NEOPHOTONICS CORP
Form 10-Q
April 09, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

OR

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

For the transition period from to

Commission File Number: 001-35061

NeoPhotonics Corporation

(Exact name of registrant as specified in its charter)

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

2911 Zanker Road

San Jose, California 95134

(Address of principal executive offices, zip code)

(408) 232-9200

(Registrant’s telephone number, including area code)

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

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

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

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

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

As of March 31, 2014, there were 31,664,151 shares of the registrant’s Common Stock outstanding.

NEOPHOTONICS CORPORATION

For the Quarter Ended September 30, 2013

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	As of	
(In thousands, except share and per share data)	September 30, 2013	December 31, 2012 Revised (see Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$43,656	$ 36,940
Short-term investments	26,908	64,301
Accounts receivable, net of allowance for doubtful accounts	78,898	70,354
Inventories	63,687	43,793
Prepaid expenses and other current assets	10,285	10,256
Total current assets	223,434	225,644
Property, plant and equipment, net	70,818	54,440
Purchased intangible assets, net	16,309	14,213
Other long-term assets	1,836	1,335
Total assets	$312,397	$ 295,632
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$54,919	$ 36,308
Notes payable	7,954	12,003
Current portion of long-term debt	10,570	5,000
Accrued and other current liabilities	23,960	19,959
Total current liabilities	97,403	73,270
Long-term debt, net of current portion	26,390	17,167
Other noncurrent liabilities	8,772	2,515
Total liabilities	132,565	92,952
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, $0.0025 par value		
10,000,000 shares authorized, no shares issued or outstanding	-	-
Common stock, $0.0025 par value		
	78	76

At September 30, 2013: 100,000,000 shares authorized, 31,304,853 shares issued and outstanding; At December 31, 2012: 100,000,000 shares authorized, 30,546,155 shares issued and outstanding		
Additional paid-in capital	444,552	438,858
Accumulated other comprehensive income	13,172	11,829
Accumulated deficit	(277,970)	(248,083)
Total stockholders' equity	179,832	202,680
Total liabilities and stockholders' equity	$312,397	$ 295,632

See accompanying Notes to Condensed Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except share and per share data)	Three Months Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
Revenue	$ 76,814	$ 66,152	$ 207,867	$ 183,400
Cost of goods sold	58,635	45,536	162,330	136,190
Gross profit	18,179	20,616	45,537	47,210
Operating expenses:				
Research and development	12,227	9,893	33,021	29,753
Sales and marketing	3,580	3,354	10,515	9,783
General and administrative	8,905	6,530	21,853	19,704
Adjustment to fair value of contingent consideration	1,026	(850)	1,026	(246)
Amortization of purchased intangible assets	381	321	1,128	996
Restructuring charges	450	-	775	-
Acquisition-related transaction costs	126	240	5,317	912
Total operating expenses	26,695	19,488	73,635	60,902
Income (loss) from operations	(8,516)	1,128	(28,098)	(13,692)
Interest income	66	147	269	424
Interest expense	(251)	(135)	(756)	(434)
Other income (expense), net	115	154	(432)	(121)
Total interest and other income (expense), net	(70)	166	(919)	(131)
Income (loss) before income taxes	(8,586)	1,294	(29,017)	(13,823)
Provision for income taxes	(777)	(571)	(870)	(888)
Income (loss) from continuing operations	(9,363)	723	(29,887)	(14,711)
Income from discontinued operations, net of tax (including gain on disposal of $636, net of tax, for the nine months ended September 30, 2012)	-	-	-	170
Net income (loss)	$ (9,363)	$ 723	$ (29,887)	$ (14,541)
Basic and diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:				
Continuing operations	$ (0.30)	$ 0.02	$ (0.97)	$ (0.53)
Discontinued operations	$ -	$ -	$ -	$ 0.01
Net income (loss)	$ (0.30)	$ 0.02	$ (0.97)	$ (0.52)
Weighted average shares used to compute net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:				
Basic	31,184,958	30,215,144	30,848,478	27,838,292
Diluted	31,184,958	30,611,304	30,848,478	27,838,292

See accompanying Notes to Condensed Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Net income (loss)	$ (9,363)	$ 723	$ (29,887)	$ (14,541)
Foreign currency translation adjustments	533	(190)	1,394	(537)
Unrealized gains (losses) on investments, net of tax of $0	3	163	(51)	399
Comprehensive income (loss)	$ (8,827)	$ 696	$ (28,544)	$ (14,679)

See accompanying Notes to Condensed Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	Nine Months Ended September 30, 2013	2012
Cash flows from operating activities		
Net loss	$ (29,887)	$ (14,541)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	14,863	14,302
Stock-based compensation expense	4,265	3,435
Deferred taxes	(6)	387
Write-down of inventories	1,619	3,456
Amortization of premiums and discounts on investments	859	675
Adjustment to fair value of penalty payment derivative	100	-
Gain on sale of discontinued operations	-	(750)
Allowance for doubtful accounts	(22)	178
Others	707	57
Change in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(7,629)	(481)
Inventories	(7,802)	(12,686)
Prepaid expenses and other assets	(1,556)	(2,562)
Accounts payable	13,732	141
Accrued and other current liabilities	5,750	1,012
Net cash used in operating activities	(5,007)	(7,377)
Cash flows from investing activities		
Purchase of property, plant and equipment	(14,346)	(8,963)
Proceeds from disposition of property, plant and equipment	92	-
Purchase of marketable securities	(57,893)	(151,871)
Proceeds from sale of marketable securities	45,247	103,839
Proceeds from maturity of securities	49,155	34,584
Decrease in restricted cash	1,037	471
Acquisitions, net of cash acquired	(13,128)	-
Proceeds received on sale of discontinued operations, net of tax	-	1,825
Net cash provided by (used in) investing activities	10,164	(20,115)
Cash flows from financing activities		
Proceeds from issuance of common stock, net of issuance costs	-	39,636
Proceeds from exercise of stock options and issuance of stock under ESPP	2,200	1,151
Shares repurchased for tax withholdings on vesting of restricted stock units	(483)	-
Proceeds from long-term debt	26,443	-
Repayment of long-term debt	(22,360)	(3,750)
Proceeds from issuance of notes payable	14,152	19,651
Repayment of notes payable	(18,457)	(23,098)
Net cash provided by financing activities	1,495	33,590

Effect of exchange rates on cash and cash equivalents	64	(4)
Net increase in cash and cash equivalents	6,716	6,094
Cash and cash equivalents at the beginning of the period	36,940	32,485
Cash and cash equivalents at the end of the period	$ 43,656	$ 38,579
Supplemental disclosure of noncash investing and financing activities:		
Issuance of notes to the seller of acquired business	$ 11,130	$ -

See accompanying Notes to Condensed Consolidated Financial Statements.

NeoPhotonics Corporation

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Basis of presentation and significant accounting policies

Basis of Presentation and Consolidation

The condensed consolidated financial statements of NeoPhotonics Corporation ("NeoPhotonics" or the "Company") as of September 30, 2013 and December 31, 2012 and for the three and nine months ended September 30, 2013 and 2012, have been prepared in accordance with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). In accordance with those rules and regulations, the Company has omitted certain information and notes normally provided in the Company's annual consolidated financial statements. In the opinion of management, the condensed consolidated financial statements contain all adjustments, consisting only of normal recurring items, except as otherwise noted, necessary for the fair presentation of the Company's financial position and results of operations for the interim periods. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles ("U.S. GAAP"). These condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated.

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

Use of Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenue and expenses during the reporting period. Significant estimates made by management include: the useful lives of property, plant and equipment and intangible assets as well as future cash flows to be generated by those assets; 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.

Revision of Prior Period Balance Sheet

As further described in Note 9, 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 on April 27, 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 thus classified $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 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	$2,377 (1)	$ 2,515 (1)
Redeemable common stock	5,000	—
Additional paid-in capital	433,996	438,858

(1) Includes long-term deferred tax liabilities of $653 to conform to the September 30, 2013 presentation.

Summary of Significant Accounting Policies

Except as described in Note 9 "Private Sale of Common Stock", there have been no changes in the Company's significant accounting policies for the nine months ended September 30, 2013, as compared to the significant accounting policies described in its Annual Report on Form 10-K for the year ended December 31, 2012.

Recent accounting pronouncements

In February 2013, the Financial Accounting Standard Board ("FASB") issued amendments to the FASB Accounting Standard Codification to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments require new disclosures for items reclassified out of accumulated other comprehensive income ("AOCI"), including (1) changes in AOCI balances by component and (2) significant items reclassified out of AOCI. The guidance does not amend any existing requirements for reporting net income or OCI in the financial statements. As this guidance only requires expanded disclosures, the adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

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

Note 2. Net income (loss) per share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Income (loss) from continuing operations	$(9,363)	$723	$(29,887)	$(14,711)
Income from discontinued operations	-	-	-	170
Net income (loss)	$(9,363)	$723	$(29,887)	$(14,541)
Denominator:				
Weighted average shares used to compute basic net income (loss) per share	31,184,958	30,215,144	30,848,478	27,838,292
Weighted average shares used to compute diluted net income (loss) per share	31,184,958	30,611,304	30,848,478	27,838,292
Basic and diluted net income (loss) per share:				
Continuing operations	$(0.30)	$0.02	$(0.97)	$(0.53)
Discontinued operations	$-	$-	$-	$0.01

Net income (loss)	$(0.30)	$0.02	$(0.97)	$(0.52)

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

The Company has excluded the impact of the following outstanding stock awards from the computation of diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders, as their effect would have been antidilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Employee stock options	3,979,813	1,454,417	3,979,813	2,725,525
Restricted stock units	1,135,929	37	1,135,929	914,587
Employee stock purchase plan	236,423	-	236,423	269,514
Common stock warrants	4,482	4,482	4,482	4,482
	5,356,647	1,458,936	5,356,647	3,914,108

Note 3. Discontinued operations

The Company' s condensed consolidated statement of operations for the nine months ended September 30, 2012 includes revenue of $0.6 million related to the discontinued operations of Broadband, a subsidiary in China.

Note 4. Cash equivalents and investments and fair value disclosures

Cash equivalents and investments

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

	As of September 30, 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 equivalents								
Money market funds	$11	$ -	$ -	$11	$11	$ -	$ -	$11
Short-term investments								
Money market funds	12,217	-	-	12,217	7,259	-	-	7,259
Corporate bonds	7,645	14	-	7,659	23,151	43	(1)	23,193
U.S. federal agencies	-	-	-	-	27,241	10	-	27,251
Foreign bonds and notes	5,230	5	(3)	5,232	4,682	14	-	4,696
Municipal obligations	1,800	-	-	1,800	1,902	-	-	1,902
Total short-term investments	26,892	19	(3)	26,908	64,235	67	(1)	64,301
Total investments	$26,903	$ 19	$ (3)	$26,919 (1)	$64,246	$ 67	$ (1)	$64,312 (1)

[1]Interest income receivable included in total investment balance was $0.2 million and $0.4 million at September 30, 2013 and December 31, 2012, respectively.

As of September 30, 2013, maturities of investments are as follows (in thousands):

	September 30, 2013
Less than 1 year	$ 23,114
Due in 1 to 2 years	-
Due in 2 to 5 years	2,005
Due after 5 years	1,800
Total	$ 26,919

The Company may sell its marketable securities in the future to fund future operating needs. As a result, the Company recorded all of its marketable securities as short-term as of September 30, 2013 and December 31, 2012, regardless of the contractual maturity date of the securities.

Realized gains and losses on the sale of marketable securities during the three and nine months ended September 30, 2013 and 2012 were immaterial. The Company did not recognize any impairment losses on its marketable securities during the three and nine months ended September 30, 2013 and 2012. As of September 30, 2013, the Company did not have any investments in marketable securities that were in an unrealized loss position for a period in excess of 12 months.

Fair value disclosures

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

	As of September 30, 2013				As of December 31, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Money market funds	$12,228	$-	$ -	$12,228	$7,270	$-	$ -	$7,270
Marketable securities								
Corporate bonds	-	7,659	-	7,659	-	23,193	-	23,193
U.S. federal agencies	-	-	-	-	-	27,251	-	27,251
Foreign bonds and notes	-	5,232	-	5,232	-	4,696	-	4,696
Municipal obligations	-	1,800	-	1,800	-	1,902	-	1,902
	$12,228	$14,691	$ -	$26,919	$7,270	$57,042	$ -	$64,312

Additionally, the Company's cash and cash equivalents at September 30, 2013 and December 31, 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 following table sets forth the fair value of the Company's financial liabilities as of the dates presented (in thousands):

	As of September 30, 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 9)	$—	$ —	$238	$238	$—	$ —	$ 138	$138

Note 5. Business Combination

On March 29, 2013 (the "closing date") the Company acquired certain assets and assumed certain liabilities related to the Optical Components Business Unit (the "OCU") of LAPIS Semiconductor Co., Ltd., a wholly owned subsidiary of Rohm Co., Ltd ("LAPIS") of Japan with the intention of operating the OCU as an ongoing business. The 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 from the closing date through March 29, 2014. The notes payable of $11.1 million are to be paid in three equal installments on the first, second and third anniversaries of the closing date. Each year an additional amount calculated as 1.5% per year of the unpaid balance of the notes becomes due. LAPIS retains a lien on the land and building sold until the third payment is paid. The notes payable to Lapis are denominated in Japanese Yen.

In connection with the acquisition, the Company incurred approximately $5.3 million in acquisition-related transaction 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 were included in operating expenses in the Company's condensed consolidated statement of operations for the nine months ended September 30, 2013.

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 three months and nine months ended September 30, 2013, NeoPhotonics Semiconductor's contribution to total revenues was $14.0 million and $25.3 million, respectively. 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(1)	14,433
Intangible assets acquired:	
Developed technology	2,120
Customer relationships	3,180
	$ 33,077

(1) Includes land of $3.5 million, buildings of $3.9 million and machinery, equipment, furniture and fixtures of $7.0 million.

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 10 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 amount of intangible assets acquired is 5.4 years.

Pro Forma Financial Information (unaudited)

The following unaudited supplemental pro forma information presents the combined results of operations of NeoPhotonics Corporation and NeoPhotonics Semiconductor for the three and nine months ended September 30, 2013 and 2012, as if the NeoPhotonics Semiconductor acquisition had been completed at the beginning of fiscal 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 on sales to the Company in the appropriate pro forma periods as though the companies were combined as of the beginning of 2012. As a result of the elimination adjustments, revenues were reduced by $1.9 million for the nine months ended September 30, 2013 and were reduced by $1.5 million and $2.9 million for the three and nine months ended September 30, 2012, respectively, and cost of goods sold was reduced by $1.8 million for the nine months ended September 30, 2013 and was reduced by $1.3 million and $2.5 million in the three and nine months ended September 30, 2012, respectively. The pro forma financial information for the nine months ended September 30, 2013 also included elimination of $5.3 million in transaction costs and cost of goods sold was decreased by $1.1 million in the three months ended September 30, 2013 and was decreased by $2.9 million and increased by $4.2 million in the nine months ended September 30, 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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue	$76,814	$81,816	$220,558	$228,158
Net income (loss)	$(8,146)	$3,499	$(18,942)	$(10,822)
Basic net income (loss) per share	$(0.26)	$0.12	$(0.61)	$(0.39)
Diluted net income (loss) per share	$(0.26)	$0.11	$(0.61)	$(0.39)

The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved had the acquisition taken place at the beginning of the period presented, nor does it intend to be a projection of future results.

Note 6. Balance sheet components

Accounts receivable, net

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

	September 30, 2013	December 31, 2012
Accounts receivable	$ 73,418	$ 66,338
Trade notes receivable	6,327	4,979
Allowance for doubtful accounts	(847)	(963)
	$ 78,898	$ 70,354

Inventories

Inventories consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Raw materials	$ 19,282	$ 20,520
Work in process	22,132	8,603
Finished goods [1]	22,273	14,670
	$ 63,687	$ 43,793

[1] Finished goods inventory at offsite managed inventory locations were $6.0 million and $4.5 million as of September 30, 2013 and December 31, 2012, respectively.

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Prepaid expenses and other current assets

Prepaid expenses and other current assets consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Restricted cash	$ 1,641	$ 2,626
Prepaid expenses	3,133	2,471
Other	5,511	5,159
	$ 10,285	$ 10,256

Purchased intangible assets

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

	September 30, 2013			December 31, 2012		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Technology and patents	$34,517	$ (25,176)	$9,341	$32,176	$ (22,869)	$9,307
Customer relationships	15,147	(9,314)	5,833	11,898	(8,148)	3,750
Leasehold interest	1,391	(256)	1,135	1,355	(241)	1,114
Noncompete agreements	950	(950)	-	950	(908)	42
	$52,005	$ (35,696)	$16,309	$46,379	$ (32,166)	$14,213

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Cost of goods sold	$ 738	$ 616	$1,937	$1,830
Operating expenses	381	321	1,128	996
Total	$ 1,119	$ 937	$3,065	$2,826

The estimated future amortization expense of purchased intangible assets as of September 30, 2013, is as follows (in thousands):

2013 (remaining 3 months)	$1,120
2014	4,468
2015	4,453
2016	3,706
2017	846
Thereafter	1,716
	$16,309

Accrued and other current liabilities

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

	September 30, 2013	December 31, 2012
Employee-related accrued expenses	$ 10,497	$ 12,293
Other accrued expenses	13,463	7,666
	$ 23,960	$ 19,959

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Other noncurrent liabilities

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

	September 30, 2013	December 31, 2012 Revised, see Note 1
Pension and other employee-related	$ 6,386	$ 188
Penalty payment derivative (Note 9)	238	138
Other	2,148	2,189
	$ 8,772	$ 2,515

Warranty Accrual

The Company provides warranties to cover defects in workmanship, materials and manufacturing for a period of one to two years to meet the stated functionality as agreed to in each sales arrangement. The Company accrues for estimated warranty costs based upon historical experience, and for specific items, at the time their existence is known and the amounts are estimable.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Beginning balance	$ 1,461	$ 1,298	$ 1,072	$ 1,443
Warranty accruals	703	98	1,137	251
Settlements and adjustments	(219)	(65)	(264)	(363)
Ending balance	$ 1,945	$ 1,331	$ 1,945	$ 1,331

Note 7. Debt

The Company records debt at its carrying amount. The Company uses a market approach to determine fair value, which results in a Level 2 fair value measurement. As of September 30, 2013 the carrying value of the Company's debt approximated its fair value. The following table provides the components of debt and weighted average interest rates related to the Company's outstanding debt instruments (in thousands, except percentages):

	September 30, 2013		December 31, 2012	
	Carrying Amount	Weighted Average Interest Rate	Carrying Amount	Weighted Average Interest Rate

Notes payable	$ 7,954			$ 12,003		
Notes payable related to NeoPhotonics Semiconductor acquisition	$3,570	1.50	%	$-		
Short-term debt	7,000	2.93	%	5,000	2.20	%
Total short-term debt	$ 10,570			$ 5,000		
Long-term notes payable related to NeoPhotonics Semiconductor acquisition	$7,140	1.50	%	$-		
Long-term debt	19,250	2.93	%	17,167	2.20	%
Total long-term debt	$ 26,390			$ 17,167		

Notes payable

The Company frequently directs its banking partners to issue notes payable to its suppliers in China in exchange for accounts payable. These banks issue notes to vendors and issue payment to the vendors upon redemption. The Company owes the payable balance to the issuing bank. These notes are unsecured, noninterest bearing and are due approximately six months after issuance. As a condition of the notes payable lending 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 notes payable are paid by its subsidiaries in China. These balances are classified as restricted cash on the Company's condensed consolidated balance sheets. As of September 30, 2013, restricted cash totaled $1.6 million.

Notes payable related to NeoPhotonics Semiconductor acquisition

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 to Lapis.

Bank borrowings

The Company has lending arrangements with several financial institutions, including a loan and security agreement with Comerica Bank in the U.S., which has been amended several times.

As of December 31, 2012, $8.0 million was outstanding under the revolving line of credit agreement and $0.0 million was available for borrowing. Borrowings under this facility bear interest at a rate of LIBOR plus 2%.
As of December 31, 2012, no amounts were outstanding under the equipment advance line advance and all $7.0 million was available for borrowing. Borrowings under this facility would bear interest at a rate of LIBOR plus 2%.
As of December 31, 2012, $14.2 million was outstanding under the acquisition advance and $5.8 million was available for borrowing. The advances bear interest at a rate of LIBOR plus 2%.
On March 21, 2013, the Company amended and restated the prior loan and security agreement in its entirety. The components of the available credit facilities as of September 30, 2013 are as follows:

As of September 30, 2013, no amount was outstanding under the revolving line of credit agreement and all $20.0 million was available for borrowing subject to covenant requirements. Amounts are due on or before March 2016 and borrowings under this revolving line of credit include an interest rate option of a base rate as defined in the agreement plus 1.5% or LIBOR plus 2.5%. As of September 30, 2013 the rate on the LIBOR option was 2.68%.
As of September 30, 2013, $26.3 million was outstanding under the term loan of the credit facility and interest is payable quarterly in arrears; the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan include an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of September 30, 2013 the rate on the LIBOR option was 2.93%.
The Company's Credit Agreement requires the maintenance of specified financial covenants, including a liquidity ratio, restricts its 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. A breach of any of these covenants in the future could have an adverse impact on availability of financial assurances. In addition, the amounts outstanding could also be subject to acceleration of maturity. If such acceleration were to occur, the Company may not have sufficient liquidity available to repay the indebtedness. As of September 30, 2013 and December 31, 2012, the Company was in compliance with the covenants contained in this agreement.

Subsequent to December 31, 2013, the Company executed a series of amendments to the Credit Agreement that modified certain covenants and extended the delivery date of the Company's September 30, 2013 quarterly report on form 10-Q and its amended March 31, 2013 and June 30, 2013 quarterly reports on forms 10-Q/A. 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.

Note 8. Commitments and contingencies

Litigation

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

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and the Company, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the codefendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. On March 23, 2010, the Company filed an answer to the complaint and counterclaims, asserting two claims of patent infringement and additional claims asserting that Finisar has violated state and federal competition laws and violated its obligations to license on reasonable and non-discriminatory terms. On May 5, 2010, the court dismissed without prejudice all co-defendants (including the Company) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against the Company. On January 18, 2011, the Company 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 the Company and Finisar agreed to further toll their respective claims until the refiling of certain of the previously asserted claims from this dispute. As a result, Finisar is permitted to bring a new lawsuit against the Company if it chooses to do so, and the Company may bring new claims against Finisar upon seven days written notice prior to filing such claims. The Company is currently unable to predict the outcome of this dispute and therefore cannot determine the likelihood of loss nor estimate a range of possible loss.

Indemnifications

In the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and provide for general indemnification. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations. As of September 30, 2013, the Company does not have any material indemnification claims that were probable or reasonably possible.

Leases

The Company leases various facilities under non-cancelable operating leases. Future minimum payments under these operating leases totaled \$5.7 million as of September 30, 2013. Rent expense was \$0.5 million and \$1.7 million for the three and nine months ended September 30, 2013, respectively, and \$0.6 million and \$1.7 million for the three and nine months ended September 30, 2012, respectively.

Note 9. Stockholders' Equity and Equity Incentive Programs

Common Stock

As of September 30, 2013, the Company had reserved 6,132,549 common stock shares for the issuance under the Company's stock option plans, 594,874 common stock shares for the issuance under the stock purchase plan and 4,482 common stock shares to be issued upon exercise of the outstanding warrants.

Private Sale of Common Stock

On April 27, 2012, the Company issued and sold approximately 4.97 million shares of its common stock in a private placement transaction at a price of $8.00 per share for a gross amount of approximately $39.8 million.

The shares of common stock are restricted from transfer pursuant to a lockup agreement for up to two years, at the end of which the Company is obligated to file one or more registration statements covering the potential resale of the shares of common stock.

In connection with this private placement transaction, the Company agreed to certain performance obligations including establishing a wholly-owned subsidiary in the Russian Federation and making a $30.0 million investment commitment (the 'Investment Obligation') towards the Company's Russian operations. The Investment Obligation can be partially satisfied by investment outside of the Russian Federation 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 expenditures and the remaining $15.0 million can be satisfied through general working capital and research and development expenditures. 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 expenditure must be spent inside Russia. General working capital can include acquisition of other businesses or portions thereof to be owned by the Russian subsidiary.

The purchaser of the common stock has non-transferable veto rights over the Company's Russian subsidiary's annual budget during the investment period and must approve non-cash asset transfers to be made in satisfaction of the Investment Obligation. 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 the $39.8 million received in the private placement transaction or on withdrawal from the Company's bank accounts for use in general corporate purposes.

The Company is required to satisfy the Investment Obligation by July 31, 2014 or, in the event the Company has not recorded aggregate revenue from sales of its products in the Russian Federation of at least $26.8 million during the period beginning July 1, 2012 and ending June 30, 2014, then will be automatically extended from July 31, 2014 to March 31, 2015. The Company expects the date for achievement of the Investment Obligation will be extended to March 31, 2015. Therefore, the Company intends to meet its Investment Obligation by March 31, 2015. If the Company fails 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, the Company will be required to pay a $5.0 million penalty (the 'Penalty Payment') as the sole and exclusive remedy for damages and monetary relief available to the purchaser for failure to meet the Investment Obligation.

The Company has accounted for the $5.0 million Penalty Payment as an embedded derivative instrument, with the underlying being the performance or nonperformance of meeting the Investment Obligation by the extended deadline of March 31, 2015 and has classified $4.9 million of the $5.0 million as additional paid-in capital and the remaining $0.1 million, representing the estimated fair value of the Penalty Payment derivative, as other noncurrent liabilities.

The fair value of the Penalty Payment derivative has been estimated at the date of the original common stock sale (April 27, 2012) and at each subsequent balance sheet date using a probability-weighted discounted future cash flow approach using unobservable inputs, which are classified as Level 3 within the fair value hierarchy. The primary inputs for this approach include the probability of achieving the Investment Obligation and a discount rate that approximates the Company's incremental borrowing rate. After the initial measurement, changes in the fair value of this derivative were recorded in other income (expense).

The estimated fair value of this derivative was $0.2 million and $0.1 million at September 30, 2013 and December 31, 2012, respectively.

Accumulated Deficit

Approximately $6.3 million of the Company's accumulated deficit at December 31, 2012 was subject to restriction due to the fact that the Company's 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.

Stock Options

The Company granted 369,900 and 1,534,030 stock options during the third quarter and first nine months of 2013, respectively, with weighted-average grant-date fair values per share of $7.78 and $5.82, respectively. The Company granted 107,770 and 251,475 stock options during the third quarter and first nine months of 2012, respectively, with weighted-average grant-date fair values per share of $5.00 and $4.90, respectively.

The fair values of option awards were estimated at each grant date using the Black-Scholes option valuation model. The Black-Scholes model requires the input of assumptions, including the expected stock-price volatility and estimated option life. The expected volatilities utilized were based on the actual volatility of similar entities due to the limited history of the trading of the Company's common stock since the initial public offering in February 2011. The expected lives of options granted were estimated using the Company's historical and expected future exercise behavior. The risk-free interest rates utilized were based on the U.S. Treasury yield in effect at each grant date. No dividends were assumed in estimated option values. Assumptions used in the Black-Scholes model are presented below:

	Three Months Ended September 30,				Nine Months Ended September 30,			
Stock Options	2013		2012		2013		2012	
Weighted-average expected term (years)	6.55		6.78		6.48		6.77	
Weighted-average volatility	71	%	71	%	72	%	71	%
Risk-free interest rate	1.82-1.82	%	1.07-1.07	%	1.08-1.82	%	1.07-1.83	%
Expected dividends	0	%	0	%	0	%	0	%

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On December 12, 2012, the Company granted 1,060,000 shares of stock options to key employees subject to an increase in the shares available to be granted which was approved by our stockholders at our Annual Meeting on June 11, 2013. The Company determined that the grant date for these performance options was June 11, 2013 for accounting purposes. During the three months ended September 30, 2013, the Company granted an additional 110,000 shares of performance-based stock options. These shares will vest during the term if the average closing price of the Company's common stock over a period of 20 consecutive trading days is equal to or greater than $15.00 per share and the recipient remains in continuous service with the Company through such period, or fully accelerate and vest on the seventh anniversary of the grant date. The Company estimated the fair value of its performance options as $5.68 for the three months ended September 30, 2013 using a Monte Carlo simulation model on the date of grant with the assumptions discussed above. The Company recorded $0.2 million and $0.2 million of compensation expense for these options for the three months and nine months ended September 30, 2013, respectively.

As of September 30, 2013, there were 3,979,813 unexercised stock options outstanding.

Restricted Stock Units ("RSUs")

The Company granted 606,300 and 637,340 RSUs during the third quarter and first nine months of 2013, respectively, with weighted-average grant-date fair values per share of $6.98 and $6.98, respectively. The Company granted 428,000 and 615,609 RSUs during the third quarter and first nine months of 2012, respectively, with weighted-average grant-date fair values per share of $4.96 and $5.27, respectively. As of September 30, 2013, there were 1,135,929 RSUs outstanding.

Stock appreciation units ("SAUs")

The Company granted 25,000 and 275,000 SAUs during the third quarter and first nine months of 2013, with weighted-average grant-date fair values per share of $8.33 and $5.40, respectively. The Company did not grant SAUs during the third quarter and first nine months of 2012. As of September 30, 2013, there were 433,708 SAUs outstanding. SAUs are liability classified share-based awards which are re-measured each reporting period at fair value.

The fair values of SAUs were estimated at each grant date using the Black-Scholes option valuation model. The expected volatilities utilized were based on the actual volatility of similar entities. Vested SAUs first become exercisable upon the expiration of the lock-up period associated with the initial public offering. Therefore, the Company estimated the term of the SAUs based on an average of the weighted-average exercise period and the remaining contractual term. The risk-free interest rates utilized were based on the U.S. Treasury yield in effect at each grant date. No dividends were assumed in estimated option values. Assumptions used in the Black-Scholes model are presented below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Stock Appreciation Units	2013	2012	2013	2012
Weighted-average expected term (years)	1.92	3.10	2.29	3.27
Weighted-average volatility	52 %	65 %	57 %	68 %
Risk-free interest rate	0.15-0.66 %	0.30-0.57 %	0.14-0.66 %	0.30-1.04 %
Expected dividends	0 %	0 %	0 %	0 %

The Company granted 250,000 shares and 25,000 shares of stock appreciation units to key employees on June 11, 2013 and August 6, 2013, respectively. These performance shares will vest during the term of the average closing price of the Company's common stock over a period of 20 consecutive trading days is equal to or greater than $15.00 per share and the recipient remains in continuous service with the Company through such period, or fully accelerate and vest on the seventh anniversary of the grant date. The Company estimated the fair value of performance shares of $5.41 and $4.81for June 11, 2013 and August 6, 2013, respectively, for the three months ended September 30, 2013 using a Monte Carlo simulation model on the date of grant with the assumptions discussed above. The Company recorded $49,000 and $62,000 of compensation expense for these stock appreciation units for the three and nine months ended September 30, 2013, respectively.

Employee Stock Purchase Plan ("ESPP")

Employees purchased 262,860 shares in the first nine months of 2013 for $1.2 million and 257,335 shares in the first nine months of 2012 for $0.9 million under the ESPP. The value of the ESPP consists of: (1) the 15% discount on the purchase of the stock, (2) 85% of the call option and (3) 15% of the put option. The call option and put option were valued using the Black-Scholes option pricing model. The expected volatilities utilized were based on the actual volatility of similar entities. The expected term represents the period of time from the beginning of the offering period to the purchase date. The risk-free interest rates utilized were based on the U.S. Treasury yield in effect at each grant date. No dividends were assumed in estimated option values. Assumptions used in the Black-Scholes model are presented below:

	Three months ended September 30,		Nine months ended September 30,	
ESPP	2013	2012	2013	2012
Weighted-average expected term (years)	0.73	0.75	0.73	0.75
Weighted-average volatility	48 %	71 %	48 %	71 %
Risk-free interest rate	0.09-0.16 %	0.04-0.15 %	0.09-0.16 %	0.04-0.15 %
Expected dividends	0 %	0 %	0 %	0 %

Stock-based compensation expense

The Company's stock-based compensation expense was recorded as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2013	2012	2013	2012
Cost of goods sold	$ 471	$ 228	$ 845	$ 553
Research and development	417	404	1,435	1,268
Sales and marketing	253	242	835	656
General and administrative	449	408	1,150	958
	$ 1,590	$ 1,282	$ 4,265	$ 3,435

Note 10. Income taxes

The Company's income tax expense for the three and nine months ended September 30, 2013 was primarily related to income taxes of the Company's non-U.S. operations. The Company recorded an income tax provision of $0.8 million and $0.9 million for the three months and nine months ended September 30, 2013, as compared to an income tax provision of $0.6 million and $0.9 million for the three and nine months ended September 30, 2012, respectively.

The Company conducts its business globally and its operating income is subject to varying rates of tax in the United States, China and Japan. Consequently, the Company's effective tax rate is dependent upon the geographic distribution of its earnings or losses and the tax laws and regulations in each geographical region. The Company expects that its income taxes will vary in relation to its profitability and the geographic distribution of its profits. Historically, the Company has experienced net losses in the United States and in the short term, expects this trend to continue. One of the Company’s subsidiaries in China generates a cash tax liability. The subsidiary has qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate. The preferential rate applies to 2012-2013, and has been benefited for years 2008-2011 as well and the Company intends to reapply for the preferential rate for 2014 to 2016.

Due to historic losses in the US, the Company has a full valuation allowance on the US federal and state deferred tax assets and also has a full valuation allowance on the deferred tax assets of its NeoPhotonics Semiconductor subsidiary. Management continues to evaluate the realizability of deferred tax assets and the related valuation allowance. If management's assessment of the deferred tax assets or the corresponding valuation allowance were to change, the Company would record the related adjustment to income during the period in which management makes the determination.

As of September 30, 2013, there were no material changes to either the nature or the amounts of the uncertain tax positions previously determined for the year ended December 31, 2012.

Note 11. Pension

Japan Defined Benefit Plans

We assumed two defined benefit plans that provide retirement benefits to our employees in Japan in connection with our acquisition of NeoPhotonics Semiconductor on March 29, 2013. Under the defined benefit plans in Japan, we calculate benefits based on an employee's individual grade level, years of service and performance. Employees are entitled to a lump sum benefit upon retirement or upon certain instances of termination. Partially offsetting this liability is a $1.9 million receivable equal to the value of the plan assets. The Company is currently in the process of establishing a new pension plan ("New Pension Plan") for its employees in Japan. Until the New Pension Plan is established, the value of the plan assets will remain in plans administered by LAPIS and LAPIS has an obligation to transfer the value of these assets to the New Pension Plan. The net pension liability was $6.1 million at September 30, 2013 with anticipated outflows as follows (in thousands):

2013 (remaining 3 months)	$46
2014	401
2015	194
2016	626
2017	844
Thereafter	3,991
	$6,102

Net periodic pension costs for the three months and nine months periods ended September 30, 2013 included the following (in thousands):

	Three months ended September 30, 2013	Nine months ended September 30, 2013
Service costs	$ 85	$ 173
Interest cost	20	40
Expected return on plan assets	(11)	(22)
Net periodic pension costs	$ 94	$ 191

The Company had contributed $0.3 million to the benefit plans as of September 30, 2013 and contributed an additional $0.2 million during the period from October 1, 2013 to December 31, 2013.

Note 12. Restructuring Charges

In the first quarter of 2013, the Company exited and closed one facility at its headquarters location to align its facilities usage with its current size. As a result, the Company recorded a restructuring charge in operating expenses related to the facility impairment of approximately $0.3 million. As of September 30, 2013, the remaining balance on this restructuring obligation was $0.2 million, which the Company expects to pay through 2015.

In the third quarter of 2013, the Company approved and implemented a restructuring plan to reduce its workforce and close a facility in China and to exit its contract manufacturing activities in Malaysia. The workforce reduction affected 67 employees, or approximately 3% of the Company's total workforce, all of which were terminated prior to

September 30, 2013. The Company recorded a restructuring charge of $1.1 million in the quarter ended September 30, 2013 of which $0.5 million was recorded in operating expenses with the remainder recorded in cost of goods sold.

The following table summarizes activity associated with the restructuring during the nine months ended September 30, 2013 (in thousands):

	Severance	Facilities	Contract Termination	Total
Restructuring obligations, December 31, 2012	$ -	$ -	$ -	$ -
Restructuring costs incurred in 2013	699	317	387	1,403
Cash payments	(699)	(152)	-	(851)
Non-cash settlements and other	-	71	-	71
Restructuring obligations, September 30, 2013	$ -	$ 236	$ 387	$ 623

Note 13. Subsequent Event

Settlement with Santur

In January 2014, the Company reached a non-binding verbal understanding for the terms of a settlement agreement (“Settlement”) covering the outstanding claims in connection with its 2011 acquisition of Santur Corporation (“Santur”). The Settlement is subject to the execution of a definitive written agreement between the Company and the other parties. Under the Settlement, a net amount of $1.9 million will be paid to the Company from the escrow account that was set up under the original merger agreement. This amount comprises $3.9 million related to certain indemnification claims by the Company (“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, the Company had recorded $1.0 million as its estimated fair value of the Contingent Consideration Amount. As a result of this Settlement the Company recorded an additional $1.0 million in its operating expenses for the three and nine months ended September 30, 2013 to adjust the fair value of the Contingent Consideration Amount to the full $2.0 million settlement amount, which is included in accrued and other current liabilities on its condensed consolidated balance sheets. Because it is considered to be a contingent gain, the $3.9 million Indemnification Amount will not be recognized as other income until paid.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q for the period ended September 30, 2013 and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2012 included in our Annual Report on Form 10-K. References to "NeoPhotonics" "we," "our" and "us" are to NeoPhotonics Corporation unless otherwise specified or the context otherwise requires.

This Quarterly Report on Form 10-Q for the period ended September 30, 2013 contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q for the period ended September 30, 2013 that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Terminology such as "believe," "may," "might," "objective," "estimate," "continue," "anticipate," "intend," "should," "plan," "expect," "predict," "potential," or the n terms or other similar expressions is intended to identify forward-looking statements.

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

Business overview

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

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

We have research and development and wafer fabrication facilities in San Jose and Fremont, California which coordinate with our research and development and manufacturing facilities in Shenzhen and Wuhan, China, Tokyo, Japan, and Ottawa, Canada. We utilize proprietary design tools and design-for-manufacturing techniques to align our design process with our precision nanoscale, vertically integrated manufacturing and testing capabilities. We sell our products to the leading network equipment vendors globally, including ADVA AG Optical Networking Ltd., Alcatel-Lucent SA, Ciena Corporation, Cisco Systems, Inc., Coriant (formerly Nokia Siemens Networks B.V.), ECI Telecom Ltd., FiberHome Technologies Group, Fujitsu Limited, Huawei Technologies Co, Ltd., or 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.

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 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 our 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 the Company's Russian operations. See—Liquidity and Capital Resources, Contractual Obligations and Commitments and Note 9 to the Condensed Consolidated Financial Statements.

On March 29, 2013, we acquired the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd. ("OCU"). OCU is a leading provider of lasers, drivers, and detectors for high speed 100G applications located in Japan. This acquired business is now known as NeoPhotonics Semiconductor. We believe the acquisition of NeoPhotonics Semiconductor enhances our competitive position in 100G products.

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

For the three and nine months ended September 30, 2013 compared to the same periods in 2012, we continued to experience an increase in demand for our 100Gbps products as carriers continued to accelerate deployment of high capacity optical transport networks. This trend helped revenue from our Speed and Agility products to grow on a year over year basis. We expect continued volume growth for our 100Gbps products; however, at declining prices due to the results of our annual customer negotiation and new entrants into the market. In the third quarter of 2013, demand for our Access products declined relative to the same period in 2012 due to lower fiber-to-the-home deployments in China and North America. The market for optical communications products remains highly competitive. We expect to continue to experience competition from companies that range from large international companies offering a wide range of products to smaller companies specializing in narrow markets. We anticipate that macroeconomic conditions, including the slow recovery in the U.S., European sovereign debt issues, and a potential slowdown in the economic growth rate in China, could impact our results.

Critical accounting policies and estimates

Other than the item, "Business Combinations" below, there have been no material changes to our critical accounting policies and estimates during the nine months ended September 30, 2013 from those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2012 Form 10-K.

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.

Results of operations

Revenue

We sell substantially all of our products to original equipment manufacturers, or OEMs. Revenue is recognized when title of our products passes 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") or U.S. dollars. For the three and nine months ended September 30, 2013, 31% and 32% of our sales were derived from our China-based subsidiaries, respectively. For the three and nine months ended September 30, 2012, 42% and 46% of our sales were derived from our China-based subsidiaries, respectively. Revenue is driven by the volume of shipments and may be impacted by pricing pressures. We have generated most of our revenue from a limited number of customers. Given the high concentration of network equipment vendors in our industry, our top ten customers represented approximately 85% and 91% of our revenue in the three months ended September 30, 2013 and 2012, respectively, and 85% and 90% of our revenue in the nine months ended September 30, 2013 and 2012, respectively.

	Three Months Ended September 30,				Nine Months Ended September 30,			
(in thousands)	2013	2012	$ Change	% Change	2013	2012	$ Change	% Change
Total revenue	$76,814	$66,152	$10,662	16 %	$207,867	$183,400	$24,467	13 %

Total revenue increased by $10.7 million in the three months ended September 30, 2013 compared to the three months ended September 30, 2012, representing a 16% increase. Total revenue increased by $24.5 million in the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, representing a 13% increase. The increase in revenue was primarily attributable to revenue from NeoPhotonics Semiconductor, which we acquired at the end of the first quarter of 2013 and which contributed to growth in our Speed and Agility products as carriers increased deployment of 40 Gbps and 100 Gbps telecommunications networks. Revenue from our high speed products, which is primarily 100Gbps was $28.4 million or 37% of total revenue in the third quarter of 2013, an increase of 31% over the third quarter of 2012. This increase was partially offset by a decrease in demand for our access products and other telecom products primarily as a result of decrease in demand relating to applications of below10 Gbps.

For the three months ended September 30, 2013, Huawei Technologies (23%), Alcatel-Lucent SA (17%) and Ciena Corporation (13%), each accounted for 10% or more of our total revenue. For the nine months ended September 30, 2013, Huawei Technologies (26%), Ciena Corporation (16%), and Alcatel-Lucent SA (14%) each accounted for 10% or more of our total revenue. For the three months ended September 30, 2012, Huawei Technologies (29%), Alcatel-Lucent SA (20%), and Ciena Corporation (18%) each accounted for 10% or more of our total revenue. For the nine months ended September 30, 2012, Huawei Technologies (35%), Alcatel-Lucent SA (16%) and Ciena Corporation (15%) each accounted for 10% or more of our total revenue. No other customers accounted for 10% or more of total revenue. We expect that a significant portion of our revenue will continue to be derived from a limited number of customers. As a result, the loss of, or a significant reduction in, orders from Huawei Technologies or any of our other key customers would materially and adversely affect our revenue and results of operations. We expect a significant portion of our sales to be denominated in foreign currencies in the future, and therefore may continue to be affected by changes in foreign exchange rates.

Cost of goods sold and gross margin

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

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

	Three Months Ended September 30,									
	2013			2012						
(in thousands, except percentages)	Amount	% of Revenue		Amount	% of Revenue		$ Change	% Change	
Cost of goods sold	$58,635	76	%	$45,536	69	%	$13,099	29	%

	Nine Months Ended September 30,								
	2013			2012					
(in thousands, except percentages)	Amount	% of Revenue		Amount	% of Revenue		$ Change	% Change	
Cost of goods sold	$162,330	78	%	$136,190	74	%	$26,140	19	%

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2013		2012		2013		2012	
Gross margin	24	%	31	%	22	%	26	%

Cost of goods sold increased by $13.1 million and $26.1 million in the three and nine months ended September 30, 2013, respectively, compared to the corresponding 2012 periods. Gross margin for the three and nine months ended September 30, 2013 was 24% and 22%, respectively, compared to 31% and 26% for the corresponding 2012 periods. The decrease in gross margin partially resulted from costs associated with our NeoPhotonics Semiconductor acquisition. In connection with this acquisition, we recorded $3.1 million of inventory step up equal to the excess of the fair value of the inventory over its cost at the acquisition date, all of which was amortized into cost of goods sold during the nine months ended September 30, 2013. Our gross margin for the three and nine months ended September 30, 2013 was also impacted by restructuring charges of $0.6 million and lower average selling prices resulting from increased competition and pricing pressure from our major customers. These factors were partially offset by a $1.8 million decrease in the write-down of inventory in the nine months ended September 30, 2013 compared to the same period in 2012.

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

Operating expenses

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

	Three Months Ended September 30,					
	2013		2012			
(in thousands, except percentages)	Amount	% of Revenue	Amount	% of Revenue	$ Change	% Change
Research and development	$12,227	16 %	$9,893	15 %	$2,334	24 %
Sales and marketing	3,580	5 %	3,354	5 %	226	7 %
General and administrative	8,905	12 %	6,530	10 %	2,375	36 %
Adjustment to fair value of contingent consideration	1,026	1 %	(850)	-1 %	1,876	221 %
Amortization of purchased intangible assets	381	- %	321	- %	60	19 %
Restructuring charges	450	1 %	-	- %	450	100 %
Acquisition-related transaction costs	126	- %	240	- %	(114)	-48 %
Total operating expenses	$26,695	35 %	$19,488	29 %	$7,207	37 %

	Nine Months Ended September 30,					
	2013		2012			
(in thousands, except percentages)	Amount	% of Revenue	Amount	% of Revenue	$ Change	% Change
Research and development	$33,021	16 %	$29,753	16 %	$3,268	11 %
Sales and marketing	10,515	5 %	9,783	5 %	732	7 %
General and administrative	21,853	10 %	19,704	11 %	2,149	11 %
Adjustment to fair value of contingent consideration	1,026	- %	(246)	- %	1,272	517 %
Amortization of purchased intangible assets	1,128	1 %	996	1 %	132	13 %
Restructuring charges	775	- %	-	- %	775	100 %
Acquisition-related transaction costs	5,317	3 %	912	- %	4,405	483 %
Total operating expenses	$73,635	35 %	$60,902	33 %	$12,733	21 %

Research and development

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

Research and development expense increased by $2.3 million in the three months ended September 30, 2013 compared to the three months ended September 30, 2012, representing a 24% increase. The acquisition of NeoPhotonics Semiconductor increased our research and development expense by $1.3 million. The increase was also due to $1.1 million increase in research and development projects to support our business growth partially offset by a $0.1 million net decrease in compensation-related costs.

Research and development expense increased by $3.3 million in the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012, representing an 11% increase. The acquisition of NeoPhotonics Semiconductor increased our research and development expense by $2.6 million. The increase was also due to $1.3 million increase in research and development projects to support our business growth, partially offset by a net decrease of $0.5 million in compensation-related costs compared to the same period in 2012, which included additional costs related to the acquisition of Santur.

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

Sales and marketing

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

Sales and marketing expense increased by $0.2 million in the three months ended September 30, 2013 compared to the three months ended September 30, 2012, representing a 7% increase which is primarily due to increases from the acquisition of NeoPhotonics Semiconductor.

Sales and marketing expense increased by $0.7 million in the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, representing a 7% increase. The increase is largely due to the acquisition of NeoPhotonics Semiconductor which increased our sales and marketing expense by $0.3 million and expenses incurred as part of our geographic expansion into Russia.

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

General and administrative

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

General and administrative expense increased by $2.4 million in the three months ended September 30, 2013 compared to the three months ended September 30, 2012, representing a 36% increase. Costs in the newly acquired NeoPhotonics Semiconductor increased our general and administrative expenses by $1.0 million. We incurred $1.6 million in higher consulting and professional services costs, of which approximately $1.0 million was attributable to resources engaged to assist in addressing internal control issues, provide technical accounting support and fill vacant key positions on an interim basis. We expect such costs to continue to be high through the second quarter of 2014. Additional increases included $0.2 million in IT related costs and $0.4 million in other costs to support our continued growth. These increases were partially offset by a net $0.9 million decrease in payroll related costs primarily attributable to a decrease in accrued bonus expense.

General and administrative expense increased by $2.1 million in the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, representing an 11% increase. Increases included $2.2 million in consulting and professional services, $1.0 million in IT related costs, costs in the newly acquired NeoPhotonics Semiconductor of $0.9 million and $0.5 million in other costs to support our continued growth. These increases were partially offset by a net decrease in payroll and related costs of $2.4 million primarily due to a decrease in accrued bonus expense.

We expect our general and administrative expense to increase in absolute terms as a result of the acquisition of NeoPhotonics Semiconductor and as we expand and grow our operations and business.

Adjustment to the fair value of contingent consideration

In January 2014, the Company reached a non-binding verbal understanding for the terms of a settlement agreement (“Settlement”) covering the outstanding claims in connection with its 2011 acquisition of Santur Corporation (“Santur”). The Settlement is subject to the execution of a definitive written agreement between the Company and the other parties. Under the Settlement, a net amount of $1.9 million will be paid to the Company from the escrow account that was set up under the original merger agreement. This amount comprises $3.9 million related to certain indemnification claims by the Company (“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, the Company had recorded $1.0 million as its estimated fair value of the Contingent Consideration Amount. As a result of this Settlement the Company recorded an additional $1.0 million in its operating expenses for the three and nine months ended September 30, 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 as other income until paid.

Amortization of purchased intangible assets

We completed a series of business acquisitions in 2005 and 2006 and, more recently, in the fourth quarter of 2011 and in the first quarter of 2013, which included the acquisition of intangible assets. These intangible assets are being amortized over their estimated useful lives. Amortization expense relating to technology and patents and leasehold interests are included within cost of goods sold, while customer relationships and noncompete agreements are recorded within operating expenses. See Note 5 “Business Combination” and Note 6 “Balance Sheet Components” in our Notes to Condensed Consolidated Financial Statements for details.

Restructuring charges

In the first quarter of 2013, we exited and closed one facility at our headquarters location to align our facilities usage with our current size. As a result, we recorded a restructuring charge in operating expenses related to the facility impairment of approximately

$0.3 million including $0.1 million write-off of deferred rent. As of September 30, 2013, the remaining balance on this restructuring obligation was $0.2 million, which we expect to pay through 2015.

In the third quarter of 2013, we approved and implemented a restructuring plan to reduce our workforce and close a facility in China and to exit our contract manufacturing activities in Malaysia. The workforce reduction affected 67 employees, or approximately 3% of our total workforce, all of which were terminated prior to September 30, 2013. We recorded a restructuring charge of $1.1 million in the quarter ended September 30, 2013 of which $0.5 million was recorded in operating expenses with the remainder recorded in costs of goods sold.

Acquisition-related transaction costs

In connection with the NeoPhotonics Semiconductor acquisition we incurred $0.1 million and $5.3 million in acquisition-related transaction costs in the three and nine months ended September 30, 2013, respectively. The costs related to investment banking, legal, accounting and other professional services and fees as well as transfer and acquisition taxes related to real property acquired.

We accounted for our 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. See Note 5 "Business Combination" in our Notes to Condensed Consolidated Financial Statements for details.

Interest and other expense, net

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
(in thousands)	2013	2012	$ Change	% Change	2013	2012	$ Change	% Change
Interest income	$66	$147	$ (81)	-55 %	$269	$424	$ (155)	-37 %
Interest expense	(251)	(135)	(116)	86 %	(756)	(434)	(322)	74 %
Other income (expense), net	115	154	(39)	-25 %	(432)	(121)	(311)	257 %
Total	$(70)	$166	$ (236)	-142 %	$(919)	$(131)	$ (788)	602 %

Total interest and other expense, net, increased by $0.2 million in the three months ended September 30, 2013, compared to the three months ended September 30, 2012. Total interest and other expense, net, increased by $0.8 million in the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012. The change in both periods was primarily related to higher interest expense due to additional borrowings and foreign exchange changes due to currency fluctuations. We expect our interest income to remain relatively modest given the low yields available in the marketplace and lower investable balances. See Note 7 "Debt" in our Notes to Condensed Consolidated Financial Statements for more information.

Income taxes

We conduct our business globally. Therefore, our operating income is subject to varying rates of tax in the United States, China, Japan and other various foreign jurisdictions. Consequently, our effective tax rate is dependent upon the geographic distribution of our earnings or losses and the tax laws and regulations in each geographical region. We expect that our income taxes will vary in relation to our profitability and the geographic distribution of our profits. Historically, we have experienced net losses in the U.S. and in the short term, we expect this trend to continue. In China, one of our subsidiaries has qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate. The preferential rate applies to 2012-2013, and has been benefited for years 2008-2011 as well and we intend to reapply for the preferential rate for 2014-2016.

	Three Months Ended September 30,		Nine Months Ended June 30,	
(in thousands)	2013	2012	2013	2012
Provision for income taxes	$ 777	$ 571	$ 870	$ 888

Our income tax expense for the three and nine months ended September 30, 2013 was primarily related to income taxes of our non-U.S. operations.

Liquidity and capital resources

We have financed our operations through issuances of investment securities and from various lending arrangements. At September 30, 2013, our cash and cash equivalents totaled $43.7 million, and our short-term investments totaled $26.9 million. Cash and cash equivalents were held for working capital purposes and were invested primarily in money market funds. We do not enter into investments for trading or speculative purposes.

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

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

Frequently, we also direct our banking partners to issue notes payable to our suppliers in China in exchange for accounts payable. Our Chinese subsidiaries' banks issue the notes to vendors and issue payment to the vendors upon redemption. We owe the payable balance to the issuing bank. The notes payable are non-interest bearing and are generally due within six months of issuance. As a condition of the notes payable lending arrangements, we are required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the notes payable are paid by our subsidiaries in China. These balances are classified as restricted cash and included in prepaid expenses and other current assets on our consolidated balance sheets. As of September 30, 2013, our restricted cash totaled $1.6 million.

Approximately $6.3 million of our accumulated deficit at December 31, 2012 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.

We assumed two defined benefit plans that provide retirement benefits to our employees in Japan in connection with our acquisition of NeoPhotonics Semiconductor on March 29, 2013. Under these defined benefit plans, we calculate benefits based on an employee's individual grade level, years of service and performance. Employees are entitled to a lump sum benefit upon retirement or upon certain instances of termination. Per the terms of the Demerger Agreement with LAPIS, we have up to one year to establish a new pension plan ("New Pension Plan") for our employees in Japan. Until the New Pension Plan is established, the value of the plan assets will remain in plans administered by LAPIS and LAPIS has an obligation to transfer the value of these assets to the New Pension Plan.

Credit agreements

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

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

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

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

On March 21, 2013, we amended and restated the prior loan and security agreement in its entirety. The components of the available credit facilities as of September 30, 2013 are as follows:

As of September 30, 2013, no amount was outstanding under the revolving line of credit agreement and all $20.0 million was available for borrowing subject to covenant requirements. Amounts are due on or before March 2016 and borrowings under this revolving line of credit include an interest rate option of a base rate as defined in the agreement plus 1.5% or LIBOR plus 2.5%. As of September 30, 2013 the rate on the LIBOR option was 2.68%.

As of September 30, 2013, $26.3 million was outstanding under the term loan of the credit facility and interest is payable quarterly in arrears; the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan include an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of September 30, 2013 the rate on the LIBOR option was 2.93%.
Our Credit Agreement requires the maintenance of specified financial covenants, including a liquidity ratio, 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 the Company's U.S. assets, other than intellectual property assets. Our ability to meet the financial covenants in future periods will depend on events beyond our control, and we cannot be assured that we will meet those requirements. A breach of any of these covenants in the future could have an adverse impact on availability of financial assurances. In addition, the amounts outstanding could also be subject to acceleration of maturity if we breach a covenant. If such acceleration were to occur, we may not have sufficient liquidity available to repay the indebtedness. As of September 30, 2013 and December 31, 2012, we were in compliance with the covenants contained in this agreement.

Subsequent to December 31, 2013, we executed a series of amendments to the Credit Agreement that modified certain covenants and extended the delivery date of our September 30, 2013 Quarterly Report on Form 10-Q and our amended March 31, 2013 and June 30, 2013 Quarterly Reports on Forms 10-Q/A. 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.

Our subsidiaries in China have short-term line of credit facilities with several banking institutions. These short-term loans have an original maturity date of one year or less as of September 30, 2013. Amounts requested by us are not guaranteed and are subject to the banks' funds and currency availability. The short-term loan agreements do not contain financial covenants. As of September 30, 2013, we had no short-term loans outstanding.

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 the Russian Federation and making a $30.0 million investment commitment (the 'Investment Obligation') towards the Company's Russian operations. The Investment Obligation can be partially satisfied by cash and/or stock investment inside or outside of the Russian Federation 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.

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

	Nine months ended September 30,	
(in thousands)	2013	2012
Net cash used in operating activities	$ (5,007)	$ (7,377)
Net cash provided by (used in) investing activities	10,164	(20,115)
Net cash provided by financing activities	1,495	33,590
Effect of exchange rates on cash and cash equivalents	64	(4)
Net increase in cash and cash equivalents	$ 6,716	$ 6,094

Operating activities

Cash used in operating activities consists of our net loss adjusted for certain non-cash items, including depreciation and amortization, stock-based compensation expense, write-down of inventory and the effect of changes in working capital and other activities.

During the nine months ended September 30, 2013, net cash used in operating activities was $5.0 million which was a $2.4 million decrease from the $7.4 million used in the nine months ended September 30, 2012. Contributing to the decrease was an increase in accounts payable due to higher inventory purchases and payment timing differences during the latter part of the 2013 period and higher accrued and other current liabilities, mainly from the newly acquired NeoPhotonics Semiconductor business. Operating cash flows also benefited from lower growth in inventory over the nine months ended September 30, 2013 compared to the same period in 2012. These factors were partially offset by a higher net loss and an increase in accounts receivable due to higher revenue in the 2013 quarter.

Investing activities

During the nine months ended September 30, 2013, net cash provided by investing activities was $10.2 million, which was a $30.3 million change from the $20.1 million used in investing activities during the nine months ended September 30, 2012. The change was primarily due to net sales and maturities of marketable securities, partially offset by higher purchases of property and equipment and cash used to purchase NeoPhotonics Semiconductor in the 2013 period.

Financing activities

During the nine months ended September 30, 2013, net cash provided by financing activities was $1.5 million, which was a $32.1 million decrease from the $33.6 million provided by financing activities during the nine months ended September 30, 2012. The 2012 period benefitted from $39.6 million generated from the private placement transaction. Also contributing to the change was $4.1 million in net proceeds from our amended Credit Agreement in the 2013 period.

Contractual obligations and commitments

The following summarizes our contractual obligations as of September 30, 2013:

	Payments due by period				
		Less than	1-3	3-5	More than
(in thousands)	Total	1 Year	Years	Years	5 Years
Notes payable [(1)]	$7,954	$7,954	$-	$-	$ -

Short-term and long-term loan (2)	10,710	3,570	7,140	-	-
Debt obligations (3)	26,250	7,000	14,000	5,250	-
Retirement obligations (4)	6,102	46	595	1,470	3,991
Operating leases (5)	5,747	1,851	2,305	1,010	581
Purchase commitments (6)	31,780	31,780	-	-	-
Penalty payment derivative (7)	238	-	238	-	-
Asset retirement obligations (8)	832	-	-	-	832
	89,613	52,201	24,278	7,730	5,404
Expected interest payments (9)	1,651	792	808	51	-
Total commitments	$91,264	$52,993	$25,086	$7,781	$ 5,404

(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.

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

(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 $6.1 million as of September 30, 2013.

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

(6) We are obligated to make payments under various arrangements with suppliers for the procurement of goods and services.

(7) See “Private placement transaction” below and Note 9 to the condensed consolidated financial statements.

(8) We have an asset retirement obligation of $0.7 million associated with our facility lease in California, which expires in October 2019. This obligation is included in other noncurrent liabilities in the condensed consolidated balance sheet as of September 30, 2013. We also have a $0.1 million asset retirement obligation in Japan.

(9) We calculate the expected interest payments based on our outstanding notes payable, loan and debt obligations at prevailing interest rates as of September 30, 2013.

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 the Russian Federation 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 the Russian Federation 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 three and nine months ended September 30, 2013, we did not have any significant off-balance sheet arrangements.

Recent accounting pronouncements

See Note 1 “Basis of presentation and significant accounting policies” in the Notes to Condensed Consolidated Financial Statements on this Quarterly Report on Form 10-Q for a description of recent accounting pronouncements and accounting changes.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate fluctuation risk

Our cash equivalents consisted primarily of money market funds and interest and non-interest bearing bank deposits. The main objective of these instruments was safety of principal and liquidity while maximizing return, without significantly increasing risk. Given the short-term nature of our cash equivalents, we do not anticipate any material effect on our portfolio due to fluctuations in interest rates.

We started to invest our excess cash in short-term and long-term marketable securities in 2011 to take advantage of higher yields generated by these investments. As of September 30, 2013, the gross unrealized gains or losses on our investments classified as available-for-sale were primarily due to increases or decreases in the fair value of the marketable securities as a result of changes in market interest rates. We have determined that the gross unrealized gains or losses on the available-for-sale securities at September 30, 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 September 30, 2013, regardless of the contractual maturity date of the securities.

We are exposed to market risk due to the possibility of changing interest rates associated with certain outstanding balances under our debt instruments. As of September 30, 2013, we did not have outstanding debt in China. As of September 30, 2013 and 2012, our U.S. debt was based on floating rates of interest and is subject to fluctuations in interest rates. As of September 30, 2013 and 2012, we had not hedged our interest rate risk.

Foreign currency exchange risk

Foreign currency exchange rates are subject to fluctuation and may cause us to recognize transaction gains and losses in our statement of operations. A substantial portion of our business is conducted through our subsidiaries in China whose functional currency is the RMB. To the extent that transactions by our subsidiaries in China are denominated in currencies other than RMB, we bear the risk that fluctuations in the exchange rates of the RMB in relation to other currencies could decrease our revenue and increase our costs and expenses. During the three months ended September 30, 2013 and 2012, we recognized foreign currency transaction gains/(losses) of $0.1 million and $(0.1) million, respectively. During the nine months ended September 30, 2013 and 2012, we recognized foreign currency transaction gain/(losses) of $0.6 million and $(0.1) million, respectively. We use the U.S. dollar as the reporting currency for our consolidated financial statements. Any significant revaluation of the RMB may materially and adversely affect our results of operations upon translation of our Chinese subsidiaries' financial statements into U.S. dollars. While we generate a significant portion of our revenue in RMB, a significant portion of our operating expenses are in U.S. dollars. Therefore depreciation in RMB against the U.S. dollar would negatively impact our revenue upon translation to the U.S. dollars but the impact on operating expenses would be less. For example, for the three and nine months ended September 30, 2013, a 10% depreciation in RMB against the U.S. dollar would have resulted in a $2.2 million and $6.1 million decrease in our revenue, respectively, and a $0.1 million and 0.1 million decrease in our net loss, respectively. Comparatively, for the three and nine months ended September 30, 2012, a 10% depreciation in RMB against the U.S. dollar would have resulted in a $2.5 million and $7.6 million decrease in our revenue, respectively, and a $0.3 million and $0.5 million decrease in our net income, respectively.

In connection with the NeoPhotonics Semiconductor acquisition in the first quarter of 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 in the period a payment is made. Following the NeoPhotonics Semiconductor acquisition the number and volume of our transactions in Japanese Yen has grown which increases our exposure to potential volatility in this currency.

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 another 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 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2013. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were not effective as a result of the material weaknesses that existed in our internal control over financial reporting.

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

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

In the Evaluation of Disclosure Controls and Procedures included in Amendment No. 1 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as a result of the material weaknesses that existed in our internal controls over financial reporting related to annual inventory counts and the preparation and review of the consolidated statement of cash flows.

As reported in Amendment No. 2 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, our Chief Executive Officer and new Chief Financial Officer subsequently concluded that the following additional material weaknesses also existed as of March 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 the 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 the 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 as well as the material weaknesses described above.
- 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.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934, as amended) as of September 30, 2013 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, as described below under "Remedial Measures," our Board of Directors, our Audit Committee and our new management team has subsequently dedicated significant efforts to improve the control environment and to remedy the material weaknesses identified herein.

Remedial Measures

Our management continued significant efforts in 2013 to establish a framework to improve internal controls over financial reporting. We committed considerable resources to the design, implementation, documentation, and testing of our internal controls. Additional efforts were required to remediate and re-test certain internal control deficiencies. Our management believes that these efforts have improved our internal control over financial reporting. With the oversight of senior management and our audit committee, we have taken steps and plan to take additional measures to remediate the underlying causes of the material weaknesses. Our management and the Board of Directors have taken the following steps as part of our ongoing remediation efforts to address these material weaknesses:

- Hired a new Chief Financial Officer;
- Hired a new World-Wide Corporate Controller;
- Hired a World-Wide Operations Controller;
- Implemented enhanced communication and monitoring processes and the appropriate documentation of such to ensure the Audit Committee's effectiveness in executing its oversight responsibilities;
- Engaged an external team of experienced senior finance and accounting consultants to review and analyze our consolidated financial statement close and reporting processes, and
- Designed and implemented an inventory control and annual physical count training program for relevant personnel specifically focusing on material located in the income/receiving areas.

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

- Implemented inventory control and annual physical count training for relevant personnel per above;
- Performed more frequent inventory cycle and physical counts at our Fremont and San Jose, California facilities, and
- Instituted a process of review and assessment of more frequent inventory cycle and physical counts at our California facilities in order to improve procedures.

While these steps have helped address some of the root causes of the material weaknesses noted above, they have not been sufficient to fully remediate the material weaknesses that existed as of September 30, 2013. We intend to take the following additional steps to remediate these material weaknesses:

- Add additional key positions to the finance team;
- Increase management oversight by expanding our disclosure process to include all senior managers with responsibility for responding to issues raised during the financial reporting process and enhanced required certifications from all executive management;
- Improve the documentation, communication and periodic review of our accounting policies throughout our domestic and international locations for consistency and application with generally accepted accounting principles, and
- Enhance the training and education for our world-wide finance and accounting personnel.

Notwithstanding the identified material weaknesses, management believes that the consolidated financial statements contained in this report present fairly our financial condition, results of operations, and cash flows for the periods covered thereby in all material respects. To address the material weaknesses in our internal control over financial reporting, we also performed additional manual procedures and analysis and other post-closing procedures in order to prepare the consolidated financial statements included in this Quarterly Report on Form 10-Q.

While management is dedicated to improving our internal controls over financial reporting, the nature and significance of the outstanding material weaknesses may prevent successful remediation of all material weaknesses during 2013 and 2014.

Inherent Limitation on the Effectiveness of Internal Controls

The effectiveness of any system of internal control over financial reporting is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting can only provide reasonable, not absolute assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We intend to continue to monitor and upgrade our internal controls as necessary or appropriate for our business, but cannot assure that such improvements will be sufficient to provide us with effective internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. 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 Quarterly Report on Form 10-Q, 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 codefendants' 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 our 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 our 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 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.

ITEM 1A. RISK FACTORS

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

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 September 30, 2013, our accumulated deficit was $278.0 million. We also expect to continue to make significant expenditures related to the development of our business. These include expenditures to hire additional personnel related to the sales, marketing and development of our products and to maintain and expand our manufacturing facilities and research and development operations.

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

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

We make planning and spending decisions, including determining the levels of business that we will seek and accept, production schedules, and inventory levels, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers and the possibility of unexpected changes in demand for their products reduce our ability to accurately estimate future customer requirements. On occasion, customers may require rapid increases in production, which can strain our resources, cause our manufacturing to be negatively impacted by materials shortages, necessitate higher or more restrictive procurement commitments, increase our manufacturing yield loss and scrapping of excess materials, and reduce our gross margin. We may not have sufficient capacity at 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 first three quarters of 2013. We expect these impacts to continue through the remainder of 2013 and for 2014, which is expected to adversely affect our gross margins.

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 the nine months ended September 30, 2013, Huawei Technologies, Alcatel-Lucent SA and Ciena Corporation accounted for 26%, 14% and 16% of our revenue, respectively. In fiscal 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 90.2% 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 (for instance, in 2009, the filing of a voluntary petition for bankruptcy protection by one of our customers, Nortel Networks Limited, prevented us from timely collection of our accounts receivable from that customer). In addition, network equipment vendors serving the communications networks industry may continue to consolidate, and we may not be able to offset any potential decline in revenue arising from consolidation of our existing customers with revenue from new customers.

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, 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 4 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, we experienced such increased costs with one of our high speed products and one of our wafer fabrication facilities. These higher costs continued in 2013 and 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 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 mobile video and data services, wireless 4G/LTE services, HD and 3D video, music, 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 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. In addition, during 2012, we established a Russian subsidiary. However we have limited history operating in the Russian Federation, which makes it difficult to evaluate our business and financial prospects there. 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 our technical and operations employees. 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, at the earliest, 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. law. Particularly, our U.S. patents do not afford any intellectual property protection in China, Japan, Canada, Malaysia or the Philippines, where we have company operations, or in the Russian Federation, 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.

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, 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. (OCU). 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 financial and management resources from existing operations;
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;
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; and
dilutive effect on our stock as a result of any equity-based 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 OCU may affect our future results of operations and financial condition.

In connection with our acquisitions of Santur and OCU, 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 OCU may view our larger company as a competitor, and therefore may reduce or end their purchases of OCU products for competitive reasons;
Japanese customers of OCU, 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 OCU’s legacy products for network applications that are declining within our customer base (such as OCU’s gallium arsenide integrated circuits for 10G network applications)
we could have difficulty implementing and maintaining financial reporting requirements for OCU’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 OCU’s previous business operations;
we could incur additional costs associated with known and unknown environmental contamination of the real estate acquired from OCU; and
we could incur costs associated with new export or compliance issues associated with OCU 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, China, and Dongguan, China an area that is 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.

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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 over the next two years, 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. The value of the RMB against the U.S. dollar and other currencies fluctuates and is 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 31% appreciation of the RMB against the U.S. dollar between July 21, 2005 and December 31, 2012. 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 are denominated in currencies other than the RMB, we bear the risk that fluctuations in the exchange rates of the RMB 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, conversely, a majority of our operating expenses are in U.S. dollars. Therefore, any depreciation in the RMB against the U.S. dollar would adversely impact our revenue upon translation to U.S. dollars, but the positive impact on operating expenses would be less. This would result in an overall adverse effect on our results of operations and financial position. For example, for the year ended December 31, 2012, a 10% depreciation in RMB against the U.S. dollar would have resulted in a $9.9 million decrease in our revenue and a $0.7 million increase in our net loss for the period. Comparatively, for the year ended December 31, 2011, a 10% depreciation in RMB against the U.S. dollar would have resulted in a $11.2 million decrease in our revenue and a $0.7 million decrease in our net loss for the period.

We also transact in other currencies that have had historical volatility, including Japanese Yen and Russian Rubles. Following our acquisition of OCU in 2013, the number and volume of our transactions in Japanese Yen has grown significantly, thus increasing our exposure to potential volatility in this currency. 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. As disclosed in Item 9A of our Annual Report on Form 10-K for year ended December 31, 2012, our management identified a material weakness in our internal control over financial reporting related to the reconciliation of inventory count results to the Company's accounting records as of December 31, 2012 primarily in our Fremont, California facility which was a former facility of Santur (a company we acquired in 2011).

In the Evaluation of Disclosure Controls and Procedures included in Amendment No.1 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as a result of the material weaknesses that existed in our internal controls over financial reporting related to annual inventory counts and the preparation and review of the consolidated statement of cash flows.

As reported in Amendment No. 2 to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, our Chief Executive Officer and new Chief Financial Officer subsequently concluded that the following additional material weaknesses also existed as of March 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 the 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 the 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 as well as the material weaknesses described above.

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 "Part I. Item 4. 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 Santur and OCU. Santur and OCU were not subject as stand-alone entities 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 former Santur and OCU 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.

*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., and our subsidiaries in China have line of credit arrangements. 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. 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, 2012, we had net operating loss, or NOL, carryforwards for U.S. federal and state tax purposes of $205.3 million and $144.9 million, respectively. As these net operating losses have not been utilized, a portion began to expire in 2012 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.

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 OCU, 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 $121.2 million, or 49%, of our revenue in 2012 was recognized from customers for whom we shipped products to a location in China. Additionally, a substantial portion of our property, plant and equipment, 46% as of September 30, 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, 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.

Prior to January 1, 2008, entities established in China were generally subject to a 30% state and 3% local enterprise income tax rate. In accordance with the China Income Tax Law for Enterprises with Foreign Investment and Foreign Enterprises, effective through December 31, 2007, our subsidiaries in China enjoyed preferential income tax rates. 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 2012, 2011 and 2010. We realized benefits from this 10% reduction in tax rate of $0.9 million, $0.4 million and $1.7 million for 2012, 2011 and 2010, respectively. The preferential rate has been approved to remain at 15% for 2013 and 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, 2012, 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.

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.

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 and 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."

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 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. Previously, an employer had discretionary power in deciding the probation period, not to exceed nine months. Additionally, the employment contract could only be terminated for cause. 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. It is our policy to implement safeguards to discourage these practices by our employees. However, 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 Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2013 (the “Quarterly Report”), we were not in full compliance with the NYSE Listed Company Manual, Section 802.01E, which required us to file our Quarterly Report on or before November 12, 2013 (the “Filing Due

Date”). We expect to have cured this deficiency by filing this 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 this Quarterly Report within the time frame required by the SEC. As a result of our failure to file this Quarterly 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 Quarterly Report on Form 10-Q, 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 59% 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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See Index to Exhibits at the end of this report.

SIGNATURE

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

		NeoPhotonics Corporation
Date:	April 9, 2014	By: /S/ CLYDE RAYMOND WALLIN
		Clyde Raymond Wallin
		Chief Financial Officer and Senior Vice President
		(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit no.	Description of exhibit
3.1(1)	Amended and Restated Certificate of Incorporation of NeoPhotonics Corporation.
3.2(2)	Amended and Restated Bylaws of NeoPhotonics Corporation.
4.1†	Specimen Common Stock Certificate of NeoPhotonics Corporation.
4.2†	2008 Investors' Rights Agreement by and between NeoPhotonics Corporation and the investors listed on Exhibit A thereto, dated May 14, 2008.
4.3†	Warrant to Purchase Common Stock by and between NeoPhotonics Corporation and Comerica Bank, dated December 20, 2007.
10.1+	Consulting Agreement by and between FLG Partners, LLC and NeoPhotonics Corporation, dated August 29, 2013.
10.2+	Transition Agreement with James D. Fay, dated August 29, 2013.
10.3+	2013 Executive Officer Bonus Program.
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a).
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a).
32.1(3)	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

+Management compensatory plan or arrangement.

†Filed as the like-numbered exhibit to our Registration Statement on Form S-1, as amended (Reg. No. 333- 166096), and incorporated herein by reference.

(1) Filed as Exhibit 3.1 to the Current Report on Form 8-K (File No. 001-35061), filed with the SEC on February 10, 2011, and incorporated herein by reference.

(2) Filed as Exhibit 3.4 to our Registration Statement on Form S-1, as amended (File No. 333-166096), filed with the SEC on November 22, 2010, and incorporated herein by reference.

(3) The certifications attached as Exhibit 32.1 accompany this Quarterly Report on Form 10-Q, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of NeoPhotonics Corporation, under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.