled Special Note Regarding Forward-Looking Statements and Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the SEC on March 15, 2013. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Business overview

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

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

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

On April 27, 2012, we issued and sold approximately 4.97 million shares of our common stock in a private placement transaction at a price of $8.00 per share for gross proceeds of approximately $39.8 million. The shares of common stock are restricted from transfer pursuant to a lockup agreement for up to two years, at the end of which we are obligated to file one or more registration statements covering the potential resale of the shares of common stock. We intend to use a portion of the net proceeds from the sale of the shares of common stock for general corporate purposes and to establish a presence in the Russian Federation. In addition, we intend to establish a production facility in the Russian Federation, in accordance with the terms of a rights agreement entered into in connection with the private placement, for the benefit of the global organization. The expansion into the Russian Federation is targeted for completion by July 31, 2014.

On January 22, 2013, we signed a definitive agreement to acquire the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd. (OCU). OCU is a leading provider of lasers, drivers, and detectors for high speed 100G applications located in Japan. This transaction was closed in March 2013. We believe the acquisition of OCU will serve to enhance our competitive position in 100G products.

In 2012, our revenue growth of 22% over the prior-year was driven primarily by increasing demand for our 40Gbps and 100Gbps speed products, which grew by over 300% over the prior year, as carriers continued to accelerate deployment of high capacity optical transport networks. We operated a sales model that focused on direct alignment with our customers through coordination of our sales, product engineering and manufacturing teams. Our sales and marketing organizations supported our strategy of increasing product penetration with our Tier 1 customers while also serving our broader customer base. We use a direct sales force in the U.S., China, Canada, Israel, Japan, the Russian Federation and the European Union. These individuals worked with our product engineers, and product marketing and sales operations teams, in an integrated approach to address our customers current and future needs. We also engaged independent commissioned representatives worldwide to extend our global reach.

Table of Contents

For the first three months of fiscal 2013 compared to the same period in fiscal 2012, we continued to experience an increase in demand for our 100Gbps products as carriers continued to accelerate deployment of high capacity optical transport networks. This trend helped revenue from our Speed and Agility products to grow on a year over year basis. In the first quarter of 2013 demand for our Access products also declined relative to the same period in 2012 due to lower in fiber-to-the-home deployments in China and North America. The market for optical communications products remains highly competitive. We expect to continue to experience competition from companies that range from large international companies offering a wide range of products to smaller companies specializing in narrow markets. We anticipate macroeconomic conditions, including the slow recovery in the U.S., European sovereign debt issues, and a potential slowdown in the economic growth rate in China, could impact our results.

Critical accounting policies and estimates

There have been no material changes to our critical accounting policies and estimates during the three months ended March 31, 2013 from those disclosed in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations in our 2012 Form 10-K.

Results of operations

Revenue

We sell substantially all of our products to original equipment manufacturers, or OEMs. Revenue is recognized upon delivery of our product to the OEM. We price our products based on market and competitive conditions and may periodically reduce the price of our products as market and competitive conditions change and as manufacturing costs are reduced. Our sales transactions to customers are denominated primarily in Chinese Renminbi (RMB) or U.S. dollars. For the three months ended March 31, 2013 and 2012, 33% and 46% of our sales were derived from our China-based subsidiaries, respectively. Revenue is driven by the volume of shipments and may be impacted by pricing pressures. We have generated most of our revenue from a limited number of customers. Given the high concentration of network equipment vendors in our industry, our top ten customers represented approximately 91% of our revenue in each of the three months ended March 31, 2013 and 2012.

	Three months ended March 31,	
(in thousands)	**2013**	**2012**
Total revenue	$ 56,063	$ 54,223

Total revenue increased by $1.8 million in the three months ended March 31, 2013 compared to the three months ended March 31, 2012, representing a 3% increase. The increase in revenue was primarily attributable to growth in our speed and agility products as carriers increased deployment of 40 Gbps and 100 Gbps telecommunications networks, offset by decrease in demand for transceivers used in legacy networks at data rates at 10Gbps and below.

For the three months ended March 31, 2013, Huawei (27%), Ciena Corporation (22%), Alcatel-Lucent SA (13%) and Cisco (11%) each accounted for 10% or more of our total revenue. For the three months ended March 31, 2012, Huawei (36%), Ciena Corporation (14%) and Alcatel-Lucent SA (11%) each accounted for 10% or more of our total revenue. No other customers accounted for 10% or more of total revenue. We expect that a significant portion of our revenue will continue to be derived from a limited number of customers. As a result, the loss of, or a significant reduction in, orders from Huawei Technologies or any of our other key customers would materially and adversely affect our revenue and results of operations. We expect a significant portion of our sales to be denominated in foreign currencies in the future, and therefore may continue to be affected by changes in foreign exchange rates.

Cost of goods sold and gross margin

Our cost of goods sold consists primarily of the cost to produce wafers and to manufacture and test our products. We have a global set of suppliers to help balance considerations related to product availability, quality and cost. Some of our cost of goods sold are denominated primarily in RMB. Our manufacturing process extends from wafer fabrication through final module and subsystem assembly and test. The cost of our manufacturing, assembly and test processes includes the cost of personnel and the cost of our manufacturing equipment and facilities. Our cost of goods sold is impacted by manufacturing variances such as assembly and test yields and production volume. We typically experience lower yields and higher associated costs on new products. In general, our cost of goods sold associated with a particular product declines over time as a result of decreases in wafer costs associated with the increase in the volume of wafers produced, as well as yield improvements and assembly and test enhancements. Additionally, our cost of goods sold includes stock-based compensation, reserves for excess and obsolete inventory, royalty payments, amortization of certain purchased intangible assets and acquisition-related fair value adjustments, warranty, shipping and allocated facilities costs.

Gross profit as a percentage of total revenue, or gross margin, has been and is expected to continue to be affected by a variety of factors, including the introduction of new products, production volume, production volume compared to sales over time, the mix of products sold, inventory changes, changes in the average selling prices of our products, changes in the cost and volumes of materials purchased from our suppliers, changes in labor costs, changes in overhead costs or requirements, revaluation of stock appreciation unit awards that are impacted by our stock price, and any reserves for excess and obsolete inventories. Our newer and more advanced products typically have higher average selling prices and higher gross margins. Average selling prices by product typically decline as a result of periodic negotiations with our customers and competitive pressures. We strive to increase our gross margin as we seek to manage the costs of our supply chain and increase productivity in our manufacturing processes.

	Three months ended March 31,			
	2013		2012	
(in thousands, except percentages)	Amount	% of revenue	Amount	% of revenue
Cost of goods sold	$ 44,333	79%	$ 42,817	79%

	Three months ended March 31,	
	2013	2012
Gross margin	21%	21%

Cost of goods sold increased by $1.5 million in the three months ended March 31, 2013 compared to the three months ended March 31, 2012, representing a 4% increase. The slight increase in cost of goods sold for the three months ended March 31, 2013 compared to the same quarter of 2012 was mainly driven by higher sales. Gross margin remained relatively flat for the three months ended March 31, 2013, compared to the three months ended March 31, 2012.

We may experience higher China manufacturing labor cost due to future labor or other laws and regulations in China, and our gross margins and results of operations may be adversely affected.

Operating expenses

Our operating expenses consist of research and development, sales and marketing, general and administrative, amortization of purchased intangible assets, and adjustment to the fair value of contingent consideration. Personnel costs are the most significant component of operating expenses and consist of costs such as salaries, benefits, bonuses, stock-based compensation and, with regard to sales and marketing expense, sales commissions. Our operating expenses are denominated primarily in RMB and U.S. dollars.

	Three months ended March 31,			
	2013		2012	
(in thousands, except percentages)	Amount	% of revenue	Amount	% of revenue
Research and development	$ 9,707	17%	$ 10,538	19%
Sales and marketing	3,586	6%	3,023	6%
General and administrative	8,545	15%	6,995	13%
Amortization of purchased intangible assets	321	1%	354	1%
Adjustment to fair value of contingent consideration		0%	1,907	3%
Restructuring charges	325	1%	130	0%
Total operating expenses	$ 22,484	40%	$ 22,947	42%

Research and development

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

Research and development expense decreased by $0.8 million in the three months ended March 31, 2013 compared to the three months ended March 31, 2012, representing an 8% decrease. This decrease was primarily due to a $0.5 million lower payroll and employee-related costs in 2013, due to our integration of Santur, and a $0.3 million decrease due to lower material consumption from research and development projects.

We intend to continue to invest in research and development and expect this expense to increase as we grow our business. As a percentage of total revenue, our research and development expense may vary as our revenue changes over time.

Sales and marketing

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

Sales and marketing expense increased by $0.6 million in the three months ended March 31, 2013 compared to the three months ended March 31, 2012, representing an 19% increases. This increase was primarily due to a $0.3 million increase in additional payroll and employee-related costs to support sales growth and a $0.2 million increase in allowance for doubtful account reserve.

We expect our sales and marketing expense to increase as a result of the acquisition of OCU and as we grow our business, expand our marketing activities, increase the number of sales and marketing professionals and incur employee-related costs accordingly. As a percentage of total revenue, our sales and marketing expense may vary as our revenue changes over time.

General and administrative

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

General and administrative expense increased by $1.6 million in the three months ended March 31, 2013 compared to the three months ended March 31, 2012, representing a 22% increase. This was primarily due to a $3.2 million increase in acquisition-related cost for OCU, offset by a $1.0 million decrease in payroll and employee-related costs and a $0.6 million decrease in professional fees.

We expect our general and administrative expense to increase as a result of the acquisition of OCU and as we expand and grow our operations and business. As a percentage of total revenue, our general and administrative expense may vary as our revenue changes over time.

Amortization of purchased intangible assets

We completed a series of business acquisitions in 2005 and 2006 and, more recently, in the fourth quarter of 2011 and in the first quarter of 2013, which included the acquisition of intangible assets. These intangible assets are being amortized over their estimated useful lives. Amortization expense relating to technology and patents and leasehold interests are includes within cost of goods sold, while customer relationships and noncompete agreements are recorded within operating expenses.

Amortization of purchased intangible assets decreased by 9% in the three months ended March 31, 2013 compared to the three months ended March 31, 2012. The decrease was primarily due to lower amortization from fully amortized assets associated with the acquisitions completed in 2005 and 2006. Amortization of purchased intangible related to our acquisition of OCU will be amortized beginning in the second quarter of 2013. Please refer to note 6. Business Combination of our Notes to Condensed Consolidated Financial Statements for details.

Adjustment to the fair value of contingent consideration

In connection with our acquisition of Santur Corporation (Santur) in October 2011, we may be required to pay up to an additional $7.5 million in cash as further consideration for the business acquisition, contingent upon Santur s gross profit performance during 2012. The fair value of the contingent consideration is re-measured each reporting period and any changes in the fair value of the contingent consideration are recognized as a gain or loss in the consolidated statements of operations. During the three months ended March 31, 2013 and 2012, we recorded adjustments to the fair value of the consideration of $0.0 million and $1.9 million, respectively. As of March 31, 2013 and December 31, 2012, the fair value of the contingent consideration was $1.0 million. Although we believe the fair value of the contingent consideration is in accordance with the terms of the Santur acquisition agreements, the selling parties disputes the final amount to be paid. Any adjustments to the fair value of the contingent consideration may impact the result of operations in the period the adjustment is made.

Purchase Price Allocation

We accounted for our acquisition of the OCU assets and assumed liabilities using the acquisition method of accounting for business combinations. The OCU s tangible and identifiable intangible assets acquired and liabilities assumed were recorded based upon their estimated fair values as of the closing date of the acquisition. The excess of purchase price over the value of the net assets acquired was recorded as goodwill. Our purchase price allocation is preliminary. The fair values of acquired assets and liabilities may be further adjusted as additional information becomes available during the allocation period. Additional information that may become available subsequently and may result in changes in the values allocated to various assets and liabilities includes, but is not limited to, pension and retirement liabilities, asset retirement obligations, inventory fair value, working capital adjustments to be agreed with the Lapis. Any changes in the values allocated to tangible and specifically identified intangible assets acquired and liabilities assumed during the allocation period may result in material adjustments to goodwill. Please refer to Note 6.

Restructuring charges

In the first quarter of 2013, we exited and closed one facility at our headquarters location to align our facilities usage with our current size. As a result, we recorded a restructuring charge related to the facility impairment of approximately $0.3 million including $0.1 million wrote off on deferred rent. As of March 31, 2013, the remaining balance on this restructuring obligation was $0.4 million, which we expect to pay through 2015.

Interest and other expense, net

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

Table of Contents

(in thousands)	Three months ended March 31, 2013	2012
Interest income	$ 131	$ 132
Interest expense	(163)	(154)
Other expense, net	(274)	(275)
Total	$ (306)	$ (297)

Total interest and other expense, net remained relatively flat in the three months ended March 31, 2013 compared to the three months ended March 31, 2012. We expect our interest income to remain relatively modest given the low yields available in the marketplace and lower investable balances. And we expect our interest expense to increase due to additional borrowings. Please refer to note 8. Debt of our Notes to Condensed Consolidated Financial Statements for details.

Income taxes

We conduct our business globally. Therefore, our operating income is subject to varying rates of tax in the United States, China, Japan and other various foreign jurisdictions. Consequently, our effective tax rate is dependent upon the geographic distribution of our earnings or losses and the tax laws and regulations in each geographical region. We expect that our income taxes will vary in relation to our profitability and the geographic distribution of our profits. Historically, we have experienced net losses in the U.S. and in the short term, we expect this trend to continue. In China, one of our subsidiaries has qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate. The preferential rate applies from 2010 to 2013. The preferential rate applied to 2013 have been approved to remain at 15% through 2014.

(in thousands, except percentages)	Three months ended March 31, 2013	2012
Income tax benefit	$ 596	$ 60
Effective tax rate	6%	1%

We had an effective tax benefit rate of 6% in the three months ended March 31, 2013, compared with an effective tax benefit rate of 1% in the three months ended March 31, 2012. Our income tax benefit was primarily due to recording a deferred tax asset arising from transaction costs related to our acquisition of OCU, partially offset by the operating profit realized in our foreign subsidiaries, and a consolidated loss before income taxes during the three months ended March 31, 2013. Our income tax benefit incurred was primarily due to the loss before income taxes realized in our foreign subsidiaries during the three months ended March 31, 2012.

Liquidity and capital resources

We have financed our operations through issuances of investment securities and cash generated from operations and from various lending arrangements. At March 31, 2013, our cash and cash equivalents totaled $51.4 million, and our short-term investments totaled $48.4 million. Cash and cash equivalents were held for working capital purposes and were invested primarily in money market funds. We do not enter into investments for trading or speculative purposes.

On April 27, 2012, we issued and sold approximately 4.97 million shares of our common stock in a private placement transaction at a price of $8.00 per share for gross proceeds of approximately $39.8 million. The shares of common stock are restricted from transfer pursuant to a lockup agreement for up to two years, at the end of which we are obligated to file one or more registration statements covering the potential resale of the shares of common stock. We intend to use a portion of the net proceeds from the sale of the shares of common stock for general corporate purposes and to establish a design center in the Russian Federation. In addition, we will establish a production facility in the Russian Federation, in accordance with the terms of a rights agreement entered into in connection with the private placement, for the benefit of the global organization. The expansion into the Russian Federation is targeted for completion by July 31, 2014, and is not expected to have a material impact on our results of operations in 2013.

Table of Contents

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

A customary business practice in China is for customers to exchange our accounts receivable with notes receivable issued by their bank. From time to time we accept notes receivable from certain of our customers in China. These notes receivable are non-interest bearing and are generally due within six months, and such notes receivable may be redeemed with the issuing bank prior to maturity at a discount. Historically, we have collected on the notes receivable in full at the time of maturity.

Frequently, we also direct our banking partners to issue notes payable to our suppliers in China in exchange for accounts payable. Our Chinese subsidiaries banks issue the notes to vendors and issue payment to the vendors upon redemption. We owe the payable balance to the issuing bank. The notes payable are non-interest bearing and are generally due within six months of issuance. As a condition of the notes payable lending arrangements, we are required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the notes payable are paid by our subsidiaries in China. These balances are classified as restricted cash on our consolidated balance sheets. As of March 31, 2013, our restricted cash totaled $2.1 million.

We have lending arrangements with several financial institutions, including a loan and security agreement with Comerica Bank in the U.S., which has been amended several times. As of December 31, 2012, our loan and security agreement in the U.S. included the following components:

As of December 31, 2012, $8.0 million was outstanding under the revolving line of credit agreement and $0.0 million was available for borrowing. Borrowings under this facility bear interest at a rate of LIBOR plus 2%.

As of December 31, 2012, no amounts were outstanding under the equipment advance line advance and all $7.0 million was available for borrowing. Borrowings under this facility would bear interest at a rate of LIBOR plus 2%.

As of December 31, 2012, $14.2 million was outstanding under the acquisition advance and $5.8 million was available for borrowing. The advances bear interest at a rate of LIBOR plus 2%.

On March 21, 2013, we amended and restated in our entirety Loan and Security Agreement with the same bank and added East-West Bank as a lender. The components of the available credit facilities as of March 31, 2013 as follows:

As of March 31, 2013, $12.0 million was outstanding under the revolving line of credit agreement and $8.0 million was available for borrowing. Amounts are due on or before March 2016 and borrowings under this revolving line of credit include an interest rate option of the Prime rate plus 4.75% or LIBOR plus 2.5%. Until March 31, 2013, the Prime option was used, and in April 2013, the LIBOR option was selected.

As of March 31, 2013, $28.0 million was outstanding under the term loan of the credit facility and interest is payable quarterly in arrears; the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan include an interest rate option of the Prime rate plus 5.0% or LIBOR plus 2.75%. Until March 31, 2013, the Prime option was used, and in April 2013, the LIBOR option was selected.

Table of Contents

Our U.S. loan and security agreement requires us to maintain specified financial covenants, including a liquidity ratio, restricts our ability to incur additional debt or to engage in specified transactions and is secured by substantially all of our U.S. assets, other than intellectual property assets. As of March 31, 2013, we were in compliance with the covenants contained in this agreement.

Our subsidiaries in China have short-term line of credit facilities with several banking institutions. These short-term loans have an original maturity date of one year or less as of March 31, 2013. Amounts requested by us are not guaranteed and are subject to the banks funds and currency availability. The short-term loan agreements do not contain financial covenants. As of March 31, 2013, we had no short-term loans outstanding.

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

	Three months ended March 31,	
(in thousands)	**2013**	**2012**
Net cash provided by (used in) operating activities	$ 1,703	$ (1,638)
Net cash provided by (used in) investing activities	(3,622)	7,149
Net cash provided by (used in) financing activities	16,311	(1,315)
Effect of exchange rates on cash and cash equivalents	72	209
Net increase in cash and cash equivalents	$ 14,464	$ 4,405

Restatement of amounts related to three months ended March 31, 2013

We have restated our consolidated statement of cash flows for the three months ended March 31, 2013 to adjust a misclassification relating to purchases of property, plant and equipment. In the previously issued consolidated statement of cash flows for the interim period ended March 31, 2013, amounts related to purchases of property and equipment were inadvertently overstated resulting in the overstatement of net cash used in investing activities and the overstatement of net cash provided by operating activities by the same amount.

This restatement results in a decrease of $1.1 million in accounts payable resulting in a decrease in net cash provided by operating activities and a corresponding decrease in purchases of property, plant and equipment included in net cash used in investing activities.

This restatement has no impact on our previously reported total cash and cash equivalents, condensed consolidated balance sheet or condensed consolidated statement of operations for this period. See Note 2 to our Condensed Consolidated Financial Statements for further details.

Operating activities

During the three months ended March 31, 2013, net cash provided by operating activities was $1.7 million. Cash provided by operating activities was primarily related to cash payments to our employees and suppliers in excess of cash receipts from customers. We recognized a net loss of $10.5 million during the three months ended March 31, 2013. This net loss incorporated non-cash charges, including depreciation and amortization of $4.6 million, stock-based compensation expenses of $1.2 million, and loss on disposal of property and equipment of $0.1 million. During the three months ended March 31, 2013, there was an increase in accounts payable of $4.0 million, an increase of $3.2 million in acquisition-related costs of OCU, and a decrease of $7.2 million in accounts receivable due to improved collection efforts. These amounts were partially offset by the purchase of inventory of $4.7 million to replenish our inventories in preparation for higher customer demand in future periods, a net decrease in accrued and other liabilities of $1.5 million, and an increase in prepaid expenses and other current assets of $1.3 million during the period.

During the three months ended March 31, 2012, net cash used in operating activities was $1.6 million. Cash used in operating activities was primarily related to cash payments to our employees and suppliers in excess of cash receipts from customers. During the three months ended March 31, 2012, we recognized a net loss of $11.6 million. This net loss incorporated non-cash charges, including depreciation and amortization of $5.4 million, stock-based compensation expenses of $1.1 million, non-cash increases to our asset reserve accounts of $0.7 million, partially offset by $0.8 million gain on sale of Shenzhen Photon Broadband Technology Co., Ltd. (Broadband), a China subsidiary. During the three months ended March 31, 2012, there was a decrease of $9.2 million in accounts receivable due to improved collection efforts. These amounts were partially offset by the purchase of inventory of $4.7 million to replenish our inventories in preparation for higher customer demand in future periods, and the net increase in prepaid expenses and other current assets of $1.8 million during the period.

Investing activities

Our investing activities consisted primarily of purchases and sales of investments and capital expenditures.

During the three months ended March 31, 2013, net cash used in investing activities was $3.6 million. We received $44.6 million for the sale and maturity of investment securities, which was offset by $14.6 million of cash used for the acquisition of OCU, $29.0 million for the purchase of investment securities, and $5.1 million in capital expenditures.

During the three months ended March 31, 2012, net cash provided by investing activities was $7.1 million. We received $20.2 million for the sale and maturity of investment securities and $1.8 million for the sale of Broadband, which was partially offset by $13.0 million of cash used for the purchase of investment securities and $2.0 million of capital expenditures.

Table of Contents

Financing activities

Our financing activities consisted primarily of proceeds from the issuance of stock and activity associated with our various lending arrangements.

During the three months ended March 31, 2013, net cash provided from financing activities was $16.3 million. We received $40.0 million in proceeds from bank loans and $4.9 million from the issuance of notes payable, which was offset by $22.2 million used for the repayment of bank loans, and $6.5 million for the repayment of notes payables.

During the three months ended March 31, 2012, net cash used in financing activities was $1.3 million. We used $1.3 million of cash for the repayment of bank loans, and $0.1 million for the repayment of notes payable, net of proceeds.

Contractual obligations and commitments

The following summarizes our contractual obligations as of March 31, 2013:

		Payments due by period			
(in thousands)	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Notes payable [(1)]	$ 10,431	$ 10,431	$	$	$
Short-term loan [(2)]	3,710	3,710			
Long-term loan [(3)]	7,420		7,420		
Debt obligations [(4)]	40,000	7,000	26,000	7,000	
Operating leases [(5)]	6,300	2,022	2,311	1,241	726
Purchase commitments [(6)]	26,167	26,167			
Contingent consideration [(7)]	7,500	7,500			
Asset retirement obligations [(8)]	1,148				1,148
	102,676	56,830	35,731	8,241	1,874
Expected interest payments [(9)]	3,134	1,254	1,729	151	0
Total commitments	$ 105,810	$ 58,084	$ 37,460	$ 8,392	$ 1,874

(1) In China, we issue notes payable to our suppliers frequently. The notes payable are generally due within six months of issuance and are non-interest bearing. The amount presented in the table represents the principal portion of the obligations.

(2) In connection with acquisition of OCU on March 29, 2013, we have $11.1 million to be paid in three equal installments on the first, second and third anniversaries of the closing date for the purchase of the real estate used by the OCU. The amount presented in the table presents short-term portion.

(3) In connection with acquisition of OCU on March 29, 2013, we have $11.1 million to be paid in three equal installments on the first, second and third anniversaries of the closing date for the purchase of the real estate used by the OCU. The amount presented in the table presents long-term portion.

(4) We have lending arrangements with several financial institutions, including a loan and security agreement with Comerica Bank in the U.S., which has been amended several times. On March 21, 2013, the Company amended and restated in its entirety Loan and Security Agreement with the same bank and added East-West Bank as a lender. The amount presented in the table represents the principal portion of the obligations. All of the outstanding debt was subject to fluctuations in interest rates. Interest is paid monthly over the term of the debt arrangement.

(5) We have entered into various non-cancelable operating lease agreements for our offices in China, U.S. and Japan.

(6) We are obligated to make payments under various arrangements with suppliers for the procurement of goods and services.
(7) We are obligated to pay up to an additional $7.5 million for the acquisition of Santur, contingent upon Santur meeting gross profit performance objectives in 2012. As of March 31, 2013, the fair value of the contingent consideration was $1.0 million.
(8) We have an asset retirement obligation of $1.0 million associated with our facility lease in California, which expires in October 2019. This obligation is included in other noncurrent liabilities in the condensed consolidated balance sheet as of March 31, 2013. We also have a $0.1 million asset retirement obligation on our owned facility in Japan.
(9) We calculate the expected interest payments based on our outstanding notes payable, loan and debt obligations at prevailing interest rates as of March 31, 2013.

Off-balance sheet arrangements

During the three months ended March 31, 2013, we did not have any significant off-balance sheet arrangements.

Recent accounting pronouncements

See Note 2 Significant accounting policies in the Notes to Condensed Consolidated Financial Statements on this Quarterly Report on Form 10-Q for a description of recent accounting pronouncements and accounting changes.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2013. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

In the Evaluation of Disclosure Controls and Procedures included in our original Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as a result of the material weakness that existed in our internal control over financial reporting related to annual inventory counts. Our Chief Executive Officer and Chief Financial Officer subsequently concluded that the material weakness described below related to the preparation and review of the consolidated statement of cash flows also existed as of March 31, 2013. As a result, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of March 31, 2013.

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

As previously reported in our Annual Report on Form 10-K, as of December 31, 2012, our management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2012, because of the material weakness described in our Annual Report on Form 10-K, specifically our internal controls over annual inventory counts did not operate effectively to provide reasonable assurance that all inventory count results were reconciled to our accounting records.

In addition, our management concluded that as of March 31, 2013 we did not maintain effective internal control over financial reporting over the preparation and review of our consolidated statement of cash flows. Specifically, we did not execute controls related to the review of non-cash adjustments pertaining to purchases of property, plant and equipment. This control deficiency resulted in the restatement of our consolidated financial statements for the quarter ended March 31, 2013. Additionally, this control deficiency could result in misstatements of the consolidated statement of cash flows that would result in a material misstatement of the consolidated financial statements that would not be prevented or detected on a timely basis. Accordingly, our management has determined that this control deficiency constitutes a material weakness.

With the oversight of senior management and our audit committee, we have taken steps and plan to take additional measures to remediate the underlying causes of the material weakness, primarily by continuing to train our finance employees to increase the effectiveness of review over non-cash adjustments pertaining to purchases of property, plant, and equipment. While we believe we will have remediated the material weaknesses prior to filing our Form 10-K for the period ended and as of December 31, 2013 we can provide no assurance at this time that management will be able to report that our internal control over financial reporting is effective as of December 31, 2013.

Notwithstanding the identified material weaknesses, management believes the consolidated financial statements included in this Amended Quarterly Report on Form 10-Q/A fairly represent in all material respects our financial condition, results of operations and cash flows at and for the period presented in accordance with U.S. GAAP.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Table of Contents

Changes in Internal Control over Financial Reporting

In response to the material weakness identified related to annual inventory counts, in the fiscal quarter ended March 31, 2013, we instituted several new internal controls in order to remediate this weakness:

- inventory control and annual physical count training program for relevant personnel specifically focusing on material located in the income/receiving areas; and

- performing more frequent inventory cycle and physical counts at our Fremont and San Jose, California facilities.

We believe these additional internal controls will be effective in remediating the material weakness related to annual inventory counts described above. As we continue to evaluate and work to improve our internal control over financial reporting, management may determine to take additional measures to address the material weakness or determine to modify the remediation plan described above.

Other than the changes described above there was no significant change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described above that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1A. *RISK FACTORS*

The risk factors facing our company have not changed materially from those set forth in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the SEC on March 15, 2013, which risk factors are set forth below, except for those risk factors denoted by an asterisk (*).

Table of Contents

Risks related to our business

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

We have a history of losses and we may incur additional losses in future periods. As of March 31, 2013, our accumulated deficit was $258.5 million. We also expect to continue to make significant expenditures related to the development of our business. These include expenditures to hire additional personnel related to the sales, marketing and development of our products and to maintain and expand our manufacturing facilities and research and development operations.

We have entered into lending arrangements that provide for some of the capital necessary to develop our business further and these lending arrangements contain various restrictions and financial covenants, including a covenant not to exceed a maximum ration of funded debt to adjusted EBITDA on a quarterly basis. Significant additional losses in future period could cause us to breach these covenants. A breach of any of these covenants or a failure to pay interest or indebtedness when due under any of these lending arrangements, could result in a variety of material adverse consequences.

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

We make planning and spending decisions, including determining the levels of business that we will seek and accept, production schedules, and inventory levels, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers and the possibility of unexpected changes in demand for their products reduce our ability to accurately estimate future customer requirements. On occasion, customers may require rapid increases in production, which can strain our resources, cause our manufacturing to be negatively impacted by materials shortages, necessitate higher or more restrictive procurement commitments, increase our manufacturing yield loss and scrapping of excess materials, and reduce our gross margin. We may not have sufficient capacity at a