

INFINERA Corp  
Form 10-Q  
November 08, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2018

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-33486

INFINERA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 77-0560433

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

140 Caspian Court 94089  
Sunnyvale, CA

(Address of principal executive offices) (Zip Code)

(408) 572-5200

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

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

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

As of November 1, 2018, 174,986,726 shares of the registrant's Common Stock, \$0.001 par value, were issued and outstanding.

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FOR THE FISCAL QUARTER ENDED September 29, 2018  
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## PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements (Unaudited)

## INFINERA CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par values)

(Unaudited)

	September 29, 2018	December 30, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 416,406	\$ 116,345
Short-term investments	30,480	147,596
Accounts receivable, net of allowance for doubtful accounts of \$866 in 2018 and \$892 in 2017	153,901	126,152
Inventory	211,945	214,704
Prepaid expenses and other current assets	43,756	43,140
Total current assets	856,488	647,937
Property, plant and equipment, net	131,923	135,942
Intangible assets	66,144	92,188
Goodwill	180,986	195,615
Long-term investments	850	36,129
Other non-current assets	11,007	9,859
Total assets	\$ 1,247,398	\$ 1,117,670
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 83,249	\$ 58,124
Accrued expenses	43,324	39,782
Accrued compensation and related benefits	35,738	45,751
Short-term debt, net	—	144,928
Accrued warranty	13,475	13,670
Deferred revenue	42,724	72,421
Total current liabilities	218,510	374,676
Long-term debt, net	262,580	—
Accrued warranty, non-current	17,007	17,239
Deferred revenue, non-current	15,790	22,502
Deferred tax liability	14,977	21,609
Other long-term liabilities	14,217	16,279
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock, \$0.001 par value	—	—
Authorized shares – 25,000 and no shares issued and outstanding		
Common stock, \$0.001 par value		
Authorized shares – 500,000 as of September 29, 2018 and December 30, 2017		
Issued and outstanding shares – 153,988 as of September 29, 2018 and 149,471 as of December 30, 2017	154	149
Additional paid-in capital	1,547,451	1,417,043
Accumulated other comprehensive income (loss)	(19,785	) 6,254

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Accumulated deficit	(823,503	) (758,081	)
Total stockholders' equity	704,317	665,365	
Total liabilities and stockholders' equity	\$ 1,247,398	\$ 1,117,670	

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

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INFINERA CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
Revenue:				
Product	\$ 167,030	\$ 159,579	\$ 513,947	\$ 449,992
Services	33,383	33,001	97,374	94,931
Total revenue	200,413	192,580	611,321	544,923
Cost of revenue:				
Cost of product	117,152	111,803	335,674	311,437
Cost of services	13,075	12,951	38,945	36,772
Restructuring and related	7	—	50	—
Total cost of revenue	130,234	124,754	374,669	348,209
Gross profit	70,179	67,826	236,652	196,714
Operating expenses:				
Research and development	50,658	56,616	165,497	169,076
Sales and marketing	26,073	27,824	86,286	86,662
General and administrative	18,415	17,634	54,616	53,556
Restructuring and related	191	—	1,708	—
Total operating expenses	95,337	102,074	308,107	309,294
Loss from operations	(25,158 )	(34,248 )	(71,455 )	(112,580 )
Other income (expense), net:				
Interest income	292	857	1,818	2,470
Interest expense	(2,160 )	(3,549 )	(8,344 )	(10,408 )
Other gain (loss), net	(5,449 )	(80 )	(3,514 )	(462 )
Total other income (expense), net	(7,317 )	(2,772 )	(10,040 )	(8,400 )
Loss before income taxes	(32,475 )	(37,020 )	(81,495 )	(120,980 )
Provision for (benefit from) income taxes	135	211	(667 )	(459 )
Net loss	(32,610 )	(37,231 )	(80,828 )	(120,521 )
Net loss per common share:				
Basic	\$(0.21 )	\$(0.25 )	\$(0.53 )	\$(0.82 )
Diluted	\$(0.21 )	\$(0.25 )	\$(0.53 )	\$(0.82 )
Weighted average shares used in computing net loss per common share:				
Basic	153,492	148,777	152,028	147,367
Diluted	153,492	148,777	152,028	147,367

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

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INFINERA CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 29,	September 30,
	2018	2017	2018	2017
Net loss	\$(32,610)	\$ (37,231 )	\$(80,828 )	\$ (120,521 )
Other comprehensive income (loss), net of tax:				
Change in unrealized gain (loss) on available-for-sale investments	175	87	274	27
Foreign currency translation adjustment	2,069	12,614	(26,242 )	37,257
Tax related to available-for-sale investment	(45 )	(11 )	(71 )	(11 )
Net change in accumulated other comprehensive income (loss)	2,199	12,690	(26,039 )	37,273
Comprehensive loss	\$(30,411)	\$ (24,541 )	\$(106,867)	\$ (83,248 )

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

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INFINERA CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	September 30, 2018	September 30, 2017
Cash Flows from Operating Activities:		
Net loss	\$(80,828 )	\$ (120,521 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	50,339	49,391
Non-cash restructuring and related credits	(81 )	—
Amortization of debt discount and issuance costs	6,752	8,399
Realized gain on sale of non-marketable equity investments	(1,050 )	—
Impairment on non-marketable equity investment	4,260	—
Stock-based compensation expense	34,394	35,424
Other loss	214	622
Changes in assets and liabilities:		
Accounts receivable	(27,728 )	15,078
Inventory	(926 )	(9,601 )
Prepaid expenses and other assets	294	(15,366 )
Accounts payable	26,254	25,840
Accrued liabilities and other expenses	(30,754 )	(18,757 )
Deferred revenue	(8,669 )	8,575
Net cash used in operating activities	(27,529 )	(20,916 )
Cash Flows from Investing Activities:		
Purchase of available-for-sale investments	(2,986 )	(122,249 )
Proceeds from sales of available-for-sale investments	53,039	10,531
Proceeds from maturities of investments	98,112	111,970
Proceeds from sale of non-marketable equity investment	1,050	—
Purchase of property and equipment	(27,027 )	(50,247 )
Net cash provided by (used in) investing activities	122,188	(49,995 )
Cash Flows from Financing Activities:		
Proceeds from issuance of debt, net	391,431	—
Purchase of capped call transactions	(48,880 )	—
Repayment of debt	(150,000 )	—
Acquisition of noncontrolling interest	—	(471 )
Proceeds from issuance of common stock	17,693	17,991
Minimum tax withholding paid on behalf of employees for net share settlement	(1,093 )	(963 )
Net cash provided by financing activities	209,151	16,557
Effect of exchange rate changes on cash and restricted cash	(3,054 )	3,855
Net change in cash, cash equivalents and restricted cash	300,756	(50,499 )
Cash, cash equivalents and restricted cash at beginning of period	121,486	177,580
Cash, cash equivalents and restricted cash at end of period <sup>(1)</sup>	\$422,242	\$ 127,081
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net of refunds	\$3,320	\$ 4,159
Cash paid for interest	\$1,332	\$ 1,317
Supplemental schedule of non-cash investing activities:		
Transfer of inventory to fixed assets	\$1,165	\$ 3,110





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(1) Reconciliation of cash, cash equivalents and restricted cash to the condensed consolidated balance sheets:

September 30,  
2018      2017

(In thousands)

Cash and cash equivalents	\$416,406	\$ 122,042
Short-term restricted cash	402	740
Long-term restricted cash	5,434	4,299
Total cash, cash equivalents and restricted cash	\$422,242	\$ 127,081

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

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INFINERA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

Infinera Corporation (the “Company”) prepared its interim condensed consolidated financial statements that accompany these notes in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”), consistent in all material respects with those applied in the Company’s Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

The Company has made certain estimates, assumptions and judgments that can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Significant estimates, assumptions and judgments made by management include revenue recognition, stock-based compensation, inventory valuation, accrued warranty, business combinations, fair value measurement of investments and accounting for income taxes. Other less significant estimates, assumptions and judgments made by management include allowances for sales returns, allowances for doubtful accounts, useful life of intangible assets, and property, plant and equipment. Management believes that the estimates and judgments upon which they rely are reasonable based upon information available to them at the time that these estimates and judgments are made. To the extent there are material differences between these estimates and actual results, the Company’s condensed consolidated financial statements will be affected.

The interim financial information is unaudited, but reflects all adjustments that are, in management’s opinion, necessary to provide a fair presentation of results for the interim periods presented. All adjustments are of a normal recurring nature. The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

This interim information should be read in conjunction with the consolidated financial statements in the Company’s Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

To date, a few of the Company’s customers have accounted for a significant portion of its revenue. For the three months ended September 29, 2018, two customers individually accounted for 17% and 14% of the Company’s total revenue and for the corresponding period in 2017, two customers individually accounted for 16% and 12% of the Company’s total revenue. For the nine months ended September 29, 2018, two customers individually accounted for 22% and 14% of the Company’s total revenue and for the corresponding period in 2017, two customers individually accounted for 16% and 11% of the Company’s total revenue.

There have been no material changes in the Company’s significant accounting policies for the nine months ended September 29, 2018 as compared to those disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 30, 2017, with the exception of the Company’s revenue recognition policy. Effective December 31, 2017, the Company adopted Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASC 606”). See Note 3, “Revenue Recognition” to the Notes to Condensed Consolidated Financial Statements for discussion on the impact of the adoption of these standards on the Company’s policy for revenue recognition.

The Company adopted Accounting Standards Update 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash” (“ASU 2016-18”), during the first quarter of fiscal 2018, using the retrospective transition approach. Restricted cash in the prior period has been included with cash and cash equivalents when reconciling the beginning and ending total amounts on the statement of cash flows for the nine months ended September 30, 2017, to conform to the current period presentation. The adoption of ASU 2016-18 did not have a material impact on the cash flow activity presented on the Company’s condensed consolidated statement of cash flows.

2. Recent Accounting Pronouncements

Accounting Pronouncements Recently Adopted

In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, “Income Tax Accounting Implications of the Tax Cuts and Jobs Act” (“SAB 118”), which allows the Company to record provisional amounts during a

measurement period not to extend beyond one year of the enactment date. Since the U.S. Tax Cuts and

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Jobs Act (the “Tax Act”) was passed in December 2017, and ongoing guidance and accounting interpretation are expected over the next 12 months, the Company considers the accounting of the transition tax and deferred tax re-measurements to be incomplete due to the forthcoming guidance and the ongoing analysis of final year-end data and tax positions. The Company expects to complete the analysis within the measurement period in accordance with SAB 118. In March 2018, the Financial Accounting Standards Board (the “FASB”) issued ASU 2018-05, “Amendments to SEC Paragraphs Pursuant to SAB 118” and added such SEC guidance to Accounting Standards Codification 740, “Income Taxes, codified under the title: Income Tax Accounting Implications of the Tax Cuts and Jobs Act.”

In May 2017, the FASB issued Accounting Standards Update No. 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”), which amends the scope of modification accounting for share-based payment arrangements, and provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Topic 718. The Company's adoption of ASU 2017-09 during its first quarter of 2018 had no impact on its condensed consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. As such, restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and ending-of-period total amounts shown on the statement of cash flows. The Company adopted ASU 2016-18 during the first quarter of fiscal 2018, using the retrospective transition approach. See the condensed consolidated statements of cash flows for a reconciliation of cash, cash equivalents and restricted cash reported within the condensed consolidated balance sheets that sum to the total of the same such amounts on the condensed consolidated statements of cash flows.

In May 2016, the FASB issued Accounting Standards Update No. 2016-11, “Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)” (“ASU 2016-11”), which rescinds various standards codified as part of Topic 605, Revenue Recognition in relation to the future adoption of Topic 606. These rescissions include changes to topics pertaining to revenue and expense recognition for freight services in process, accounting for shipping and handling fees and costs, and accounting for consideration given by a vendor to a customer. The Company adopted ASU 2016-11 during the first quarter of 2018. See Note 3, “Revenue Recognition” to the Notes to Condensed Consolidated Financial Statements for more information.

In May 2014, the FASB issued ASC 606, which creates a single, joint revenue standard that is consistent across all industries and markets for companies that prepare their financial statements in accordance with U.S. GAAP. Under ASC 606, an entity is required to recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to receive in exchange for those goods or services. In August 2015, the FASB issued Accounting Standards update 2015-14, “Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date,” which deferred the effective date of ASC 606 by one year with early adoption permitted beginning after December 15, 2016. The updated standard is effective for interim and annual periods beginning after December 15, 2017. In April 2016, the FASB issued Accounting Standards Update No. 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing,” which clarifies the implementation guidance on identifying performance obligations and licensing. In May 2016, the FASB issued Accounting Standards Update No. 2016-12, “Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients,” which amends the guidance on collectability, noncash consideration, presentation of sales tax and transition. In December 2016, the FASB issued Accounting Standards Update No. 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers,” to increase stakeholders' awareness of the proposals and to expedite improvements to ASC 606. ASC 606 also includes Subtopic 340-40, “Other Assets and Deferred Costs - Contracts with Customers,” which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, the Company refers to ASC 606 and Subtopic 340-40 as “ASC 606.” The Company adopted ASC 606 as of December 31, 2017 using the modified retrospective transition method applied to those contracts that were not completed as of December 31, 2017. See Note 3, “Revenue Recognition” to the Notes to Condensed Consolidated Financial Statements for more information.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, “Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”), which requires equity investments to be measured at fair value with changes in fair value recognized in the income

statement and simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. The Company adopted ASU 2016-01 during its first quarter of 2018 and the adoption did not have a material impact on its condensed consolidated financial statements. See Note 4, "Fair Value Measurements" to the Notes to Condensed Consolidated Financial Statements for more information.

#### Accounting Pronouncements Not Yet Effective

In August 2018, the FASB issued Accounting Standards Update No. 2018-15 ("ASU 2018-15"), "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract." The update provides guidance for determining if a cloud computing arrangement is within the scope of internal-use software guidance, and would require capitalization of certain implementation costs. ASU 2018-15 is effective for the Company in its first quarter of 2020, with early adoption permitted. The Company is currently evaluating the impact the adoption of ASU 2018-15 will have on its consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update No. 2018-13 ("ASU 2018-13"), "Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement." The update eliminates, adds, and modifies certain disclosure requirements for fair value measurements. ASU 2018-13 is effective for the Company in its first quarter of 2020 and early adoption is permitted of the entire standard or only the provisions that eliminate or modify disclosure requirements. The Company is currently evaluating the impact the adoption of ASU 2018-13 will have on its consolidated financial statements.

In June 2018, the FASB issued Accounting Standards Update No. 2018-07, "Improvements to Non-employee Share-Based Payment Accounting" ("ASU 2018-07"), which simplifies the accounting for share-based payments granted to non-employees for goods and services. Under ASU 2018-07, certain guidance on such payments to non-employees would be aligned with the requirements for share-based payments granted to employees. The guidance will be effective for the Company's first quarter of 2019 and early adoption is permitted. As the Company does not have material non-employee awards, it does not expect the adoption of ASU 2018-07 to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, "Simplifying the Test for Goodwill Impairment" ("ASU 2017-04"). The guidance eliminates Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The same one-step impairment test will be applied to goodwill at all reporting units, even those with zero or negative carrying amounts. Entities will be required to disclose the amount of goodwill at reporting units with zero or negative carrying amounts. ASU 2017-04 will be effective for the Company's annual or any interim goodwill impairment tests in its first quarter of fiscal 2020. The Company is currently evaluating the impact the adoption of ASU 2017-04 will have on its consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"), which requires measurement and recognition of expected credit losses for financial assets held. This guidance is effective for the Company in its first quarter of fiscal 2020 and early adoption is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-13 will have on its consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update 2016-02, "Leases (Topic 842)" ("ASU 2016-02"), which amends the existing accounting standards for leases. The new standard requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). For lessees, leases will continue to be classified as either operating or financing in the income statement. This guidance is effective for the Company in its first quarter of fiscal 2019. ASU 2016-02 is required to be applied with a modified retrospective approach and requires application of the new standard at the beginning of the earliest comparative period presented. In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements," ("ASU 2018-11"), which provides lessees an additional (and optional) transition method to apply the new leasing standard to all open leases at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company is currently evaluating the impact the adoption of ASU 2016-02 and ASU 2018-11 will have on its consolidated financial statements and expects to have increases in the assets and liabilities of its consolidated balance sheets.



### 3. Revenue Recognition

Effective December 31, 2017, the Company adopted ASC 606, using the modified retrospective method applied to those contracts that were not completed as of December 31, 2017. Results for the reporting periods after December 31, 2017 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historical accounting under Topic 605.

The Company recognizes revenue when control of the promised goods or services is transferred to its customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services.

The Company determines revenue recognition by applying the following five-step approach:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract;
- determination of the transaction price;
- allocation of the transaction price to the performance obligations in the contract; and
- recognition of revenue when, or as, the Company satisfies a performance obligation.

Many of the Company's product sales are sold in combination with installation and deployment services along with initial hardware and software support. The Company's product sales are also sold with spares management, on-site hardware replacement services, network operations management, software subscription services, extended hardware warranty and training. Initial software and hardware support services are generally delivered over a one-year period in connection with the initial purchase. Software warranty provides customers with maintenance releases during the warranty support period and hardware warranty provides replacement or repair of equipment that fails to perform in line with specifications. Software subscription services include software warranty and additionally provides customers with rights to receive unspecified software product upgrades released during the support period.

Spares management and on-site hardware replacement services include the replacement of defective units at customer sites in accordance with specified service level agreements. Network operations management includes the day-to-day operation of a customer's network. These services are generally delivered on an annual basis. The Company evaluates each promised good and service in a contract to determine whether it represents a distinct performance obligation or should be accounted for as a combined performance obligation.

Services revenue includes software subscription services, installation and deployment services, spares management, on-site hardware replacement services, network operations management, extended hardware warranty and training. Revenue from software subscription services, spares management, on-site hardware replacement services, network operations management and extended hardware warranty contracts is deferred and is recognized ratably over the contractual support period, which is generally one year, as services are provided over the course of the entire period. Revenue related to training and installation and deployment services is recognized upon completion of the services.

Contracts and customer purchase orders are generally used to determine the existence of an arrangement. In addition, shipping documents and customer acceptances, when applicable, are used to verify delivery and transfer of title. The Company typically satisfies its performance obligations upon shipment or delivery of product depending on the contractual terms. Payment terms to customers generally range from net 30 to 120 days from invoice, which are considered to be standard payment terms. The Company assesses its ability to collect from its customers based primarily on the creditworthiness and past payment history of the customer.

Customer product returns are approved on a case by case basis. Specific reserve provisions are made based upon a specific review of all the approved product returns where the customer has yet to return the products to generate the related sales return credit at the end of a period. Estimated sales returns are recorded as a reduction to revenue.

For sales to resellers, the same revenue recognition criteria apply. It is the Company's practice to identify an end-user prior to shipment to a reseller. The Company does not offer rights of return or price protection to its resellers.



The Company reports revenue net of any required taxes collected from customers and remitted to government authorities, with the collected taxes recorded as current liabilities until remitted to the relevant government authority.

#### ASC 606 Adoption

The Company recorded a net reduction to the opening balance of its accumulated deficit of \$15.4 million as of December 31, 2017 due to the cumulative impact of adopting ASC 606, with the impact primarily related to its services revenue. The impact to revenue for the three and nine months ended September 29, 2018 was an increase of \$0.9 million and a decrease of \$0.6 million, respectively, as a result of applying ASC 606. The details of the significant changes and quantitative impact of the Company's adoption of ASC 606 are set out below.

#### Customer Purchase Commitments

The Company sells software licenses that provide customers the ability to purchase incremental bandwidth capacity on an already deployed piece of hardware. Infinera Instant Bandwidth ("IB") enabled systems generally include a specific initial capacity and incremental capacity can be added by the purchase of IB licenses. IB licenses are considered distinct performance obligations because customers can provision additional transmission capacity on demand without the deployment of any incremental equipment.

Some contracts commit the customer to purchase incremental IB licenses within a specified time frame from the initial shipment of the IB enabled hardware. The time frame varies by customer and generally ranges between 12 to 24 months. If the customer does not purchase the additional capacity within the time frame as stated in the contract, the Company has the right to deliver and invoice such IB licenses to the customer. Under ASC 605, the additional incremental licenses were not included as an element of the initial arrangement because fees for the future purchase were not fixed. Under ASC 606, future committed licenses are considered to be additional performance obligations when a minimum purchase obligation is present, as evidenced by enforceable rights and obligations. As such, the Company is required to estimate the variable consideration for future IB licenses as part of determining the contract transaction price.

#### Contract Termination Rights

The contract term is determined on the basis of the period over which the parties to the contract have present enforceable rights and obligations. Certain customer contracts include a termination for convenience clause that allows the customer to terminate services without penalty, upon advance notification. For such contracts, the service duration is limited to the non-cancellable portion of the contract.

#### Variable Consideration

The consideration associated with customer contracts is generally fixed. Variable consideration includes discounts, rebates, refunds, credits, incentives, penalties, or other similar items. The amount of consideration that can vary is not a substantial portion of total consideration.

Variable consideration estimates are re-assessed at each reporting period until a final outcome is determined. The changes to the original transaction price due to a change in estimated variable consideration will be applied on a retrospective basis, with the adjustment recorded in the period in which the change occurs. Changes to variable consideration will be tracked and material changes disclosed.

#### Stand-alone Selling Price

Stand-alone selling price is the price at which an entity would sell a good or service on a stand-alone (or separate) basis at contract inception. Under the model, the observable price of a good or service sold separately provides the best evidence of stand-alone selling price. However, in certain situations, stand-alone selling prices will not be readily observable and the entity must estimate the stand-alone selling price.

When allocating on a relative stand-alone selling price basis, any discount provided in the contract is generally allocated proportionately to all of the performance obligations in the contract.

The majority of products and services offered by the Company have readily observable selling prices. For products and services that do not, the Company generally estimates stand-alone selling price using the market assessment approach based on expected selling price and adjusts those prices as necessary to reflect the Company's

costs and margins. As part of its stand-alone selling price policy, the Company reviews product pricing on a periodic basis to identify any significant changes and revise its expected selling price assumptions as appropriate.

#### Shipping and Handling

The Company treats shipping and handling activities as costs to fulfill the Company's promise to transfer products. Shipping and handling fees billed to customers are recorded as a reduction to cost of product.

#### Capitalization of Costs to Obtain a Contract

The Company has assessed the treatment of costs to obtain or fulfill a contract with a customer. Sales commissions have historically been expensed as incurred. Under ASC 606, the Company capitalizes sales commissions related to multi-year service contracts and amortizes the asset over the period of benefit, which is the service period. Sales commissions paid on contract renewals, including service contract renewals, is commensurate with the sales commissions paid on the initial contracts.

The Company elected ASC 606's practical expedient to expense sales commissions as incurred when the amortization period of the related contract term is one year or less. These costs are recorded as sales and marketing expense and included on the balance sheet as accrued compensation and related benefits until paid.

As of September 29, 2018, the ending balance of the Company's capitalized costs to obtain a contract was \$0.4 million. The Company's amortization expense was not material for the three and nine months ended September 29, 2018.

#### Disaggregation of Revenue

The following table presents the Company's revenue disaggregated by revenue source (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017 <sup>(1)</sup>	September 29, 2018	September 30, 2017 <sup>(1)</sup>
Product	\$ 167,030	\$ 159,579	\$ 513,947	\$ 449,992
Services	33,383	33,001	97,374	94,931
Total revenue	\$ 200,413	\$ 192,580	\$ 611,321	\$ 544,923

The Company sells its products directly to customers who are predominantly service providers and to channel partners that sell on our behalf. The following tables present the Company's revenue disaggregated by geography, based on the shipping address of the customer and by sales channel (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017 <sup>(1)</sup>	September 29, 2018	September 30, 2017 <sup>(1)</sup>
United States	\$ 98,097	\$ 113,617	\$ 348,109	\$ 325,593
Other Americas	6,775	5,636	16,867	14,642
Europe, Middle East and Africa	59,131	58,391	180,492	163,714
Asia Pacific	36,410	14,936	65,853	40,974
Total revenue	\$ 200,413	\$ 192,580	\$ 611,321	\$ 544,923

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017 <sup>(1)</sup>	September 29, 2018	September 30, 2017 <sup>(1)</sup>
Direct	\$ 172,918	\$ 179,300	\$ 557,004	\$ 512,072
Indirect	27,495	13,280	54,317	32,851
Total revenue	\$ 200,413	\$ 192,580	\$ 611,321	\$ 544,923

<sup>(1)</sup> Prior period amounts have not been adjusted under the modified retrospective method.



**Contract Balances**

The following table provides information about receivables, contract assets and contract liabilities from contracts with customers (in thousands):

	September 29, 2018	At Adoption
Accounts receivable, net	\$ 153,901	\$ 135,245
Contract assets	\$ 6,469	\$ 2,825
Deferred revenue	\$ 58,516	\$ 75,458

Revenue recognized for the nine months ended September 29, 2018 that was included in the deferred revenue balance at the beginning of the reporting period was \$35.2 million. Changes in the contract asset and liability balances during the three and nine months ended September 29, 2018 were not materially impacted by other factors.

**Transaction Price Allocated to the Remaining Performance Obligation**

The Company's remaining performance obligations represent the transaction price allocated to performance obligations that are unsatisfied or partially satisfied, consisting of deferred revenue and backlog. The Company's backlog represents purchase orders received from customers for future product shipments and services. The Company's backlog is subject to future events that could cause the amount or timing of the related revenue to change, and, in certain cases, may be canceled without penalty. Orders in backlog may be fulfilled several quarters following receipt or may relate to multi-year support service obligations.

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially satisfied) at the end of the reporting period (in thousands):

	Remainder of 2018	2019	2020	2021	2022	Thereafter	Total
Revenue expected to be recognized in the future as of September 29, 2018	\$ 96,246	\$ 56,853	\$ 18,278	\$ 5,056	\$ 2,536	\$ 2,300	\$ 181,269

**Impacts on Financial Statements**

The following tables summarize the impact of adopting ASC 606 on the Company's condensed consolidated statement of operations for the three and nine months ended September 29, 2018 and the Company's condensed consolidated balance sheet as of December 31, 2017 (in thousands):

	Three Months Ended September 29, 2018		
	As Reported	Adjustments	Balances Without Adoption of ASC 606
<b>Income Statement</b>			
<b>Revenue</b>			
Product	\$ 167,030	\$ (1,845 )	\$ 165,185
Services	33,383	900	34,283
	\$ 200,413	\$ (945 )	\$ 199,468
<b>Costs and expenses</b>			
Cost of revenue	\$ 130,234	\$ 1,356	\$ 131,590
Net loss	\$(32,610 )	\$( 2,301 )	\$(34,911 )
Net loss per share - basic and diluted	\$(0.21 )	\$( 0.02 )	\$(0.23 )

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Nine Months Ended September 29,  
2018

	As Reported	Adjustments	Balances Without Adoption of ASC 606
<b>Income Statement</b>			
<b>Revenue</b>			
Product	\$513,947	\$ (2,740 )	\$511,207
Services	97,374	3,380	100,754
	\$611,321	\$ 640	\$611,961
<b>Costs and expenses</b>			
Cost of revenue	\$374,669	\$ 2,596	\$377,265
Net loss	\$(80,828 )	\$( 1,956 )	\$(82,784 )
Net loss per share - basic and diluted	\$(0.53 )	\$( 0.01 )	\$(0.54 )

	Balance at December 30, 2017	Adjustments due to ASC 606	As Adjusted Balance at December 31, 2017
<b>Balance Sheet</b>			
<b>Assets</b>			
Accounts receivable, net	\$126,152	\$ 9,093	\$135,245
Inventory	\$214,704	\$( 239 )	\$214,465
Prepaid expenses and other assets	\$43,339	\$ 2,731	\$46,070
<b>Liabilities</b>			
Accrued expenses	\$39,782	\$ 15,645	\$55,427
Deferred revenue	\$94,923	\$( 19,465 )	\$75,458
<b>Equity</b>			
Accumulated deficit	\$(758,081)	\$ 15,406	\$(742,675)

Balance Sheet

Assets

Accounts receivable, net	\$126,152	\$ 9,093	\$135,245
Inventory	\$214,704	\$( 239 )	\$214,465
Prepaid expenses and other assets	\$43,339	\$ 2,731	\$46,070

Liabilities

Accrued expenses	\$39,782	\$ 15,645	\$55,427
Deferred revenue	\$94,923	\$( 19,465 )	\$75,458

Equity

Accumulated deficit	\$(758,081)	\$ 15,406	\$(742,675)
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4. Fair Value Measurements

Pursuant to the accounting guidance for fair value measurements and its subsequent updates, fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

Valuation techniques used by the Company are based upon observable and unobservable inputs. Observable or market inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's assumptions about market participant assumptions based on the best information available. Observable inputs are the preferred source of values. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Prices or valuations that require management inputs that are both significant to the fair value measurement and unobservable.

The Company measures its cash equivalents, foreign currency exchange forward contracts and marketable debt securities at fair value and classifies its investments in accordance with the fair value hierarchy. The

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Company's money market funds and U.S. treasuries are classified within Level 1 of the fair value hierarchy and are valued based on quoted prices in active markets for identical securities.

The Company classifies its certificates of deposit, commercial paper, U.S. agency notes, corporate bonds and foreign currency exchange forward contracts within Level 2 of the fair value hierarchy as follows:

**Certificates of Deposit**

The Company reviews market pricing and other observable market inputs for the same or similar securities obtained from a number of industry standard data providers. In the event that a transaction is observed for the same or similar security in the marketplace, the price on that transaction reflects the market price and fair value on that day. In the absence of any observable market transactions for a particular security, the fair market value at period end would be equal to the par value. These inputs represent quoted prices for similar assets or these inputs have been derived from observable market data.

**Commercial Paper**

The Company reviews market pricing and other observable market inputs for the same or similar securities obtained from a number of industry standard data providers. In the event that a transaction is observed for the same or similar security in the marketplace, the price on that transaction reflects the market price and fair value on that day and then follows a revised accretion schedule to determine the fair market value at period end. In the absence of any observable market transactions for a particular security, the fair market value at period end is derived by accreting from the last observable market price. These inputs represent quoted prices for similar assets or these inputs have been derived from observable market data accreted mathematically to par.

**U.S. Agency Notes**

The Company reviews trading activity and pricing for its U.S. agency notes as of the measurement date. When sufficient quoted pricing for identical securities is not available, the Company uses market pricing and other observable market inputs for similar securities obtained from a number of industry standard data providers. These inputs represent quoted prices for similar assets in active markets or these inputs have been derived from observable market data.

**Corporate Bonds**

The Company reviews trading activity and pricing for each of the corporate bond securities in its portfolio as of the measurement date and determines if pricing data of sufficient frequency and volume in an active market exists in order to support Level 1 classification of these securities. If sufficient quoted pricing for identical securities is not available, the Company obtains market pricing and other observable market inputs for similar securities from a number of industry standard data providers. In instances where multiple prices exist for similar securities, these prices are used as inputs into a distribution-curve to determine the fair market value at period end.

**Foreign Currency Exchange Forward Contracts**

As discussed in Note 5, "Derivative Instruments" to the Notes to Condensed Consolidated Financial Statements, the Company mainly holds non-speculative foreign exchange forward contracts to hedge certain foreign currency exchange exposures. The Company estimates the fair values of derivatives based on quoted market prices or pricing models using current market rates. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit risk, foreign exchange rates, and forward and spot prices for currencies.

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The following tables represent the Company's fair value hierarchy for its assets and liabilities measured at fair value on a recurring basis (in thousands):

	As of September 29, 2018			As of December 30, 2017		
	Fair Value Measured Using			Fair Value Measured Using		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Assets						
Money market funds	\$50	\$	—\$ 50	\$20,371	\$	—\$ 20,371
Certificates of deposit	—	—	—	—	240	240
Commercial paper	—	—	—	—	26,912	26,912
Corporate bonds	—	25,490	25,490	—	118,558	118,558
U.S. agency notes	—	2,994	2,994	—	5,480	5,480
U.S. treasuries	1,996	—	1,996	35,408	—	35,408
Foreign currency exchange forward contracts	—	5	5	—	—	—
Total assets	\$2,046	-				
		1,877				
Revenue in excess of certain expenses	\$	9,666				

See accompanying notes to combined statement of revenue and certain expenses.



**SAVVIS PORTFOLIO**

**Notes to Combined Statement of Revenue and Certain Expenses**

**Period from March 5, 2004 (inception) through December 31, 2004**

**(1) Basis of Presentation**

The accompanying combined statement of revenue and certain expenses relates to the operations of the properties known as Savvis Portfolio (the Portfolio). The Portfolio includes four data centers located in Santa Clara, California and El Segundo, California and one office property located in Santa Clara, California.

A wholly-owned subsidiary of Digital Realty Trust, Inc. plans to acquire the Portfolio from an affiliate of DuPont Fabros Development (the Owner) for \$92,500,000. The Owner acquired the Portfolio on March 5, 2004. Prior to March 5, 2004, the Portfolio was not leased; accordingly, this period is not included in the accompanying combined financial statement.

The accompanying combined statement of revenue and certain expenses has been prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission and, accordingly, are not representative of the actual results of operations of the Portfolio for the period from March 5, 2004 (inception) through December 31, 2004 due to the exclusion of the following expenses, which may not be comparable to the proposed future operations of the Portfolio:

Depreciation and amortization

Interest expense

Federal and state income taxes

Other costs not directly related to the proposed future operations of the Portfolio.

Management is not aware of any material factors relating to the Portfolio other than those already described above that would cause the reported financial information not to be necessarily indicative of future operating results.

**(2) Summary of Significant Accounting Policies and Practices**

**(a) Revenue Recognition**

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Rental revenue is recognized on a straight-line basis over the term of the respective leases.

The straight line rent adjustment increased base rental revenue by approximately \$8,911,769 for the period from March 5, 2004 (inception) through December 31, 2004.

### *(b) Use of Estimates*

Management has made a number of estimates and assumptions relating to the reporting and disclosure of revenue and certain expenses during the reporting period to prepare the combined statement of revenue and certain expenses in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

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**SAVVIS PORTFOLIO**

**Notes to Combined Statement of Revenue and Certain Expenses (Continued)**

**Period from March 5, 2004 (inception) through December 31, 2004**

**(3) Minimum Future Lease Rentals**

Future minimum contractual rentals to be received under noncancelable operating leases in effect as of December 31, 2004 are as follows (in thousands):

Year ending December 31:	
2005	\$ 9,206
2006	10,349
2007	10,703
2008	10,987
2009	11,307
Thereafter	120,771
	<u>          </u>
	<u>\$ 173,323</u>

**(4) Tenant Concentrations**

All five of the properties within the Portfolio are leased to a single tenant, Savvis Asset Holdings, Inc., an affiliate of Savvis Communications.

**4,030,000 Shares**

**Common Stock**

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**PROSPECTUS SUPPLEMENT**

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**Merrill Lynch & Co.**

March 29, 2006

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