NEOPHOTONICS CORP
Form 10-K
June 04, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 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

001-35061

(Commission File No.)

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)

Registrant's telephone number, including area code:

+1 (408) 232-9200

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, par value $0.0025 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes ¨ No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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. (Check one):

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

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

As of June 30, 2013, the approximate aggregate market value of voting stock held by non-affiliates of the Registrant, based upon the last sale price of the Registrant's common stock on the last business day of the Registrant's most recently completed second fiscal quarter, June 30, 2013 (based upon the closing sale price of the Registrant's common stock on the New York Stock Exchange), was approximately $178,623,115. This calculation excludes 10,415,286 shares held by directors, executive officers and stockholders affiliated with our directors and executive officers.

As of May 27, 2014, the Registrant had 31,780,761 outstanding shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

None

NEOPHOTONICS CORPORATION

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2013

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PART I

ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

You should read the following discussion in conjunction with our Consolidated Financial Statements and the related "Notes to Consolidated Financial Statements", and "Financial Statements and Supplementary Data" included in this Annual Report on Form 10-K. This discussion contains forward-looking statements including statements concerning our possible or assumed future results of operations, business strategies, competitive position, industry environment, potential growth opportunities and the effects of competition. Such statements are based upon our management's beliefs and assumptions and on information currently available to us. Forward-looking statements include statements that are not historical facts and can be identified by terms such as "anticipates," "believes," "could," "seeks," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "projects," "should," "will," "would" or similar expressions. Forw statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. These risks, uncertainties and other factors in this Annual Report on Form 10-K are discussed in greater detail under the heading "Risk Factors." Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this Annual Report on Form 10-K. You should read this Annual Report on Form 10-K completely and with the understanding that our actual future results may be materially different from what we expect. Except as required by law, we assume no obligation to update these forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

BUSINESS

Overview

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

Our products are designed to enable cost-effective, high-speed data transmission and efficient allocation of bandwidth over communications networks. We have a portfolio of over 40 product families, including products that enable data transmission at 10 gigabits per second, or Gbps, to 100Gbps and above, including for high speed coherent networks, agility products such as drop modules for use in ROADM, or reconfigurable add/drop multiplexer, nodes and tunable lasers that are used to dynamically allocate bandwidth to adjust for traffic patterns, and access products that provide high-bandwidth connections to more devices and people over fixed and wireless networks.

Our PIC technology utilizes proprietary design elements that provide optical functionality on a silicon or III-V compound semiconductor chip and includes active PIC design elements including lasers, modulators and photodiodes. Our 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, increasing reliability and reducing power requirements. 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 have research and development and wafer fabrication facilities in San Jose and Fremont, California and in Tokyo, Japan which coordinate with our research and development and manufacturing facilities in Shenzhen and Wuhan, China, 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.

We were incorporated in the State of Delaware in October 1996 as NanoGram Corporation, and we changed our name to NeoPhotonics Corporation in 2002. Our principal offices are located at 2911 Zanker Road, San Jose, CA 95134, USA and our telephone number is +1 (408) 232-9200. Our website address is www.neophotonics.com. Information found on, or accessible through, our website is not a part of, and is not incorporated into, this Annual Report on Form 10-K.

In October 2011, we acquired Santur Corporation, or Santur, a designer and manufacturer of optical indium phosphide (InP)-based PIC products and in March 2013, we acquired the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd. (OCU) in Japan, a leading provider of lasers, drivers, and detectors for high speed 100Gbps applications. OCU is now known as NeoPhotonics Semiconductor.

In the first quarter of 2012, we completed the sale of a component of our business, Shenzhen Photon Broadband Technology Co., Ltd., or Broadband, a subsidiary in China. We sold Broadband because the nature of Broadband's business, the development and sale of hybrid fiber coaxial subsystems for cable television transmission, was different than our core technology and strategy.

Our solutions

We offer a broad portfolio of products that are critical in enabling speed, agility and access across communications networks. The key benefits of our solutions include:

Enabling high speed 100Gbps and above communications network implementation through large scale integration. Our products are designed to simplify communications network deployments by delivering high levels of functional integration through our PIC solutions, which combine multiple discrete elements onto integrated semiconductor chips. Our PIC-based approach is designed to enable us to deliver the increased performance necessary for data transmission at 100Gbps, while also being designed to enhance reliability, reduce cost and increase density.

Enabling service providers and datacenter operators to cost-effectively deploy and rapidly scale high-bandwidth capacity networks. Our solutions are designed to be compatible with existing network architectures and enable incremental system upgrades, enabling service providers to rapidly and efficiently scale network capacity and cost-effectively deploy enhanced services over existing optical fiber infrastructure.

Simplifying communications networks implementation through large scale integration. Our products are designed to simplify communications networks deployments by delivering high levels of functional integration through our PIC solutions, which combine multiple discrete elements on integrated semiconductor chips. Our PIC-based approach is designed to enable us to deliver the increased performance necessary for data transmission at 100Gbps and above, while also being designed to reduce cost, physical size and power requirements.

Enabling acceleration of time-to-market for network equipment vendors. We believe our technology enables service providers to implement new features and scale network capacity rapidly and cost-effectively to meet time-to-market requirements. Our products are developed using proprietary PIC-based design elements, which are similar in concept to standard design cells used in the semiconductor industry. These elements can be used as building blocks to construct complex modules and subsystems.

Satisfying our customers' quality and volume requirements. We believe we are one of the highest volume PIC manufacturers in the world and have the ability to grow our capacity to meet customer demand. Our Tokyo, Japan, Silicon Valley (San Jose and Fremont), California and China-based manufacturing facilities utilize semiconductor manufacturing techniques, such as statistical process control and wafer scale fabrication, which are designed to produce our products in high volume at nanoscale tolerances with high yields.

Technology

We have developed expertise in the design, large-scale fabrication, high-volume module manufacturing and commercial deployment of our PIC products and technologies. The process of designing and manufacturing PICs in high volume with predictable, well-characterized performance and low manufacturing costs is complex and multi-faceted. We believe we have been able to develop the technologies that address and solve a range of interrelated problems that enable the efficient design and manufacture of complex, high-performance components, modules and subsystems for fiber optic networks. The basic elements of our technology are as follows:

Photonic integrated circuits (PICs). We have developed a set of proprietary design elements that provide optical functionality on silicon and other integrated compound semiconductor chips including indium phosphide, or InP, gallium arsenide, or GaAs, and silicon germanium, or SiGe, for drivers and related high-speed electronic optical control functions. We utilize micron and sub-micron scale structures of multiple precision-doped silica planar waveguides and InP waveguides to fabricate functional elements such as integrated optical filters, switches and variable attenuators. By increasing the level of material doping in our planar waveguides, or by using different materials such as InP, we decrease the size of our functional elements, thereby creating a path for larger scale integration of multiple elements in the same chip area. We integrate these functional design elements into optical circuits to achieve a desired functionality and specification that is incorporated in our products.

Hybrid PIC integration. Through precise fabrication and positioning of physical features, we can integrate PIC devices fabricated on separate wafers out of different materials, matching the material to the function to improve performance attributes and reduce production costs. Our hybrid integration allows us to integrate active devices, such as photodiodes or lasers fabricated using InP, with high-performance passive devices, such as switches, routers and filters, fabricated on silicon, to provide the desired network functions in a single device.

Hardware and firmware integration. We sell our products as modules and subsystems which contain electronic hardware and firmware controls that interface directly with our customers' systems. We design the electronic hardware and develop the firmware to integrate with our optical products to meet customer specifications.

Fabrication and manufacturing processes. We have developed expertise in the technology domains relevant to high-volume fabrication and manufacturing of our PIC products with wafer-scale processes, including the complex interaction of electro-optic, thermal-optic and mechanical micro-thermal features. We have developed and characterized our complex manufacturing steps, which are analogous to those used in the semiconductor industry. Each PIC element is tested and characterized using our proprietary equipment before incorporation into our products.

Circuit design and design-for-manufacturing tools. We utilize a comprehensive set of proprietary as well as industry standard software design tools, which permit us to model relevant geometries, dimensions and thermal management for a broad range of photonic devices, which then allows us to develop products with minimal design iterations and to manufacture to a range of specifications.

Products

We have a broad portfolio of over 40 product families, including high-speed products that enable data transmission at rates of 10Gbps to 100Gbps and above, agility products such as drop modules for use in ROADM nodes that dynamically allocate bandwidth to adjust for volatile traffic patterns, and access products that provide high-bandwidth connections to more devices and people over fixed and wireless networks. Our products can be categorized into groups including High Speed, Agility, Access and Other Telecom.

High Speed

High Speed refers to the ability to transmit data at high data rates. A key limitation of network capacity is the amount of data that can be transmitted through a single wavelength on a fiber from one point to another. To address this limitation, we have a portfolio of products enabling data transmission at speeds of 10Gbps, 40Gbps, 100Gbps and above.

Product Category	Product Description
100Gbps Products	Products that enable the transmission of data at speeds of 100Gbps. Products for coherent transmission include integrated coherent receivers (ICR), coherent mixers, integrated coherent transmitters (ICT) and narrow linewidth tunable lasers (NLW-TL). Transceiver products include 100Gbps CFP, CFP2 and CFP4 modules.
DWDM Tunable Lasers	DWDM tunable lasers that offer up to 96 channels at 20mW or 35mW and are tunable over the C or L bands. Tunable laser products include narrow line width tunable lasers (NLW-TL) and integrated tunable laser assemblies (ITLA), which are designed to be used in 40Gbps and 100Gbps coherent systems.
TLMZ	Tunable Laser Mach Zehnder (TLMZ) modulator devices combine a DWDM tunable laser with a 10G modulator to constitute a tunable Transmitter Optical Sub-Assembly (T-TOSA) for 10G transponder applications.
High Speed Transceivers	Transmits data into or receives data from optical fiber and includes SFP+ and XFP modules for 10Gbps, and CFP, CFP-2 and CFP4 modules for 40Gbps and 100Gbps, with

	transmission distances up to 80 km.
EML Lasers and Drivers	Externally modulated lasers (EML) and laser drivers generate specific wavelengths of light at data rates of 10 Gbps, 25 Gbps or 40 Gbps.
APDs and TIAs	Avalanche photodiodes (APD) and transimpedance (TIA) amplifiers for use in OC-192 and above applications.

Agility

Agility refers to the tunability and re-configurability of products to support efficient bandwidth allocation for growing and changing traffic patterns over communications networks. We provide a portfolio of products that enable network agility.

Product Category	Product Description
Athermal Arrayed Waveguide Gratings (AWG)	Combines or separates up to 88 different optical wavelengths on a single optical fiber and does not require active stabilization against ambient temperature variations. Supports channel spacings of 50GHz and 100GHz. Products are also available in module and shelf configurations.
OADMs	Optical add and drop multiplexers (OADM) that dynamically or statically remove or add individual optical wavelengths from a single optical fiber and include programmable OADM (OADM) and variable optical attenuator multiplexer (VMUX) configurations with up to 48 channels. Products are also available in module and shelf configurations.

Access

Access refers to the ability to provide high-bandwidth connections to more devices and people over fixed and wireless networks. We offer a portfolio of products for wireless backhaul applications, fiber-to-the-home networks and point to point networks, shown below.

Product Category	Product Description
Optical Line Terminals	Central office equipment which connects up to 64 users to the fiber optic network and includes products for GEPON and GPON systems as well as new 10GEPON and NGPON networks operating at 10Gbps.
Transceivers	SFP, SFP+ and XFP devices transmits data into or receives data from optical fiber for wireless backhaul and point to point applications and includes transceivers for 3G and 4G/LTE wireless backhaul and compact SFP transceivers for point to point networks.
Athermal AWGs and Splitters	Products for outdoor use connecting up to 64 end users to a single optical fiber which include splitters with split ratios ranging from 1x4 to 2x64 and AWGs for use in WDM-PON systems. These products do not require active compensation for temperature changes.

Other Telecom

Other telecom products refer to products that are used in other broadly deployed telecommunication systems.

Product Category	Product Description
Sonet/SDH Transceivers	Transmits data into or receives data from optical fiber and includes SFP, SFF and SC modules that transmit data at 2.5 Gbps and below.
Thermal Arrayed Waveguide Gratings (AWG)	Combines or separates up to 88 different optical wavelengths on a single optical fiber and requires active stabilization against ambient temperature variations and channel spacings of 50GHz and 100GHz. Products are also available in module and shelf configurations.
Variable Optical Attenuators	Adjusts the power of a signal in an optical fiber utilizing micro electro-mechanical systems, or MEMS, for attenuator control and offer low optical signal loss, low polarization and low wavelength dependence.

Customers

We focus on a global customer base of network equipment vendors and their affiliates that we refer to as our Tier 1 customers. These customers include:

ADVA AG Optical Networking Ltd.	ECI Telecom Ltd.	Mitsubishi Electric Corporation
Alcatel-Lucent SA	FiberHome Technologies Group	NEC Corporation
Ciena Corporation	Fujitsu Limited	Telefonaktiebolaget LM Ericsson
Cisco Systems, Inc.	Huawei Technologies Co., Ltd.	ZTE Corporation
Coriant Gmbh & Co. KG	Juniper Networks, Inc.	

We also sell our products to numerous other customers globally.

In 2013, 2012 and 2011, our ten largest customers accounted for 86%, 90% and 91% of our total revenue, respectively. For the year ended December 31, 2013, Huawei Technologies Co., Ltd., or Huawei Technologies, Ciena Corporation, and Alcatel-Lucent SA accounted for 27%, 16% and 14% of our total revenue, respectively. For the year ended December 31, 2012, Huawei Technologies, Ciena Corporation and Alcatel-Lucent SA accounted for 36%, 15% and 16% of our total revenue, respectively. For the year ended December 31, 2011, Huawei Technologies accounted for 51% of our total revenue. No other customers accounted for 10% or more of our total revenue in any year presented. We focus on increasing our penetration of our Tier 1 customers by adding design wins across our product families.

Sales and marketing

We operate a sales model that focuses on alignment with our customers through coordination of our sales, product application engineering and manufacturing teams. Our sales and marketing organizations support our strategy of increasing product penetration with our Tier 1 customers while also serving our broader customer base. Our sales cycles typically require a significant amount of time and a substantial expenditure of resources before we can realize revenue from the sale of products. The length of our sales cycle, from initial request to design win, is typically 6 to 12 months for an existing product and 12 to 18 months or longer for a new product.

We use a global direct sales force based in North America, Europe, Middle East and Asia, including China and Japan. These individuals work with our product application engineers, and product marketing and sales operations teams, in an integrated approach to address our customers' current and future needs. We believe that these collaborative engineering activities provide us insight into our customers' broader and longer term needs. We expect to continue to add sales and related support personnel as we grow our business.

Our marketing team focuses on product strategy, product development, roadmap development, new product introduction processes, program management, product demand stimulation and assessment, and competitive analysis. Our marketing team also seeks to educate the market about our products by communicating the value proposition and product differentiation in direct customer interactions and presentations and at industry tradeshows and at technical conferences.

Research and development

We have product development and product sustaining engineering teams in Silicon Valley (San Jose and Fremont, California), Tokyo, Japan, and Shenzhen and Wuhan, China. In our Silicon Valley and Tokyo facilities we conduct PIC research, development and product roadmap definitions. In our Shenzhen facilities, we conduct new product development, manufacturing and process engineering, quality control, continuous improvement and cost reduction relating to product manufacturing, assembly and test. In our Wuhan, China and Ottawa, Canada facilities we conduct new product development. We have invested and expect to continue to invest significant time and capital into our research and development operations. Research and development expenses were $45.9 million, $38.3 million and $30.9 million in 2013, 2012 and 2011, respectively.

Intellectual property

Our success as a company depends in part upon our ability to obtain and maintain proprietary protections for our technology and intellectual property and prevent others from infringing these proprietary rights. To accomplish this objective, we rely on a combination of intellectual property rights, including patent, trademark, copyright, trade secret, and unfair competition laws, as well as license agreements and other contractual protections.

We seek to establish and maintain our proprietary rights in our technology and products through the use of patents, copyrights and trade secret laws. We have filed applications for patents to protect certain of our intellectual property in the U.S. and in other countries, including Australia, Canada, Japan, Korea, Hong Kong, China, The Russian Federation, India, Taiwan and several European Union countries. As of December 31, 2013, we had 535 issued patents, expiring between 2014 and 2032, covering various aspects of our technologies. We believe our patents and other intellectual property rights have value, but we do not consider any single patent to be essential to our business. We also seek to maintain our trade secrets and confidential information by non-disclosure policies and through the use of appropriate confidentiality agreements.

Because our U.S. and Japan patents do not afford any intellectual property protection in China, where we have substantial operations, we also seek to secure, to the extent possible, intellectual property protections in China. While we have issued patents and pending patent applications in China, portions of our intellectual property portfolio are not yet protected by patents in China. Moreover, the level of protection afforded by patent and other laws in China may not be comparable to that afforded in the U.S. or in Japan. See "Risk factors—Risks related to our business—If we fail to protect, or incur significant costs in defending, our intellectual property and other proprietary rights, our business and results of operation could be materially harmed."

Our portfolio of patents and patent applications covers a range of intellectual property, including without limitation PIC fabrication and design, hybrid PIC integration, large scale integration for optical circuit designs, and methods and apparatus for assembly and packaging.

We seek to protect our intellectual property rights by having our employees and independent consultants enter into confidentiality and inventions assignment agreements when they join us. Additionally, we enter into non-disclosure agreements with other third parties who may have access to our proprietary technologies and information.

In addition, we have registered the trademark "NeoPhotonics" in the U.S.

Manufacturing, assembly and test

We have manufacturing operations in the U.S., Japan and China. Our wafer fabrication operations are located in our San Jose and Fremont, California facilities, as well as in our Japan facilities, and include chip design, clean room fabrication, integration and related facilities for PICs. Our manufacturing, assembly and test operations are located in our Shenzhen and Dongguan, China facilities, and in Silicon Valley, California and include clean room fabrication, general manufacturing and assembly and test operations utilizing production expertise and cost-effective volume capabilities. Our operations in Shenzhen have primary responsibility for assembly and test of our PIC-based products, in addition to small scale assembly and test of PIC-based products in Silicon Valley, California. Our operations in Dongguan focus on high volume transceiver products. We have quality control processes and quality management methods in our internal manufacturing operations. Certain of our products are designed and qualified to meet applicable Telcordia Technologies, Inc., TÜV SÜD America Inc. and Underwriters Laboratories Inc. standards. Our manufacturing facilities in Shenzhen are third-party certified to TL 9000, ISO 9001, ISO 14001 and OHSAS 18000 standards and our facilities in Tokyo, Japan, and San Jose and Fremont, California are certified to ISO 9001 standards. We also use contract manufacturers from time to time for the production of some of our products. In 2013, a substantial portion of our tunable lasers were manufactured at Venture Electronic Systems in Penang, Malaysia. Since January 2014, these products have been manufactured in our Shenzhen, China facility. We also use contract manufacturers in Japan, China and other Asia locations for the backend manufacturing of our certain products.

We use suppliers from the U.S., China, Japan and other locations. Although there are multiple sources for most of the component parts of our products, some components are sourced from single or, in some cases, limited sources. For example, various types of adhesives are sourced from various manufacturers which presently are sole sources for these particular adhesives. We typically do not have written agreements with the majority of these component manufacturers to guarantee the supply of the key components used in our products.

Backlog

Sales of our products generally are made pursuant to purchase orders, often with short lead times. These purchase orders are typically made without deposits and may be subject to revision or cancellation. The quantities actually purchased by our customers, as well as the shipment schedules, are frequently revised to reflect changes in our customers' needs and in our supply of products.

In 2013, we had more customers using vendor managed inventory (“VMI”) compared to 2012. VMI is product which we manufacture at a customer’s request, then ship to its facility or a designated contract manufacturer for the customer, to be held until it is used by the customer. We maintain title to vendor managed inventory until the customer uses the inventory. At that time the customer takes title to the products, it reports the consumption to us and we recognize the revenue for the product sale. The increased use of VMI by our customers may increase the possibility of changes to our backlog since customers may consume VMI more quickly or more slowly than we had planned.

Because of the possibility of changes in delivery or acceptance schedules, cancellations, modifications or price reductions with limited or no penalties and the increasing use by customers of VMI, we do not believe that backlog is a firm or reliable indicator of our future revenue and do not rely on backlog to manage our business or evaluate our performance. Changes in the amount of our backlog do not necessarily reflect a corresponding change in the level of actual or potential sales.

Financial Information by Geographic Region

For information regarding our revenue and long-lived assets by geographic region, see Note 17 to the Consolidated Financial Statements. For risks relating to our operations see “Item 1A. Risk Factors” and particularly the risks under the caption “Risks related to our operations in China” and the risk factors “Our future results of operations may be subject to volatility as a result of exposure to fluctuations in foreign exchange rates, primarily the Chinese Renminbi (RMB) and Japanese Yen (JPY) exchange rates”, “We face a variety of risks associated with international sales and operations, which if not adequately managed could adversely affect our business and financial results” and “We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets”.

Competition

The market for optical communications systems is highly competitive. While no single company competes against us in all of our product areas, our competitors range from large international companies offering a wide range of products to smaller companies specializing in narrow markets. We believe the principal competitive factors in this market are:

- ability to provide leading edge technologies for high speed communications;
- ability to design and manufacture high quality, reliable products, including customized solutions;
- breadth of product solutions;
- price to performance characteristics;
- financial stability;
- ability to quickly and consistently produce in high volume and high quality;
- ability to meet customers’ specific requirements;
- ability to meet customer lead time demands; and
- depth of relationships with and proximity to key customers globally.

We believe we compete favorably with respect to these factors. We believe our principal competitors include Accelink Technologies Co., Ltd., Avago Technologies Limited, Emcore Corporation, Finisar Corporation, JDS Uniphase Corporation, NTT Electronics Corporation, Source Photonics, Inc., Oclaro, Inc., and Sumitomo Electric Device Innovations, Inc.

Our competitors may have substantially greater name recognition and technical, financial and marketing resources than we do. Many of our competitors have greater resources to develop products or pursue acquisitions, and more experience in developing or acquiring new products and technologies and in creating market awareness for these products and technologies than we do. In addition, a number of our competitors have the financial resources to offer competitive products at below market pricing levels that could prevent us from competing effectively and which could adversely affect our financial performance.

We also face competition from some of our customers, including Huawei Technologies, who evaluate our capabilities against the merits of manufacturing products internally. These customers may have the ability to manufacture competitive products at a lower cost than we would charge as a result of their higher levels of integration. As a result, these customers may purchase less of our products and there would be additional pressure to lower our selling prices which, accordingly, would negatively impact our revenue and gross margin.

Employees

As of December 31, 2013, we had 2,094 employees and non-employee contractors, of which 291 were based in our corporate headquarters in California, 1,678 were based in China, 8 were based in Canada, 2 were based in Malaysia, 112 were based in Japan and 3 were based in Russia.

None of our U.S. employees are represented by a labor union. Chinese law allows that all employees be members of a union that is overseen by the People's Republic of China. The majority of the employees in our Japanese subsidiaries are also members of a union. We have never experienced employment-related work stoppages and we consider our employee relations to be good.

Environmental, health and safety matters

Our research and development and manufacturing operations and our products are subject to a variety of environmental, health and safety laws and regulations in the jurisdictions in which we operate. These regulations govern, among other things, the discharge of pollutants to air, water, and soil; the remediation of soil and groundwater contamination; the use, handling and disposal of hazardous materials; employee health and safety; and the hazardous material content and recycling of our products. We use, store and dispose of hazardous materials in our manufacturing operations and as components in our products. We incur costs to comply with existing environmental, health and safety requirements, and any failure to comply, or the identification of contamination for which we are found liable, could cause us to incur additional costs, including cleanup costs, monetary fines, or civil or criminal penalties, or result in the curtailment of our operations. In addition, environmental, health and safety requirements have become more stringent over time, and changes to existing requirements could restrict our ability to expand our facilities, require us to acquire costly pollution control equipment, or cause us to incur other significant expenses or to modify our manufacturing processes or the contents of our products. Some jurisdictions in which we operate or sell our products have enacted requirements regarding the recycling of waste electronic equipment, and/or the packaging and hazardous material content of certain products. For example, jurisdictions including China and the European Union, among a growing number of jurisdictions, have placed restrictions on the use of lead, among other chemicals, in electronic products, which affects the composition and packaging of our products. The passage of such requirements in additional jurisdictions, or the tightening of standards or elimination of certain exemptions in jurisdictions where our products are already subject to such requirements, could cause us to incur significant expenditures to make our products compliant with new requirements, or could limit the markets into which we may sell our products.

Additionally, increasing efforts to control emissions of greenhouse gases, or GHG, may also impact us. For example, our semiconductor manufacturing operations in California use perfluorocarbons, which are classified as a high global warming potential greenhouse gas. Under California's recently enacted Global Warming Solutions Act, we designed and installed additional pollution control equipment at our San Jose, California, manufacturing plant to reduce our perfluorocarbon emissions beginning in 2012. As of December 31, 2012 and continuing through December 31, 2013, our San Jose and Fremont, California, manufacturing facilities were in compliance with the Global Warming Solutions Act. In the U.S., the Environmental Protection Agency has announced a finding relating to GHG emissions that may result in promulgation of federal GHG air quality standards. The U.S. Congress has considered various options, including a cap and trade system which would impose a limit and a price on GHG emissions and establish a market for trading GHG credits. China has recently agreed to join the Copenhagen Climate Accord, a voluntary (and non-binding) GHG agreement. Globally, negotiations for a treaty to succeed the 1997 Kyoto Protocol Treaty are ongoing, and it is not yet known whether (or on what terms) agreement will be reached on a successor treaty. Additional restrictions, limits, taxes, or other controls on GHG emissions could significantly increase our operating costs and, while it is not possible to estimate the specific impact any final GHG regulations will have on our operations, there can be no assurance that these measures will not have significant additional impact on us. In addition, some of our operations might be affected by the physical impacts of climate change. For example, some of our facilities are located in coastal areas that might be vulnerable to changes in sea level.

Available Information

We file electronically with the U.S. Securities and Exchange Commission, or SEC, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. We make available on our website at www.neophotonics.com, free of charge, copies of these reports as soon as reasonably practicable after filing these reports with, or furnishing them to, the SEC.

ITEM 1A. RISK FACTORS
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 December 31, 2013, our accumulated deficit was $282.4 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.

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 any given time to meet the volume demands of our customers, or one or more of our suppliers may not have sufficient capacity at any given time to meet our volume demands. Conversely, a downturn in the markets in which our customers compete can cause, and in the past have caused, our customers to significantly reduce or delay the amount of products ordered from us or to cancel existing orders, leading to lower utilization of our facilities. Because many of our costs and operating expenses are relatively fixed, reduction in customer demand due to market downturns or other reasons would have a material adverse effect on our gross margin, operating income and cash flow. For example, in the fourth quarter of 2012, we experienced an increase in manufacturing costs for one of our high speed products and separately, lower utilization of one of our water fabrication facilities, which adversely affected our gross margin in the fourth quarter of 2012 and each quarter of 2013.

Our products are typically sold pursuant to individual purchase orders or by use of a vendor-managed inventory, or VMI, model, which is a process by which we ship agreed quantities of products to a customer-designated location and those products remain our inventory and we retain the title and risk of loss for those products until the customer takes possession of the products. While our customers generally provide us with their demand forecasts and may give us a promised market share award, they are typically not contractually committed to buy any quantity of products beyond firm purchase orders. Many of our customers may increase, decrease, cancel or delay purchase orders already in place. We have experienced and expect to continue to experience wide fluctuations in demand from customers using VMI, particularly Huawei Technologies, even in instances where we have built and shipped products to the customer-designated locations as VMI. In recent periods, there has been an increase in the number of our customers utilizing VMI, which may increase our exposure to risks of wide fluctuations in demand from VMI customer locations. If any of our major customers decrease, stop or delay purchasing our products for any reason, our business and results of operations would be harmed. Cancellation or delays of such orders may cause us to incur an adverse effect on our revenues, as well as adversely affect our overall results of operations.

We are dependent on Huawei Technologies, Alcatel-Lucent SA, Ciena and our other key customers for a significant portion of our revenue and the loss of, or a significant reduction in orders from, Huawei Technologies or any of our other key customers may reduce our revenue and adversely impact our results of operations.

Historically, we have generated most of our revenue from a limited number of customers. In 2013, Huawei Technologies, Alcatel-Lucent SA and Ciena Corporation accounted for 27%, 14% and 16% of our revenue, respectively, and our top ten customers represented 86% of our total revenue. In the year 2012, Huawei Technologies, Alcatel-Lucent SA and Ciena Corporation accounted for 36%, 16% and 15% of our revenue, respectively and our top ten customers represented 90% of our total revenue. As a result, the loss of, or a significant reduction in orders from Huawei Technologies, Alcatel-Lucent SA, Ciena Corporation or any of our other key customers would materially and adversely affect our revenue and results of operations. Adverse events affecting our customers could also adversely affect our revenue and results of operations.

We are under continuous pressure to reduce the prices of our products, which may adversely affect our gross margins.

The communications networks industry has been characterized by declining product prices over time. We have reduced the prices of many of our products in the past and we expect to continue to experience pricing pressure for our products in the future, including from our major customers. When seeking to maintain or increase their market share, our competitors may also reduce the prices of their products. In addition, our customers may have the ability or seek to internally develop and manufacture competing products at a lower cost than we would otherwise charge, which would add additional pressure on us to lower our selling prices. If we are unable to offset any future reductions in our average selling prices by increasing our sales volume, reducing our costs and expenses or introducing new products, our gross margin would suffer.

We face intense competition which could negatively impact our results of operations and market share.

The communications networks industry is highly competitive. Our competitors range from large, international companies offering a wide range of products to smaller companies specializing in niche markets. In addition, we believe that a number of companies have developed or are developing planar light wave, indium phosphide, high speed drivers or MEMS-based PIC devices and other products that compete directly with our products. Current and potential competitors may have substantially greater financial, marketing, research and manufacturing resources than we possess, and there can be no assurance that our current and future competitors will not be more successful than us in specific product lines or as a whole.

Some of our competitors have substantially greater name recognition, technical, financial, and marketing resources, and greater manufacturing capacity, as well as better-established relationships with customers, than we do. Some of our competitors have more resources to develop or acquire, and more experience in developing or acquiring, new products and technologies and in creating market awareness for these products and technologies. Some of our competitors may be able to develop new products more quickly than us and may be able to develop products that are more reliable or which provide more functionality than ours. In addition, some of our competitors have the financial resources on business strategy to offer competitive products at below-market pricing levels that could prevent us from competing effectively and result in a loss of sales or market share or cause us to lower prices for our products.

We also face competition from some of our customers who evaluate our capabilities against the merits of manufacturing products internally, including Huawei Technologies. Due to the fact that such customers are not seeking to make a profit directly from the manufacture of these products, they may have the ability to manufacture competitive products at a lower cost than we would charge such customers. As a result, these customers may purchase less of our products and there would be additional pressure to lower our selling prices which, accordingly, would negatively impact our revenue and gross margin.

In particular we have developed new technologies and products that we believe are key components in our customers' systems for 100Gbps data transmission. The emergence of technologies and products from our competitors and their success in competing against our technologies and products for 100Gbps data transmission could render our existing products uncompetitive from a pricing standpoint, obsolete or otherwise unmarketable.

Intense competition in our markets could result in aggressive business tactics by our competitors, including aggressively pricing their products or selling older inventory at a discount. If our current or future competitors utilize aggressive business tactics, including those described above, demand for our products could decline, we could experience delays or cancellations of customer orders, or we could be required to reduce our sales prices.

Increasing costs may adversely impact our gross margins.

The rate of increase in our costs and expenses, including as a result of rising labor costs in China, may exceed the rate of increase in our revenue, either of which would materially and adversely affect our business, our results of operations and our financial condition.

Manufacturing problems could result in delays in product shipments to customers and could adversely affect our revenue, competitive position and reputation.

We may experience delays, disruptions or quality control problems in our manufacturing operations. For instance, we could experience a disruption in our fabrication facilities for our PIC products due to any number of reasons, such as equipment failure, contaminated materials or process deviations, which could adversely impact manufacturing yields or delay product shipments. As a result, we could incur additional costs that would adversely affect our gross margin, and product shipments to our customers could be delayed beyond the shipment schedules requested by our customers, which would negatively affect our revenue, competitive position and reputation.

Additionally, manufacturing yields depend on a number of factors, including the stability and manufacturability of the product design, manufacturing improvements gained over cumulative production volumes, the quality and consistency of component parts and the nature and extent of customization requirements by customers. Capacity constraints, raw materials shortages, logistics issues, labor shortages, the introduction of new product lines, rapid increases in production demands and changes in customer requirements, manufacturing facilities or processes, or those of some third party contract manufacturers and suppliers of raw materials and components have historically caused, and may in the future cause, reduced manufacturing yields, negatively impacting the gross margin on, and our production capacity for, those products. Moreover, an increase in the rejection and rework rate of products during the quality control process before, during or after manufacture would result in our experiencing lower yields, gross margin and production capacity. Our ability to maintain sufficient manufacturing yields is particularly challenging with respect to PICs due to the complexity and required precision of a large number of unique manufacturing process steps. Manufacturing yields for PICs can also suffer if contaminated materials or materials that do not meet highly precise composition requirements are inadvertently utilized. Because a large portion of our PIC manufacturing costs are fixed, PIC manufacturing yields have a substantial effect on our gross margin. Lower than expected manufacturing yields could also delay product shipments and decrease our revenue. It can be hard to cost-effectively increase our production output rapidly, and we can experience yield loss and excess material scrap, which can increase our cost of goods sold and harm our profitability. Also, if we do not have sufficient demand for our PIC-based products our cost of goods sold can increase as the fixed costs of our fabrication facilities are spread over lower production. For example, in the fourth quarter of 2012 and in 2013, we experienced such increased costs with one of our high speed products and one of our wafer fabrication facilities. These higher costs are expected to continue through 2014, and could re-occur due to these or other reasons, in the future.

We are subject to the cyclical nature of the markets in which we compete and any future downturn may reduce demand for our products and revenue.

The markets in which we compete are tied to the aggregate capital expenditures of telecommunications service providers as they build out and upgrade their network infrastructure. These markets are highly cyclical and characterized by constant and rapid technological change, price erosion, evolving standards and wide fluctuations in product supply and demand. In the past, including recently to varying degrees in China, the U.S. and Europe, these markets have experienced significant downturns, often connected with, or in anticipation of, the maturation of product cycles—for both manufacturers' and their customers' products—or in response to over or under purchasing of inventory by our customers relative to ultimate carrier demand, and with declining general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices.

Our historical results of operations have been subject to substantial fluctuations, and we may experience substantial period-to-period fluctuations in future results of operations. Any future downturn in the markets in which we compete could significantly reduce the demand for our products and therefore may result in a significant reduction in revenue. It may also increase the volatility of the price of our common stock. Our revenue and results of operations may be materially and adversely affected in the future due to changes in demand from individual customers or cyclical changes in the markets utilizing our products.

In addition, the communications networks industry from time to time has experienced and may again experience a pronounced downturn. To respond to a downturn, many service providers may slow their capital expenditures, cancel or delay new developments, reduce their workforces and inventories and take a cautious approach to acquiring new equipment and technologies from original equipment manufacturers, which would have a negative impact on our business. Weakness in the global economy or a future downturn in the communications networks industry may cause our results of operations to fluctuate from quarter-to-quarter and year-to-year, harm our business, and may increase the volatility of the price of our common stock.

It could be discovered that our products contain defects that may cause us to incur significant costs, divert our attention, result in a loss of customers and result in product liability claims.

Our products are complex and undergo quality testing as well as formal qualification, both by our customers and by us. However, defects may occur from time to time. Our customers' testing procedures are limited to evaluating our products under likely and foreseeable failure scenarios and over varying amounts of time. For various reasons, such as the occurrence of performance problems that are unforeseeable in testing or that are detected only when products age or are operated under peak stress conditions, our products may fail to perform as expected long after customer acceptance. Failures could result from faulty components or design, problems in manufacturing or other unforeseen reasons. As a result, we could incur significant costs to repair or replace defective products under warranty, particularly when such failures occur in installed systems. We have experienced such failures in the past and will continue to face this risk going forward, as our products are widely deployed throughout the world in multiple demanding environments and applications. In addition, we may in certain circumstances honor warranty claims after the warranty has expired or for problems not covered by warranty in order to maintain customer relationships. Any significant product failure could result in lost future sales of the affected product and other products, as well as customer relations problems, litigation and damage to our reputation.

In addition, our products are typically embedded in, or deployed in conjunction with, our customers' products, which incorporate a variety of components, modules and subsystems and may be expected to interoperate with modules produced by third parties. As a result, not all defects are immediately detectable and when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems or loss of customers, all of which would harm our business.

The occurrence of any defects in our products could give rise to liability for damages caused by such defects. They could, moreover, impair our customers' acceptance of our products. Both could have a material adverse effect on our business and financial condition. Although we carry product liability insurance which covers this risk, this insurance may not adequately cover our costs arising from defects in our products or otherwise.

If spending for communications networks does not continue to grow as expected, our business and financial results may suffer.

Our future success as a provider of modules and subsystems to leading network equipment vendors depends on their continued capital spending on global communications networks. Network traffic has experienced rapid growth driven primarily by bandwidth-intensive content, including cloud services, mobile video and data services, wireless 4G/LTE services, HD and 3D entertainment services, social networking, video conferencing and other multimedia. This growth is intensified by the proliferation of fixed and wireless network-attached devices, including smartphones, laptops, netbooks, tablet computers, PCs, e-readers, televisions and gaming devices that are enabling consumers to access content at increasing data rates anytime and anywhere. Our future success depends on continued demand for high-bandwidth, high-speed communications networks and the ability of network equipment vendors to meet this demand. Growth in demand for communications networks is limited by several factors, including an evolving regulatory environment and uncertainty regarding long-term sustainable business models. We cannot be certain that demand for bandwidth-intensive content will continue to grow in the future. If expectations for growth of communications networks and bandwidth consumption are not realized and investment in communications networks does not grow as anticipated, our business could be harmed.

We depend upon outside contract manufacturers for a portion of the manufacturing process for some of our products. Our operations and revenue related to these products could be adversely affected if we encounter problems with this contract manufacturer.

Almost all of our products are manufactured internally. However we also rely upon contract manufacturers in China, Japan and other Asia locations to provide back-end manufacturing and produce the finished portion of a few of our products. Our reliance on a contract manufacturer for these products makes us vulnerable to possible capacity constraints and reduced control over delivery schedules, manufacturing yields, manufacturing quality/controls and costs. If one of our contract manufacturers is unable to meet all of our customer demand in a timely fashion, this could have a material adverse effect on the revenue from our products. If the contract manufacturer for one of our product were unable or unwilling to manufacture such product in required volumes and at high quality levels or to continue our existing supply arrangement, we would have to identify, qualify and select an acceptable alternative contract manufacturer or move these manufacturing operations to our internal manufacturing facilities. An alternative contract manufacturer may not be available to us when needed or may not be in a position to satisfy our quality or production requirements on commercially reasonable terms, including price. Any significant interruption in manufacturing our products would require us to reduce our supply of products to our customers, which in turn would reduce our revenue, harm our relationships with the customers of these products and cause us to forego potential revenue opportunities.

Our revenues and costs will fluctuate over time, making it difficult to predict our future results of operations.

Our revenue, gross margin and results of operations have varied significantly and are likely to continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. For instance, changes in gross margin may result from various factors, such as changes in pricing, changes in our fixed costs, changes in the cost of labor, changes in the mix of our products sold, changes in the amount of product manufactured versus the amount of product sold over time, and charges for excess and obsolete inventory. It is difficult for us to accurately forecast our future revenue and gross margin and plan expenses accordingly and, therefore, it is difficult for us to predict our future results of operations.

We must continually achieve new design wins and enhance existing products or our business and future revenue may be harmed.

The markets for our products are characterized by frequent new product introductions, changes in customer requirements and evolving industry standards, all with an underlying pressure to reduce cost and meet stringent reliability and qualification requirements. Our future performance will depend on our successful development, introduction and market acceptance of new and enhanced products that address these challenges. The anticipated or actual introduction of new and enhanced products by us and by our competitors may cause our customers to defer or cancel orders for our existing products. In addition, the introduction of new products by us or our competitors could result, and in the past, has resulted, in a slowdown in demand for our existing products and could result, and in the past, has resulted, in a write-down in the value of inventory. We have both recently and in the past experienced a slowdown in demand for existing products and delays in new product development, and such delays may occur in the future. To the extent customers defer or cancel orders for our products for any reason or we fail to achieve new design wins, our competitive position would be adversely affected and our ability to grow revenue would be impaired.

Product development delays may result from numerous factors, including:

- changing product specifications and customer requirements;
- unanticipated engineering complexities;
- difficulties in reallocating engineering resources and overcoming resource limitations; and
- changing market or competitive product requirements.

Furthermore, fast time-to-market with new products can be critical to success in our markets. It is difficult to displace an existing supplier for a particular type of product once a network equipment vendor has chosen a supplier, even if a later-to-market product provides superior performance or cost efficiency. If we are unable to make our new or enhanced products commercially available on a timely basis, we may lose existing and potential customers and our financial results would suffer.

The development of new, technologically-advanced products is a complex and uncertain process requiring frequent innovation, highly-skilled engineering and development personnel and significant capital, as well as the accurate anticipation of technological and market trends. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure you that our new products will gain market acceptance or that we will be able to respond effectively to product introductions by competitors, technological changes or emerging industry standards. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements, license these technologies from third parties, or remain competitive in our markets.

Our success will depend on our ability to anticipate and quickly respond to evolving technologies and customer requirements.

The communications networks industry is characterized by substantial investment in new technology and the development of diverse and changing technologies and industry standards. For example, new technologies are required to satisfy the emerging standards for 100Gbps, 400 Gbps and higher data transmission in communications networks.

Our ability to anticipate and respond to evolving technology, industry standards, customer requirements and product offerings, and to develop and introduce new and enhanced products and technologies, will be critical factors in our ability to succeed. If we are unable to anticipate and respond to such changes in the future, our competitive position could be adversely affected. In addition, the introduction of new products by other companies embodying new technologies, or the emergence of new industry standards, could render our existing products uncompetitive from a pricing standpoint, obsolete or otherwise unmarketable.

If our customers do not qualify our products for use, then our results of operations may suffer.

Prior to placing volume purchase orders with us, most of our customers require us to obtain their approval—called qualification in our industry—of our new and existing products, and our customers often audit our manufacturing facilities and perform other vendor evaluations during this process. The qualification process involves product sampling and reliability testing and collaboration with our product management and engineering teams in the design and manufacturing stages. If we are unable to qualify our products with customers, then our revenue would be lower than expected and we may not be able to recover the costs associated with the qualification process which would have an adverse effect on our results of operations.

In addition, due to evolving technological changes in our markets, a customer may cancel or modify a design project before we have qualified our product or begun volume manufacturing of a qualified product. It is unlikely that we would be able to recover the expenses for cancelled or unutilized custom design projects. It is difficult to predict with any certainty whether our customers will delay or terminate product qualification or the frequency with which customers will cancel or modify their projects, but any such delay, cancellation or modification would have a negative effect on our results of operations.

In particular, we have developed new technologies and products that we believe are key components in our customers' systems for 100Gbps data transmission. There are multiple modulation approaches for these systems and not all are likely to be equally successful. While we are shipping certain products for 100Gbps system designs today, many of our products for these systems are currently being qualified for use by our customers. Our ability to successfully qualify and scale capacity for these new technologies and products is important to our ability to grow our business and market presence. If we are unable to qualify and sell any of these products in volume on time, or at all, our results of operations may be adversely affected.

If we fail to retain our key personnel or if we fail to attract additional qualified personnel, we may not be able to achieve our anticipated level of growth and our business could suffer.

Our success and ability to implement our business strategy depends upon the continued contributions of our senior management team and others, including senior management in foreign subsidiaries and our technical and operations employees in all locations. Our future success depends, in part, on our ability to attract and retain key personnel, including our senior management and others, and on the continued contributions of members of our senior management team and key technical and operations personnel, each of whom would be difficult to replace. The loss of services of members of our senior management team or key personnel or the inability to continue to attract and retain qualified personnel could have a material adverse effect on our business. Competition for highly skilled technical and operations people where we operate is extremely intense, and we continue to face challenges identifying, hiring and retaining qualified personnel in many areas of our business. If we fail to retain our senior management and other key personnel or if we fail to attract additional qualified personnel, our business could suffer.

The communications networks industry has long product development cycles requiring us to incur product development costs without assurances of an acceptable investment return.

The communications networks industry is highly capital-intensive. Large volumes of equipment and support structures are installed with considerable expenditures of funds and other resources, and long investment return period expectations. At the component supplier level, these cycles create considerable, typically multi-year, gaps between the commencement of new product development and volume purchases. Accordingly, we and our competitors often incur significant research and development and sales and marketing costs for products that, initially, will be purchased by our customers long after much of the cost is incurred and, in some cases, may never be purchased due to changes in industry or customer requirements in the interim.

Due to changing industry and customer requirements, we are constantly developing new products, including seeking to further integrate functions on PICs and developing and using new technologies in our products. These development activities can and are expected to necessitate significant investment of capital. Our new products often require a long time to develop because of their complexity and rigorous testing and qualification requirements. Additionally, developing a manufacturing approach with an acceptable cost structure and yield for new products can be expensive and time-consuming. Due to the costs and length of research and development and manufacturing process cycles, we may not recognize revenue from new products until long after such expenditures are incurred, if at all, and our gross margin may decrease if our costs are higher than expected.

While we rely on many suppliers, there are a few which, if they stopped, decreased or delayed shipments to us, it could have an adverse effect on our business and financial results.

We depend on a limited number of suppliers for certain components and materials we have qualified to use in the manufacture of certain of our products. Some of these suppliers could disrupt our business if they stop, decrease or delay shipments or if the components they ship have quality, consistency, or business continuity issues. Some of these components and materials are available only from a sole source, or have been qualified only from a single source, although other sources may exist. For example, we use various types of adhesives that are sourced from various manufacturers, which presently are sole sources for these particular adhesives. Furthermore, there are a limited number of entities from which we could obtain certain other components and materials. We may also face component shortages if we experience increased demand for components beyond what our qualified suppliers can deliver. We have experienced component shortages from certain key suppliers, which has resulted and, if this occurs in the future, may result in an inability to meet customer demand, higher purchasing costs, or both. Although we engage in various actions to mitigate the impact of these shortages, any inability on our part to obtain sufficient quantities of critical components at reasonable costs could adversely affect our ability to meet demand for our products, which could cause our revenue, results of operations, or both to suffer.

Our customers generally restrict our ability to change the component parts in our modules without their approval. For more critical components, such as PICs, lasers and photo detectors, any changes may require repeating the entire qualification process. We typically have not entered into long-term or written agreements with our suppliers to guarantee the supply of the key components used in our products, and, therefore, our suppliers could stop supplying materials and equipment at any time or fail to supply adequate quantities of component parts on a timely basis. It is difficult, costly, time consuming and, on short notice, sometimes impossible for us to identify and qualify new component suppliers. The reliance on a sole supplier, single qualified vendor or limited number of suppliers could result in delivery and quality problems, reduced control over product pricing, reliability and performance and an inability to identify and qualify another supplier in a timely manner. We have in the past had to change suppliers, which has, in some instances, resulted in delays in product development and manufacturing and loss of revenue. Any such delays in the future may limit our ability to respond to changes in customer and market demands. Any supply deficiencies relating to the quality, quantities or timeliness of delivery of components that we use to manufacture our products could adversely affect our ability to fulfill our customer orders and our results of operations.

If we fail to protect, or incur significant costs in defending, our intellectual property and other proprietary rights, our business and results of operations could be materially harmed.

Our success depends to a significant degree on our ability to protect our intellectual property and other proprietary rights. We rely on a combination of patent, trademark, copyright, trade secret and unfair competition laws, as well as license agreements and other contractual provisions, to establish and protect our intellectual property and other proprietary rights. We have applied for patent registrations in the U.S. and in other foreign countries, some of which have been issued. In addition, we have registered the trademark "NeoPhotonics" in the U.S. We cannot guarantee that our pending applications will be approved by the applicable governmental authorities. Moreover, our existing and future patents and trademarks may not be sufficiently broad to protect our proprietary rights or may be held invalid or unenforceable in court. A failure to obtain patents or trademark registrations or a successful challenge to our registrations in the U.S. or other foreign countries may limit our ability to protect the intellectual property rights that these applications and registrations intended to cover.

Policing unauthorized use of our technology is difficult and we cannot be certain that the steps we have taken will prevent the misappropriation, unauthorized use or other infringement of our intellectual property rights. Further, we may not be able to effectively protect our intellectual property rights from misappropriation or other infringement in foreign countries where we have not applied for patent protections, and where effective patent, trademark, trade secret and other intellectual property laws may be unavailable, or may not protect our proprietary rights as fully as U.S. or Japan law. Particularly, our U.S. patents do not afford any intellectual property protection in China, Japan, Canada or other Asia locations where we have company operations, or in Russia, where we intend to expand operations. We seek to secure, to the extent possible, comparable intellectual property protections in China and other areas in which we operate. However, while we have issued patents and pending patent applications in China, portions of our intellectual property portfolio are not yet protected by patents in China. Moreover, the level of protection afforded by patent and other laws in countries such as China and Russia may not be comparable to that afforded in the U.S. or Japan.

We attempt to protect our intellectual property, including our trade secrets and know-how, through the use of trade secret and other intellectual property laws, and contractual provisions. We enter into confidentiality and invention assignment agreements with our employees and independent consultants. We also use non-disclosure agreements with other third parties who may have access to our proprietary technologies and information. Such measures, however, provide only limited protection, and there can be no assurance that our confidentiality and non-disclosure agreements will not be breached, especially after our employees or those of our third-party contract manufacturers end their employment or engagement, and that our trade secrets will not otherwise become known by competitors or that we will have adequate remedies in the event of unauthorized use or disclosure of proprietary information. Unauthorized third parties may try to copy or reverse engineer our products or portions of our products, otherwise obtain and use our intellectual property, or may independently develop similar or equivalent trade secrets or know-how. If we fail to protect our intellectual property and other proprietary rights, or if such intellectual property and proprietary rights are infringed or misappropriated, our business, results of operations or financial condition could be materially harmed.

In the future, we may need to take legal actions to prevent third parties from infringing upon or misappropriating our intellectual property or from otherwise gaining access to our technology. Protecting and enforcing our intellectual property rights and determining their validity and scope could result in significant litigation costs and require significant time and attention from our technical and management personnel, which could significantly harm our business. In addition, we may not prevail in such proceedings. An adverse outcome of such proceedings may reduce our competitive advantage or otherwise harm our financial condition and our business.

We may be involved in intellectual property disputes in the future, which could divert management's attention, cause us to incur significant costs and prevent us from selling or using the challenged technology.

Participants in the markets in which we sell our products have experienced frequent litigation regarding patent and other intellectual property rights. Numerous patents in these industries are held by others, including our competitors. In addition, from time to time, we have been notified that we may be infringing certain patents or other intellectual property rights of others. Regardless of their merit, responding to such claims can be time consuming, divert management's attention and resources and may cause us to incur significant expenses. In addition, there can be no assurance that third parties will not assert infringement claims against us. While we believe that our products do not infringe in any material respect upon intellectual property rights of other parties and/or meritorious defense would exist with respect to any assertions to the contrary, we cannot be certain that our products would not be found infringing the intellectual property rights of others. Intellectual property claims against us could invalidate our proprietary rights and force us to do one or more of the following:

- obtain from a third party claiming infringement a license to sell or use the relevant technology, which may not be available on reasonable terms, or at all;
- stop manufacturing, selling, incorporating or using our products that use the challenged intellectual property;
- pay substantial monetary damages; or
- expend significant resources to redesign the products that use the technology and to develop non-infringing technology.

Any of these actions could result in a substantial reduction in our revenue and could result in losses over an extended period of time.

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 us, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the co-defendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products in the U.S. On March 23, 2010, we 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 us) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each co-defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against us. Since that time, we and Finisar entered into agreements that tolled our respective claims until Finisar resolved its litigation against certain other co-defendants, which litigation subsequently was resolved (commencing the tolling period with us).

On May 3, 2012, we and Finisar agreed to further toll our 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 us if it chooses to do so, and we may bring new claims against Finisar upon seven days written notice prior to filing such claims.

If we are unsuccessful in our defense of the Finisar patent infringement claims, a license to use the allegedly infringing technology may not be available to us at all, and if it is, it may not be available on commercially reasonable terms and therefore may limit or preclude us from competing in the market for optical transceivers in the U.S., which may have a material adverse effect on our results of operations and financial condition, and otherwise materially harm our business.

Although we believe that we would have meritorious defenses to the infringement allegations and intend to defend any new similar lawsuit vigorously, there can be no assurance that we will be successful in our defense. Even if we are successful, we may incur substantial legal fees and other costs in defending the lawsuit. Further, a new lawsuit, if brought by either party, would be likely to divert the efforts and attention of our management and technical personnel, which could harm our business.

If we fail to obtain the right to use the intellectual property rights of others which are necessary to operate our business, and to protect their intellectual property, our business and results of operations will be adversely affected.

From time to time we may choose to or be required to license technology or intellectual property from third parties in connection with the development of our products. We cannot assure you that third-party licenses will be available to us on commercially reasonable terms, if at all. Generally, a license, if granted, would include payments of up-front fees, ongoing royalties or both. These payments or other terms could have a significant adverse impact on our results of operations. The inability to obtain a necessary third-party license required for our product offerings or to develop new products and product enhancements could require us to substitute technology of lower quality or performance standards, or of greater cost, either of which could adversely affect our business. If we are not able to obtain licenses from third parties, if necessary, then we may also be subject to litigation to defend against infringement claims from these third parties. Our competitors may be able to obtain licenses or cross-license their technology on better terms than we can, which could put us at a competitive disadvantage. Also, we typically enter into confidentiality agreements with such third parties in which we agree to protect and maintain their proprietary and confidential information, including requiring our employees to enter into agreements protecting such information. There can be no assurance that the confidentiality agreements will not be breached by any of our employees or that such third parties will not make claims that their proprietary information has been disclosed.

Any potential dispute involving our patents or other intellectual property could also include our customers using our products, which could trigger our indemnification obligations to them and result in substantial expenses to us.

In any potential dispute involving our patents or other intellectual property, our customers could also become the target of litigation. Because we often indemnify our customers for intellectual property claims made against them for products incorporating our technology, any claims against our customers could trigger indemnification obligations in some of our supply agreements, which could result in substantial expenses such as increased legal expenses, damages for past infringement or royalties for future use. While we have not incurred any indemnification expenses to date, any future indemnity claim could adversely affect our relationships with our customers and result in substantial costs to us. Our insurance does not cover intellectual property infringement.

If we fail to adequately manage our long-term growth and expansion requirements, our business and financial results will suffer.

In recent years, we have experienced significant growth through, among other things, internal expansion programs, product development and acquisitions of other businesses and products. Our business has expanded to numerous locations, both foreign and domestic, and as a result become more complex, more demanding of management's attention and subject to new laws and regulations. If we fail to comply with new laws and regulations related to the expansion of our business, our business could suffer.

We expect to continue to grow, which could require us to expand our manufacturing operations, including hiring new personnel, purchasing additional equipment, leasing or purchasing additional facilities, developing the management infrastructure and developing our suppliers to manage any such expansion. If we fail to secure these expansion requirements or manage our future growth effectively, our business could suffer.

We have pursued and may continue to pursue acquisitions. Acquisitions could be difficult to integrate, divert the attention of key personnel, disrupt our business, dilute stockholder value and impair our financial results.

As part of our business strategy, we have pursued and intend to continue to pursue acquisitions of complementary businesses, products, services or technologies that we believe could accelerate our ability to compete in our existing markets or allow us to enter new markets. Any of these transactions could be material to our financial condition and results of operations. For instance, in October 2011, we completed the acquisition of Santur Corporation, a designer and manufacturer of InP-based PIC products, and in March 2013 we completed the acquisition of the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd., now known as NeoPhotonics Semiconductor. If we fail to properly evaluate or integrate acquisitions, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate.

Acquisitions involve numerous risks, any of which could harm our business, including:

- difficulties in integrating the operations, technologies, products, existing contracts, accounting and personnel of the target company and realizing the anticipated synergies of the combined businesses;
- difficulties in realizing our expectations for the financial performance of the target company;
- difficulties in supporting and transitioning customers, if any, of the target company;

difficulties in managing and integrating different cultures with respect to our international acquisitions;
dependence or reliance on subcontractors or suppliers to the acquired company that may not have been fully qualified or evaluated for their position in supplying the acquired company previously;
diversion of management time and potential business disruption;
the incurrence of debt to provide capital for any cash-based acquisitions;
the price we pay or other resources that we devote may exceed the value we realize, or the value we could have realized if we had allocated the purchase price or other resources to another opportunity;
risks of entering new markets in which we have limited or no experience;
potential loss of key employees, customers and strategic alliances from either our current business or the target company’s business;

assumption of unanticipated problems or latent liabilities, such as problems with the quality of the target company's products;
exposure to environmental liabilities that have not yet been discovered associated with acquired businesses' facilities;
expenses, distractions and actual or threatened claims or litigation resulting from acquisitions, whether or not they are completed;
unexpected capital expenditure requirements
inability to generate sufficient revenue to offset increased expenses association with any acquisition;
issues arising from weaknesses or deficiencies in internal controls over financial reporting for acquired businesses that were not previously subject to internal control requirements of a U.S. public company;
in the event of international acquisitions, risks associated with accounting and business practices that are different from applicable U.S. practices and requirements;
dilutive effect on our stock as a result of any equity-based acquisitions;
incurring potential writeoffs, contingent liabilities and amortization expense; and,
opportunity costs of committing capital to such acquisitions.

The failure to successfully evaluate and execute acquisitions or otherwise adequately address these risks could materially harm our business and financial results.

Acquisitions also frequently result in the recording of goodwill and other intangible assets which are subject to potential impairments which have occurred in the past and which, were they to occur in the future, could harm our financial results. As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate. The failure to successfully evaluate and execute acquisitions or investments or otherwise adequately address these risks could materially harm our business and financial results.

Failure to realize the anticipated benefits from our acquisition of Santur and NeoPhotonics Semiconductor may affect our future results of operations and financial condition.

In connection with our acquisitions of Santur and NeoPhotonics Semiconductor, we have integrated the commercial operations and personnel into our existing infrastructure. If there are unexpected difficulties in our integration of these acquired businesses, the anticipated benefits of the transaction may not be realized or may take longer to realize than expected. The anticipated benefits of the acquisition could be materially reduced by a number of factors, including the following:

the future revenue and gross margins of the acquired products may be materially different from those we originally anticipated;
we could incur material unanticipated expenses;
acquired products may not achieve the performance levels or specifications required by our customers;
claims or lawsuits may arise from the acquisition transaction or from their previous business operations;
we may experience difficulties in managing inventory and other operational processes in facilities that we acquire or lease as a result of the acquisitions;
we may experience difficulties in implementing effective internal controls over financial reporting as part of our integration actions, particularly since neither of these businesses were historically subject as a stand-alone entity to the internal control requirements of a U.S. public company;
potential growth, expected financial results, perceived synergies and anticipated opportunities may not be realized through the ongoing integration actions;
we may face competition from existing customers as well as new competitors;
some existing customers of NeoPhotonics Semiconductor may view our larger company as a competitor, and therefore may reduce or end their purchases of NeoPhotonics Semiconductor products for competitive reasons;

Japanese customers of NeoPhotonics Semiconductor, who had previously been buying from OCU as a Japanese supplier, could choose to find another Japanese supplier rather than buying products from a U.S.-headquartered company;

a potential decline in revenues could occur from NeoPhotonics Semiconductor's legacy products for network applications that are declining within our customer base (such as NeoPhotonics Semiconductor's gallium arsenide integrated circuits for 10G network applications)
we could have difficulty implementing and maintaining financial reporting requirements for NeoPhotonics Semiconductor's previous business operations, which have not previously been previously audited nor subject to the internal compliance structure of a U.S. public company;
we could have difficulty implementing our existing management, production and accounting software and programs for NeoPhotonics Semiconductor's previous business operations;
we could incur additional costs associated with known and unknown environmental contamination of the real estate acquired from NeoPhotonics Semiconductor; and
we could incur costs associated with new export or compliance issues associated with NeoPhotonics Semiconductor products.
The occurrence of any or all of these events may have an adverse effect on our business and results of operations.

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

Our worldwide operations could be subject to natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses. For example, our corporate headquarters and wafer fabrication facility in Silicon Valley, California and our Tokyo, Japan facility are located near major earthquake fault lines, and our manufacturing facilities are located in Shenzhen and Dongguan, China, areas that are susceptible to typhoons. Further, a terrorist attack, including one aimed at energy or communications infrastructure suppliers, could hinder or delay the development and sale of our products. In the event that an earthquake, tsunami, typhoon, terrorist attack or other natural or man-made catastrophe were to destroy any part of our facilities, destroy or disrupt vital infrastructure systems or interrupt our operations or the facilities or operations of our suppliers or customers for any extended period of time, our business, financial condition and results of operations would be materially and adversely affected. We are not insured against many natural disasters, including earthquakes.

Similarly, our worldwide operations could be subject to secondary effects of natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses. For instance, natural disasters and other business disruptions have created significant secondary effects in the past (such as the 2011 floods in Thailand and the 2011 earthquakes, tsunami and subsequent crisis relating to nuclear power facilities in Japan). Any of these types of events in the future could result in a slowdown of business or inability to manufacture products by our customers or others in the industry that are located in the affected areas; a disruption to the global supply chain for products manufactured in the affected areas that are included in the products either by us or by our customers; a disruption to manufacturing resulting from power shortages or other rationing of inputs to production; an increase in the cost of products that we purchase due to reduced supply; and other unforeseen impacts. These secondary effects could have a material and adverse effect on our business, financial condition, and results of operations.

Rapidly changing standards and regulations could make our products obsolete, which would cause our revenue and results of operations to suffer.

We design our products to conform to regulations established by governments and to standards set by industry standards bodies worldwide, such as The American National Standards Institute, the European Telecommunications Standards Institute, the International Telecommunications Union and the Institute of Electrical and Electronics Engineers, Inc. Various industry organizations are currently considering whether and to what extent to create standards for elements used in 100Gbps systems. Because certain of our products are designed to conform to current specific industry standards, if competing or new standards emerge that are preferred by our customers, we would have to make significant expenditures to develop new products. If our customers adopt new or competing industry standards with which our products are not compatible, or the industry groups adopt standards or governments issue regulations with which our products are not compatible, our existing products would become less desirable to our customers and our revenue and results of operations would suffer.

Failure to realize the anticipated benefits from our planned expansion in the Russian Federation may affect our future results of operations and financial condition.

In connection with our raising capital in an April 2012 private placement of common stock, we have established a wholly-owned subsidiary and company operations in the Russian Federation. The establishment of successful operations in the Russian Federation will require capital expenditure in 2014 and 2015, and will be in part dependent on the cooperation of the Russian government and other third parties. If there are delays in our efforts to establish operations in the Russian Federation, the anticipated benefits of our Russian expansion may not be realized or may take longer to realize than expected. The anticipated benefits of our Russian expansion could be materially reduced by a number of factors, including the following:

- the future revenue and gross margins of products produced in the Russian Federation may be materially different from those we originally anticipated;
- we could incur material unanticipated expenses; and
- we could have difficulty managing a business in the Russian Federation, where we did not previously have a material business presence.

In addition, in connection with the private placement transaction, we entered into a rights agreement with the sponsoring investor. Pursuant to the rights agreement, we have agreed to make a $30.0 million investment towards our Russian operations. We are required to satisfy this investment obligation by July 31, 2014, or, in the event we have not recorded aggregate revenue from sales of our products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014, then by March 31, 2015. We expect the date for achievement of the investment obligation will be extended to March 31, 2015. Pursuant to the rights agreement, failure to perform the investment obligation by the deadline will result in an obligation to pay damages to the investor in the amount of $5.0 million.

In recent years the Russian Federation has undergone substantial political, economic and social change. The business, legal and regulatory infrastructure in the Russian Federation is less well-developed that would generally exist in a more mature free market economy. In addition, the tax, currency and customs legislation within the Russian Federation is subject to varying interpretations and changes, which can occur frequently. The future economic direction of the Russian Federation remains largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory and political developments. Our failure to manage the risks associated with our planned Russian expansion could have a material adverse effect upon our results of operations.

Our planned Russian expansion could also be delayed or adversely affected by direct or indirect events arising out of the recent crisis in Ukraine. For instance, any trade restrictions or economic sanctions that may be imposed by the United States or other countries as a consequence of Russia's recent or future involvement in Ukraine could harm our business in the Russian Federation. Furthermore, we could be adversely affected by any actions taken by Russia in response to U.S. or international sanctions, such as restrictions place by Russia on U.S. companies doing business in Russia.

The occurrence of any or all of these events may have an adverse effect on our business, and results of operations and financial condition.

Potential changes in our effective tax rate could negatively affect our future results.

We are subject to income taxes in the U.S., China and other various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in differing jurisdictions. Our tax rate is affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses and the valuation of deferred tax assets and liabilities, including our ability to utilize our net operating losses. Increases in our effective tax rate could negatively affect our results of operations.

Our future results of operations may be subject to volatility as a result of exposure to fluctuations in foreign exchange rates, primarily the Chinese Renminbi (RMB) and Japanese Yen (JPY) exchange rates.

We are exposed to foreign exchange risks. Foreign currency fluctuations may adversely affect our revenue and our costs and expenses, and hence our results of operations. A substantial portion of our business is conducted through our subsidiaries based in China, whose functional currency is the RMB and Japan, whose functional currency is the JPY. The value of the RMB against the U.S. dollar and other currencies and the value of the JPY against the U.S. dollar and other currencies fluctuate and are affected by, among other things, changes in political and economic conditions.

The People's Bank of China regularly intervenes in the foreign exchange market to limit fluctuations in RMB exchange rates and achieve policy goals. Since July 21, 2005, the RMB has no longer been pegged solely to the value of the U.S. dollar. Instead, the RMB is now pegged against a basket of currencies, determined by the People's Bank of China, against which it can rise or fall by as much as 1.0% each day (which may further widen in the future). This change in policy has resulted in approximately 36% appreciation of the RMB against the U.S. dollar between July 21, 2005 and December 31, 2013. In the long term, the RMB may appreciate or depreciate significantly in value against the U.S. dollar, depending upon the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the RMB against the U.S. dollar.

Foreign currency exchange rates are subject to fluctuation and may cause us to recognize transaction gains and losses in our statements of operations. To the extent that transactions by our subsidiaries in China and Japan are denominated in currencies other than the RMB and JPY, we bear the risk that fluctuations in the exchange rates of the RMB and JPY in relation to other currencies could decrease our revenue or increase our costs and expenses, therefore having an adverse effect on our future results of operations.

While we generate a significant portion of our revenue in RMB and JPY, a majority of our operating expenses are in U.S. dollars. Therefore depreciation in RMB or JPY against the U.S. dollar would negatively impact our revenue upon translation to U.S. dollars but the impact on operating expenses would be less. For example, for the year ended December 31, 2013, a 10% depreciation in RMB against the U.S. dollar would have resulted in a $7.8 million decrease in our revenue and a $0.2 million increase in our net loss and a 10% depreciation in JPY would have resulted in a $0.8 million decrease in our revenue and a $0.03 million increase in our net loss.

We also transact in other currencies that have had historical volatility, including Russian Rubles. Fluctuations in the exchange rates of these currencies may cause us to recognize additional transaction gains or losses which could impact our results of operations.

To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedging transactions may be limited and we may not be able to successfully hedge our exposure. In addition, our currency exchange variations may be magnified by Chinese exchange control regulations that restrict our ability to convert RMB into foreign currency.

We face a variety of risks associated with international sales and operations, which if not adequately managed could adversely affect our business and financial results.

We currently derive, and expect to continue to derive, a significant portion of our revenue from international sales in various markets. In addition, a major portion of our operations is based in Shenzhen and Dongguan, China as well as our having additional operations in Japan and Canada. We are also in the process of establishing operations in Russia. Our international revenue and operations are subject to a number of material risks, including, but not limited to:

difficulties in staffing, managing and supporting operations in more than one country;
difficulties in enforcing agreements and collecting receivables through foreign legal systems;
fewer legal protections for intellectual property in foreign jurisdictions;
compliance with local regulations;
foreign and U.S. taxation issues and international trade barriers;
general economic and political conditions in the markets in which we operate;
difficulties in obtaining any necessary governmental authorizations for the export of our products to certain foreign jurisdictions;

fluctuations in foreign economies;
fluctuations in the value of foreign currencies and interest rates;
trade and travel restrictions;
outbreaks of avian flu, Severe Acute Respiratory Syndrome, or SARS, H1N1 swine flu or other contagious disease;
domestic and international economic or political changes, hostilities and other disruptions in regions where we currently operate or may operate in the future;
difficulties and increased expenses in complying with a variety of U.S. and foreign laws, regulations and trade standards, including the Foreign Corrupt Practices Act; and

different and changing legal and regulatory requirements in the jurisdictions in which we currently operate or may operate in the future.

Negative developments in any of these areas in China, Japan, Russia or other countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, difficulties in producing and delivering our products, threats to our intellectual property, difficulty in collecting receivables, and a higher cost of doing business.

In addition, although we maintain an anti-corruption compliance program throughout our company, violations of our compliance program may result in criminal or civil sanctions, including material monetary fines, penalties and other costs against us or our employees, and may have a material adverse effect on our business.

In making an investment decision relating to our common stock, you should evaluate our business in light of the risks, expenses and difficulties frequently encountered by companies operating on a global platform, particularly companies in the rapidly changing communications networks industry.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

We are subject to export and import control laws, trade regulations and other trade requirements that limit which products we sell and where and to whom we sell our products, especially laser-dependent products. In some cases, it is possible that export licenses would be required from U.S. government agencies for some of our products in accordance with various statutory authorities, including but not limited to the International Traffic in Arms Regulations, the Export Administration Act of 1979, the International Emergency Economic Powers Act of 1977, the Trading with the Enemy Act of 1917 and the Arms Export Control Act of 1976 and various country-specific trade sanctions legislation. In addition, various countries regulate the import of certain technologies and have enacted laws that could limit our ability to distribute our products. We may not be successful in obtaining the necessary export and import licenses. Failure to comply with these and similar laws on a timely basis, or at all, or any limitation on our ability to export or sell our products or to obtain any required licenses would adversely affect our business, financial condition and results of operations.

Changes in our products or changes in export and import laws and implementing regulations may create delays in the introduction of new products in international markets, prevent our customers from deploying our products internationally or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. In such event, our business and results of operations could be adversely affected.

We have identified material weaknesses in our internal control over financial reporting which could, if not remediated, result in material misstatements in our financial statements.

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended, or the Exchange Act.

The following material weaknesses in our internal control over financial reporting were identified during 2013 and had not been remediated at December 31, 2013 :

Control Environment — We did not maintain an effective control environment, which is the foundation for the discipline and structure necessary for effective internal control over financial reporting, as evidenced by: (i) an insufficient number of personnel appropriately qualified to perform control monitoring activities, including the recognition of the risks and complexities of our transactions and business operations, (ii) an insufficient number of personnel with an appropriate level of GAAP knowledge and experience or ongoing training in the application of GAAP commensurate with our financial reporting requirements, which resulted in erroneous judgments regarding the proper application of GAAP and (iii) insufficient corporate involvement to identify and resolve errors in recording transactions and financial results at our non-US subsidiaries. This control environment material weakness was exacerbated by our acquisition of NeoPhotonics Semiconductor in March 2013 and contributed to the following additional material weaknesses.

Accounting for complex transactions — We did not maintain effective internal controls related to complex transactions, including the acquisition of NeoPhotonics Semiconductor. Our controls over the accounting, process and procedures for the NeoPhotonics Semiconductor acquisition were not effective to provide reasonable assurance that (i) the business combination accounting identified and considered all known acquired liabilities, (ii) the business combination accounting reflected the appropriate application of GAAP and (iii) there was appropriate review of the purchase price allocation entries recorded in the consolidated financial statements. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

Preparation and review of consolidated financial statements — We did not maintain effective internal control over financial reporting related to the preparation and review of our consolidated financial statements. Specifically, we did not execute controls related to the review of transactions and balances for proper classification in our balance sheet, statement of operations and statement of cash flows. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

We have developed remediation plans designed to address these material weaknesses. If our remedial measures are insufficient to address the material weaknesses or if additional material weaknesses in our internal control are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results. For more information see “Item 9A. Controls and Procedures”.

If we fail to maintain effective internal control over financial reporting in the future, the accuracy and timing of our financial reporting may be adversely affected.

Preparing our consolidated financial statements involves a number of complex manual and automated processes, which are dependent upon individual data input or review and require significant management judgment. One or more of these elements may result in errors that may not be detected and could result in a material misstatement of our consolidated financial statements. Since the year ended December 31, 2011, we have been required to comply with the internal control requirements of the Sarbanes-Oxley Act of 2002. In addition, we may experience difficulties in implementing effective internal controls over financial reporting as part of our integration of NeoPhotonics Semiconductor. NeoPhotonics Semiconductor was not subject as a stand-alone entity to the internal control requirements of a U.S. public company. We could also experience unanticipated additional operating costs in implementing and managing effective internal controls over financing reporting at the NeoPhotonics Semiconductor facilities and operations, which could adversely affect our financial performance.

If a material misstatement occurs in the future, we may fail to meet our future reporting obligations, we may need to restate our financial results and the price of our common stock may decline. Our internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if we experience difficulties in the implementation, our business and operating results may be harmed and we may fail to meet our financial reporting obligations. Any failure of our internal controls could also adversely affect the results of the periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting that is now applicable to us under the rules of the Securities and Exchange Commission, or the SEC. Effective internal controls are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and results of operations could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.

We may be subject to disruptions or failures in information technology systems and network infrastructures that could have a material adverse effect on our business and financial condition.

We rely on the efficient and uninterrupted operation of complex information technology systems and network infrastructures to operate our business. A disruption, infiltration or failure of our information technology systems as a result of software or hardware malfunctions, system implementations or upgrades, computer viruses, third-party security breaches, employee error, theft or misuse, malfeasance, power disruptions, natural disasters or accidents could cause breaches of data security, loss of intellectual property and critical data and the release and misappropriation of sensitive competitive information and partner, customer and employee personal data. Any of these events could harm our competitive position, result in a loss of customer confidence, cause us to incur significant costs to remedy any damages and ultimately materially adversely affect our business and financial condition.

Covenants in our credit facilities may limit our flexibility in responding to business opportunities and competitive developments and increase our vulnerability to adverse economic or industry conditions.

We have lending arrangements with several financial institutions, including a revolving credit and term loan agreement with Comerica Bank and East-West Bank in the U.S. Our U.S. revolving credit and term loan agreement requires us to maintain certain financial covenants, including a liquidity ratio and a quarterly ratio of funded debt to adjusted EBITDA, and restricts our ability to take certain actions such as incurring additional debt, paying dividends, or engaging in certain transactions like mergers and acquisitions, investments and asset sales. On May 19, 2014 we executed an amendment to the credit agreement that waived testing of certain covenants for compliance, including the debt to EBITDA covenant, provided that we maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. We intend to work with the bank to restructure the credit agreement, including the covenant requirements. In the absence of a restructured agreement, we believe we will have difficulty complying with the existing debt to EBITDA covenant for at least the next twelve months.

These restrictions may limit our flexibility in responding to business opportunities, competitive developments and adverse economic or industry conditions. In addition, our obligations under our U.S. revolving credit and term loan agreement with Comerica Bank and East-West Bank are secured by substantially all of our assets other than intellectual property assets, which limit our ability to provide collateral for additional financing. A breach of any of these covenants, or a failure to pay interest or indebtedness when due under any of our credit facilities, could result in a variety of adverse consequences, including the acceleration of our indebtedness.

We may be unable to utilize our net operating loss carryforwards to reduce our income taxes, which could adversely affect our future financial results.

As of December 31, 2013, we had net operating loss, or NOL, carryforwards for U.S. federal and state tax purposes of $238.0 million and $155.6 million, respectively. As these net operating losses have not been utilized, a portion will begin to expire in 2014 and will continue to expire further in the current and future years. The utilization of the NOL and tax credit carryforwards are subject to a substantial limitation imposed by Section 382 of the Internal Revenue Code of 1986, as amended, or the Code, and similar state provisions. We recorded deferred tax assets, net of valuation allowance, for the NOL carryforwards currently available after considering the existing Section 382 limitation. If we incur an additional limitation under Section 382, then the NOL carryforwards, as disclosed, could be reduced by the impact of any future limitation that would result in existing NOL carryforwards and tax credit carryforwards expiring unutilized and increases in future tax liabilities.

We incur increased costs as a result of operating as a public company, and our management is required to devote substantial time to new compliance initiatives.

We became a public reporting company in February 2011. As a public company, we incur legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act, as well as rules subsequently implemented by the SEC and the New York Stock Exchange, or NYSE, imposes additional requirements on public companies, including specific corporate governance practices. For example, the listing requirements of the NYSE require that we satisfy certain corporate governance requirements relating to independent directors, audit and compensation committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of conduct. Our management and other personnel need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly. For example, these rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial additional costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

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

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

We may utilize conflict minerals in our production or rely on suppliers who utilize conflict minerals in their production, and the use of such conflict minerals may negatively impact our results of operations.

In August 2012, the U.S. Securities and Exchange Commission adopted its final rule to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding reporting obligations for the use of conflict minerals originating in the Democratic Republic of the Congo and adjoining countries, and beginning on January 1, 2013, we became subject to these reporting obligations. In connection with these requirements, we have been contacted by several customers and suppliers regarding the new conflict mineral rules and reporting obligations and continue to work with these customers and suppliers to implement any necessary or requested compliance programs. As a result of these new rules, our results in operations may suffer for a variety of reasons, including:

- difficulty in obtaining supplies that are conflict-free;
- shipping delays or the cancellation of orders for our products;
- costs associated with the implementation of the conflict minerals reporting obligations; and
- reputational damage in the event that we determine our products do incorporate conflict minerals or cannot be verified as not incorporating conflict minerals.

In some instances, we rely on third-party sales representatives to assist in selling our products, and the failure of these representatives to perform as expected could reduce our future revenue.

Although we primarily sell our products through direct sales to systems vendors, we also sell our products to some of our customers through third-party sales representatives. Many of our third-party sales representatives also market and sell competing products from our competitors. Our third-party sales representatives may terminate their relationships with us at any time, or with short notice. Our future performance will also depend, in part, on our ability to attract additional third-party sales representatives that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. If our current third-party sales representatives fail to perform as expected, our revenue and results of operations could be harmed.

We are subject to environmental, health and safety laws and regulations, which could subject us to liabilities, increase our costs, or restrict our business or operations in the future.

Our manufacturing operations and our products are subject to a variety of federal, state, local and international environmental, health and safety laws and regulations in each of the jurisdictions in which we operate or sell our products. These laws and regulations govern, among other things, air emissions, wastewater discharges, the handling and disposal of hazardous substances and wastes, soil and groundwater contamination, employee health and safety, and the use of hazardous materials in, and the recycling of, our products. Our failure to comply with present and future environmental, health or safety requirements, or the identification of contamination, could cause us to incur substantial costs, including cleanup costs, monetary fines, civil or criminal penalties, or curtailment of operations. In addition, the enactment of more stringent laws and regulations, or other unanticipated events could restrict our ability to expand our facilities, require us to install costly pollution control equipment or incur other additional expenses, or require us to modify our manufacturing processes or the contents of our products, which could have a material adverse effect on our business, financial condition and results of operations.

Additionally, increasing efforts to control emissions of greenhouse gases, or GHG, may also impact us. Additional climate change or GHG control requirements are under consideration at the federal level in the U.S. and in China. Additional restrictions, limits, taxes, or other controls on GHG emissions could increase our operating costs and, while it is not possible to estimate the specific impact any final GHG regulations will have on our operations, there can be no assurance that these measures will not have significant additional impact on us.

Our Japan operations are subject to local environmental laws and regulations, and our failure to fully comply with all applicable environmental laws and regulations could negatively affect our operations and our future results.

Following our acquisition of NeoPhotonics Semiconductor, we now own and operate a semiconductor facility in Japan which is subject to local environmental laws and regulations, including the Japanese Environmental Quality Standards ("JEQS") and the Water Pollution Control Law ("Water Law"), which includes provisions for periodic monitoring of groundwater quality. The JEQS provides guidelines for specified substances in groundwater, primarily including metals and volatile organic compounds, include some that are either used in our operations or have been used in our facilities in prior years. In addition, the Soil Contamination Countermeasures Law includes regulatory standards for many of the same substances regulated under the Water Law, some that are either used in our operations or have been used in our facilities in prior years. Should any of these regulated materials be detected in local water or soil, we could be subject to local law remedies, which could affect our ability to operate or could negatively affect our results of operations.

We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our stockholders.

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. We operate in an industry, however, that makes our prospects difficult to evaluate. It is possible that we may not generate sufficient cash flow from operations or otherwise have the capital resources to meet our future capital needs. If this occurs, we may need additional financing to execute on our current or future business strategies, including to:

- invest in our research and development efforts, including by hiring additional technical and other personnel;
- expand our operating or manufacturing infrastructure;
- acquire complementary businesses, products, services or technologies; or
- otherwise pursue our strategic plans and respond to competitive pressures.

If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders, including those acquiring shares in our initial public offering. We cannot assure you that additional financing will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, if and when needed, our ability to fund our operations, take advantage of unanticipated opportunities, develop or enhance our products, or otherwise respond to competitive pressures could be significantly limited.

Risks related to our operations in China

Our business operations conducted in China are critical to our success. A total of $122.4 million, or 43%, of our revenue in 2013 was recognized from customers for whom we shipped products to a location in China. Additionally, a substantial portion of our property, plant and equipment, 48% as of December 31, 2013, is located in China. We expect to make further investments in China in the foreseeable future. Therefore, our business, financial condition, results of operations and prospects are to a significant degree subject to economic, political, legal, and social events and developments in China.

Adverse changes in economic and political policies in China, or Chinese laws or regulations could have a material adverse effect on business conditions and the overall economic growth of China, which could adversely affect our business.

The Chinese economy differs from the economies of most developed countries in many respects, including the level of government involvement, level of development, growth rate and control of foreign exchange and allocation of resources. The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. Despite reforms, the government continues to exercise significant control over China’s economic growth by way of the allocation of resources, control over foreign currency-denominated obligations and monetary policy and provision of preferential treatment to particular industries or companies. Moreover, the laws, regulations and legal requirements in China, including the laws that apply to foreign-invested enterprises are relatively new and are subject to frequent changes. The interpretation and enforcement of such laws is uncertain. Any adverse changes to these laws, regulations and legal requirements, including tax laws, or their interpretation or enforcement, or the creation of new laws or regulations relating to our business, could have a material adverse effect on our business. For example, the Chinese government’s recent crackdown on alleged price fixing and bribery of local officials by multinational companies could signal a broad trend toward elevated scrutiny of foreign corporations operating in the country.

Furthermore, while China's economy has experienced rapid growth in the past 20 years, growth has been uneven across different regions, among various economic sectors and over time. China has also in the past and may in the future experience economic downturns due to, for example, government austerity measures, changes in government policies relating to capital spending, limitations placed on the ability of commercial banks to make loans, reduced levels of exports and international trade, inflation, lack of financial liquidity, restrictions on the flow of capital and foreign exchange, stock market volatility and global economic conditions. Any of these developments could contribute to a decline in business and consumer spending in addition to other adverse market conditions, which could adversely affect our business.

Our cost advantage from having our manufacturing and part of our research and development in China may diminish over time due to increasing labor costs, which could materially and adversely affect our operating results.

The labor market in China, particularly in the manufacturing-heavy Southeast region of China where our manufacturing facilities are located, has experienced higher costs due to increased wages. We were required to pay additional employee benefits taxes beginning in late 2010 and were subject to increases in the minimum wage for hourly workers in 2011, 2012 and 2013. We expect that we will be subject to further increases in personnel costs and taxes in the future due to market conditions and/or government mandates. If labor costs in China continue to increase, our gross margins and profit margins and results of operations may be adversely affected. In addition, our competitive advantage against competitors with manufacturing in traditionally higher cost countries would be diminished.

The termination, expiration or unavailability of our preferential income tax treatment in China may have a material adverse effect on our operating results.

Effective January 1, 2008, the China Enterprise Income Tax Law, or the EIT law, imposes a single uniform income tax rate of 25% on all Chinese enterprises, including foreign-invested enterprises, and eliminates or modifies most of the tax exemptions, reductions and preferential treatment available under the previous tax laws and regulations. As a result, our subsidiaries in China may be subject to the uniform income tax rate of 25% unless we are able to qualify for preferential status. Currently, we have qualified for a preferential 15% tax rate that is available for new and high technology enterprises. The preferential rate applied to 2013, 2012 and 2011. We realized benefits from this 10% reduction in tax rate of $0.2 million, $0.9 million and $0.5 million for 2013, 2012 and 2011, respectively. We intend to renew the preferential rate for 2014. In order to retain the preferential rate, we must meet certain operating conditions, satisfy certain product requirements, meet certain headcount requirements and maintain certain levels of research expenditures. The preferential tax rate that we enjoy could be modified or discontinued altogether at any time, which could materially and adversely affect our financial condition and results of operations.

Our subsidiaries in China may be subject to restrictions on dividend payments, on making other payments to us or any other affiliated company, and on borrowing or allocating tax losses among our subsidiaries.

Current Chinese regulations permit our subsidiaries in China to pay dividends only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations, which are different than U.S. accounting standards and regulations. In addition, our subsidiaries in China are required to set aside at least 10% of their respective accumulated profits each year, if any, to fund their statutory common reserves until such reserves have reached at least 50% of their respective registered capital, as well as to allocate a discretional portion of their after-tax profits to their staff welfare and bonus fund. As of December 31, 2013, our Chinese subsidiaries' common reserves had not reached this threshold and, accordingly, these entities are required to continue funding such reserves with accumulated net profits. The statutory common reserves are not distributable as cash dividends except in the event of liquidation. In addition, current Chinese regulations prohibit inter-company borrowings or allocation of tax losses among subsidiaries in China. Further, if our subsidiaries in China incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments to us. Accordingly, we may not be able to move our capital easily, which could harm our business.

Restrictions on currency exchange may limit our ability to receive and use our revenue and cash effectively.

Because a substantial portion of our revenue is denominated in RMB, any restrictions on currency exchange may limit our ability to use revenue generated in RMB to fund any business activities we may have outside China or to make dividend payments in U.S. dollars. Under relevant Chinese rules and regulations, the RMB is currently convertible under the "current account," which includes dividends, trade and service-related foreign exchange transactions, but not under the "capital account," which includes foreign direct investment and loans, without the prior approval of the State

Administration of Foreign Exchange, or SAFE. Currently, our subsidiaries in China may purchase foreign exchange for settlement of "current account transactions," including the payment of dividends to us, without the approval of SAFE. Although Chinese government regulations now allow greater convertibility of the RMB for current account transactions, significant restrictions remain. For example, foreign exchange transactions under our primary Chinese subsidiary's capital account, including principal payments in respect of foreign currency-denominated obligations, remain subject to significant foreign exchange controls and the approval of SAFE. These limitations could affect the ability of our subsidiaries in China to obtain foreign exchange for capital expenditures through debt or equity financing, including by means of loans or capital contributions from us. We cannot be certain that Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of the RMB, especially with respect to foreign exchange transactions. If such restrictions are imposed, our ability to adjust our capital structure or engage in foreign exchange transactions may be limited.

In August 2008, SAFE promulgated the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of Payment and Settlement of Foreign Currency Capital of Foreign-invested Enterprises, or Circular 142, a notice regulating the conversion by foreign-invested enterprises or FIE of foreign currency into RMB by restricting how the converted RMB may be used. Circular 142 requires that RMB converted from the foreign currency-dominated capital of a FIE may only be used for purposes within the business scope approved by the applicable government authority and may not be used for equity investments within China unless specifically provided for otherwise. In addition, SAFE strengthened its oversight over the flow and use of RMB funds converted from the foreign currency-dominated capital of a FIE. The use of such RMB may not be changed without approval from SAFE. Violations of Circular 142 may result in severe penalties, including substantial fines set forth in the Foreign Exchange Administration Regulations. As a result of Circular 142, our subsidiaries in China may not be able to convert our capital contributions to them into RMB for equity investments or acquisitions in China.

The Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the M&A Rules, establish complex procedures for some acquisitions of Chinese companies by foreign investors, which could make it more difficult for us to pursue growth through acquisitions in China.

The M&A Rules establish procedures and requirements that could make some acquisitions of Chinese companies by foreign investors more time-consuming and complex, including requirements in some instances that the Ministry of Commerce be notified in advance of any change-of-control transaction in which a foreign investor takes control of a Chinese domestic enterprise. We may seek to expand our business in part by acquiring complementary businesses. Complying with the requirements of the M&A Rules to complete such transactions could be time-consuming, and any required approval processes, including obtaining approval from the Ministry of Commerce, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

Uncertainties with respect to China's legal system could adversely affect the legal protection available to us.

Our operations in China are governed by Chinese laws and regulations. Our subsidiaries in China are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to wholly foreign-owned enterprises. China's legal system is a civil law system based on written statutes. Unlike common law systems, it is a legal system where decided legal cases have limited value as precedents. Since 1979, Chinese legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, China has not developed a fully-integrated legal system, and recently-enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, the interpretation and enforcement of these laws and regulations involve uncertainties, including regional variations within China. For example, we may have to resort to administrative and court proceedings to enforce the legal protection under contracts or law. However, since Chinese administrative and court authorities have significant discretion in interpreting and implementing statutory and contract terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we would receive compared to more developed legal systems. These uncertainties may impede our ability to enforce the contracts we have entered into with our distributors, business partners, customers and suppliers. In addition, protections of intellectual property rights and confidentiality in China may not be as effective as in the U.S. or other countries or regions with more developed legal systems. Furthermore, the legal system in China is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until sometime after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. All the uncertainties described above could limit the legal protections available to us and could materially and adversely affect our business and operations.

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Chinese regulations relating to offshore investment activities by Chinese residents and employee stock options granted by overseas-listed companies may increase our administrative burden, restrict our overseas and cross-border investment activity or otherwise adversely affect the implementation of our acquisition strategy. If our stockholders who are Chinese residents, or our Chinese employees who are granted or exercise stock options, fail to make any required registrations or filings under such regulations, we may be unable to distribute profits and may become subject to liability under Chinese laws.

Chinese foreign exchange regulations require Chinese residents and corporate entities to register with local branches of SAFE in connection with their direct or indirect offshore investment activities. These regulations apply to our stockholders who are Chinese residents and may apply to any offshore acquisitions that we make in the future. Pursuant to these foreign exchange regulations, Chinese residents who make, or have previously made, direct or indirect investments in offshore companies, will be required to register those investments. In addition, any Chinese resident who is a direct or indirect stockholder of an offshore company is required to file or update the registration with the local branch of SAFE, with respect to that offshore company, including any material change involving its round-trip investment, capital variation, such as an increase or decrease in capital, transfer or swap of shares, merger, division, long-term equity or debt investment or creation of any security interest. If any Chinese stockholder fails to make the required SAFE registration or file or update the registration, subsidiaries in China of that offshore parent company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation, to their offshore parent company, and the offshore parent company may also be prohibited from injecting additional capital into their subsidiaries in China. Moreover, failure to comply with the various foreign exchange registration requirements described above could result in liability under Chinese laws for evasion of applicable foreign exchange restrictions. We cannot provide any assurances that all of our stockholders who are Chinese residents have made or obtained, or will make or obtain, any applicable registrations or approvals required by these foreign exchange regulations. The failure or inability of our stockholders in China to comply with the required registration procedures may subject us to fines and legal sanctions, restrict our cross-border investment activities, or limit our Chinese subsidiaries' ability to distribute dividends or obtain foreign-exchange-dominated loans. Moreover, because of the uncertainties in the interpretation and implementation of these foreign exchange regulations, we cannot predict how they will affect our business operations or future strategy. For example, we may be subject to a more stringent review and approval process with respect to our foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, which may adversely affect our results of operations and financial condition. In addition, if we decide to acquire a domestic company in China, we cannot assure you that we or the owners of such company, as the case may be, will be able to obtain the necessary approvals or complete the necessary filings and registrations required by these foreign exchange regulations. This may restrict our ability to implement our acquisition strategy and could adversely affect our business and prospects.

On March 28, 2007, SAFE promulgated the Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas-Listed Company, or the Stock Option Rule. Under the Stock Option Rule, Chinese residents who are granted stock options by an overseas publicly-listed company are required, through a Chinese agent or Chinese subsidiary of such overseas publicly-listed company, to register with SAFE and complete certain other procedures. We and our Chinese employees who have been granted stock options are subject to the Stock Option Rule. We have completed the process of registering our stock option and appreciation plans with SAFE. On February 20, 2012, SAFE issued the Circular on Relevant Issues concerning Foreign Exchange Administration for Individuals in PRC Participating in Equity Incentive Plan of Overseas-Listed Companies, or Circular 7, which provides detailed procedures for conducting foreign exchange matters related to domestic individuals' participation in the equity incentive plans of overseas listed companies and supersedes the Stock Option Rule in its entirety. If we or our optionees in China fail to comply with the applicable regulations, we or our optionees in China may be subject to fines and legal sanctions. Several of our employees in China have exercised their stock options prior to our becoming an overseas publicly-listed company. Since there is not yet a clear regulation on how and whether Chinese employees can exercise their stock options granted by overseas private companies, it is unclear whether such exercises were permitted by Chinese laws and it is uncertain how SAFE or other government authorities will interpret or administer such regulations. Therefore, we cannot predict how such exercises will affect our business or operations. For example, we may be subject to more stringent review and approval processes with respect to our foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, which may affect our results of operations and financial condition.

We may be obligated to withhold and pay individual income tax in China on behalf of our employees who are subject to individual income tax in China arising from the exercise of stock options. If we fail to withhold or pay such individual income tax in accordance with applicable Chinese regulations, we may be subject to certain sanctions and other penalties and may become subject to liability under Chinese laws.

The State Administration of Taxation has issued several circulars concerning employee stock options. Under these circulars, our Chinese employees (which could include both employees in China and expatriate employees subject to individual income tax in China) who exercise stock options will be subject to individual income tax in China. Our subsidiaries in China have obligations to file documents related to employee stock options with relevant tax authorities and withhold and pay individual income taxes for those employees who exercise their stock options. However, since there was not yet a clear regulation on how and whether Chinese employees could exercise stock options granted by overseas private companies and how Chinese employers shall withhold and pay individual taxes, the relevant tax authority verbally advised us that due to the difficulty in determining the fair market value of our shares as a private company, we did not need to withhold and pay the individual income tax for the exercises until after we completed our initial public offering in February 2011. Thus, we have not withheld or paid the individual income tax for the option exercises through the date of our initial public offering. However, we cannot be assured that the Chinese tax authorities will not act otherwise and request us to pay the individual income tax immediately and impose sanctions on us.

If the Chinese government determines that we failed to obtain approvals of, or registrations with, the requisite Chinese regulatory authority with respect to our current and past import and export of technologies, we could be subject to sanctions, which could adversely affect our business.

China imposes controls on technology import and export. The term “technology import and export” is broadly defined to include, without limitation, the transfer or license of patents, software and know-how, and the provision of services in relation to technology. Depending on the nature of the relevant technology, the import and export of technology to or from China requires either approval by, or registration with, the relevant Chinese governmental authorities.

If we are found to be, or to have been, in violation of Chinese laws or regulations, the relevant regulatory authorities have broad discretion in dealing with such violation, including, but not limited to, issuing a warning, levying fines, restricting us from benefiting from these technologies inside or outside of China, confiscating our earnings generated from the import or export of such technology or even restricting our future export and import of any technology. If the Chinese government determines that our past import and export of technology were inconsistent with, or insufficient for, the proper operation of our business, we could be subject to similar sanctions. Any of these or similar sanctions could cause significant disruption to our business operations or render us unable to conduct a substantial portion of our business operations and may adversely affect our business and result of operations.

China regulation of loans and direct investment by offshore holding companies to China entities may delay or prevent us from using the proceeds we received from our initial public offering to make loans or additional capital contributions to our China subsidiaries.

From time to time, we may make loans or additional capital contributions to our China subsidiaries. Any loans to our China subsidiaries are subject to China regulations and approvals. For example, any loans to our China subsidiaries to finance their activities cannot exceed statutory limits, must be registered with SAFE, or its local counterpart, and must be approved by the relevant government authorities. Any capital contributions to our China subsidiaries must be approved by the Ministry of Commerce of China or its local counterpart. In addition, under Circular 142, our China subsidiaries, as FIEs, may not be able to convert our capital contributions to them into RMB for equity investments or acquisitions in China.

We cannot assure you that we will be able to obtain these government registrations or approvals on a timely basis, if at all, with respect to our future loans or capital contributions to our China subsidiaries. If we fail to receive such registrations or approvals, our ability to capitalize our China subsidiaries may be negatively affected, which could materially and adversely affect our liquidity and ability to fund and expand our business.

Dividends paid to us by our Chinese subsidiaries may be subject to Chinese withholding tax.

The EIT Law and the implementation regulations provide that a 10% withholding tax may apply to dividends payable to investors that are "non-resident enterprises," to the extent such dividends are derived from sources within China and in the absence of any tax treaty that may reduce such withholding tax rate. The comprehensive Double Taxation Arrangement between China and Hong Kong generally reduces the withholding tax on dividends paid from a Chinese company to a Hong Kong company to 5%. Dividends paid to us by our Chinese subsidiaries will be subject to Chinese withholding tax if, as expected, we are considered a "non-resident enterprise" under the EIT Law. If dividends from our Chinese subsidiaries are subject to Chinese withholding tax, our financial condition may be adversely impacted to the extent of such tax.

Our worldwide income may be subject to Chinese tax under the EIT Law.

The EIT Law provides that enterprises established outside of China whose “de facto management bodies” are located in China are considered “resident enterprises” and are generally subject to the uniform 25% enterprise income tax on their worldwide income. Under the implementation regulations for the EIT Law issued by the State Council, a “de facto management body” is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and treasury, and acquisition and disposition of properties and other assets of an enterprise. If we are deemed to be a resident enterprise for Chinese tax purposes, we will be subject to Chinese tax on our worldwide income at the 25% uniform tax rate, which could have an impact on our effective tax rate and an adverse effect on our net income (loss), however, dividends paid to us by our Chinese subsidiaries may not be subject to withholding if we are deemed to be a resident enterprise.

Dividends payable by us to our investors and gains on the sale of our common stock by our foreign investors may be subject to tax under Chinese law.

Under the EIT Law and implementation regulations issued by the State Council, a 10% withholding tax is applicable to dividends payable to investors that are “non-resident enterprises.” Similarly, any gain realized on the transfer of common stock by such investors is also subject to a 10% withholding tax if such gain is regarded as income derived from sources within China. If we are determined to be a “resident enterprise,” dividends and other income we pay on our common stock, or the gain you may realize from the transfer of our common stock, would be treated as income derived from sources within China. If we are required under the EIT Law to withhold tax from dividends payable to investors that are “non-resident enterprises,” or if a gain realized on the transfer of our common stock is subject to withholding, the value of your investment in our common stock may be materially and adversely affected.

Our contractual arrangements with our subsidiaries in China may be subject to audit or challenge by the Chinese tax authorities, and a finding that our subsidiaries in China owe additional taxes could substantially reduce our net income and the value of our stockholders’ investment.

Under the applicable laws and regulations in China, arrangements and transactions among related parties may be subject to audit or challenge by the Chinese tax authorities. We would be subject to adverse tax consequences if the Chinese tax authorities were to determine that the contracts with or between our subsidiaries were not executed on an arm’s length basis, and as a result the Chinese tax authorities could require that our Chinese subsidiaries adjust their taxable income upward for Chinese tax purposes. Such an adjustment could adversely affect us by increasing our tax expenses.

Because a substantial portion of our business is located in China, we may have difficulty maintaining adequate management, legal and financial controls, which we are required to do in order to comply with Section 404 of the Sarbanes-Oxley Act and securities laws, and which could cause a material adverse impact on our consolidated financial statements, the trading price of our common stock and our business.

Chinese companies have historically not adopted a western style of management and financial reporting concepts and practices, which includes strong corporate governance, internal controls and computer, financial and other control systems. Most of our middle management staff and some of our top management staff in China are not educated and trained in the western system, and we may have difficulty hiring new employees in China with experience and expertise relating to accounting principles generally accepted in the U.S. and U.S. public-company reporting requirements. As a result of these factors, we may experience difficulty in maintaining management, legal and financial controls, collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet U.S. public-company reporting requirements. We may, in turn, experience difficulties in maintaining adequate internal controls as required under Section 404 of the Sarbanes-Oxley Act. This may result in material weaknesses in our internal controls which could impact the reliability of our consolidated financial statements and prevent us from complying with SEC rules and regulations and the requirements of the Sarbanes-Oxley Act. Any such material weaknesses or lack of compliance with SEC rules and regulations could result in restatements of our historical consolidated financial statements, cause investors to lose confidence in our reported financial information, have an adverse impact on the trading price of our common stock, adversely affect our ability to access the capital markets and our ability to recruit personnel, lead to the delisting of our securities from the stock exchange on which they are traded. This could lead to litigation claims, thereby diverting management's attention and resources, and which may lead to the payment of damages to the extent such claims are not resolved in our favor, lead to regulatory proceedings, which may result in sanctions, monetary or otherwise, and have a material adverse effect on our reputation and business.

See also the risk factor "If we fail to maintain effective internal control over financial reporting in the future, the accuracy and timing of our financial reporting may be adversely affected."

Our consolidated affiliated entities in China are audited by auditors who are not inspected by the Public Company Accounting Oversight Board and, as such, you are deprived of the benefits of such inspection.

Publicly traded companies in the United States are audited by independent registered public accounting firms registered with the U.S. Public Company Accounting Oversight Board, or the PCAOB, and are required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. Because the auditors of our consolidated affiliated entities in China are located in China, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the Chinese authorities, such auditors are not currently inspected by the PCAOB. On May 24, 2013, the PCAOB announced that it had entered into a memorandum of understanding on enforcement cooperation with the China Securities Regulatory Commission and the Ministry of Finance of China that establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in the United States and China. However, direct PCAOB inspections of independent registered accounting firms in China are still not permitted by Chinese authorities.

Inspections of auditing firms that the PCAOB has conducted outside China have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our Chinese auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

Proceedings instituted by the SEC against five China-based accounting firms could result in our financial statements being determined to not be in compliance with the requirements of the Exchange Act.

In December 2012, the SEC instituted proceedings under Rule 102(e)(1)(iii) of the SEC's Rules of Practice against five China-based accounting firms, including the China affiliate of our independent registered public accounting firm, alleging that these firms had violated U.S. securities laws and the SEC's rules and regulations thereunder by failing to provide to the SEC the firms' work papers related to their audits of certain China-based companies that are publicly traded in the United States. On January 23, 2014, the administrative law judge presiding over the proceedings issued an initial decision denying the ability of the China affiliates of four accounting firms, including the China affiliate of our independent registered public accounting firm, to practice before the SEC for six months. This initial decision is subject to appeal. While we cannot predict the final outcome of the SEC's proceedings, if the China affiliate of our independent registered public accounting firm were denied, temporarily or permanently, the ability to practice before the SEC, and we are unable to find timely another registered public accounting firm in China which can audit the financial statements of our consolidated affiliated entities in China, our current independent registered public accounting firm may not be able to issue a report on our financial statements and our financial statements could be determined to not be in compliance with the requirements for financial statements of public companies with a class of securities registered under the Exchange Act. Such a determination could ultimately lead to the delisting of our common stock from the NYSE, which event would effectively terminate the trading market for our common stock, and to the SEC's revoking the registration of our common stock pursuant to Section 12(j) of the Exchange Act, in which event broker-dealers thereafter would be prohibited from effecting transactions in, or inducing the purchase or sale of, our common stock.

The turnover of direct labor in manufacturing industries in China is high, which could adversely affect our production, shipments, and results of operations.

Employee turnover of direct labor in the manufacturing sector in China is typically high and retention of such personnel is a challenge to companies located in or with operations in China. Although direct labor cost does not represent a high proportion of our overall manufacturing costs, direct labor is required for the manufacture of our products. If our direct labor turnover rates are higher than we expect, or we otherwise fail to adequately manage our direct labor turnover rates, then our results of operations could be adversely affected.

Our subsidiaries in China are subject to Chinese labor laws and regulations. Recently enacted Chinese labor laws may increase our operating costs in China, which could adversely affect our financial results.

China Labor Contract Law, effective January 1, 2008, together with its implementing rules, effective September 18, 2008, provides more protection to Chinese employees. Under the new rules, the probation period varies depending on contract terms and the employment contract can only be terminated during the probation period for cause upon three days' notice. Additionally, an employer may not be able to terminate a contract during the probation period on the grounds of a material change of circumstances or a mass layoff. The new law also has specific provisions on conditions when an employer has to sign an employment contract with open-ended terms. If an employer fails to enter into an open-ended contract in certain circumstances, the employer must pay the employee twice their monthly wage beginning from the time the employer should have executed an open-ended contract. Additionally an employer must pay severance for nearly all terminations, including when an employer decides not to renew a fixed-term contract.

On January 1, 2008, the Regulations on Paid Annual Leaves of Staff and Workers also took effect, followed by its implementing measures effective September 18, 2008. These regulations provide that employees who have worked consecutively for one year or more are entitled to paid annual leave. An employer must guarantee that employees receive the same wage income during the annual leave period as that for the normal working period. Where an employer cannot arrange annual leave for an employee due to production needs, upon agreement with the employee, the employer must pay daily wages equal to 300% of the employee's daily salary for each day of annual leave forfeited by such employee.

The Shenzhen municipal government, effective December 2010, issued a measure to require all government agencies, public institutions, and enterprises in Shenzhen to pay a monthly housing fund. The housing fund is designed to enhance the welfare and increase the funds available to Shenzhen employees when buying, building, renovating, or overhauling owner-occupied houses. Employee and employers are required to make equal contributions to the housing fund, which can range between 5% and 20% of the employees' average salary of the most recent year and we commenced making these contributions in the fourth quarter of 2010.

From time to time, the Chinese government has implemented requirements to increase the minimum wage for employees in China. These requirements have resulted in the past, and may result in the future, in higher employee costs for our personnel in China. Minimum wage rates generally vary by city and province within China and have historically increased as much as 20% on an annual basis. We were required to increase wages to comply with these requirements and it may be necessary for us to increase wages more than the minimum wage adjustment requires due to market conditions or additional government mandates. If labor costs in China continue to increase, our gross margins, profit margins and results of operations may be adversely affected. In addition, our competitive advantage against competitors with personnel costs or manufacturing in traditionally higher cost countries may be diminished. These newly introduced laws and regulations may materially increase the costs of our operations in China.

Adoption of international labor standards may increase our direct labor costs.

International standards of corporate social responsibility include strict requirements on labor work practices and overtime. As global service providers and their network equipment vendors adopt these standards, we have in the past incurred and may be required in the future to incur additional direct labor costs associated with our compliance with these standards.

If any of our subsidiaries in China becomes the subject of a bankruptcy or liquidation procedures, we may lose the ability to use its assets.

Because a substantial portion of our business and revenue are derived from China, if any of our subsidiaries in China goes bankrupt and all or part of its assets become subject to liens or rights of third-party creditors, we may be unable to continue some or all of our operations in China. Any delay, interruption or cessation of all or a part of our operations in China would negatively impact our ability to generate revenue and otherwise adversely affect our business.

We may be exposed to liabilities under the FCPA and Chinese anti-corruption laws, and any determination that we violated these laws could have a material adverse effect on our business.

We are subject to the Foreign Corrupt Practice Act of 1977, or FCPA, and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by U.S. persons and issuers as defined by the statute, for the purpose of obtaining or retaining business. We have operations, agreements with third parties and we make significant sales in China. China also strictly prohibits bribery of government officials. Our activities in China create the risk of unauthorized payments or offers of payments by our employees, consultants, sales agents or distributors, even though they may not always be subject to our control. Although we have implemented policies and procedures to discourage these practices by our employees, our existing safeguards and any future improvements may prove to be less than effective, and our employees, consultants, sales agents or distributors may engage in conduct for which we might be held responsible. Violations of the FCPA or Chinese anti-corruption laws may result in severe criminal or civil sanctions, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition. In addition, the U.S. government may seek to hold us liable for successor liability FCPA violations committed by companies in which we invest or that we acquire.

Risks related to ownership of our common stock

Our financial results may vary significantly from quarter-to-quarter due to a number of factors, which may lead to volatility in our stock price.

Our quarterly revenue and results of operations have varied in the past and may continue to vary significantly from quarter to quarter. This variability may lead to volatility in our stock price as research analysts and investors respond to these quarterly fluctuations. These fluctuations are due to numerous factors, including:

- fluctuations in demand for our products;
- the timing, size and product mix of sales of our products;
- changes in our pricing and sales policies or the pricing and sales policies of our competitors;
- our ability to design, manufacture and deliver products to our customers in a timely and cost-effective manner and that meet customer requirements;
- quality control or yield problems in our manufacturing operations;
- our ability to timely obtain adequate quantities of the components used in our products;
- length and variability of the sales cycles of our products;
- unanticipated increases in costs or expenses; and
- fluctuations in foreign currency exchange rates.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly and annual results of operations in the future. In addition, a significant amount of our operating expenses is relatively fixed in nature due to our internal manufacturing, research and development, sales and general administrative efforts. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of such revenue shortfall on our results of operations. Moreover, our results of operations may not meet our announced guidance or the expectations of research analysts or investors, in which case the price of our common stock could decrease significantly. There can be no assurance that we will be able to successfully address these risks.

Our failure to comply with conditions required for our common stock to be listed on the NYSE could result in delisting of our common stock from the NYSE and have a significant negative effect on the value and liquidity of our securities as well as other matters.

As a result of our failure to timely file this Annual Report on Form 10-K as well as our Quarterly Report on Form 10-Q for the three months ended March 31, 2014, we are not in full compliance with the NYSE Listed Company Manual, Section 802.01E. We believe we will cure this deficiency by our filing this Annual Report and our expected filing of the Quarterly Report. We are required to comply with the NYSE Listed Company Manual as a condition for our common stock to continue to be listed on the NYSE. If we are unable to comply with such conditions, then our shares of common stock are subject to delisting from the NYSE.

If our common stock is delisted from the NYSE, such securities may be traded over-the-counter on the “pink sheets.” The alternative market, however, is generally considered to be less efficient than, and not as broad as, the NYSE. Accordingly, delisting of our common stock from the NYSE could have a significant negative effect on the value and liquidity of our securities. In addition, the delisting of such stock could adversely affect our ability to raise capital on terms acceptable to us or at all. In addition, delisting of our common stock may preclude us from using exemptions from certain state and federal securities regulations.

Our failure to prepare and file timely our periodic reports with the SEC may make it more difficult for us to access the public markets to raise debt or equity capital.

We did not file our Annual Report within the time frame required by the SEC. As a result of our failure to file this Annual Report by the filing date required by the SEC (including the grace period permitted by Rule 12b-25 under the Exchange Act), we are not eligible to file a Form S-3 registration statement to conduct public offerings until our filings with the SEC have been timely made for a full year. Our ineligibility to use Form S-3 during this time period may have a negative impact on our ability to quickly access the public capital markets because we would be required to file a long-form registration statement and wait for the SEC to declare such registration statement effective. This may limit our ability to access the public markets to raise debt or equity capital. Our limited ability to access the public markets could prevent us from pursuing transactions or implementing business strategies that we believe would be beneficial to our business.

Our stock price may be volatile.

The market price of our common stock could be subject to wide fluctuations in response to, among other things, the risk factors described in this section of our Annual Report on Form 10-K, and other factors beyond our control, such as fluctuations in the valuation of companies perceived by investors to be comparable to us.

The stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions, such as recessions, sovereign debt or liquidity issues, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock.

In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may become the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management’s attention from other business concerns, which could seriously harm our business.

If research analysts do not publish research about our business or if they issue unfavorable commentary or downgrade our common stock, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that research analysts publish about us and our business. The price of our common stock could decline if one or more research analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business. If one or more of the research analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our common stock could decrease, which could cause our stock price or trading volume to decline.

The concentration of our capital stock ownership with our principal stockholders, executive officers and directors and their affiliates will limit other stockholders’ ability to influence corporate matters.

As of December 31, 2013, our executive officers and directors, and entities that are affiliated with them, beneficially own an aggregate of approximately 55% of our outstanding common stock. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. Also, as a result, these stockholders, acting together, will be able to control our management and affairs and matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. Consequently, this concentration of ownership may have the effect of delaying or preventing a change in control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if such a change in control would benefit our other stockholders.

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

We currently do not plan to declare dividends on shares of our common stock in the foreseeable future. In addition, the terms of our U.S. revolving credit and term loan agreement with Comerica Bank and East-West Bank restrict our ability to pay dividends. Consequently, your only opportunity to achieve a return on your investment in our company will be if the market price of our common stock appreciates and you sell your shares at a profit. There is no guarantee that the price of our common stock that will prevail in the market after our initial public offering will ever exceed the price that you pay.

Our charter documents and Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could delay or prevent a change in control of our company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include:

- providing for a classified board of directors with staggered, three-year terms;
- not providing for cumulative voting in the election of directors;
- authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock;
- prohibiting stockholder action by written consent;

- limiting the persons who may call special meetings of stockholders; and
- requiring advance notification of stockholder nominations and proposals.

In addition, we have been governed by the provisions of Section 203 of the Delaware General Corporate Law since the completion of our initial public offering. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding common stock, from engaging in certain business combinations without approval of substantially all of our stockholders for a certain period of time.

These and other provisions in our amended and restated certificate of incorporation, our amended and restated bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay for shares of our common stock in the future and result in the market price being lower than it would be without these provisions.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our properties consist primarily of owned and leased office and manufacturing facilities. Our corporate headquarters are located in San Jose, California and our manufacturing facilities are primarily located in Shenzhen and Dongguan, China. The following schedule presents the approximate square footage of our facilities as of December 31, 2013:

Location	Square Feet	Commitment and Use
San Jose, California [1]	63,526	Leased; 2 buildings used for corporate headquarters offices and wafer fabrication.
Fremont, California	73,175	Leased; 2 buildings used for wafer fabrication and research and development.
Shenzhen, China [2]	236,715	Owned; 1 building and 1 floor of a building. Used for manufacturing, research and development, and sales and marketing.
Shenzhen, China	81,580	Leased; 3 buildings used for staff dormitory.
Dongguan, China	93,517	Leased; 2 buildings used for manufacturing and staff dormitory.
Tokyo, Japan	13,351	Owned; 1 building used for manufacturing, research and development and marketing.

(1) One building, 24,212 square feet has been sub-leased until October 2015.

(2) The owned floor of the building in Shenzhen, representing 23,361 square feet, was leased to a tenant effective February 2014.

In addition, we lease a number of smaller offices for warehouse, manufacturing, research and other functions.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in litigation that we believe is of the type common to companies engaged in our line of business, including commercial disputes and employment issues. As of the date of this Annual Report on Form 10-K, other than as described below, we are not involved in any pending legal proceedings that we believe could have a material adverse effect on our financial condition, results of operations or cash flows. However, as described below, a certain dispute involves a claim by a third party that our activities infringe their intellectual property rights. This and other types of intellectual property rights claims generally involve the demand by a third party that we cease the manufacture, use or sale of the allegedly infringing products, processes or technologies and/or pay substantial damages or royalties for past, present and future use of the allegedly infringing intellectual property. Claims that our products or processes infringe or misappropriate any third-party intellectual property rights (including claims arising through our contractual indemnification of our customers) often involve highly complex, technical issues, the outcome of which is inherently uncertain. Moreover, from time to time, we may pursue litigation to assert our intellectual property rights. Regardless of the merit or resolution of any such litigation, complex intellectual property litigation is generally costly and diverts the efforts and attention of our management and technical personnel which could adversely affect our business.

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 us, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the co-defendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. On March 23, 2010, we 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 us) 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 us. On January 18, 2011, we and Finisar 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 we 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 us if it chooses to do so, and we may bring new claims against Finisar upon seven days written notice prior to filing such claims.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

As of May 27 , 2014, there were approximately 160 holders of record of our common stock (not including beneficial holders of our common stock holder in street names). We have not paid cash dividends on our common stock since our inception, and we do not anticipate paying any in the foreseeable future. Any future determination as to the declaration and payment of dividends, if any, will be at the discretion of our board of directors and will depend on then existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects, consent from our existing credit facility lender in the U.S., and other factors our board of directors may deem relevant.

The following table sets forth, for the periods indicated, the high and low sales prices of our common stock as reported by the New York Stock Exchange.

	Low	High
Fiscal Year 2013:		
First Quarter	$4.79	$6.09
Second Quarter	$4.75	$8.81
Third Quarter	$6.20	$9.77
Fourth Quarter	$5.31	$7.98
Fiscal Year 2012:		
First Quarter	$4.50	$6.38
Second Quarter	$3.92	$5.50
Third Quarter	$4.67	$6.08
Fourth Quarter	$4.90	$5.99

The graph below shows the cumulative total stockholder return of an investment of $100 (and the reinvestment of any dividends thereafter) on February 2, 2011 (the first trading day of NeoPhotonics Corporation common stock) in (i) our common stock, (ii) the S&P 500 Index and (iii) the NASDAQ Telecommunications Index. Our stock price performance shown in the graph below is not indicative of future stock price performance. The following graph and related information shall not be deemed “soliciting material” or be deemed to be “filed” with the SEC, nor shall such information be incorporated by reference into any future filing, except to the extent that we specifically state that such graph and related information are incorporated by reference into such filing.

	NeoPhotonics	S&P 500	NASDAQ Telecom
02/02/11	$ 100	$ 100	$ 100
12/31/11	$ 35	$ 96	$ 83
12/31/12	$ 43	$ 109	$ 84
12/31/13	$ 53	$ 142	$ 105

For equity compensation plan information refer to Item 12 of this Annual Report on Form 10-K.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read together with our consolidated financial statements and the related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Annual Report on Form 10-K. The selected consolidated financial data in this section is not intended to replace our consolidated financial statements and the related notes.

We derived the consolidated statements of operations data for the years ended December 31, 2013, 2012 and 2011 and the consolidated balance sheet data as of December 31, 2013 and 2012 from our consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data for the years ended December 31, 2010 and 2009 and the consolidated balance sheet data as of December 31, 2011, 2010 and 2009 are derived from our consolidated financial statements, which are not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of our future results.

In the fourth quarter of 2011, we initiated a plan to sell a component of our business, Shenzhen Photon Broadband Technology Co., Ltd. (Broadband), a subsidiary in China. In January 2012, we entered into a purchase agreement with a third party to dispose of our 100% equity interest in Broadband for a total cash consideration of RMB 13.0 million ($2.1 million), and the transaction closed in March 2012. As such, the net assets of Broadband were classified as held-for-sale in our consolidated balance sheets and the results of operations associated with Broadband were presented as discontinued operations in our consolidated statements of operations for all periods presented through 2012.

	Years ended December 31,				
Consolidated Statement of Operations Data:	2013 [2]	2012	2011 [1]	2010	2009
	(in thousands, except per share data)				
Revenue	$282,242	$245,423	$201,029	$177,679	$145,286
Cost of goods sold	217,069	184,163	150,944	123,373	106,833
Gross profit	65,173	61,260	50,085	54,306	38,453
Operating expenses [3]	98,846	78,167	78,551	47,812	41,222
Income (loss) from operations	(33,673)	(16,907)	(28,466)	6,494	(2,769)
Interest and other income (expense), net [4]	538	599	14,231	(533)	(593)
Provision for income taxes	(1,204)	(1,364)	(1,155)	(2,289)	(1,465)
Income (loss) from continuing operations	$(34,339)	$(17,672)	$(15,390)	$3,672	$(4,827)
Basic and diluted net income (loss) per share from continuing operations attributable to NeoPhotonics Corporation common stockholders: [5]	$(1.11)	$(0.62)	$(1.45)	$—	$(2.60)

Years ended December 31,

Consolidated Balance Sheet Data:	2013	2012	2011	2010	2009
	(in thousands)				
Cash and cash equivalents	$57,101	$36,940	$32,321	$24,659	$41,781
Short-term investments	17,916	64,301	54,063	—	—
Working capital [6]	124,298	152,374	124,199	44,129	44,167
Total assets	302,227	295,632	277,049	172,495	162,248
Long-term debt (including current portion)	34,475	22,167	27,166	8,836	8,147
Redeemable convertible preferred stock [7]	—	—	—	211,541	205,450
Common stock and additional paid-in capital [7][8]	447,546	438,934	392,854	93,354	91,899
Total equity (deficit)	176,811	202,680	173,654	(109,638)	(119,582)

(1) We acquired Santur on October 12, 2011 and its results of operations are included from the date of acquisition.

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(2) We acquired NeoPhotonics Semiconductor on March 29, 2013 and its results of operations are included from the date of acquisition.

(3) Due to the decrease in our market capitalization as of the end of the fourth quarter of 2011, we determined that the indicators of impairment existed and that the carrying value of our goodwill was not recoverable. As a result, we recorded a goodwill impairment charge of $13.1 million, of which $8.8 million was related to the acquisition of Santur in October 2011.

(4) In 2010, we purchased shares of Ignis ASA ("Ignis"), a Norwegian company traded on the Oslo Borse (Norway stock exchange) for $8.1 million. In 2011, we sold our shares in Ignis for $21.3 million and recognized a gain of $13.8 million. The gain was recognized as other income in the consolidated statement of operations for the year ended December 31, 2011.

(5) See Note 6 to the Consolidated Financial Statements for a description of our calculation of net income (loss) per share.

(6) Working capital is defined as total current assets less total current liabilities.

(7) In connection with the closing of our initial public offering in February 2011, all of the shares of Series 1, Series 2, Series 3 and Series X preferred stock outstanding automatically converted into shares of common stock.

(8) The December 31, 2012 balance reflects a revision related to the accounting for a $5.0 million penalty payment in connection with the sale of common stock in a private placement transaction in April, 2012. See Note 1 to the Consolidated Financial Statements.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis by our management of our financial condition and results of operations in conjunction with our consolidated financial statements and the accompanying notes.

The following discussion contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. Our actual results could differ materially from those discussed in the forward-looking statements. Please also see the cautionary language at the beginning of Part I of this Annual Report on Form 10-K regarding forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in "Risk Factors" of this Annual Report on Form 10-K.

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 have research and development and wafer fabrication facilities in San Jose and Fremont, California and in Tokyo, Japan which coordinate with our research and development and manufacturing facilities in Shenzhen and Wuhan, China 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., Coriant Gmbh & Co. KG (formerly Nokia Siemens Networks B.V.), ECI Telecom Ltd., FiberHome Technologies Group, Fujitsu Limited, Huawei Technologies, Juniper Networks, Inc., Mitsubishi Electric Corporation, NEC Corporation, Telefonaktiebolaget LM Ericsson and ZTE Corporation. We refer to these companies as our Tier 1 customers.

In October 2011, we acquired Santur, a designer and manufacturer of Indium Phosphide (InP) based PIC products. The acquisition of Santur enhances the Company's position in PIC-based modules and subsystems for high speed networks.

In January 2012, we entered into a purchase agreement with a third party to divest our 100% equity interest in Shenzhen Photon Broadband Technology Co., Ltd. (Broadband) for a total cash consideration of RMB 13.0 million ($2.1 million), and the transaction closed in March 2012. The results of operations associated with Broadband are presented as discontinued operations in our consolidated statements of operations in 2011 and 2012. Unless otherwise indicated, all discussions relate to our continuing operations.

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 a gross proceeds amount of approximately $39.8 million. We intend to use the amount received for general corporate purposes. 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. Because we did not timely file our Quarterly

Report on Form 10-Q for the period ended September 30, 2013 and this Annual Report on Form 10-K for the fiscal year ended December 31, 2013, we are currently ineligible to file the required registration statement on Form S-3 within the original time frame and we have requested an extension from the purchaser. In connection with this private placement transaction, we agreed to certain performance obligations, including establishing a wholly-owned subsidiary in the Russian Federation and making a $30.0 million investment commitment towards our Russian operations. See—Liquidity and Capital Resources, Contractual Obligations and Commitments and Note 14 to the Consolidated Financial Statements.

On March 29, 2013, we acquired the semiconductor optical components business unit of LAPIS Semiconductor Co., Ltd., now known as NeoPhotonics Semiconductor. NeoPhotonics Semiconductor is a leading provider of lasers, drivers, and detectors for high speed 100Gbps applications and is located in Tokyo, Japan.

In 2013, our revenue growth of 15% over the prior-year was driven primarily by demand for our 100Gbps speed products, as carriers continued to accelerate deployment of high capacity optical transport networks and by our acquisition of NeoPhotonics Semiconductor, many of whose products are 100Gbps. 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 used a direct sales force in the U.S., China, Canada, Israel, Japan, Russia 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.

We expect continued volume growth for our 100Gbps products; however at declining prices due to the results of our annual customer negotiations and new entrants into the market. We expect to continue experiencing 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 concerns relating to inflation in China, could impact our results.

Critical accounting policies and estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP"). These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, expenses and cash flow, and related disclosure of contingent assets and liabilities. Our estimates include those related to revenue recognition, stock-based compensation expense, impairment analysis of goodwill and long-lived assets, valuation of inventory, purchased intangibles, warranty liabilities and accounting for income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

We believe that of our significant accounting policies, which are described in Note 2 of Notes to Consolidated Financial Statements, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, we believe these are the most critical to fully understand and evaluate our financial condition and results of operations.

Revenue recognition

We recognize revenue from the sale of our products provided that persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectability is reasonably assured. Contracts and/or customer purchase orders are used to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. We assess collectability based primarily on the creditworthiness of the customer as determined by credit checks and the customer's payment history.

We recognize revenue when the product is shipped and title has transferred to the buyer. We bear all costs and risks of loss or damage to the goods up to that point. On most orders, our terms of sale provide that title passes to the buyer upon shipment by us. In certain cases, our terms of sale may provide that title passes to the buyer upon delivery of the goods to the buyer. Revenue related to the sale of consignment inventory at customer vendor managed locations is not recognized until the product is pulled from inventory stock by customers. Payments made to third-party sales representatives are recorded to sales and marketing expense and not a reduction of revenue as the sales agent services they provide have an identifiable benefit and are made at similar rates of other sales agent service providers. Shipping and handling costs are included in the cost of goods sold. We present revenue net of sales taxes and any similar assessments.

Stock-based compensation expense

We grant stock options, stock purchase rights, stock appreciation units and restricted stock units to employees, directors and consultants. The stock-based awards are accounted for at fair value as of the measurement date. For stock options and restricted stock units, the measurement date is the grant date and for stock purchase rights the measurement date is the first day of the offering period. Stock appreciation units are subject to re-measurement each reporting period.

We recognize the fair value over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period) on a straight-line basis. Stock-based compensation expense includes the impact of estimated forfeitures. We estimate future forfeitures at the date of grant and revise the estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

We generally account for stock-based compensation using the Black-Scholes-Merton option-pricing model. Determining the appropriate fair value model and calculating the fair value of stock-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected life. If any of these assumptions used in the option-pricing models change, our stock-based compensation expense could change on our consolidated financial statements.

Business Combinations

We allocate the fair value of purchase consideration to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets.

Fair value estimates are based on the assumptions management believes a market participant would use in pricing the asset or liability. Critical estimates in valuing certain intangible assets include but are not limited to future expected cash flows from customer relationships and acquired patents and developed technology; and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates.

Amounts recorded in a business combination may change during the measurement period, which is a period not to exceed one year from the date of acquisition, as additional information about conditions existing at the acquisition date becomes available.

Long-lived assets

We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance and may differ from actual cash flows. If our estimates regarding future cash flows derived from such assets were to change, we may record an impairment to the value of these assets.

Valuation of inventories

We record inventories at the lower of cost (using the first-in, first-out method) or market, after we give appropriate consideration to obsolescence and inventories in excess of anticipated future demand. In assessing the ultimate recoverability of inventories, we are required to make estimates regarding future customer demand, the timing of new product introductions, economic trends and market conditions. If the actual product demand is significantly lower than forecasted, we could be required to record additional inventory write-downs which would be charged to cost of goods sold. Obsolescence is determined from several factors, including competitiveness of product offerings, market conditions and product life cycles. Write-downs of excess and obsolete inventory are charged to cost of goods sold. At the point of the loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. If this lower-cost inventory is subsequently sold, it will result in lower costs and higher gross margin for those products. Any write-downs would have an adverse impact on our gross margin. During the years ended December 31, 2013, 2012 and 2011, we recorded excess and obsolete inventory charges of $3.2 million, $3.1 million and $0.6 million, respectively.

Warranty liabilities

We provide warranties to cover defects in workmanship, materials and manufacturing of our products for a period of one to two years to meet stated functionality specifications. From time to time, we have agreed, and may agree, to warranty provisions providing for extended terms or with a greater scope. We test products against specified functionality requirements prior to delivery, but we nevertheless from time to time experience claims under our warranty guarantees. We accrue 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. We charge a provision for estimated future costs related to warranty activities to cost of goods sold based upon historical product failure rates and historical costs incurred in correcting product failures. If we experience an increase in warranty claims compared with our historical experience, or if the cost of servicing warranty claims is greater than expected, our gross margin and profitability would be adversely affected. We recorded warranty expense of $1.5 million, $0.1 million and $0.4 million for each of the years ended December 31, 2013, 2012 and 2011, respectively.

Accounting for income taxes

We record income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. In estimating future tax consequences, generally we consider all expected future events, other than enactments or changes in tax law or rates. We provide valuation allowances when necessary to reduce deferred tax assets to the amount expected to be realized.

We operate in various tax jurisdictions and are subject to audit by various tax authorities. We provide for tax contingencies whenever it is deemed probable that a tax asset has been impaired or a tax liability has been incurred for events such as tax claims or changes in tax laws. Tax contingencies are based upon their technical merits, relevant tax law and the specific facts and circumstances as of each reporting period. Changes in facts and circumstances could result in material changes to the amounts recorded for such tax contingencies.

As part of the process of preparing our consolidated financial statements, we are required to estimate our taxes in each of the jurisdictions in which we operate. We estimate actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets.

We make estimates and judgments about our future taxable income that are based on assumptions that are consistent with our plans and estimates. Should the actual amounts differ from our estimates, the amount of our valuation allowance could be materially impacted. Any adjustment to the deferred tax asset valuation allowance would be recorded in the consolidated statement of operations in the period that the adjustment is determined to be required.

Results of operations

The following table presents certain Consolidated Statements of Operations data for the periods indicated as a percentage of total revenue:

	Years Ended December 31,		
	2013	2012	2011
Revenue	100 %	100 %	100 %
Gross profit	23 %	25 %	25 %
Operating expenses	35 %	32 %	39 %
Loss from operations	(12)%	(7)%	(14)%
Interest and other income (expense), net	— %	— %	7 %
Loss before income taxes	(12)%	(7)%	(7)%
Net loss	(12)%	(7)%	(7)%

Revenue

(in thousands, except percentages)	2013	% Change 2012 to 2013	2012	% Change 2011 to 2012	2011
Total revenue	$282,242	15 %	$245,423	22 %	$201,029

We sell substantially all of our products to original equipment manufacturers, or OEMs. We recognize revenue upon delivery of our products 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”), Japanese Yen (“JPY”) and U.S. dollars. 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 86%, 90% and 91% of our revenue in 2013, 2012 and 2011, respectively. For the year ended December 31, 2013, Huawei Technologies, Ciena Corporation and Alcatel-Lucent SA accounted for 27%, 16% and 14% of our revenue, respectively. For the year ended December 2012, Huawei Technologies, Ciena Corporation and Alcatel-Lucent SA accounted for 36%, 15% and 16% of our total revenue, respectively. For the year ended December 31, 2011, Huawei accounted for 51% of our total revenue. No other customers accounted for 10% or more of our total revenue in any year presented. For the year ended December 31, 2013, 2012 and 2011, our sales from our China-based subsidiaries, the majority of which were denominated in RMB were 31%, 49% and 64%, respectively.

Total revenue increased by $36.8 million in 2013 compared to 2012, representing a 15% increase. This increase was primarily attributable to a $44.9 million increase in revenue from our high speed 100Gbps and 40Gbps products, including a significant contribution from the newly acquired NeoPhotonics Semiconductor in Japan, partially offset by a decrease in revenue contribution from our legacy products. In 2013, high speed products were up 69% over 2012, while our Access products were down 13% from 2012.

Total revenue increased by $44.4 million in 2012 compared to 2011, representing a 22% increase. This increase in revenue was primarily attributable to growth in our high speed 100Gbps and 40Gbps products which generally have higher average selling prices as compared to more mature products. Our high speed 100Gbps products grew more than 300% from 2011 to 2012. On a global basis, in 2012 we experienced greater revenue growth from Western customers compared to customers located in China, while in 2011 the increase in revenue was primarily realized in China and to a lesser extent in the U.S.

In 2014, we expect continued growth in revenue from our 100Gbps products. We also 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 our largest customers, including Alcatel-Lucent, Ciena and Huawei Technologies, or any of our other key customers would materially affect our revenue and results of operations. We expect a significant portion of our sales to continue to be denominated in RMB, and, to a lesser extent, in JPY and therefore may be affected by changes in foreign exchange rates.

Cost of goods sold and gross profit

(in thousands, except percentages)	2013	% Change 2012 to 2013	2012	% Change 2011 to 2012	2011
Cost of goods sold	$217,069	18 %	$184,163	22 %	$150,944

	2013	2012	2011
Gross margin	23 %	25 %	25 %

Our cost of goods sold consists primarily of the cost to produce wafers and to manufacture and test our products. Additionally, our cost of goods sold includes stock-based compensation, write-downs of excess and obsolete inventory, royalty payments, amortization of certain purchased intangible assets, depreciation, acquisition-related fair value adjustments, restructuring cost, warranty, shipping and allocated facilities and IT costs.

Gross margin decreased to 23% in 2013 compared to 25% in both 2012 and 2011. The decrease in gross margin partially resulted from costs associated with our NeoPhotonics Semiconductor acquisition, including $2.9 million fair value of the inventory over its cost at the acquisition date recognized during the period, as well as a $1.4 million increase in our warranty provision primarily due to higher warranty-related costs in the US and China and a $0.3 million warranty accrual release in 2012 related to Santur. Our 2013 gross margin was also impacted by restructuring charges of $0.7 million and lower average selling prices resulting from increased competition and pricing pressure from our major customers.

We expect that our gross profit is likely to continue to fluctuate due to 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, write-downs of excess and obsolete inventories and warranty costs. In addition, we periodically negotiate pricing with certain customers which can cause our gross margins to fluctuate, particularly in the quarters in which the negotiations occurred. We strive to increase our gross margin through management of the costs of our supply chain and productivity in our manufacturing processes.

Operating expenses

(in thousands, except percentages)	2013	% Change 2012 to 2013		2012	% Change 2011 to 2012		2011
Research and development	$45,853	20	%	$38,288	24	%	$30,855
Sales and marketing	14,242	8	%	13,241	13	%	11,686
General and administrative	30,012	23	%	24,361	16	%	20,911
Acquisition-related transaction costs	5,406	274	%	1,447	46	%	989
Amortization of purchase intangible assets	1,532	16	%	1,316	32	%	994
Adjustment to fair value of contingent consideration	1,026	285	%	(554)	57	%	(1,287)
Goodwill impairment charges	—	—	%	—	(100	)%	13,106
Restructuring charges	775	1040	%	68	(95	)%	1,297
Total operating expenses	$98,846	26	%	$78,167	—	%	$78,551

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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 equipment and facility costs. We record all research and development expense as incurred.

Research and development expense increased by $7.6 million in 2013 compared to 2012, representing a 20% increase. The acquisition of NeoPhotonics Semiconductor increased our research and development expense by $3.7 million. Other increases in 2013 included $2.9 million for research and development projects to support our business growth, $1.4 million for labor and facilities expenses related to manufacturing support of research and development activities, $0.5 million in higher compensation-related costs, partially offset by a $1.0 million decrease related to additional retention-related compensation costs in 2012 related to the acquisition of Santur.

Research and development expense increased by $7.4 million in 2012 compared to 2011, representing a 24% increase. This increase was primarily due to a $4.6 million increase in additional compensation and employee-related costs mainly due to the acquisition of Santur in the fourth quarter of 2011, $1.6 million increase in depreciation expense and $0.8 million increase in stock-based compensation expense.

We believe that investments in research and development are important to help meet our strategic objectives. In 2014, we plan to continue to invest in certain research and development activities including new products that will further enhance our competitive position. As a percentage of total revenue, our research and development expense may vary as our investment levels and revenue change 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 $1.0 million in 2013 compared to 2012, representing an 8% increase which was primarily due to increases from the acquisition of NeoPhotonics Semiconductor and higher variable compensation costs.

Sales and marketing expense increased by $1.6 million in 2012 compared to 2011, representing a 13% increase. This increase was primarily due to a $0.9 million increase in additional compensation and employee-related costs as a result of increased headcount.

We expect our sales and marketing expense to grow modestly in 2013 as our business continues to expand geographically. 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 of personnel costs, including stock-based compensation, for our finance, 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 and facility costs.

General and administrative expense increased by $5.7 million in 2013 compared to 2012, representing a 23% increase. Consulting and professional fees increased by $3.6 million primarily related to resources to assist us in the process of remediating weaknesses in our controls over financial reporting, to provide technical accounting support and to fill key vacant positions on an interim basis as well as costs related to the restatement of our Quarterly Report on forms 10-Q for the quarters ended March 31 and June 30, 2013. Additional increases included $1.4 million in higher software license and other IT-related expenses, costs from the newly acquired NeoPhotonics Semiconductor of $1.3 million, $0.5 million in higher audit-related fees, $0.6 million in loss on disposal of fixed assets, $1.2 million in higher stock-based compensation, payroll and related costs and $0.5 million in other costs to support our continued growth. These increases were partially offset by a $3.3 million decrease in bonus expense and a $0.4 million decrease in depreciation expense.

General and administrative expense increased by $3.5 million in 2012 compared to 2011, representing a 16% increase. This was primarily due to a $1.3 million increase in depreciation expenses as a result of the acquisition of Santur, a $1.6 million increase in compensation and employee-related costs, and a $1.0 million increase in accounting system upgrades.

We expect the higher consulting and professional fees to continue through the first half of 2014 and to then decrease in the second half of 2014 with completion of the filing of our 2013 Quarterly Reports, including restatements, and this Annual Report on Form 10-K. As a percentage of total revenue, our general and administrative expense may vary as our revenue changes over time.

Amortization of purchased intangible assets

Our intangible assets are being amortized over their estimated useful lives. Amortization expense relating to technology and patents and leasehold interests are included within cost of goods sold, while customer relationships and noncompete agreements are recorded within operating expenses.

Amortization of purchased intangible assets increased by $0.2 million in 2013 compared to 2012, representing a 16% increase and was due to intangible assets from our NeoPhotonics Semiconductor in 2013.

Amortization of purchased intangible assets increased by $0.3 million in 2012 compared to 2011, representing a 32% increase and was due to assets acquired from Santur in the fourth quarter of 2011.

Adjustment to the fair value of contingent consideration

In May 2014, we entered into a settlement agreement covering the outstanding claims in connection with our 2011 acquisition of Santur. Under the terms of the settlement agreement, a net amount of $1.9 million was paid to us from the escrow account that was set up under the original merger agreement, which comprises $3.9 million related to certain indemnification claims by us (“Indemnification Amount”) which were partially offset by $2.0 million related to additional consideration for the business acquisition that was contingent upon Santur’s gross profit performance during 2012 (“Contingent Consideration Amount”). Prior to this settlement, we had recorded $1.0 million as our estimated fair value of the Contingent Consideration Amount. As a result of this settlement, we recorded an additional $1.0 million in our operating expenses in 2013 to adjust the fair value of the Contingent Consideration Amount to the full $2.0 million settlement amount. Because it is considered to be a contingent gain, the $3.9 million Indemnification Amount will not be recognized until the quarter ended June 30, 2014.

Goodwill impairment charge

Due to the decrease in our market capitalization as of the end of the fourth quarter of 2011, and based on our assessment, we determined that the indicators of impairment existed and that the carrying value of our goodwill may not be recoverable. As a result, we recognized a goodwill impairment charge of $13.1 million, representing the entire balance of our goodwill.

Restructuring charges

During 2013, we exited and closed one facility at our headquarters location to align our facilities usage with its current size. Additionally, we approved and implemented a restructuring action in which we reduced our workforce and closed a facility in China and exited our contract manufacturing activities in Malaysia. We recorded a restructuring charge of $1.5 million during 2013 related to these actions, of which $0.8 million was recorded in operating expenses with the remainder recorded in cost of goods sold.

In 2011, we implemented a restructuring plan to effect cost-cutting measures, primarily in research and development. We made additional reductions as a result of redundancy in positions due to the acquisition of Santur in October 2011. As a result, we recorded a restructuring charge of $1.3 million for severance and benefit costs in 2011 and an additional $68,000 related to this restructuring during 2012. As of December 31, 2012, all of this restructuring expense was paid.

Interest and other income (expense), net

(in thousands, except percentages)	2013	% Change 2012 to 2013	2012	% Change 2011 to 2012	2011
Interest and other income (expense), net	$538	(10)%	$599	(96)%	$14,231

Interest and other income (expense), net consists of interest income, interest expense and other income (expense). Interest income consists of income earned on our cash, cash equivalents and short-term investments. Interest expense consists of amounts incurred for interest on our outstanding debt. Other income (expense) also includes government subsidies and foreign currency transaction gains and losses. The functional currency of our subsidiaries in China and Japan is the RMB and the JPY, respectively.

Interest and other income (expense), net, decreased by 10% in 2013 compared to 2012. The decrease is primarily due to a $0.4 million increase in interest expense related to higher long-term debt in 2013 and a $0.2 million decrease in interest income, which was partially offset by a $0.6 million increase in other income. Included in other income was a $0.9 million net foreign exchange gain in 2013 which was a $1.1 million increase from a $0.2 million foreign exchange loss in 2012.

Interest and other income (expense), net decreased by $13.6 million in 2012 compared to 2011, representing a 96% decrease. The decrease was primarily due to a gain of $13.8 million from the sale of an investment in an unconsolidated investee in 2011.

Income taxes

	Years ended December 31,		
(in thousands, except percentages)	2013	2012	2011
Provision for income taxes	$(1,204)	$(1,364)	$(1,155)
Effective tax rate	(4)%	(8)%	(8)%

In 2013, 2012 and 2011, our income tax provision was primarily related to the operating profit realized in our foreign subsidiaries, despite a consolidated loss before income taxes. 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. The preferential rate applied to 2013, 2012 and 2011. We realized benefits from this 10% reduction in tax rate of $0.2 million, $0.9 million and $0.5 million for 2013, 2012 and 2011, respectively. We intend to apply for renewal of the preferential rate for 2014. In order to retain the preferential rate, we must meet certain operating conditions, satisfy certain product requirements, meet certain headcount requirements and maintain certain levels of research expenditures. The preferential tax rate that we enjoy could be modified or discontinued altogether at any time, which could materially and adversely affect our financial condition and results of operations.

The effective tax rate in 2013 of 4% was 4% lower than the 8% effective rate in 2012 and 2011, primarily due to a higher U.S. loss relative to our earnings in foreign subsidiaries.

Liquidity and capital resources

At December 31, 2013, we had working capital of $124.3 million and total cash, cash equivalents and short-term investments of $75.0 million of which 31% was held in accounts by our subsidiaries in China and 20% was held in accounts by our subsidiaries in Japan.

Approximately $6.5 million of our accumulated deficit at December 31, 2013 was subject to restriction due to the fact that our subsidiaries in China are required to set aside at least 10% of their respective accumulated profits each year to fund statutory common reserves as well as allocate a discretional portion of their after-tax profits to their staff welfare and bonus fund. This restricted amount is not distributable as cash dividends except in the event of liquidation.

We have a bank credit agreement with Comerica Bank as the lead bank. As of December 31, 2013 this credit agreement included the following:

A revolving credit facility under which there was no amount outstanding and $20.0 million available for borrowing at December 31, 2013, subject to covenant requirements. There was $8.0 million outstanding under this line at December 31, 2012. Amounts borrowed are due on or before March 2016 and borrowings bear interest at an interest rate option of a base rate as defined in the agreement plus 1.5% or LIBOR plus 2.5%. As of December 31, 2013 the rate on the LIBOR option was 2.67%.

A term loan facility under which $24.5 million was outstanding at December 31, 2013. Interest is payable quarterly in arrears and the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan bear interest at an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of December 31, 2013 the rate on the LIBOR option was 2.92%.

Our credit agreement requires the maintenance of specified financial covenants, including a debt to EBITDA ratio and liquidity ratios. The agreement also restricts our ability to incur additional debt or to engage in specified transactions, restricts the payment of dividends and is secured by substantially all of our U.S. assets, other than intellectual property assets. We were not in compliance with the debt to EBITDA covenant at December 31, 2013 and obtained a waiver from the bank with respect to such noncompliance.

We executed a series of amendments to the credit agreement through April 2014 that modified certain covenants and extended the delivery date of certain of our Quarterly Reports on Form 10-Q and this Annual Report on Form 10-K. The amendments also increased the applicable interest margins by 0.25% per annum. As amended, loans under the term loan facility bear interest equal to either the LIBOR rate, plus an applicable margin equal to 3.00% per annum, or a base rate (as defined) plus an applicable margin equal to 2.00% per annum. Loans under the revolving loan facility bear interest at a rate equal to either the LIBOR rate, plus an applicable margin equal to 2.75% per annum, or a base rate (as defined) plus an applicable margin equal to 1.75% per annum. These new interest rate options will be in effect at least until the lender's review of our June 30, 2014 financial statements.

On May 19, 2014 we executed an amendment to the credit agreement that waived testing of certain covenants for compliance, including the debt to EBITDA covenant, provided that we maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. We intend to work with the bank to restructure the credit agreement, including the covenant requirements. In the absence of a restructured agreement, we believe we may need to continue to maintain the compensating balances at least through the end of 2014. As of May 19, 2014, the amount of our cash and short-term investments in these compensating balance accounts was $21.1 million.

At December 31, 2013 our subsidiaries in China had two short-term line of credit facilities with banking institutions. Amounts requested by us were not guaranteed and were subject to the banks' funds and currency availability. As of December 31, 2013, we had no short-term loans outstanding under these facilities. As of June 3, 2014, both credit facilities had expired and were in the process of being renewed.

We also issue notes payable to our suppliers in China in exchange for accounts payable. These notes are supported by non-interest bearing bank acceptance drafts and are due three to six months after issuance. As a condition of the notes payable 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 amounts are settled. These balances are classified as restricted cash on our consolidated balance sheets. As of December 31, 2013, our restricted cash totaled $2.1 million. In May 2014, one of our subsidiaries in China issued a 90-day bank acceptance draft of approximately $8.0 million to another of our subsidiaries that required a compensating balance of approximately $2.4 million. This bank acceptance draft can be sold for cash at a discount prior to its expiration.

On May 23, 2014, one of our subsidiaries in China borrowed CNY 50 million ($8.0 million) under a working capital loan agreement with a bank. The loan bears interest at 7% per annum. Interest is payable monthly and the principle is due on November 23, 2014.

From time to time we accept notes receivable in exchange for accounts receivable from certain of our customers in China. These notes receivable are non-interest bearing and are generally due within six months. Historically, we have collected on the notes receivable in full at the time of maturity.

We believe that our existing cash, 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, even with the compensating balance requirement discussed above. 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 and our foreign operations, 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.

Private placement transaction

In connection with the 2012 private placement transaction (see—Business Overview), we agreed to certain performance obligations including establishing a wholly-owned subsidiary in Russia and making a $30.0 million investment commitment (the 'Investment Obligation') towards our Russian operations. The Investment Obligation can be partially satisfied by cash and/or stock investment inside or outside of Russia and/or by way of non-cash asset transfers, including but not limited to capital equipment, small tools, intellectual property, and other intangibles. A minimum of $15.0 million of the Investment Obligation is required to be satisfied by making capital expenditure investments and we expect that the remaining $15.0 million will be satisfied through cash and non-cash general working capital and research and development expenditures and commitments. All of the amount for general working capital can be spent either inside or outside of Russia. However, at least 80% of the amount expended for research and development must be spent inside Russia. General working capital can include cash or stock acquisition of technology and other businesses or portions thereof to be owned by the Russian subsidiary. Our current plan is to substantially meet the $15.0 million capital expenditure portion of the Investment Obligation by transferring non-cash assets from other entities within the consolidated Company to the Russian subsidiary, subject to the purchaser’s approval as required in the rights agreement. We expect that the remaining $15.0 million will be satisfied through some combination of working capital and research and development spending, which may include technology or other acquisitions acquired by cash or stock through March 2015. The exact timing and composition of those expenditures has not yet been determined.

The purchaser of the common stock has nontransferable veto rights over our Russian subsidiary’s annual budget during the investment period, and non-cash asset transfers to be made in satisfaction of the Investment Obligation requires approval by the purchaser. Spending and/or commitments to spend for general working capital and research and development do not require approval by the purchaser. There are no legal restrictions on the specific usage of amounts received in the private placement transaction or on withdrawal from our bank accounts for use in general corporate purposes.

We are required to satisfy the Investment Obligation by July 31, 2014, or, in the event we have not recorded aggregate revenue from sales of our products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014, then by March 31, 2015. We expect the date for achievement of the Investment Obligation will be extended to March 31, 2015. Therefore, we intend to meet the Investment Obligation by March 31, 2015. If we fail to meet the Investment Obligation by the deadline, including failure to meet the Investment Obligation because the purchaser of the common stock does not approve the transfer of non-cash assets, we will be required to pay a $5.0 million penalty as the sole and exclusive remedy for damages and monetary relief available to the purchaser for failure to meet the Investment Obligation.

Cash flow discussion

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

	Year ended December 31,		
(in thousands)	2013	2012	2011
Net cash provided by (used in) operating activities	$4,511	$(8,790)	$(12,510)
Net cash provided by (used in) investing activities	13,304	(20,999)	(83,863)
Net cash provided by financing activities	2,515	34,064	102,635
Effect of exchange rates on cash and cash equivalents	(169)	180	758
Net increase in cash and cash equivalents	$20,161	$4,455	$7,020

Operating activities

In 2013, net cash provided by operating activities was $4.5 million, which was a $13.3 million increase over the $8.8 million cash used in operating activities in 2012. Contributing to the increase was a decrease in accounts receivable, particularly in China where days sales outstanding declined and revenue was lower at the end of 2013 compared to the end of 2012. Additionally, operating cash flow benefitted from an increase in accounts payable primarily due to higher inventory purchases in China near the end of 2013 and higher accrued and other current liabilities, partially offset by a higher net loss in 2013.

In 2012, net cash used in operating activities was $8.8 million. During the year ended December 31, 2012, we recognized a net loss of $17.5 million, which incorporated non-cash charges, including depreciation and amortization of $18.7 million, stock-based compensation expenses of $4.8 million and write-down of inventories of $3.1 million. These amounts were partially offset by the purchase of inventory of $11.8 million, a reduction of accounts payable of $3.0 million and a reduction of accrued and other liabilities of $1.0 million.

In 2011, net cash used in operating activities was $12.5 million. During the year ended December 31, 2011, we recognized a net loss of $14.8 million, which incorporated non-cash charges, including goodwill impairment charges of $13.1 million, depreciation and amortization of $12.9 million and stock-based compensation expenses of $3.2 million. These amounts were partially offset by the gain on sale of our investment in an unconsolidated investee of $13.9 million, the purchase of inventory of $8.5 million to replenish our inventories in preparation for higher customer demand in future periods, and changes in accrued and other liabilities.

Investing activities

In 2013, net cash provided by investing activities was $13.3 million, which was a $34.3 million increase from the $21.0 million used in investing activities in 2012. The increase was due to $56.0 million in higher net proceeds from the sale and maturity of marketable securities, partially offset by $13.1 million cash used to purchase NeoPhotonics Semiconductor and $6.8 million in higher purchases of property and equipment in 2013.

In 2012, net cash used in investing activities was $21.0 million. During 2012, we used $155.9 million of cash for the purchase of equity securities and $12.7 million for capital equipment, which was offset by $145.2 million of cash received for the sale and maturity of equity securities. We also received $1.8 million from the sale of our former Broadband subsidiary.

In 2011, net cash used in investing activities was $83.9 million. During 2011, we used $173.0 million of cash for the purchase of equity securities, which was partially offset by $118.5 million of cash received for the sale and maturity of equity securities. We also used $39.0 million of cash for the acquisition of Santur, net of cash acquired, and received $21.3 million for the sale of our investment in an unconsolidated investee. During 2011, capital expenditures totaled $11.7 million.

Financing activities

Net cash provided by financing activities was $2.5 million and $34.1 million in 2013 and 2012, respectively. In 2012, the major factor was $39.6 million generated from the private placement transaction. Additionally, 2013 cash from financing activities benefitted from $7.4 million in lower net payments of bank loans and notes payable and $1.3 million in higher proceeds from the exercise of stock options and stock issued under the ESPP.

In 2012, net cash provided by financing activities was $34.1 million. Our private placement transaction generated proceeds of $39.6 million, net of offering expenses. We also received $2.1 million of proceeds from the purchase of common stock under the ESPP and the exercise of employee stock options. In addition, we received $26.0 million of proceeds from the issuance of notes payable, offset by $28.6 million of repayment of notes payable and $5.0 million of repayment of bank existing bank loans.

In 2011, net cash provided by financing activities was $102.6 million. In February 2011, we completed our initial public offering, which generated proceeds of $86.4 million, net of offering expenses. We received cash proceeds of $28.0 million from our newly amended lending arrangement, drawn by us in connection with our acquisition of Santur, which was partially offset by $14.2 million of cash used for the repayment of existing bank loans. In addition, we received $1.2 million of proceeds from the issuance of notes payable, net of repayment. We also received $0.9 million of proceeds from purchase of our equity securities pursuant to our ESPP.

Contractual obligations and commitments

The following summarizes our contractual obligations as of December 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)	$9,738	$ 9,738	$—	$—	$ —
Acquisition-related note payable (2)	9,975	3,325	6,650	—	—
Bank borrowings (3)	24,500	7,000	14,000	3,500	—
Retirement obligations (4)	5,882	200	710	1,139	3,833
Operating leases (5)	5,310	1,756	2,087	1,020	447
Purchase commitments (6)	40,000	40,000	—	—	—
Contingent consideration (7)	1,985	1,985	—	—	—
Penalty payment derivative (8)	239	—	239	—	—
Asset retirement obligations (9)	837	—	—	—	837
	98,466	64,004	23,686	5,659	5,117
Expected interest payments (10)	1,415	720	674	21	—
Total commitments	$99,881	$ 64,724	$24,360	$5,680	$ 5,117

(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 NeoPhotonics Semiconductor on March 29, 2013, we have 1,050 million Yen 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 NeoPhotonics Semiconductor. The amount in the table is presented in USD.

(3) We have a credit agreement led by Comerica Bank in the U.S., which has been amended by our lender several times as business conditions require. The amount presented in the table represents the principal portion of the

obligations. Interest is paid monthly over the term of the debt arrangement.

(4) In connection with our acquisition of NeoPhotonics Semiconductor on March 29, 2013, we assumed two defined benefit plans that provide retirement benefits to the NeoPhotonics Semiconductor employees in Japan. The net pension liability was $5.9 million as of December 31, 2013.

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

(6) This is an estimate of the amount outstanding under open purchase orders for the purchase of inventory and other goods at December 31, 2013. Certain of these open purchase orders may be cancellable without penalty.

(7) Contingent consideration is related to our acquisition of Santur.

(8) See “Private placement transaction” below and Note 14 to the Consolidated Financial Statements.

(9) We have an asset retirement obligation of $0.7 million associated with our facility lease in California which is included in other noncurrent liabilities in the consolidated balance sheet as of December 31, 2013. We also have a $0.1 million asset retirement obligation in Japan.

(10) We calculate the expected interest payments based on our outstanding notes payable, loan and debt obligations at prevailing interest rates as of December 31, 2013.

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Uncertain Tax Positions

As of December 31, 2013, the liability for uncertain tax positions was $0.2 million. We cannot conclude on the timing of cash payments associated with our uncertain tax positions.

Private placement transaction

In connection with our April 2012 common stock private placement transaction, we agreed to certain performance obligations including establishing a wholly-owned subsidiary in Russia and making a $30.0 million investment (the "Investment Obligation") towards our Russian operations. The Investment Obligation can be partially satisfied by cash and/or stock investment inside or outside of Russia and/or by way of non-cash asset transfers, including but not limited to capital equipment, small tools, intellectual property, and other intangibles. A minimum of $15.0 million of the Investment Obligation is required to be satisfied by making capital expenditure investments and we expect that the remaining $15.0 million will be satisfied through cash and non-cash general working capital and research and development expenditures and commitments. All of the amount for general working capital can be spent either inside or outside of Russia. However, at least 80% of the amount expended for research and development must be spent inside Russia. General working capital can include cash or stock acquisition of other businesses or portions thereof to be owned by the Russian subsidiary.

Our current plan is to substantially meet the $15.0 million capital expenditure portion of the Investment Obligation by transferring non-cash assets from other entities within the consolidated Company to the Russian subsidiary, subject to the purchaser's approval as required in the rights agreement. We expect that the remaining $15.0 million will be satisfied through some combination of working capital and research and development spending, which may include technology or other acquisitions acquired by cash or stock through March 2015. The exact timing and composition of those expenditures has not yet been determined. There are no legal restrictions on the specific usage of amounts received in the private placement transaction or on withdrawal from our bank accounts for use in general corporate purposes.

We are required to satisfy the Investment Obligation by July 31, 2014, or, in the event we have not recorded aggregate revenue from sales of our products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014, then by March 31, 2015. We expect the date for achievement of the Investment Obligation will be extended to March 31, 2015. Therefore, we intend to meet the Investment Obligation by March 31, 2015. If we fail to meet the Investment Obligation by the deadline, including failure to meet the Investment Obligation because the purchaser of the common stock does not approve the transfer of non-cash assets, we will be required to pay a $5.0 million penalty as the sole and exclusive remedy for damages and monetary relief available to the purchaser for failure to meet the Investment Obligation.

Off-balance sheet arrangements

During the years ended December 31, 2013, and 2012, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K.

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.

As this guidance only requires expanded disclosures, the adoption of this guidance did not have a material effect on our 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 were effective prospectively for fiscal years beginning after December 15, 2013. Early adoption is permitted. The adoption of this guidance did not have an impact on our consolidated financial statements.

In July 2013, the FASB issued amendments to the FASB Accounting Standard Codification on Income Taxes, to improve the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance is expected to reduce diversity in practice and is expected to better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. This guidance is effective for reporting periods beginning after December 15, 2013. The adoption of this guidance did not have an impact on our consolidated financial statements.

In April 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU 2014-08") which raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. ASU 2014-08 is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals that have not been reported in financial statements previously issued. We are currently in the process of evaluating the impact of the adoption on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. We are in the process of evaluating the impact of adoption on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate fluctuation risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. To achieve this objective, we invest our excess cash in a variety of securities, including U.S. government agency securities, corporate notes and bonds and money market funds meeting certain criteria. These securities are classified as available-for-sale which are recorded on the balance sheet at fair value. We have determined that the gross unrealized gains or losses on the available-for-sale securities at December 31, 2013 are temporary in nature. We may sell these marketable securities investments in the future to fund future operating needs. As a result, we recorded all our marketable securities in short-term investments as of December 31, 2013, regardless of the contractual maturity date of the securities.

As of December 31, 2013 we had $24.5 million outstanding under our U.S. credit facilities, which was subject to fluctuations in interest rates. For the year ended December 31, 2013, a hypothetical 10% increase in the interest rate could result in approximately $71,000 of additional annual interest expense. The hypothetical assumptions made above will be different from what actually occurs in the future. Furthermore, the computations do not anticipate actions that may be taken by our management should the hypothetical market changes actually occur over time. As a result, actual impacts on our results of operations in the future will differ from those quantified above.

Foreign currency exchange risk

Foreign currency exchange rates are subject to fluctuation and may cause us to recognize transaction gains and losses in our statements of operations. A large portion of our business is conducted through our subsidiaries in China, whose functional currency is the RMB and, to a lesser extent in 2013, Japan, whose functional currency is the JPY. To the extent that transactions by these subsidiaries are in currencies other than their functional currencies, we bear the risk that fluctuations in the exchange rates of the RMB and JPY in relation to other currencies could decrease our revenue and increase our costs and expenses. During the year ended December 31, 2013, we recognized foreign currency transaction gains of $0.9 million. We use the U.S. dollar as the reporting currency for our consolidated financial statements. Any significant revaluation of the RMB or JPY may materially and adversely affect our results of operations upon translation of these subsidiaries' financial statements into U.S. dollars. While we generate a significant portion of our revenue in RMB and JPY, a majority of our operating expenses are in U.S. dollars. Therefore depreciation in RMB or JPY against the U.S. dollar would negatively impact our revenue upon translation to U.S. dollars but the impact on operating expenses would be less. For example, for the year ended December 31, 2013, a 10% depreciation in RMB against the U.S. dollar would have resulted in a $7.8 million decrease in our revenue and a $0.2 million increase in our net loss and a 10% depreciation in JPY would have resulted in a $0.8 million decrease in our revenue and a $0.03 million increase in our net loss.

In connection with the NeoPhotonics Semiconductor acquisition in March 2013, we recorded a note payable of $11.1 million. The payment is denominated in Japanese Yen. Any currency fluctuations may impact our results of operations.

To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedging transactions may be limited and we may not be able to successfully hedge our exposure. In addition, our currency exchange variations may be magnified by any Chinese exchange control regulations that restrict our ability to convert RMB into foreign currency.

Inflation risk

Inflationary factors, such as increases in our cost of goods sold and operating expenses, may adversely affect our results of operations. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, an increase in the rate of inflation in the future, particularly in China, may have an adverse effect on our levels of gross profit and operating expenses as a percentage of revenue if the sales prices for our products do not proportionately increase with these increased expenses.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of NeoPhotonics Corporation

San Jose, CA

We have audited the accompanying consolidated balance sheet of NeoPhotonics Corporation and subsidiaries (the "Company") as of December 31, 2013, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such 2013 consolidated financial statements present fairly, in all material respects, the financial position of NeoPhotonics Corporation and subsidiaries at December 31, 2013, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on the criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 3, 2014 expressed an adverse opinion on the Company's internal control over financial reporting because of material weaknesses.

/s/ DELOITTE & TOUCHE LLP

San Jose, CA

June 3, 2014

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of NeoPhotonics Corporation:

In our opinion, the consolidated balance sheet as of December 31, 2012 and the related consolidated statements of operations, comprehensive loss, redeemable convertible preferred stock and stockholders' equity and cash flows for each of two years in the period ended December 31, 2012 present fairly, in all material respects, the financial position of NeoPhotonics Corporation and its subsidiaries at December 31, 2012, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/PricewaterhouseCoopers LLP

San Jose, California

March 15, 2013, except for the effects of the revision discussed in Note 1 to the consolidated financial statements, as to which the date is May 30, 2014

NEOPHOTONICS CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)	December 31, 2013	2012 Revised, see Note 1
ASSETS		
Current assets:		
Cash and cash equivalents	$57,101	$ 36,940
Short-term investments	17,916	64,301
Restricted cash	2,138	2,626
Accounts receivable, net of allowance for doubtful accounts of $531 and $963 at December 31, 2013 and 2012, respectively	64,533	70,354
Inventories	64,908	43,793
Prepaid expenses and other current assets	9,977	7,630
Total current assets	216,573	225,644
Property, plant and equipment, net	68,851	54,440
Purchased intangible assets, net	15,005	14,213
Other long-term assets	1,798	1,335
Total assets	$302,227	$ 295,632
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$48,569	$ 36,308
Notes payable	9,738	12,003
Current portion of long-term debt	10,325	5,000
Accrued and other current liabilities	23,643	19,959
Total current liabilities	92,275	73,270
Long-term debt, net of current portion	24,150	17,167
Deferred income tax liabilities	1,004	653
Other noncurrent liabilities	7,987	1,862
Total liabilities	125,416	92,952
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $0.0025 par value, 10,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock, $0.0025 par value, 100,000,000 shares authorized		
At December 31, 2013, 31,571,584 shares issued and outstanding; At December 31, 2012, 30,546,155 shares issued and outstanding	79	76
Additional paid-in capital	447,467	438,858
Accumulated other comprehensive income	11,687	11,829
Accumulated deficit	(282,422)	(248,083)
Total stockholders' equity	176,811	202,680
Total liabilities and stockholders' equity	$302,227	$ 295,632

See accompanying Notes to Consolidated Financial Statements.

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NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)	Years ended December 31, 2013	2012	2011
Revenue	$282,242	$245,423	$201,029
Cost of goods sold	217,069	184,163	150,944
Gross profit	65,173	61,260	50,085
Operating expenses:			
Research and development	45,853	38,288	30,855
Sales and marketing	14,242	13,241	11,686
General and administrative	30,012	24,361	20,911
Acquisition-related transaction costs	5,406	1,447	989
Amortization of purchased intangible assets	1,532	1,316	994
Adjustment to fair value of contingent consideration	1,026	(554)	(1,287)
Goodwill impairment charges	—	—	13,106
Restructuring charges	775	68	1,297
Total operating expenses	98,846	78,167	78,551
Loss from operations	(33,673)	(16,907)	(28,466)
Interest income	348	592	407
Interest expense	(996)	(568)	(422)
Other income (expense), net	1,186	575	14,246
Total interest and other income (expense), net	538	599	14,231
Loss before income taxes	(33,135)	(16,308)	(14,235)
Provision for income taxes	(1,204)	(1,364)	(1,155)
Loss from continuing operations	(34,339)	(17,672)	(15,390)
Income from discontinued operations, net of tax	—	142	636
Net loss	(34,339)	(17,530)	(14,754)
Deemed dividend on beneficial conversion of Series X redeemable convertible preferred stock	—	—	(17,049)
Accretion of redeemable convertible preferred stock	—	—	(7)
Net loss attributable to NeoPhotonics Corporation common stockholders	$(34,339)	$(17,530)	$(31,810)
Basic and diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:			
Continuing operations	$(1.11)	$(0.62)	$(1.45)
Discontinued operations	$—	$—	$0.03
Net loss	$(1.11)	$(0.62)	$(1.42)
Basic and diluted weighted average shares used to compute net loss per share attributable to NeoPhotonics Corporation common stockholders	31,000,325	28,529,849	22,359,802

See accompanying Notes to Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)	2013	2012	2011
Net loss	$(34,339)	$(17,530)	$(14,754)
Other comprehensive income (loss)			
Foreign currency translation adjustments (net of zero tax)	41	101	3,265
Unrealized gains (losses) on available-for-sale securities (net of zero tax)	(65)	375	(307)
Defined benefit pension plans adjustment (net of tax of $73)	(118)	—	—
Unrealized gain on equity investment (net of zero tax)	—	—	8,291
Less: Reclassification adjustment for gain on sale of equity investment included in net income (net of zero tax)	—	—	(12,703)
Total other comprehensive income (loss)	(142)	476	(1,454)
Comprehensive loss	$(34,481)	$(17,054)	$(16,208)

See accompanying Notes to Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY

	Redeemable convertible preferred stock		Common stock					
(In thousands, except share data)	Shares	Amount	Shares	Amount	Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Total stockholders' equity
Balances at December 31, 2010	6,658,010	$211,541	1,955,280	$5	$93,349	$12,807	$(215,799)	$(109,638)
Comprehensive loss						(1,454)	(14,754)	(16,208)
Accretion of preferred stock to redemption value	—	7	—	—	(7)	—	—	(7)
Deemed dividend on beneficial conversion of Series X redeemable convertible preferred stock	—	17,049	—	—	(17,049)	—	—	(17,049)
Issuance of common stock upon initial public offering at $11.00 per share, net of issuance costs of $4,263	—	—	8,625,000	22	83,949	—	—	83,971
Conversion of preferred stock into shares of common stock	(6,658,010)	(228,597)	14,038,489	35	228,562	—	—	228,597
Issuance of common stock upon exercise of stock options	—	—	79,144	—	340	—	—	340
Repurchase of common stock	—	—	(51)	—	—	—	—	—
	—	—	164,723	—	863	—	—	863

Issuance of common stock under employee stock purchase plan								
Vesting of early exercised stock options	—	—	—	—	19	—	—	19
Stock-based compensation expense	—	—	—	—	2,766	—	—	2,766
Balances at December 31, 2011	—	—	24,862,585	62	392,792	11,353	(230,553)	173,654
Comprehensive loss	—	—	—	—	—	476	(17,530)	(17,054)
Initial public offering cost adjustment	—	—	—	—	63	—	—	63
Issuance of common stock for investment (revised, see Note 1)	—	—	4,972,905	12	39,389	—	—	39,401
Issuance of common stock upon exercise of stock options	—	—	190,554	1	101	—	—	102
Issuance of common stock under employee stock purchase plan	—	—	520,111	1	1,865	—	—	1,866
Stock-based compensation expense	—	—	—	—	4,648	—	—	4,648
Balances at December 31, 2012	—	—	30,546,155	76	438,858	11,829	(248,083)	202,680
Comprehensive loss	—	—	—	—	—	(142)	(34,339)	(34,481)
Issuance of common stock upon exercise of stock options	—	—	260,604	1	1,212	—	—	1,213
Issuance of common stock under employee stock purchase plan	—	—	487,856	2	2,155	—	—	2,157
	—	—	276,969	—	—	—	—	—

Issuance of common stock for vested restricted stock units								
Tax withholding related to vesting of restricted stock units	—	—	—	—	(565)	—	—	(565)
Stock-based compensation expense	—	—	—	—	5,807	—	—	5,807
Balances at December 31, 2013	—	$—	31,571,584	$ 79	$ 447,467	$ 11,687	$ (282,422)	$ 176,811

See accompanying Notes to Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
(In thousands)	2013	2012	2011
Cash flows from operating activities			
Net loss	$(34,339)	$(17,530)	$(14,754)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	20,381	18,716	12,931
Goodwill impairment charges	—	—	13,106
Stock-based compensation expense	5,736	4,777	3,156
Deferred taxes	(469)	221	(452)
Investment-related amortization and accrued interest	1,003	585	345
Loss on disposal of property and equipment	710	152	224
Adjustment to fair value of contingent consideration	1,026	(554)	(1,287)
Adjustment to fair value of penalty payment derivative	101	—	—
Gain on sale of an unconsolidated investee, net of direct cost	—	—	(13,867)
Gain on discontinued operations	—	(750)	—
Allowance for doubtful accounts	(253)	312	535
Write-down of inventories	3,207	3,132	680
Others	(667)	—	—
Change in assets and liabilities, net of effects of acquisitions:			
Accounts receivable	7,234	(1,802)	(2,750)
Inventories	(10,458)	(11,828)	(8,508)
Prepaid expenses and other assets	(1,795)	(199)	1,795
Accounts payable	7,712	(2,992)	(452)
Accrued and other liabilities	5,382	(1,030)	(3,212)
Net cash provided by (used in) operating activities	4,511	(8,790)	(12,510)
Cash flows from investing activities			
Purchase of property, plant and equipment	(19,566)	(12,738)	(11,677)
Proceeds from disposition of property, plant and equipment	92	—	—
Purchase of marketable securities	(58,860)	(155,887)	(172,972)
Proceeds from sale of marketable securities	53,847	104,258	113,909
Proceeds from maturity of securities	50,358	40,935	4,623
Decrease (increase) in restricted cash	561	608	(48)
Acquisitions, net of cash acquired	(13,128)	—	(38,986)
Proceeds received on sale of discontinued operations, net of tax	—	1,825	—
Proceeds from sale of an unconsolidated investee	—	—	21,288
Net cash provided by (used in) investing activities	13,304	(20,999)	(83,863)
Cash flows from financing activities			
Proceeds from initial public offering of common stock, net of issuance costs	—	—	86,412
Proceeds from issuance of common stock, net of issuance costs	—	39,636	—
Proceeds from exercise of stock options and issuance of stock under ESPP	3,370	2,070	1,204
Tax withholding on restricted stock units	(565)	—	—
Proceeds from bank loans	26,443	—	28,000

Repayment of bank loans	(24,110)	(5,000)	(14,214)
Proceeds from issuance of notes payable	19,543	25,959	29,390
Repayment of notes payable	(22,166)	(28,601)	(28,157)
Net cash provided by financing activities	2,515	34,064	102,635
Effect of exchange rates on cash and cash equivalents	(169)	180	758
Net increase in cash and cash equivalents	20,161	4,455	7,020
Cash and cash equivalents at the beginning of the period	36,940	32,485	25,465
Cash and cash equivalents at the end of the period	$57,101	$36,940	$32,485
Supplemental disclosure of cash flow information:			
Cash paid for interest	$837	$571	$368
Cash paid for income taxes	1,013	531	1,532
Supplemental disclosure of noncash investing and financing activities:			
Changes in accounts payable and accrued liabilities related to property and equipment purchases	(1,397)	2,551	986
Issuance of notes to the seller of acquired business	11,130	—	—
Accretion of redeemable convertible preferred stock	—	—	7
Conversion of preferred stock to common stock upon IPO	—	—	228,597

See accompanying Notes to Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and basis of presentation

Business and organization

NeoPhotonics Corporation and its subsidiaries (NeoPhotonics or the Company) is a leading designer and manufacturer of PIC-based modules and subsystems for bandwidth-intensive, high-speed communications networks.

Certain Significant Risks and Uncertainties

The Company operates in a dynamic industry and, accordingly, can be affected by a variety of factors. For example, any of the following areas could have a negative effect on the Company in terms of its future financial position, results of operations or cash flows: the general state of the U.S. and world economies, the highly cyclical nature of the industries the Company serves; the loss of any of a small number of its larger customers; ability to obtain additional financing; inability to meet certain debt covenants; failure to successfully integrate completed acquisitions; fundamental changes in the technology underlying the Company's products; the hiring, training and retention of key employees; successful and timely completion of product design efforts; and new product design introductions by competitors.

Revision of Prior Period Balance Sheet

As further described in Note 14, the Company may be required to pay a $5.0 million penalty if it does not achieve certain performance obligations agreed to in connection with the sale of its common stock in a private placement transaction in April 2012. The penalty payment was originally classified outside of equity as redeemable common stock at December 31, 2012 since, while the Company intends to meet its performance obligations, it determined the ability to satisfy some of the obligations may be outside of the Company's control. The Company has since determined that the $5.0 million penalty payment is an embedded derivative instrument, with the underlying being the performance or nonperformance of meeting its performance obligations by the deadline, and has revised to correctly classify $4.9 million of the $5.0 million to additional paid-in capital and the remaining $0.1 million, representing the estimated fair value of the penalty payment derivative, to other noncurrent liabilities at December 31, 2012. The Company has assessed the impact of the correction on the 2012 interim and annual consolidated balance sheets and has concluded that the correction is not material to the previously reported consolidated balance sheets. The effect on the Company's balance sheet at December 31, 2012 for this matter was as follows:

	December 31, 2012	
(in thousands)	Previously Reported	As Revised
Other noncurrent liabilities	$ 1,724	$ 1,862
Redeemable common stock	5,000	—
Additional paid-in capital	433,996	438,858

Discontinued operations

In January 2012, the Company entered into a purchase agreement with a third party to divest its 100% equity interest in Shenzhen Photon Broadband Technology Co., Ltd. (Broadband), a subsidiary in China, for a total cash consideration of RMB 13.0 million ($2.1 million), and the transaction closed in March 2012. As such, the results of operations associated with Broadband are presented as discontinued operations in the Company's consolidated statements of operations for 2011 and 2012. Unless otherwise indicated, all discussions herein relate to the Company's continuing operations.

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

2. Summary of significant accounting policies

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; fair values of identifiable assets acquired and liabilities assumed in business combinations; allowances for doubtful accounts; valuation allowances for deferred tax assets; write off of excess and obsolete inventories and the valuations and recognition of stock-based compensation, among others. Actual results could differ from these estimates.

Concentration of credit risk and significant customers

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily cash and cash equivalents and trade accounts receivable. The Company’s investment policy requires cash and cash equivalents to be placed with high-credit quality institutions and limits on the amount of credit risk from any one issuer. The Company performs ongoing credit evaluations of its customers’ financial condition whenever deemed necessary and generally does not require collateral. The Company maintains an allowance for doubtful accounts based upon the expected collectability of all accounts receivable, which takes into consideration an analysis of historical bad debts, specific customer creditworthiness and current economic trends.

For the year ended December 2013, three customers accounted for 27%, 16% and 14% of the Company’s total revenue. For the year ended December 31, 2012, three customers accounted for 36%, 16% and 15% of the Company’s total revenue. For the year ended December 31, 2011, a single customer accounted for 51% of the Company’s total revenue. No other customers accounted for 10% or more of total revenue in any year presented.

As of December 31, 2013, two customers accounted for 14% and 10% for the Company’s total accounts receivable and as of December 31, 2012, two customers accounted for 42% and 16% of the Company’s total accounts receivable. No other customers accounted for 10% or more of total accounts receivable as of December 31, 2013 or 2012.

Restricted cash

As a condition of the notes payable lending arrangements of the Company’s subsidiaries in China, these subsidiaries 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. These balances have been excluded from the Company’s cash and cash equivalents balance and are classified as restricted cash on the Company’s consolidated balance sheets. As of December 31, 2013 and 2012, the amount of restricted cash was $2.1 million and $2.6 million, respectively.

Cash, cash equivalents and investments

Highly liquid investments with a maturity of 90 days or less at the date of purchase are considered cash equivalents. Cash and cash equivalents consist primarily of bank deposits. The Company’s policy is to classify money market accounts as short-term investments other than minor amounts included in cash equivalents for administrative purposes.

The Company regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is other-than-temporary include: the length of time and extent to which the fair market value has been lower than the cost basis, the financial condition and near-term prospects of the investee, credit quality, likelihood of recovery, and the Company’s ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair market value.

Unrealized gains and losses, net of tax, are included in accumulated other comprehensive income as a separate component of stockholders’ equity on the consolidated balance sheets. The amortization of premiums and discounts on the investments, and realized gains and losses on available-for-sale securities are included in other income (expense), net in the consolidated statements of operations. The Company uses the specific-identification method to determine cost in calculating realized gains and losses upon sale of its marketable securities.

Marketable securities are reported at fair value and are classified as available-for-sale investments in our current assets because they represent investments of cash available for current operations.

Fair Value Measurements

Fair value is defined as the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are applied. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency for the instruments or market and the instruments' complexity. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The authoritative accounting guidance describes a fair value hierarchy based on three levels of inputs that may be used to measure fair value, of which the first two are considered observable and the last is considered unobservable. These levels of inputs are as follows:

Level 1—Observable inputs such as unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2—Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3—Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

For marketable securities measured at fair value using Level 2 inputs, we review trading activity and pricing for these investments as of the measurement date. When sufficient quoted pricing for identical securities is not available, we use market pricing and other observable market inputs for similar securities obtained from various third party data providers. These inputs either represent quoted prices for similar assets in active markets or have been derived from observable market data.

Accounts receivable

Accounts receivable include trade receivables and notes receivable from customers. The Company receives notes receivable in exchange for accounts receivable from certain customers in China that are secured by the customer's affiliated financial institution. The notes are generally due within 6 months.

An allowance for doubtful accounts is calculated based on the aging of the Company's trade receivables, historical experience, and management judgment. The Company writes off trade receivables against the allowance when management determines a balance is uncollectible and no longer actively pursues collection of the receivable.

Inventories

Inventories consist of on-hand raw materials, work-in-progress inventories and finished goods. Raw materials and work-in-process inventories are stored mainly on the Company's premises. Finished goods are stored on the Company's premises as well as on consignment at certain customer sites.

Inventories are stated at the lower of standard cost, which approximates actual cost determined on the weighted average basis, or market value. Inventories are recorded using the first-in, first-out method. The Company routinely evaluates quantities and values of inventories in light of current market conditions and market trends, and records a write-down for quantities in excess of demand and product obsolescence. The evaluation may take into consideration historic usage, expected demand, anticipated sales price, new product development schedules, the effect new products might have on the sale of existing products, product obsolescence, customer concentrations, product merchantability and other factors. Market conditions are subject to change and actual consumption of inventory could differ from forecasted demand. The Company also regularly reviews the cost of inventories against their estimated market value and records a lower of cost or market write-down for inventories that have a cost in excess of estimated market value, resulting in a new cost basis for the related inventories which is not reversed.

Business Combinations

We allocate the fair value of purchase consideration to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets.

Fair value estimates are based on the assumptions management believes a market participant would use in pricing the asset or liability. Critical estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from customer relationships and acquired patents and developed technology; and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates.

Amounts recorded in a business combination may change during the measurement period, which is a period not to exceed one year from the date of acquisition, as additional information about conditions existing at the acquisition date becomes available.

Goodwill

Goodwill is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value of goodwill may not be recoverable. The Company will first assess the qualitative factors to determine whether it is more likely than not that the fair value of our single reporting operating unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment under Accounting Standards Update (ASU) No. 2011-08, Goodwill and Other (Topic 350): Testing Goodwill for Impairment, issued by the Financial Accounting Standards Board (FASB). If the Company determines that it is more likely than not that its fair value is less than its carrying amount, then the two-step goodwill impairment test is performed. The first step, identifying a potential impairment, compares the fair value of the reporting unit with its carrying amount. If the carrying amount exceeds its fair value, the second step would need to be performed; otherwise, no further steps are required. The second step, measuring the impairment loss, compares the implied fair value of the goodwill with the carrying amount of the goodwill. Any excess of the goodwill carrying amount over the applied fair value is recognized as an impairment loss, and the carrying value of goodwill is written down to fair value. The Company recognized a goodwill impairment charge of $13.1 million in 2011 and did not have any goodwill on its consolidated balance sheets at December 31, 2013 or 2012.

Long-lived assets

Property, plant and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the following estimated useful lives:

Buildings	20-30 years
Machinery and equipment	2-7 years
Furniture, fixtures and office equipment	3-5 years
Software	5-7 years
Leasehold improvements	life of the asset or lease term, if shorter

Repairs and maintenance costs are expensed as incurred.

Intangible assets acquired in a business combination are recorded at fair value. Identifiable finite-lived intangible assets are amortized over the period of estimated benefit using the straight-line method, reflecting the pattern of economic benefits associated with these assets. The estimated useful lives of the Company's intangible assets generally range from five to seven years, except for acquired land use rights in China, which have an estimated useful life of 45 years.

The carrying value of intangible assets and other long-lived assets is reviewed on a regular basis for the existence of facts or circumstances, both internally and externally, that may suggest impairment. Some factors which the Company considers to be triggering events for impairment review include a significant decrease in the market value of an asset, a significant change in the extent or manner in which an asset is used, a significant adverse change in the business climate that could affect the value of an asset, an accumulation of costs for an asset in excess of the amount originally expected, a current period operating loss or cash flow decline combined with a history of operating loss or cash flow uses or a projection that demonstrates continuing losses and a current expectation that, it is more likely than not, a long-lived asset will be disposed of at a loss before the end of its estimated useful life.

If one or more of such facts or circumstances exist, the Company will evaluate the carrying value of long-lived assets to determine if impairment exists, by comparing it to estimated undiscounted future cash flows over the remaining useful life of the assets. If the carrying value of the assets is greater than the estimated future cash flow, the assets are written down to the estimated fair value. The Company's cash flow estimates contain management's best estimates, using appropriate and customary assumptions and projections at the time. Any write-down would be treated as a permanent reduction in the carrying amount of the asset and an operating loss would be recognized.

Revenue recognition

Revenue is derived from the sale of the Company's products. The Company recognizes revenue provided that persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectability is reasonably assured. Contracts and/or customer purchase orders are used to determine the existence of an arrangement. Delivery is considered to have occurred when title and risk of loss have transferred to the customer. The price is equal to the amount invoiced to the customer and is not subject to adjustment and customers do not have the right of return. The Company evaluates the creditworthiness of its customers to determine that appropriate credit limits are established prior to the acceptance of an order.

Revenue is recognized when the product is shipped and title has transferred to the buyer. The Company bears all costs and risks of loss or damage to the goods up to that point. On most orders, the Company's shipment terms provide that title passes to the buyer upon shipment by the Company. Other shipment terms may provide that title passes to the buyer upon delivery of the goods to the buyer. Revenue related to the sale of consignment inventory at customer vendor managed locations is not recognized until the product is pulled from inventory stock by customers. Shipping and handling costs are included in the cost of goods sold. The Company presents revenue net of sales taxes and any similar assessments.

Product warranties

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.

Research and development

Research and development expense consists of personnel costs, including stock-based compensation expense, for the Company's research and development personnel and product development costs, including engineering services, development software and hardware tools, depreciation of capital equipment and facility costs. Research and development costs are expensed as incurred.

Advertising costs

Advertising costs are expensed as incurred and, to date, have not been significant.

Stock-based compensation

The Company grants stock options, stock purchase rights, stock appreciation units and restricted stock units to employees, consultants and directors. The stock-based awards are accounted for at fair value.

The Company generally determines the fair value of stock options on the date of grant utilizing the Black-Scholes-Merton option-pricing model. The fair value of the options is recognized over the period during which an employee is required to provide services in exchange for the option award, known as the requisite service period (usually the vesting period) on a straight-line basis.

Stock purchase rights are accounted for at fair value, utilizing the Black-Scholes-Merton option-pricing model. The expense for each purchase period is recognized on a straight-line basis over the requisite service period, from the beginning of the offering period through the respective purchase date.

The Company records an expense (credit) and an equal adjustment to the liability for stock appreciation units equal to the fair value of the vested portion of the awards as of each period end. Each reporting period thereafter, compensation expense will be recorded, based on the remaining service period and the then fair value of the award until vesting of the award is completed. After vesting is completed, the Company will continue to re-measure the fair value of the liability until the award is exercised or expires, with changes in the fair value of the liability recorded in the consolidated statements of operations.

Restricted stock units are valued at the closing sales price as quoted on the New York Stock Exchange on the date of grant, and are converted into shares of common stock upon vesting on a one-for-one basis. Vesting of restricted stock units is subject to the employee's continuing service to the Company. The compensation expense related to the restricted stock units is determined using the fair value of common stock on the date of grant, and the expense is recognized on a straight-line basis over the vesting period.

Stock-based compensation expense recognized at fair value includes the impact of estimated forfeitures. The Company estimates future forfeitures at the date of grant and revises the estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Income taxes

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, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in the consolidated statement of operations in the period that includes the enactment date.

The Company operates in various tax jurisdictions and is subject to audit by various tax authorities. In preparing the Company’s consolidated financial statements, the Company is required to estimate its taxes in each of the jurisdictions in which it operates. The Company estimates actual current tax exposure as well as assesses temporary differences resulting from different treatment of items, such as accruals and allowances not currently deductible for tax purposes. These differences result in deferred tax assets which represent future tax benefits to be received when certain expenses previously recognized in the financial statements become deductible expenses under applicable income tax laws, or loss credit carryforwards are utilized.

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.

Foreign currency

Generally the functional currency of the Company’s international subsidiaries is the local currency. The Company translates the financial statements of these subsidiaries to U.S. dollars using month-end rates of exchange for assets and liabilities, and average rates of exchange for revenue, costs, and expenses. Translation gains and losses are recorded in accumulated other comprehensive income as a component of stockholders’ equity. Net gains (losses) resulting from foreign exchange transactions were $0.9 million, ($0.2) million, and ($0.1) million for the years ended December 31, 2013, 2012, and 2011, respectively. These gains and losses were recorded as other income (expense), net in our consolidated statements of operations.

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

The Company applies the two-class method for calculating and presenting net income (loss) per share attributable to NeoPhotonics Corporation common stockholders. Under the two-class method, net income (loss) is allocated between common shares and other participating securities based on their participating rights. Participating securities are defined as securities that participate in dividends with common shares according to a predetermined formula. Basic net income (loss) per share attributable to NeoPhotonics Corporation common stockholders is calculated by dividing net income (loss) attributable to NeoPhotonics Corporation common stockholders by the weighted average number of shares outstanding for the period. Diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders is calculated by dividing net income (loss) attributable to NeoPhotonics Corporation common stockholders and income allocable to participating securities to the extent it is dilutive, by the weighted average number of common shares and potential dilutive common share equivalents outstanding during the period if the effect is dilutive.

Recent accounting pronouncements

In February 2013, the 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. 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 were effective prospectively for fiscal years beginning after December 15, 2013. Early adoption is permitted. The adoption of this guidance did not have an impact on the Company’s consolidated financial statements.

In July 2013, the FASB issued amendments to the FASB Accounting Standard Codification on Income Taxes, to improve the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance is expected to reduce diversity in practice and is expected to better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. This guidance was effective for reporting periods beginning after December 15, 2013. The adoption of this guidance did not have an impact on the Company’s consolidated financial statements.

In April 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU 2014-08") which raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. ASU 2014-08 is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals that have not been reported in financial statements previously issued. The Company is currently in the process of evaluating the impact of the adoption on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

3. Discontinued Operations

The Company entered into a purchase agreement to dispose of its 100% equity interest in Shenzhen Photon Broadband Technology Co., Ltd. (“Broadband”), a subsidiary in China, for 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 the buyer, net of tax, which was included in its consolidated statement of operations in 2012.

The results of operations associated with Broadband are presented as discontinued operations in the Company’s consolidated statements of operations for the years ended December 31, 2012 and 2011. Revenue and the components of net income related to the discontinued operations were as follows (in thousands):

	2012	2011
Revenue	$590	$5,085
Income from discontinued operations before income taxes	$256	$318
Benefit from (provision for) income taxes	(114)	318
Net income from discontinued operations	$142	$636

4. Cash, cash equivalents and short-term investments

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

	As of December 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	$ —	$ —	$11	$11	$ —	$ —	$11
Short-term investments								
Money market funds	4,577	—	—	4,577	7,259	—	—	7,259
Corporate bonds	6,708	3	(5)	6,706	23,151	43	(1)	23,193
U.S. federal agencies	—	—	—	—	27,241	10	—	27,251
Foreign bonds and notes	4,827	5	—	4,832	4,682	14	—	4,696
Variable rate demand notes	1,801	—	—	1,801	1,902	—	—	1,902
Total short-term investments	17,913	8	(5)	17,916	64,235	67	(1)	64,301
Total	$17,924	$ 8	$ (5)	$17,927	$64,246	$ 67	$ (1)	$64,312

Realized gains and losses on the sale of marketable securities during the years ended December 31, 2013 and 2012 were immaterial. Variable rate demand notes (VRDNs) are floating rate municipal bonds with embedded put options that allow the bondholder to sell the security at par plus accrued interest. All of the put options are secured by a pledged liquidity source. While they are classified as short-term investments, the put option allows the VRDNs to be liquidated at par on a seven day settlement basis.

The following table summarizes the estimated fair value of the short-term investments in marketable securities designated as available-for-sale and classified by the contractual maturity date of the security as of December 31, 2013 and 2012 (in thousands):

	December 31, 2013	December 31, 2012
Less than 1 year	$ 14,118	$ 51,861
Due in 1 to 2 years	2,008	10,550
Due in 2 to 5 years	—	—
Due after 5 years	1,801	1,901
Total	$ 17,927	$ 64,312

There were no securities in a continuous loss position for 12 months or longer as of December 31, 2013 or 2012.

Other investments

In the second quarter of 2011, the Company sold all of its shares in Ignis, a Norwegian company, for gross proceeds of $21.3 million and recognized a gain of $13.8 million. The gain was included in other income (expense), net in the Company’s consolidated statement of operations for the year ended December 31, 2011.

5. Fair value measurements

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the Company's assets that are measured at fair value on a recurring basis (in thousands):

	As of December 31, 2013				As of December 31, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash, cash equivalents and short-term investments:								
Money market funds	$4,588	$—	$ —	$4,588	$7,270	$—	$ —	$7,270
Corporate bonds	—	6,706	—	6,706	—	23,193	—	23,193
U.S. federal agencies	—	—	—	—	—	27,251	—	27,251
Foreign bonds and notes	—	4,832	—	4,832	—	4,696	—	4,696
Variable rate demand notes	—	1,801	—	1,801	—	1,902	—	1,902
Mutual funds held in Rabbi Trust	442	—	—	442	188	—	—	188

Additionally, the Company's cash equivalents at December 31, 2013 and 2012 included time deposits of $6.5 million and $14.7 million, respectively, for which the fair value approximates the carrying amount using inputs classified as level 2 in the fair value hierarchy.

The Company offers a Non-Qualified Deferred Compensation Plan ("NQDC Plan") to a select group of its highly compensated employees. The NQDC Plan provides participants the opportunity to defer payment of certain compensation as defined in the NQDC Plan. A Rabbi Trust has been established to fund the NQDC Plan obligation, which was fully funded at December 31, 2013. The assets held by the Rabbi Trust are substantially in the form of exchange traded mutual funds and are included in the Company's other long-term assets on its consolidated balance sheets at December 31, 2013 and 2012.

The following table presents the Company's liabilities that are measured at fair value on a recurring basis (in thousands):

	As of December 31, 2013				As of December 31, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Contingent consideration (Note 13)	$—	$ —	$1,985	$1,985	$—	$ —	$ 959	$959
Penalty payment derivative (Note 14)	$—	$ —	$239	$239	$—	$ —	$ 138	$138

There were no transfers between levels of the fair value hierarchy during either 2013 or 2012.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain of the Company's assets, including intangible assets and goodwill are re-measured at fair value if impairment is indicated.

During 2011, the Company recorded a goodwill impairment charge of $13.1 million (See Note 8). This fair value measurement was calculated using unobservable inputs, using both the income and market approach, which are classified as Level 3 within the fair value hierarchy. Inputs for the income approach included the amount and timing of future cash flows based on the Company's operational budgets, strategic plans, terminal growth rates assumptions and other estimates. The primary input for the market approach included market multiples for guideline companies that operate in a similar business environment.

Assets and Liabilities Not Measured at Fair Value

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and notes payable approximate their fair values due to the short-term nature and liquidity of these financial instruments.

The fair values of the Company's long-term debt have been calculated using an estimate of the interest rate the Company would have had to pay on the issuance of liabilities with a similar maturity and discounting the cash flows at that rate which it considers to be a level 2 fair value measurement. The fair values do not necessarily give an indication of the amount that the Company would currently have to pay to extinguish any of this debt.

The fair value of the Company's variable rate bank borrowings was not materially different than its carrying value at December 31, 2013 as the interest rates approximated rates currently available to the Company and was approximately $21.2 million (carrying value of $22.2 million) at December 31, 2012. The fair value of the Company's acquisition-related debt was approximately $10.0 million (carrying value of $9.975 million) at December 31, 2013.

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

The following table sets forth the computation of the basic and diluted loss per share attributable to NeoPhotonics Corporation common stockholders for the periods indicated (in thousands, except share and per share amounts):

	Years ended December 31,		
	2013	2012	2011
Numerator:			
Loss from continuing operations	$(34,339)	$(17,672)	$(15,390)
Less: Accretion of redeemable convertible preferred stock	—	—	(7)
Less: deemed dividend on beneficial conversion of Series X redeemable convertible preferred stock	—	—	(17,049)
Loss from continuing operations attributable to NeoPhotonics Corporation common stockholders	(34,339)	(17,672)	(32,446)
Income from discontinued operations	—	142	636
Loss attributable to NeoPhotonics Corporation common stockholders	$(34,339)	$(17,530)	$(31,810)
Denominator:			
Weighted average shares used to compute basic and diluted net loss per share attributable to NeoPhotonics Corporation common stockholders	31,000,325	28,529,849	22,359,802
Basic and diluted net loss per share attributable to NeoPhotonics Corporation common stockholders:			
Continuing operations	$(1.11)	$(0.62)	$(1.45)
Discontinued operations	$—	$—	$0.03
Net income (loss)	$(1.11)	$(0.62)	$(1.42)

The Company has excluded the impact of outstanding employee stock options, restricted stock units, common stock warrants and shares expected to be issued under its employee stock purchase plan from the computation of diluted net loss per share attributable to NeoPhotonics Corporation common stockholders, as their effect would have been antidilutive. The shares potentially issuable for each of these outstanding awards at December 31, 2013, 2012 and 2011 were as follows:

	December 31,		
	2013	2012	2011
Employee stock options	4,103,454	2,773,887	2,631,524
Restricted stock units	1,169,649	924,823	517,445
Employee stock purchase plan	403,329	475,592	505,324
Common stock warrants	4,482	4,482	4,482
	5,680,914	4,178,784	3,658,775

7. Business Combinations

Acquisition of NeoPhotonics Semiconductor

On March 29, 2013 (the "closing date") the Company acquired certain assets and assumed certain liabilities related to the semiconductor 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 business is now known as NeoPhotonics Semiconductor. NeoPhotonics Semiconductor 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.

Total consideration for NeoPhotonics Semiconductor was approximately $24.3 million, including cash of $13.1 million and notes payable of $11.1 million. The cash of $13.1 million includes $2.0 million that was withheld and placed into escrow to cover certain indemnity obligations. 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 notes payable to LAPIS are denominated in Japanese Yen.

In connection with the acquisition, the Company incurred approximately $5.4 million in acquisition-related costs related to investment banking, legal, accounting and other professional services and transfer taxes related to real property acquired. The acquisition costs were expensed as incurred and are included in operating expenses in the Company's 2013 consolidated statement of operations.

The results of operations of NeoPhotonics Semiconductor and the estimated fair values of the assets acquired and liabilities assumed have been included in the Company's consolidated financial statements since the date of the acquisition. For the year ended December 31, 2013, NeoPhotonics Semiconductor's contribution to total revenues was $40.4 million. The portion of total expenses and net loss associated with NeoPhotonics Semiconductor cannot be separately identified due to the integration with the Company's operations.

The Company accounted for its acquisition of the NeoPhotonics Semiconductor assets and assumed liabilities as a business combination. NeoPhotonics Semiconductor'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 estimated fair values of the identifiable assets acquired and liabilities assumed approximated the purchase price; therefore, no goodwill was recorded. The following table summarizes the acquisition accounting and the tangible and intangible assets acquired as of the date of acquisition and subsequent adjustments (in thousands):

Total purchase consideration:	
Cash paid	$13,128
Notes payable	11,130
	$24,258
Liabilities assumed:	
Pension and retirement obligations	$6,471
Other compensation-related liabilities	1,083
Other current liabilities	1,265
	$8,819
Fair value of assets acquired:	
Inventory	$13,309
Other current assets	35
Land, property, plant and equipment	14,433
Intangible assets acquired:	
Developed technology	2,120
Customer relationships	3,180
	$33,077

The approach for measuring the fair value of the assets acquired and liabilities assumed is described below:

Net Tangible Assets

NeoPhotonics Semiconductor's tangible assets acquired and liabilities assumed as of March 29, 2013 were recorded at estimated fair value. The Company estimated fair value by adjusting NeoPhotonics Semiconductor's historical value of property, plant and equipment to an estimate of depreciated replacement cost, adjusted for economic obsolescence. The Company depreciates property, plant and equipment over estimated lives of 2 to 20 years, and records 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. NeoPhotonics Semiconductor'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 NeoPhotonics Semiconductor 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 intangible assets acquired is 5.4 years.

The following unaudited supplemental pro forma information presents the combined results of operations of NeoPhotonics Corporation and NeoPhotonics Semiconductor for the years ended December 31, 2013 and 2012 as if the NeoPhotonics Semiconductor acquisition had been completed at the beginning of 2012. The pro forma financial information includes adjustments related to one time charges, amortization of fair value adjustments and elimination of NeoPhotonics Semiconductor's revenues and cost of goods sold from its sales to the Company prior to the acquisition. As a result of the elimination adjustments, revenues were reduced by $1.9 million and $4.4 million for 2013 and 2012, respectively, and cost of goods sold was reduced by $1.8 million and $3.9 million for 2013 and 2012, respectively. The pro forma financial information for 2013 also included elimination of $5.4 million in transaction costs and cost of goods sold was decreased by $3.2 million and increased by $4.3 million for 2013 and 2012, respectively, due to a change in the value of inventory as a result of acquisition accounting.

The unaudited pro forma results do not assume any operating efficiencies as a result of the consolidation of operations (in thousands, except per share data):

	Year ended December 31,	
	2013	2012
Revenue	$294,933	$305,286
Net loss	$(23,340)	$(11,014)
Basic and diluted net loss per share	$(0.75)	$(0.39)

The unaudited 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.

Acquisition of Santur

In 2011, the Company acquired Santur, a leading designer and manufacturer of Indium Phosphide (InP)-based PIC products, for total cash consideration of $44.4 million, including $6.0 million that was withheld and placed into escrow to cover certain indemnity obligations. In addition, the sellers were entitled to receive up to $7.5 million based on Santur's quarterly gross profit during 2012 (see Note 13).

The Company accounted for its acquisition of Santur as a business combination. Santur'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 purchase price over the value of the net assets acquired was recorded as goodwill. The following table summarizes the purchase accounting and the net tangible assets acquired as of the date of acquisition (in thousands):

Total purchase consideration:	
Cash transferred upon closing	$44,396
Fair value of contingent consideration	2,800
	47,196
Less the fair value of net assets acquired:	
Net tangible assets acquired	21,243
Intangible assets acquired:	
Developed technology	11,800
Customer relationships	5,000
In-process research and development	370
	38,413
Goodwill	$8,783

Details of the net assets acquired are as follows (in thousands):

Cash and cash equivalents	$5,410
Accounts receivable, net	10,253
Inventories	7,578
Prepaid and other current assets.	1,329
Property, plant and equipment	13,500
Other non-current assets	453
Accounts payable	(8,371)
Other accrued liabilities	(8,798)
Lease obligation	(111)
Total net tangible assets acquired	$21,243

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

Net Tangible Assets

Santur's tangible assets acquired and liabilities assumed as of October 12, 2011 were recorded at estimated fair value. The Company increased Santur's historical value of fixed assets by $5.8 million to adjust the fixed assets to an amount equivalent to the fair market value. The fair value of fixed assets acquired was determined using several approaches depending on the nature of the fixed asset including a market approach and cost approach if market data was not available. The Company also increased Santur's cost of inventory by $0.2 million. The fair value of inventory acquired was determined using an income approach based upon the expected sales value of the inventory, less direct costs associated with the sale of the inventory and an allocation of profit margins between the buyer and seller.

Intangible Assets

Developed technology represents products that have reached technological feasibility. Santur's current products offerings include tunable lasers and transmitters, integrated tunable laser assemblies with narrow line width, and a family of PIC products that enable high capacity 40Gbps and 100Gbps transceivers. The fair value of developed technology intangibles acquired was determined using an income approach called the multi-period excess-earnings method, which involves forecasting the net earnings to be generated by the asset, reducing them by appropriate returns on contributory assets, and then discounting the resulting net returns to a present value using the Company's discount rate. The Company amortizes the developed technology intangible asset over an average estimated life of 5 years and amortization expense is recorded to cost of goods sold.

Customer relationships represent the value placed on Santur's distribution channels and end users. The fair value of customer relationship intangibles were determined based on the incremental cash flow afforded by having the customer relationships in place on the acquisition date versus having no relationships in place and needing to replicate or replace those relationships. The Company amortizes the customer relationships intangible asset over an average estimated life of 5 years and amortization expense is recorded to operating expenses.

In-process research and development represents four Santur research and development projects that had not reached technological feasibility as of the closing date of the acquisition. Acquired in-process research and development was recorded at fair value as an indefinite-lived intangible asset at the acquisition date until the completion or abandonment of the associated research and development efforts. The fair value of in-process research and development, similar to developed technology intangibles acquired, was determined using an income approach called the multi-period excess-earnings approach, with the additional inclusion of estimated costs required to complete the projects. These projects were completed in 2012. The Company amortizes the assets over an average estimated life of 5 years and amortization expense is recorded to cost of goods sold.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets, and represents the assembled workforce, the ability to generate new products and services as a combined company and expected synergistic benefits of the transaction. 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.

Santur's results of operations from October 12, 2011 through December 31, 2011 were included in the Company's consolidated statement of operations for the year ended December 31, 2011. During the year ended December 31, 2011, Santur contributed $5.8 million of revenue and $13.8 million of operating loss, which included the impact from purchase accounting related adjustments, such as the amortization of purchased intangibles, amortization of acquisition related fixed asset and inventory step-up, adjustment to the fair value of contingent consideration, retention expense, and acquisition related costs. The following table presents pro forma results of operations of the Company and Santur, as if the companies had been combined as of the beginning of 2011. The unaudited pro forma results of operations are not necessarily indicative of results that would have occurred had the acquisition taken place on January 1, 2011, or of future results. Pro-forma results include: (i) amortization of intangible assets related to the acquisition, (ii) depreciation expense associated with the fair value adjustment to Santur's property, plant and equipment, (iii) stock-based compensation expense, and (iv) interest income (expense) associated with Santur's debt eliminated in connection with the acquisition. The pro forma information for the year ended December 31, 2011 is as follows (in thousands, except per share amounts):

Total revenues	$236,449
Net loss	(29,352)
Net loss attributable to NeoPhotonics Corporation	(29,352)
Net loss attributable to NeoPhotonics Corporation common stockholders	(46,408)
Basic and diluted net loss per share attributable to NeoPhotonics Corporation common stockholders	(2.08)

8. Goodwill and purchased intangible assets

Goodwill

In the fourth quarter of 2011, the Company recognized a goodwill impairment charge of $13.1 million. As a result, the Company does not have any goodwill on its consolidated balance sheets as of December 31, 2013 or 2012.

Both an income and market approach were used to estimate the fair value of the reporting unit. For the income approach, the Company used a discounted cash flow analysis, which included assumptions about future revenue, operating expenses, taxes and working capital and capital asset requirements. Material assumptions used for the income approach were eleven years of projected net cash flows, a discount rate of 18%, and a long-term growth rate of 5%. For the market approach, the Company used a market capitalization analysis, guideline public company analysis and a guideline transactions analysis. The market capitalization approach used the mid-point of the range of closing share prices of the Company's common stock as of the valuation date and for the three months prior to the valuation date and applied a 40% control premium. The guideline public company analysis measured the enterprise value of eleven companies and also applied a 40% control premium. The guideline transactions analysis looked at thirteen transactions in the optical components industry over the last 3.5 years.

The resulting analyses were weighted as follows in measuring the fair value of the reporting unit:

Discounted cash flow	16.7%
Market capitalization	50.0%
Guideline public company	16.7%
Guideline transactions	16.7%

The market capitalization analysis was weighted higher than the other approaches, as the Company believes that the value indication provided by the market is highly relevant to the valuation of the reporting unit.

Purchased intangible assets

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

	December 31, 2013			December 31, 2012		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Technology and patents	$34,524	$ (25,931)	$8,593	$32,176	$ (22,869)	$9,307
Customer relationships	15,004	(9,732)	5,272	11,898	(8,148)	3,750
Leasehold interest	1,406	(266)	1,140	1,355	(241)	1,114
Non-compete agreements	950	(950)	—	950	(908)	42
	$51,884	$ (36,879)	$15,005	$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 non-compete agreements within operating expenses. The following table presents details of the amortization expense of the Company's purchased intangible assets as reported in the consolidated statements of operations (in thousands):

	Years ended December 31,		
	2013	2012	2011
Cost of goods sold	$2,543	$2,472	$598
Operating expenses	1,532	1,316	994
Total	$4,075	$3,788	$1,592

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

2014	$4,402
2015	4,386
2016	3,640
2017	793
2018	580

Thereafter	1,204
	$15,005

9. Balance sheet components

Accounts receivable, net

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

	December 31,	
	2013	2012
Accounts receivable	$57,010	$66,338
Trade notes receivable	8,054	4,979
Allowance for doubtful accounts	(531)	(963)
	$64,533	$70,354

The table below summarizes the movement in the Company's allowance for doubtful accounts (in thousands):

Balance at December 31, 2010	$(1,582)
Provision for bad debt	(196)
Write-offs, net of recoveries	1,272
Balance at December 31, 2011	(506)
Provision for bad debt	(457)
Write-offs, net of recoveries	—
Balance at December 31, 2012	(963)
Provision for bad debt	253
Write-offs, net of recoveries	179
Balance at December 31, 2013	$(531)

Inventories

Inventories consist of the following (in thousands):

	December 31,	
	2013	2012
Raw materials	$26,379	$19,038
Work in process	14,341	8,940
Finished goods	24,188	15,815
	$64,908	$43,793

Included in finished goods was $5.4 million and $4.5 million of inventory at customer vendor managed inventory locations at December 31, 2013 and 2012, respectively.

Property, plant and equipment, net

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

	December 31,	
	2013	2012
Land	$3,167	$—
Buildings	23,194	16,484
Machinery and equipment	104,287	92,139
Furniture, fixtures, software and office equipment	11,441	8,300
Leasehold improvements	7,837	4,373
	149,926	121,296
Less: Accumulated depreciation	(81,075)	(66,856)
	$68,851	$54,440

Depreciation expense was $16.3 million, $12.4 million and $10.8 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Accrued and other current liabilities

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

	December 31,	
	2013	2012
Employee-related	$12,297	$12,293
Other	11,346	7,666
	$23,643	$19,959

Accrued warranty

The table below summarizes the movement in the warranty accrual, which is included in accrued and other current liabilities (in thousands):

	Years ended December 31,		
	2013	2012	2011
Beginning balance	$1,072	$1,443	$299
Warranty accruals	1,514	385	393
Assumed warranty from acquisitions	135	—	999
Settlements and adjustments	(984)	(756)	(248)
Ending balance	$1,737	$1,072	$1,443 (1)

(1) Included within the ending balance is an accrual of $0.3 million relating to a specific part, for which the liability was assumed as part of the acquisition of Santur. The Company did not experience any claims for this product after October 2011 and it believed warranty claims were remote. Therefore, the Company released this obligation in the fourth quarter of 2012.

Other noncurrent liabilities

Other noncurrent liabilities consist of the following (in thousands):

	December 31,	
	2013	2012
Pension and other employee-related	$6,206	$188
Penalty payment derivative	239	138
Other	1,542	1,536
	$7,987	$1,862

10. Restructuring

During 2013, the Company exited and closed one facility at its headquarters location to align its facilities usage with its current size. Additionally, the Company approved and implemented a restructuring action to reduce its workforce and close a facility in China and to exit its contract manufacturing activities in Malaysia. The Company recorded a restructuring charge of $1.5 million during 2013 related to these actions, of which $0.8 million was recorded in operating expenses with the remainder recorded in cost of goods sold. The remaining balance related to facilities will be paid through 2015.

The following table summarizes activity associated with the restructuring during the year ended December 31, 2013 (in thousands):

	Severance	Facilities	Contract Termination	Total
Restructuring obligations, December 31, 2012	$ —	$ —	$ —	$—
Restructuring costs incurred in 2013	699	318	457	1,474
Cash payments	(699)	(178)	(391)	(1,268)
Non-cash settlements and other	—	71	—	71
Restructuring obligations, December 31, 2013	$ —	$ 211	$ 66	$277

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During the fourth quarter of 2011, the Company approved and implemented a restructuring plan, which resulted in the involuntary termination of 37 employees in the U.S. and 43 employees in China. The reduction in workforce was primarily related to cost-cutting measures in research and development. In addition, the Company made reductions in the areas of sales, marketing and administrative functions as a result of redundancy in positions due to the acquisition of Santur in October 2011. The Company recorded a restructuring charge of $1.3 million for severance and benefit costs in 2011. As of December 31, 2012 all of the restructuring expense had been paid.

11. Debt

The table below summarizes the carrying amount and weighted average interest rate of the Company's notes payable and long-term debt (in thousands, except percentages):

	December 31, 2013			December 31, 2012		
	Carrying Amount	Weighted Average Interest Rate		Carrying Amount	Weighted Average Interest Rate	
Notes payable	$9,738	—		$12,003	—	
Long-term debt:						
Acquisition-related	$9,975	1.50	%	$—	—	
Bank borrowings	24,500	2.92	%	22,167	2.20	%
	34,475			22,167		
Less: current portion of long-term debt	(10,325)			(5,000)		
Total long-term debt, net of current portion	$24,150			$17,167		

Notes payable

The Company frequently issues notes payable to its suppliers in China in exchange for accounts payable. These notes are supported by noninterest bearing bank acceptance drafts and are due three to six months after issuance. As a condition of the notes payable arrangements, the Company is required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the amounts are settled. These balances are classified as restricted cash on the Company's consolidated balance sheets. As of December 31, 2013 and 2012, restricted cash totaled $2.1 million and $2.6 million, respectively. In May 2014, one of the Company's subsidiaries in China issued a 90-day bank acceptance draft of approximately $8.0 million to another of the Company's subsidiaries that required a compensating balance of approximately $2.4 million. This bank acceptance draft can be sold for cash at a discount prior to its expiration.

At December 31, 2013, the Company's subsidiaries in China had two short-term line of credit facilities with banking institutions. Amounts requested by the Company were not guaranteed and were subject to the banks' funds and currency availability. The Company had no amount outstanding under these facilities at December 31, 2013 or 2012. As of June 3, 2014, both credit facilities had expired and were in the process of being renewed.

Acquisition-related

In connection with the acquisition of NeoPhotonics Semiconductor on March 29, 2013, the Company is obligated to pay 1,050 million Japanese Yen in three equal installments on the first, second and third anniversaries of the closing date for the purchase of the real estate used by NeoPhotonics Semiconductor. The obligation bears interest at 1.5% per year and the acquired real estate property is security for the loan from LAPIS.

Bank borrowings

The Company has a credit agreement with Comerica Bank in the U.S., which has been amended several times. In March 2013, the Company amended and restated its credit agreement in its entirety. The components of the available credit facilities are as follows:

A revolving credit facility under which there was nothing outstanding and $20.0 million available for borrowing at December 31, 2013, subject to covenant requirements. There was $8.0 million outstanding under this line at December 31, 2012. Amounts borrowed are due on or before March 2016 and borrowings bear interest at an interest rate option of a base rate as defined in the agreement plus 1.5% or LIBOR plus 2.5%. As of December 31, 2013 the rate on the LIBOR option was 2.67%.

A term loan facility of $28.0 million, under which $24.5 million was outstanding at December 31, 2013. Interest is payable quarterly in arrears and the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan bear interest at an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of December 31, 2013 the rate on the LIBOR option was 2.92% Additionally, as of December 31, 2012, there was $14.2 million outstanding under an acquisition advance facility under the previous agreement, which bore interest at a rate of LIBOR plus 2%.

In connection with the credit agreement, the Company issued a warrant to the lender to purchase 4,482 shares of common stock at an exercise price of $29.00 per share. As of December 31, 2013, the warrant had not been exercised.

The Company's credit agreement requires the maintenance of specified financial covenants, including a debt to EBITDA ratio and liquidity ratios. The agreement also restricts the Company's ability to incur additional debt or to engage in specified transactions, restricts the payment of dividends and is secured by substantially all of its U.S. assets, other than intellectual property assets. The Company was not in compliance with the debt to EBITDA covenant at December 31, 2013 and obtained a waiver from the bank with respect to such noncompliance.

The Company executed a series of amendments to its credit agreement through April 2014 that modified certain covenants and extended the delivery date of certain of its Quarterly Reports on Form 10-Q and this Annual Report on Form 10-K. The amendments also increased the applicable interest margins by 0.25% per annum. Loans under the term loan facility bear interest equal to either the LIBOR rate, plus an applicable margin equal to 3.00% per annum, or a base rate (as defined) plus an applicable margin equal to 2.00% per annum. Loans under the revolving loan facility bear interest at a rate equal to either the LIBOR rate, plus an applicable margin equal to 2.75% per annum, or a base rate (as defined) plus an applicable margin equal to 1.75% per annum. These new interest rate options will be in effect at least until the lender's review of the Company's June 30, 2014 financial statements.

On May 19, 2014 the Company executed an amendment to the credit agreement that waived testing of certain covenants for compliance, including the debt to EBITDA covenant, provided that the Company maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. The Company intends to work with the bank in the coming months to restructure the credit agreement, including the covenant requirements. In the absence of a restructured agreement, the Company believes it will need to continue to maintain the compensating balances at least through the end of 2014. As of May 19, 2014, the amount of the Company's cash and short-term investments in these compensating balance accounts was $21.1 million.

At December 31, 2013, maturities of long-term debt were as follows (in thousands):

2014