NEOPHOTONICS CORP
Form 10-K
March 15, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

OR

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

For the transition period from to

001-35061

(Commission File No.)

NeoPhotonics Corporation

(Exact name of Registrant as specified in its charter)

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

2911 Zanker Road

San Jose, California 95134

(Address of principal executive offices, zip code)

Registrant s telephone number, including area code:

+1 (408) 232-9200

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

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

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

None

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

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

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

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

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

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

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

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

As of June 30, 2012, the approximate aggregate market value of voting stock held by non-affiliates of the Registrant, based upon the last sale price of the Registrant s common stock on the last business day of the Registrant s most recently completed second fiscal quarter, June 30, 2012 (based upon the closing sale price of the Registrant s common stock on the New York Stock Exchange), was approximately $97,572,400. This calculation excludes 10,385,805 shares held by directors, executive officers and stockholders affiliated with our directors and executive officers.

As of February 28, 2013, the Registrant had 30,589,498 outstanding shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive Proxy Statement for the Registrant s 2013 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K to the extent stated herein. The Proxy Statement will be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days of the Registrant s fiscal year ended December 31, 2012.

Table of Contents

NEOPHOTONICS CORPORATION

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2012

Table of Contents

Table of Contents

PART I

ITEM 1. *BUSINESS*
FORWARD LOOKING STATEMENTS

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

BUSINESS

Overview

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

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

Our PIC technology utilizes proprietary design elements that provide optical functionality on a silicon or III-V semiconductor chip and includes active PIC design elements including lasers, modulators and photodiodes. Our PIC devices can integrate many more functional elements than discretely packaged components, enabling increased functionality in a small form factor while reducing packaging and interconnection costs. In addition, the cost advantages of PIC-based components are similar to the economics of semiconductor wafer mass manufacturing, where the marginal cost of producing an incremental chip is much less than that of a discrete component.

We have research and development and wafer fabrication facilities in San Jose and Fremont, California 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, which we refer to as our Tier 1 customers.

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

We have completed several acquisitions as follows:

- In March 2003, we acquired Lightwave Microsystems Corporation, a developer and fabricator of photonic integrated circuits;
- In March 2006, we completed the acquisition of Photon Technology Co., Ltd. (now named NeoPhotonics (China) Co., Ltd.), a manufacturer of active optoelectronics, transceivers and modules;
- In June 2006, we acquired Lightconnect, Inc., which expanded our product portfolio by adding a line of micro-electromechanical systems based optical components and modules;
- In June 2006, we acquired OpTun, Inc., a developer of ROADM technology;
- In August 2006, we completed an acquisition of BeamExpress, Inc., an integrator of active indium phosphide telecommunications devices in parallel optics high-speed transceivers;
- In November 2006, we acquired Paxera Corporation, a developer of tunable technology for dynamically reconfigurable networks;
- In February 2008, we acquired certain assets and intellectual property from Mitsubishi Electric Corporation relating to the manufacture of high-speed transceivers; and
- In October 2011, we acquired Santur, a designer and manufacturer of optical indium phosphide (InP)-based PIC products.

In addition, in January 2013 we signed a definitive agreement to acquire the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd. (OCU) in Japan. OCU is a leading provider of lasers, drivers, and detectors for high speed 100G applications. When closed, we believe this acquisition will enhance our position in 100G products. We expect this transaction to be completed in the first or second quarter of 2013.

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

Our solutions

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

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

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

Table of Contents

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

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

Technology

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

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

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

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

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

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

Table of Contents

Products

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

High Speed

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

Product Category	**High Speed Product Description**
40Gbps/100Gbps Products	Products that enable the transmission of data at speeds of 40Gbps and 100Gbps. Products for coherent transmission include integrated coherent receivers (ICR) and coherent mixers. Transceiver products include 40Gbps and 100Gbps CFP modules.
DWDM Tunable Lasers	DWDM tunable lasers that offer up to 96 channels at 20mW or 35mW and are tunable over the C or L bands. Tunable laser products include narrow linewidth tunable lasers (NLW-TL), which are designed to be used in 40Gbps and 100Gbps coherent systems.
TLMZ	Tunable Laser Mach Zhender modulator devices combine a DWDM tunable laser with a 10G modulator to constitute a tunable Transmitter Optical Sub-Assembly (T-TOSA) for 10G transponder applications.
High Speed Transceivers	Transmits data into or receives data from optical fiber and includes SFP+ and XFP modules for 10Gbps, and CFP and CFP-2 modules for 40Gbps and 100Gbps, with transmission distances up to 80 km.

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

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

Table of Contents

Access

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

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

Other Telecom

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

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

Customers

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

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

We also sell our products to numerous other customers globally.

We calculate the percentage of our total revenue attributable to specific customers based on sales to the customers that qualified our products. In 2012, 2011 and 2010, our ten largest customers accounted for 90%, 91% and 92%, respectively, of our total revenue. In 2012, 2011 and 2010, sales to Huawei Technologies accounted for 36%, 51% and 50% of our total revenue, respectively. For the year ended December 31, 2012, Huawei Technologies, Alcatel-Lucent SA and Ciena Corporation accounted for 36%, 16% and 15% of our total revenue, respectively. For the year ended December 31, 2011, Huawei accounted for 51% of our total revenue. For the year ended December 31, 2010, Huawei and Alcatel-Lucent SA accounted for 50% and 10% of our total revenue, respectively. No other customers accounted for 10% or more of our total revenue in any year presented. We focus on increasing our penetration of our Tier 1 customers by adding design wins across our product families. Additionally, we plan to continue to develop relationships and achieve design wins with new and existing high-growth customers.

Sales and marketing

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

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

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

Research and development

We have new product development and product sustaining engineering teams in Silicon Valley (San Jose and Fremont, California), and in Shenzhen and Wuhan, China. In our Silicon Valley facilities, we conduct PIC research, development and product roadmap definitions. In our Shenzhen facilities, we conduct new product development, manufacturing and process engineering, quality control and continuous improvement and cost reduction relating to product manufacturing, assembly and test. In our Wuhan facility, we conduct new product development. In addition, we have a design and sourcing center in Tokyo, Japan. We have invested and expect to continue to invest significant time and capital into our research and development operations. Research and development expenses were $38.3 million, $30.9 million and $21.0 million in 2012, 2011 and 2010, respectively.

Intellectual property

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

We seek to establish and maintain our proprietary rights in our technology and products through the use of patents, copyrights and trade secret laws. We have filed applications for patents to protect certain of our intellectual property in the U.S. and in other countries, including Australia, Japan, Korea, China, Taiwan and

Table of Contents

certain countries in the European Union. As of December 31, 2012, we had 388 issued patents, expiring between 2013 and 2029, covering various aspects of our technologies. We believe our patents and other intellectual property rights have value, but we do not consider any single patent to be essential to our business. We also seek to maintain our trade secrets and confidential information by non-disclosure policies and through the use of appropriate confidentiality agreements.

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

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

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

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

Manufacturing, assembly and test

We have manufacturing operations in the U.S. and China. Our wafer fabrication operations are located in our San Jose and our Fremont, California facilities and include chip design, clean room fabrication, integration and related facilities for PICs. Our manufacturing, assembly and test operations are located in our Shenzhen, China area facilities, and include clean room fabrication, general manufacturing and assembly and test operations utilizing production expertise and cost-effective volume capabilities. Our operations in Shenzhen have primary responsibility for assembly and test of our PIC-based products, in addition to small scale assembly and test of PIC-based products in the Silicon Valley, California. We have quality control processes and quality management methods in our internal manufacturing operations. Certain of our products are designed and qualified to meet applicable Telcordia Technologies, Inc., TÜV SÜD America Inc. and Underwriters Laboratories Inc. standards. Our manufacturing facilities in Shenzhen are third-party certified to TL 9000, ISO 9001, ISO 14001 and OHSAS 18000 standards and our facilities in San Jose and Fremont are certified to ISO 9001 standards. We also use contract manufacturers from time to time for the production of some of our products. In 2012, a substantial portion of our tunable lasers were manufactured at Venture Electronic Systems in Penang, Malaysia.

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

Backlog

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

Table of Contents

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

In 2012 we have more customers using vendor managed inventory (VMI) compared to 2011. VMI is product which we manufacture at a customer s request, then ship to its facility or a designated contract manufacturer for the customer, to be held until it is used by the customer. We maintain title to vendor managed inventory until the customer uses the inventory. At that time the customer takes title to the products, it reports the consumption to us and we recognize the revenue for the product sale. The increased use of VMI by our customers may increase the possibility of changes to our backlog since customers may consume VMI more quickly or more slowly than we had planned.

Financial Information by Geographic Region

For information regarding our revenue and long-lived assets by geographic region, see Note 15 to the Consolidated Financial Statements. For risks relating to our operations see Item 1A. Risk Factors and particularly the risks under the caption Risks related to our operations in China and the risk factors Our future results of operations may be subject to volatility as a result of exposure to fluctuations in foreign exchange rates, primarily the Chinese Renminbi (RMB)/U.S. dollar exchange rate , We face a variety of risks associated with international sales and operations, which if not adequately managed could adversely affect our business and financial results and We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets .

Competition

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

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

We believe we compete favorably with respect to these factors. We believe our principal competitors include Finisar Corporation, JDS Uniphase Corporation, NTT Electronics Corporation, Source Photonics, Inc., Oclaro, Inc., Emcore Corporation and Sumitomo Electric Device Innovations, Inc. We also compete with various other companies.

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

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

Employees

As of December 31, 2012, we had 2,348 employees and (non-employee) contractors, of which 273 employees were based in our corporate headquarters in California, 2,048 were based in China, 4 were based in Canada, 13 were based in Malaysia, 7 were based in Japan and 3 were based in Russia.

None of our employees are covered by a collective bargaining agreement. Chinese law allows that all employees be members of a union that is overseen by the People s Republic of China. We have never experienced employment-related work stoppages and we consider our employee relations to be good.

Environmental, health and safety matters

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

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

Available Information

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

ITEM 1A. ***RISK FACTORS***
Risks related to our business

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

We have a history of losses and we may incur additional losses in future periods. As of December 31, 2012, our accumulated deficit was $248.1 million. We also expect to continue to make significant expenditures related to the development of our business. These include expenditures to hire additional personnel related to the sales, marketing and development of our products and to maintain and expand our manufacturing facilities and research and development operations.

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

We make planning and spending decisions, including determining the levels of business that we will seek and accept, production schedules, and inventory levels, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers and the possibility of unexpected changes in demand for their products reduce our ability to accurately estimate future customer requirements. On occasion, customers may require rapid increases in production, which can strain our resources, cause our manufacturing to be negatively impacted by materials shortages, necessitate higher or more restrictive procurement commitments, increase our manufacturing yield loss and scrapping of excess materials, and reduce our gross margin. We may not have sufficient capacity at any given time to meet the volume demands of our customers, or one or more of our suppliers may not have sufficient capacity at any given time to meet our volume demands. Conversely, a downturn in the markets in which our customers compete can cause, and in the past have caused, our customers to significantly reduce or delay the amount of products ordered from us or to cancel existing orders, leading to lower utilization of our facilities. Because many of our costs and operating expenses are relatively fixed, reduction in customer demand due to market downturns or other reasons would have a material adverse effect on our gross margin, operating income and cash flow. For example, in the fourth quarter of 2012, we experienced an increase in manufacturing costs for one of our high speed products and separately, lower utilization of one of our water fabrication facilities, which adversely affected our gross margin in the fourth quarter of 2012. We expect these impacts continue into the second quarter of 2013, which is expected to adversely affect our gross margins for the first and second quarters of 2013.

Our products are typically sold pursuant to individual purchase orders or by use of a vendor-managed inventory, or VMI, model, which is a process by which we ship agreed quantities of products to a customer-designated location and those products remain our inventory and we retain the title and risk of loss for those

Table of Contents

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 2012, there was 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 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 2012, our largest customer, Huawei Technologies, represented 35.8% of our total revenue 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 or any of our other key customers would materially and adversely affect our revenue and results of operations. For instance, in the three months ended September 30, 2011, demand from Huawei Technologies was lower than expected, which adversely affected our revenue for such period. 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.

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.

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, 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.

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 are expected to continue through the second quarter of 2013, and could re-occur due to these or other reasons, in the future.

Table of Contents

We depend upon an outside contract manufacturer 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 other products are manufactured internally. However we also rely upon a contract manufacturer in Malaysia 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. For instance, recently our contract manufacturer has been unable to meet all of our customer demand in a timely fashion. Although we have not experienced any adverse impact from these delays, if these issues continue, they could have a materials adverse effect on the revenue from our products. If the contract manufacturer for our products were unable or unwilling to manufacture our products 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 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 may 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;

16

Table of Contents

- 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

Table of Contents

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.

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 lightwave, 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. 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 40Gbps and 100Gbps data transmission. The emergence of technologies and products from our competitors and their success in competing against our technologies and products for 40Gbps and 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.

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 or Malaysia, 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.

Table of Contents

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. Finisar sought to recover unspecified damages, up to treble the amount of actual damages, together with attorneys fees, interest and costs. Finisar alleged that at least some of the patents asserted are a part of certain digital diagnostic standards for optoelectronics transceivers and, therefore, are being utilized in such digital diagnostic standards. On March 23, 2010, 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).

In 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.

Table of Contents

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 more 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.

Table of Contents

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 January 2013 we signed a definitive agreement to acquire the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd. (OCU). 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.

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 managing and integrating different cultures with respect to our international acquisitions;
- 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;
- 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;

- 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.

Table of Contents

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

In connection with our acquisition of Santur and OCU, we have recently integrated Santur s commercial operations and personnel into our existing infrastructure and intend to similarly integrate OCU s business. If there are unexpected difficulties in our integration of these, 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;
- the Santur or OCU products may not achieve the performance levels or specifications required by our customers;
- we could have difficulty integrating and managing Santur s and OCU s international business locations in places where we did not previously have a significant or, in some cases, any business presence, including Malaysia, Canada and Japan;
- claims or lawsuits may arise from the acquisition transaction or from Santur s or OCU s previous business operations;
- we may experience difficulties in managing inventory and other operational processes in Santur s and OCU s former 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 of Santur and OCU, each of which was historically not 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 of our Santur s and OCU s businesses;
- we may face competition from existing customers as well as new competitors for legacy Santur or OCU products;
- 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 costs associated with unknown environmental contamination of the real estate to be 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. In addition, the combined effects of these natural disasters have created significant uncertainty, and it is possible that these events could result in reduced end user demand due to a specific location and the global economy; a slowdown of business or inability to manufacture products by our customers or others in the industry that are located in Thailand and/or Japan; a disruption to the global supply chain for products manufactured in Thailand and/or Japan 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 as a result of the uncertainty in Thailand and Japan.

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.

In addition, 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, 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.

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 significant capital expenditure in a short amount of time, particularly in 2013 and 2014, 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.

Table of Contents

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 use at least $30 million of the proceeds from the private placement to establish a wholly-owned subsidiary and facility in the Russian Federation for the production of certain of our products. Pursuant to the rights agreement, failure to perform certain performance covenants set forth therein by July 31, 2014 (subject to extension to March 31, 2015, as set forth therein), 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.

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)/U.S. dollar exchange rate.

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 may fluctuate and is affected by, among other things, changes in political and economic conditions. 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. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the Chinese government to adopt an even more flexible currency policy, which may result in a further and more significant appreciation of the RMB against the U.S. dollar. 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.

Table of Contents

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 an $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.

In 2013, we expect to transact in currencies that have had historical volatility, including Japanese Yen and Russian Rubles. Fluctuations in the exchange rates of these currencies may cause us to recognize additional transaction gains or losses which could impact our results of operations.

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

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

We currently derive, and expect to continue to derive, a significant portion of our revenue from international sales in various markets. In addition, a major portion of our operations is based in Shenzhen, China as well as our having additional operations in Japan, Canada and a contract manufacturing relationship in Malaysia. We also plan to establish a subsidiary and operations in the Russian Federation. 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;
- 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.

Table of Contents

Negative developments in any of these areas in China 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 (including those we recently acquired in the Santur acquisition). 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 a material weakness 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. As disclosed in Item 9A of this report, 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). A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a result of this material weakness, our management concluded that our internal control over financial reporting was not effective as of December 31, 2012, based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control An Integrated Framework*. We are actively engaged in developing a remediation plan designed to address this material weakness. If our remedial measures are insufficient to address the material weakness, or if additional material weaknesses in our internal control are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results. For more information see Item 9A. Controls and Procedures.

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

Preparing our consolidated financial statements involves a number of complex manual and automated processes, which are dependent upon individual data input or review and require significant management judgment. One or more of these elements may result in errors that may not be detected and could result in a material misstatement of our consolidated financial statements. Beginning with the year ended December 31, 2011, we are 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 have historically been private companies and 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 loan and security agreement with Comerica Bank in the U.S., and our subsidiaries in China have line of credit arrangements. Our U.S. loan and security agreement requires us to maintain certain financial covenants, including a liquidity ratio, 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. loan and security agreement with Comerica Bank are secured by substantially all of our U.S. assets other than intellectual property assets, which limits 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.

Table of Contents

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 has begun to expire in the current year. 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, imposes additional requirements on public companies, including specific corporate governance practices. For example, the listing requirements of the New York Stock Exchange 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 are working 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.

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, 59% as of December 31, 2012, 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. In November 2012 China s Communist Party announced the selection of a new Politburo Standing Committee, which controls government operations in China, and this recent change in leadership may affect Chinese laws or regulations in a manner that would adversely affect our business as set forth in this risk factor. 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.

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.

Table of Contents

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 and 2012. We will be subject to an increase in the minimum wage in 2013, and expect that we will be required to increase wages and/or be subject to further increase in personnel costs on 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

Table of Contents

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.

Table of Contents

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, 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 assure you 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

Table of Contents

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. For example, the minimum wage in Shenzhen increased by 20% in April 2011 and 14% in February 2012. 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 the majority of our 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 stock price may be volatile.

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

The stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations,

Table of Contents

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 February 28, 2013, our executive officers and directors, and entities that are affiliated with them, beneficially own an aggregate of approximately 52% 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, may 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 loan and security agreement with Comerica Bank restrict our ability to pay dividends. Consequently, your only opportunity to achieve a return on your investment in our company will be if the market price of our common stock appreciates and you sell your shares at a profit. There is no guarantee that the price of our common stock that will prevail in the market after our initial public offering will ever exceed the price that you pay.

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

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

- providing for a classified board of directors with staggered, three-year terms;

- not providing for cumulative voting in the election of directors;

- authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock;
- prohibiting stockholder action by written consent;
- limiting the persons who may call special meetings of stockholders; and
- requiring advance notification of stockholder nominations and proposals.

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

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

ITEM 1B. *UNRESOLVED STAFF COMMENTS*

Not applicable.

ITEM 2. *PROPERTIES*

Our properties consist primarily of owned and leased office and manufacturing facilities. Our corporate headquarters are located in San Jose, California and our manufacturing facilities are located in Shenzhen, China. The following schedule presents the approximate square footage of our facilities as of December 31, 2012:

Location	Square Feet	Commitment and Use
San Jose, California	63,526	Leased; 2 buildings, 24,212 square feet expiring in October 2015 and 39,314 square feet expiring in October 2019. Used for corporate headquarters offices and wafer fabrication.
Fremont, California	53,175	Leased; 2 buildings, 19,175 square feet expiring in June 2016 and 34,000 square feet expiring in June 2016. Used for wafer fabrication and research and development.
Shenzhen, China	236,715	Owned; 1 building and 1 floor of a building. Used for manufacturing, research and development, and sales and marketing.
Shenzhen, China	117,639	Leased; 4 buildings, expiring on various dates ranging from February 2013 to October 2013. Used for staff dormitory.
Dongguan, China	84,217	Leased; 1 building and 5 floors, 56,737 square feet expiring in May 2014 and 27,480 square feet expiring in May 2015. Used for manufacturing.

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

Table of Contents

ITEM 3. ***LEGAL PROCEEDINGS***

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

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and us, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the codefendants respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. Finisar sought to recover unspecified damages, up to treble the amount of actual damages, together with attorneys fees, interest and costs. Finisar alleged that at least some of the patents asserted are a part of certain digital diagnostic standards for optoelectronics transceivers, and, therefore, are being utilized in such digital diagnostic standards. On March 23, 2010, 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. We and Finisar had agreed to suspend our respective claims for a 90 day period and not to refile the originally asserted claims against each other until one or more specified events occur resulting in the partial or complete resolution of the litigation between Source Photonics and Finisar. On September 10, 2010, Source Photonics and Finisar settled their lawsuit, commencing the suspension period, which ended in December 2010. On January 18, 2011, we and Finisar again 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 4. ***MINE SAFETY DISCLOSURE***

Not applicable.

Table of Contents

PART II

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

On February 2, 2011, the effective date of our Registration Statement on Form S-1 (File No. 333-166096), our common stock began to trade on the New York Stock Exchange under the symbol NPTN . Prior to that time, there was no public market for our common stock. As of February 28, 2013, there were approximately 224 holders of record of our common stock (not including beneficial holders of our common stock holder in street names). We have not paid cash dividends on our common stock since our inception, and we do not anticipate paying any in the foreseeable future. Any future determination as to the declaration and payment of dividends, if any, will be at the discretion of our board of directors and will depend on then existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects, consent from our existing credit facility lender in the U.S., and other factors our board of directors may deem relevant.

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

	Low	High
Fiscal Year 2011:		
First Quarter (February 2, 2011 through March 31, 2011)	$ 8.29	$ 20.94
Second Quarter	$ 6.18	$ 12.18
Third Quarter	$ 5.46	$ 8.20
Fourth Quarter	$ 3.63	$ 6.90
Fiscal Year 2012:		
First Quarter	$ 4.50	$ 6.38
Second Quarter	$ 3.92	$ 5.50
Third Quarter	$ 4.67	$ 6.08
Fourth Quarter	$ 4.90	$ 5.99

The graph below shows the cumulative total stockholder return of an investment of $100 (and the reinvestment of any dividends thereafter) on February 2, 2011 (the first trading day of NeoPhotonics Corporation common stock) in (i) our common stock, (ii) the S&P 500 Index and (iii) the NASDAQ Telecommunications Index. Our stock price performance shown in the graph below is not indicative of future stock price performance.

The following graph and related information shall not be deemed soliciting material or be deemed to be filed with the SEC, nor shall such information be incorporated by reference into any future filing, except to the extent that we specifically state that such graph and related information are incorporated by reference into such filing.

	NeoPhotonics	S&P 500	NASDAQ Telecom
2/2/2011	$ 100.00	$ 100.00	$ 100.00
03/31/11	$ 85.36	$ 101.67	$ 94.09
06/30/11	$ 52.23	$ 101.27	$ 89.23
09/30/11	$ 51.92	$ 86.76	$ 74.82
12/31/11	$ 34.57	$ 96.44	$ 82.75
03/31/12	$ 35.70	$ 108.01	$ 92.96
06/30/12	$ 37.28	$ 104.46	$ 77.56
09/30/12	$ 44.08	$ 110.48	$ 83.45
12/31/12	$ 43.32	$ 109.37	$ 84.40

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

On February 2, 2011, our registration statement on Form S-1 (File No. 333-166096) was declared effective for our initial public offering, pursuant to which we registered the offering and sale of 8,625,000 shares of common stock, including the full underwriters over-allotment option, at a public offering price of $11.00 per share. Merrill Lynch, Pierce, Fenner & Smith Incorporated and Deutsche Bank Securities Inc. acted as the managing underwriters for our initial public offering. The offering was completed February 7, 2011. As a result of our initial public offering, we received net proceeds of $88.2 million before offering expenses. None of such payments were a direct or indirect payment to any of our directors or officers or their associates, to persons owning ten percent or more of our common stock or any of our other affiliates.

There has been no material change in the planned use of proceeds from our initial public offering as described in our final prospectus filed with the SEC pursuant to Rule 424(b). As of December 31, 2012, we had used the entire net proceeds for working capital, the continued expansion of our existing business and general corporate purposes including the repayment of outstanding indebtedness, investments in available-for-sale securities, and the acquisition of complementary businesses, products, services, or technologies, such as the acquisition of Santur.

Table of Contents

ITEM 6. ***SELECTED FINANCIAL DATA***

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

We derived the consolidated statements of operations data for the years ended December 31, 2012, 2011 and 2010 and the consolidated balance sheet data as of December 31, 2012 and 2011 from our consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K. The consolidated statements of operations data and the consolidated balance sheet data as of December 31, 2009 and 2008 are derived from our consolidated financial statements, which are not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of our future results.

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

	Years ended December 31,				
Consolidated Statement of Operations Data:	**2012**	**2011** [(1)]	**2010**	**2009**	**2008**
	(in thousands, except share and per share data)				
Revenue	$ 245,423	$ 201,029	$ 177,679	$ 145,286	$ 120,869
Cost of goods sold	184,163	150,944	123,373	106,833	100,075
Gross profit	61,260	50,085	54,306	38,453	20,794
Operating expenses:					
Research and development	38,288	30,855	20,962	16,545	20,480
Sales and marketing	13,241	11,686	9,078	7,634	8,837
General and administrative	25,808	21,900	16,628	14,673	13,798
Amortization of purchased intangible assets	1,316	994	1,144	1,137	1,665
Adjustment to fair value of contingent consideration [(2)]	(554)	(1,287)	0	0	0
Goodwill impairment charges [(3)]	0	13,106	0	0	0
Asset impairment charges [(4)]	0	0	0	1,233	4,047
Restructuring charges [(5)]	68	1,297	0	0	1,383
Total operating expenses	78,167	78,551	47,812	41,222	50,210
Income (loss) from operations	(16,907)	(28,466)	6,494	(2,769)	(29,416)
Interest income	592	407	187	340	433
Interest expense	(568)	(422)	(612)	(873)	(1,480)
Other income (expense), net	575	14,246	(108)	(60)	524
Interest and other income (expense), net [(6)]	599	14,231	(533)	(593)	(523)
Benefit from (provision for) income taxes	(1,364)	(1,155)	(2,289)	(1,465)	1,579
Income (loss) from continuing operations	$ (17,672)	$ (15,390)	$ 3,672	$ (4,827)	$ (28,360)
Basic and diluted net income (loss) per share from continuing operations attributable to NeoPhotonics Corporation common stockholders: [(7)]	$ (0.62)	$ (1.45)	$ 0.00	$ (2.60)	$ (14.96)

Table of Contents

Consolidated Balance Sheet Data:	2012	2011	2010	2009	2008
			Years ended December 31, *(in thousands)*		
Cash and cash equivalents	$ 36,940	$ 32,321	$ 24,659	$ 41,781	$ 27,248
Restricted cash	$ 2,626	$ 3,227	$ 2,828	$ 2,609	$ 1,516
Short-term investments	$ 64,301	$ 54,063	$ 0	$ 0	$ 0
Working capital [8]	$ 152,374	$ 124,199	$ 44,129	$ 44,167	$ 30,583
Net assets held for sale	$ 0	$ 173	$ 1,932	$ 1,910	$ 4,748
Total assets	$ 295,632	$ 277,049	$ 172,495	$ 162,248	$ 154,776
Long-term debt (including current portion)	$ 22,167	$ 27,166	$ 8,836	$ 8,147	$ 17,740
Redeemable convertible preferred stock [9]	$ 0	$ 0	$ 211,541	$ 205,450	$ 196,430
Redeemable common stock	$ 5,000	$ 0	$ 0	$ 0	$ 0
Common stock and additional paid-in capital [9]	$ 434,072	$ 392,854	$ 93,354	$ 91,899	$ 91,281
Total equity (deficit)	$ 197,818	$ 173,654	$ (109,638)	$ (119,582)	$ (113,023)

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

(2) In connection with our acquisition of Santur, we may be required to pay an earn out of up to an additional $7.5 million in cash, contingent upon Santur s gross profit performance during 2012. The fair value of the contingent consideration was measured at the date of acquisition and is subject to remeasurement each reporting period.

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

(4) In 2008, we recorded asset impairment charges relating to intangible assets of $3.3 million and property and equipment of $0.7 million, both triggered by our decision to discontinue development of a product relating to our acquisition of Paxera Corporation in 2006. In 2009, we entered into an agreement to sell our ownership interest in Shenzhen Archcom Technology Co., Ltd, or Archcom, for less than our share of the net assets of Archcom and, as a result, we recognized an impairment charge of $0.8 million. In 2009, we also recorded an asset impairment charge of $0.4 million resulting from the write-off of machinery and equipment no longer in use.

(5) In 2011, we implemented a restructuring plan designed to reduce our research and development expenses. As a result, we recorded $1.3 million of restructuring expense for severance and benefits. In 2008, we initiated a restructuring plan as part of a companywide cost saving initiative aimed to reduce operating costs by moving manufacturing operations from the U.S. to our primary subsidiary in China. As a result, we recorded $1.4 million of restructuring expense in 2008, primarily related to severance costs resulting from the involuntary termination of employees located in the U.S. and China.

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

(7) We apply the two-class method of computing net income (loss) per share. In addition, our computation of net income (loss) per share takes into account the accretion and deemed dividend associated with our preferred stock beneficial conversation feature and excludes net income (loss) attributable to noncontrolling interest. For further information, see Note 5 to the Consolidated Financial Statements.

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

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

Table of Contents

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

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

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

Business overview

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

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

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

In February 2011, we completed our initial public offering of 8,625,000 shares of common stock, including the full underwriters over-allotment option, at a public offering price of $11.00 per share. Our initial public offering generated net proceeds of $88.2 million before offering expenses. In connection with the closing of the initial public offering, all of the shares of our Series 1, Series 2 and Series 3 preferred stock then outstanding automatically converted into 6,639,513 shares of common stock on a 1-for-1 basis and all of the shares of our Series X preferred stock then outstanding automatically converted into 7,398,976 shares of common stock on a 400-for-1 basis.

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

On April 27, 2012, we issued and sold approximately 4.97 million shares of our common stock in a private placement transaction at a price of $8.00 per share for gross proceeds of approximately $39.8 million. The shares of common stock are restricted from transfer pursuant to a lockup agreement for up to two years, at the end of which we are obligated to file one or more registration statements covering the potential resale of the shares of common stock. We intend to use a portion of the net proceeds from the sale of the shares of common stock for

Table of Contents

general corporate purposes and to establish a presence in the Russian Federation. In addition, we intend to establish a production facility in the Russian Federation, in accordance with the terms of a rights agreement entered into in connection with the private placement, for the benefit of the global organization. The expansion into the Russian Federation is targeted for completion by July 31, 2014.

In the fourth quarter of 2011, we initiated a plan to sell a component of our business, Shenzhen Photon Broadband Technology Co., Ltd. (Broadband), a subsidiary in China. In January 2012, we entered into a purchase agreement with a third party to dispose of our 100% equity interest in Broadband for a total cash consideration of RMB 13.0 million ($2.1 million), and the transaction closed in March 2012. The net assets of Broadband were classified as held-for-sale in our 2011 consolidated balance sheets and the results of operations associated with Broadband are presented as discontinued operations in our consolidated statements of operations for all periods presented. Unless otherwise indicated, all discussions relate to our continuing operations. As a result of the sale of a component of our business in the first quarter of 2012, our audited consolidated financial statements, accompanying notes and other information provided in this Form 10-K reflect Broadband as a discontinued operation for all periods presented.

In 2012, our revenue growth of 22% over the prior-year was driven primarily by increasing in 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 used 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.

We expect to continue experiencing competition from companies that range from large international companies offering a wide range of products to smaller companies specializing in narrow markets. We anticipate macroeconomic conditions, including the slow recovery in the U.S., European sovereign debt issues, and concerns relating to inflation in China, could impact our Company s results. On January 22, 2013, we signed a definitive agreement to acquire the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd. (OCU). OCU is a leading provider of lasers, drivers, and detectors for high speed 100G applications located in Japan. When closed, we believe this acquisition will enhance our competitive position in 100G products. We expect this transaction to be completed in the first or second quarter of 2013.

Critical accounting policies and estimates

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

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

Revenue recognition

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

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

Stock-based compensation expense

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

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

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

Goodwill

Goodwill is assessed for impairment annually or more frequently when an event occurs or circumstances change between annual tests that would more likely than not reduce the fair value of the reporting unit below its carrying value. In fiscal year 2012, the Financial Accounting Standards Board (*FASB*) amended its guidance to simplify testing goodwill for impairment. The amended guidance allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If an entity determines that as a result of the qualitative assessment that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the quantitative test is required. Otherwise, no further testing is required. We performed our annual goodwill impairment tests on December 31, 2011. We recognized a goodwill impairment charge of $13.1 million due to a decline in our market capitalization during the fourth quarter of 2011, the result of which is that we do not have any goodwill on our consolidated balance sheets as of December 31, 2011 and 2012.

Table of Contents

Long-lived assets

We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss would be recognized when the sum of the future net cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance and may differ from actual cash flows. If our estimates regarding future cash flows derived from such assets were to change, we may record an impairment to the value of these assets. We did not record any asset impairment charges during the years ended December 31, 2012, 2011 or 2010.

Valuation of inventories

We record inventories at the lower of cost (using the first-in, first-out method) or market, after we give appropriate consideration to obsolescence and inventories in excess of anticipated future demand. In assessing the ultimate recoverability of inventories, we are required to make estimates regarding future customer demand, the timing of new product introductions, economic trends and market conditions. If the actual product demand is significantly lower than forecasted, we could be required to record additional inventory write-downs which would be charged to cost of goods sold. Obsolescence is determined from several factors, including competitiveness of product offerings, market conditions and product life cycles. Increases to the provision for excess and obsolete inventory are charged to cost of goods sold. At the point of the loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. If this lower-cost inventory is subsequently sold, it will result in lower costs and higher gross margin for those products. Any write-downs would have an adverse impact on our gross margin. During the years ended December 31, 2012, 2011 and 2010, we recorded excess and obsolete inventory charges of $3.1 million, $0.6 million and $1.2 million, respectively.

Warranty liabilities

We provide warranties to cover defects in workmanship, materials and manufacturing of our products for a period of one to two years to meet stated functionality specifications. From time to time, we have agreed, and may agree, to warranty provisions providing for extended terms or with a greater scope. We test products against specified functionality requirements prior to delivery, but we nevertheless from time to time experience claims under our warranty guarantees. We accrue for estimated warranty costs under those guarantees based upon historical experience, and for specific items at the time their existence is known and the amounts are determinable. We charge a provision for estimated future costs related to warranty activities to cost of goods sold based upon historical product failure rates and historical costs incurred in correcting product failures. If we experience an increase in warranty claims compared with our historical experience, or if the cost of servicing warranty claims is greater than expected, our gross margin and profitability would be adversely affected. We recorded warranty expense of $0.1 million, $0.4 million and $0.2 million for each of the years ended December 31, 2012, 2011 and 2010, respectively.

Accounting for income taxes

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

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

Table of Contents

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

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

Results of operations

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

	Years Ended December 31,		
	2012	**2011**	**2010**
Revenue	100%	100%	100%
Cost of goods sold	75	75	69
Gross profit	25	25	31
Operating expenses:			
Research and development	16	15	12
Sales and marketing	5	6	5
General and administrative	10	11	9
Amortization of purchased intangible assets	1	0	1
Adjustment to fair value of contingent consideration	(0)	(1)	0
Goodwill impairment charges	0	7	0
Restructuring charges	0	1	0
Total operating expenses	32	39	27
Income (loss) from operations	(7)	(14)	4
Interest income	0	0	0
Interest expense	0	0	0
Other income (expense), net	0	7	0
Total interest and other income (expense), net	0	7	0
Income (loss) before income taxes	(7)	(7)	4
Provision for income taxes	(1)	(1)	(1)
Income (loss) from continuing operations	(8)	(8)	3
Income (loss) from discontinued operations, net of tax	0	0	0
Net income (loss)	(8)%	(8)%	3%

Revenue

(in thousands, except percentages)	**2012**	**% Change 2011 to 2012**	**2011**	**% Change 2010 to 2011**	**2010**

Total revenue	$ 245,423	22%	$ 201,029	13%	$ 177,679

We sell substantially all of our products to original equipment manufacturers, or OEMs. We recognize revenue upon delivery of our product to the OEM. We price our products based on market and competitive conditions and may periodically reduce the price of our products as market and competitive conditions change and as manufacturing costs are reduced. Our sales transactions to customers are denominated primarily in Chinese Renminbi (RMB) or U.S. dollars. 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 90%, 91% and 92% of our revenue in 2012, 2011 and 2010, respectively. In 2012, we made substantial progress to reduce customer concentration. For the year ended December 2012, Huawei, Alcatel-Lucent SA and Ciena Corporation accounted for 36%, 16% and 15% of our total revenue, respectively. For the year ended December 31, 2011, Huawei accounted for 51% of our total revenue. For the year ended December 31, 2010, Huawei and Alcatel-Lucent SA accounted for 50% and 10% of our total revenue. No other customers accounted for 10% or more of our total revenue in any year presented. For the year ended December 31, 2012, 2011 and 2010, our sales from our China-based subsidiaries, the majority of which were denominated in RMB were 49%, 64% and 57%, respectively.

Total revenue increased by $44.4 million in 2012 compared to 2011, representing a 22% increase. This increase in revenue was primarily attributable to growth in our high speed 100G and 40G products which generally have higher average selling prices as compared to more mature products. Our high speed 100G products grew more than 300% from 2011 to 2012. Total revenue increased by $23.4 million in 2011 compared to 2010, representing a 13% increase. The increase in revenue was primarily attributable to increases in demand for our products as carriers continued to deploy fiber-to-home solutions and deploy 40Gbps, 100Gbps and other telecom networks. On a global basis, in 2012 we experienced greater revenue growth from Western customers compared to customers located in China, while in 2011 the increase in revenue was primarily realized in China and to a lesser extent in the U.S.

In 2013, we expect our revenue to continue to grow. We also expect that a significant portion of our revenue will continue to be derived from a limited number of customers, as a result of growth in purchases by our key China, U.S. and European customers. As a result, the loss of, or a significant reduction in orders from our largest customer, 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 continue to be denominated in RMB, and therefore may be affected by changes in foreign exchange rates.

Cost of goods sold and gross profit

(in thousands, except percentages)	2012	% Change 2011 to 2012	2011	% Change 2010 to 2011	2010
Cost of goods sold	$ 184,163	22%	$ 150,944	22%	$ 123,373
Gross profit	$ 61,260	22%	$ 50,085	(8)%	$ 54,306

Gross profit represents net sales less cost of goods sold. Our cost of goods sold consists primarily of the cost to produce wafers and to manufacture and test our products. Additionally, our cost of goods sold includes stock-based compensation, reserves for excess and obsolete inventory, royalty payments, amortization of certain purchased intangible assets and acquisition-related fair value adjustments, and warranty, shipping and allocated facilities costs.

Gross profit increased by $11.2 million in 2012 compared to 2011, and was primarily due to sales mix and growth in our 40G and 100G products, given these products tend to have higher margins on average compared to our other products. Gross profit decreased by $4.2 million in 2011 compared to 2010, and was primarily due to additional cost of goods sold of $6.4 million including amortization of intangible and other fixed manufacturing costs associated with the acquisition of Santur in 2011. The impact from the acquisition of Santur in 2011 was partially offset by overall continuous pricing reductions in material purchases and higher efficiencies in manufacturing.

We expect that our gross profit is likely to continue to fluctuate due to a variety of factors, including the introduction of new products, production volume, production volume compared to sales over time, the mix of

Table of Contents

products sold, inventory changes, changes in the average selling prices of our products, changes in the cost and volumes of materials purchased from our suppliers, changes in labor costs, changes in overhead costs or requirements, revaluation of stock appreciation unit awards that are impacted by our stock price, and any reserves for excess and obsolete inventories. In addition, we periodically negotiate pricing with certain customers which can cause our gross margins to fluctuate particularly in the quarters in which the negotiations occurred. We strive to increase our gross margin as we seek to manage the costs of our supply chain and increase productivity in our manufacturing processes.

Operating expenses

(in thousands, except percentages)	2012	% Change 2011 to 2012	2011	% Change 2010 to 2011	2010
Research and development	$ 38,288	24%	$ 30,855	47%	$ 20,962
Sales and marketing	13,241	13%	11,686	29%	9,078
General and administrative	25,808	18%	21,900	32%	16,628
Amortization of purchase intangible assets	1,316	32%	994	(13)%	1,144
Adjustment to fair value of contingent consideration	(554)	(57)%	(1,287)	(100)%	0
Goodwill impairment charges	0	(100)%	13,106	100%	0
Restructuring charges	68	(95)%	1,297	100%	0
Total operating expenses	$ 78,167	0%	$ 78,551	64%	$ 47,812

Research and development

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

Research and development expense increased by $9.9 million in 2011 compared to 2010, representing a 47% increase. This increase was primarily due to a $5.9 million increase in additional compensation and employee-related costs as a result of increased headcount and our acquisition of Santur, and a $1.0 million per quarter increase in material consumption, facility costs and equipment usage to support our research and development projects.

We believe that investments in research and development are important to help meet our strategic objectives. In 2013, we plan to continue to invest in research and development and new products that will further enhance our competitive position. As a percentage of total revenue, our research and development expense may vary as our investment levels and revenue change over time.

Sales and marketing

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

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

Sales and marketing expense increased by $2.6 million in 2011 compared to 2010, representing a 29% increase. This increase was primarily due to additional compensation and employee-related costs as a result of increased headcount and our acquisition of Santur.

We expect our sales and marketing expense to grow modestly in 2013 as our business continues to expand geographically. As a percentage of total revenue, our sales and marketing expense may vary as our revenue changes over time.

General and administrative

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

General and administrative expense increased by $3.9 million in 2012 compared to 2011, representing an 18% increase. This was primarily due to a $1.8 million increase in depreciation expenses as a result of the acquisition of Santur, a $1.6 million increase in compensation and employee-related costs, and a $1.0 million increase in accounting system upgrades.

General and administrative expense increased by $5.3 million in 2011 compared to 2010, representing a 32% increase. This was primarily due to a $2.7 million increase in additional compensation and employee-related costs as a result of higher headcount, a $1.0 million increase in business tax mainly related to city construction tax and educational surtax as required by the Chinese government, a $1.0 million increase in facilities-related costs, and a $0.7 million increase in professional services expense related to public company compliance expenses and legal fees.

We expect our general and administrative expense to grow modestly in 2013 as our business continues to expand. As a percentage of total revenue, our general and administrative expense may vary as our revenue changes over time.

Amortization of purchased intangible assets

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

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

Amortization of purchased intangible assets decreased by $0.2 million in 2011 compared to 2010, representing a 13% decrease. The decreases were primarily due to some of intangible assets becoming fully amortized in the second half of 2010, partially offset by an increase in amortization expense related to assets acquired from Santur in the fourth quarter of 2011.

Adjustment to the fair value of contingent consideration

In connection with our acquisition of Santur, we may be required to pay up to an additional $7.5 million in cash as further consideration for the business acquisition, contingent upon Santur s gross profit performance during 2012. The fair value of the contingent consideration is re-measured each reporting period and any changes in the fair value of the contingent consideration are recognized as a gain or loss in the consolidated statements of operations. As of December 31, 2012 and 2011, we estimate the fair value of the contingent consideration was $1.0 million and $1.5 million, respectively. Although we believe the fair value of the contingent consideration is

Table of Contents

in accordance with the terms of the Santur acquisition agreements, the selling parties may dispute the final amount to be paid.

Goodwill impairment charge

Due to the decrease in our market capitalization as of the end of the fourth quarter of 2011, and based on our assessment, we determined that the indicators of impairment existed and that the carrying value of our goodwill may not be recoverable. As a result, we recognized a goodwill impairment charge of $13.1 million, representing the entire balance of our goodwill. As of December 31, 2012 and 2011, we had no goodwill on our consolidated balance sheet.

Restructuring charges

During the fourth quarter of 2011, we implemented a restructuring plan, which resulted in the involuntary termination of 37 employees in the U.S. and 43 employees in China. The reduction in workforce was primarily related to cost-cutting measures in research and development. In addition, we made reductions in the areas of sales, marketing and administrative functions as a result of redundancy in positions due to the acquisition of Santur in October 2011. As a result, we recorded a restructuring charge of $1.3 million for severance and benefit costs in 2011 and we recorded an incremental restructuring charge of $68,000 related to this restructuring plan during 2012. As of December 31, 2012, all of the restructuring expense was paid.

Interest and other income (expense), net

(in thousands, except percentages)	2012	% Change 2011 to 2012	2011	% Change 2010 to 2011	2010
Interest and other income (expense), net	$ 599	(96)%	$ 14,231	(2,770)%	$ (533)

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

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

Interest and other income (expense), net increased by $14.8 million in 2011 compared to 2010. The increase was primarily related to a gain of $13.8 million from the sale of an investment in an unconsolidated investee in 2011, and the equity loss of $0.6 million on an unconsolidated investee in 2010, a $0.2 million increase in interest income related to our investment in securities, and a $0.2 million decrease in interest expense as a result of our lower loan balances outstanding in both the U.S. and China on a weighted average basis.

Income taxes

	Years ended December 31,		
(in thousands, except percentages)	2012	2011	2010
Provision for income taxes	$ (1,364)	$ (1,155)	$ (2,289)
Effective tax rate	(8)%	(8)%	38%

Table of Contents

We conduct our business globally. Therefore, our operating income is subject to varying rates of tax in the U.S., China 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. The preferential rate applies 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 effective tax rate was negative 8% in 2012 and 2011. Our operating income is subject to varying rates of tax in the U.S. and 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. In 2012, our income tax expense incurred was primarily related to the operating profit realized in our foreign subsidiaries, despite a consolidated loss before income taxes. In 2011, our tax expense incurred was also primarily related to the earnings generated by our foreign subsidiaries.

Our effective tax rate was 38% in 2010, compared with an effective tax rate of negative 44% in 2009. In 2009, we incurred tax expense despite a consolidated loss before income taxes, primarily due to foreign income taxes paid based on earnings generated by our foreign subsidiaries of $1.2 million and withholding taxes on royalties received from our foreign subsidiaries of $0.8 million.

Liquidity and capital resources

Total cash, cash equivalents and short-term investments at December 31, 2012 and 2011 were $101.2 million and $86.4 million, respectively. At December 31, 2012, we had working capital of $152.4 million. We believe that our existing cash and cash equivalents, and cash flows from our operating activities, will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced products, the costs to increase our manufacturing capacity, the continuing market acceptance of our products and acquisitions of businesses and technology. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition would be adversely affected.

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

Frequently, we also direct our banking partners to issue notes payable to our suppliers in China in exchange for accounts payable. Our Chinese subsidiaries banks issue the notes to vendors and issue payment to the vendors upon redemption. We owe the payable balance to the issuing bank. The notes payable are non-interest bearing and are generally due within six months of issuance. As a condition of the notes payable lending arrangements, we are required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the notes payable are paid by our subsidiaries in China. These balances are classified as restricted cash on our consolidated balance sheets. As of December 31, 2012, our restricted cash totaled $2.6 million.

We have lending arrangements with several financial institutions, including a loan and security agreement with Comerica Bank in the U.S. and several line of credit arrangements for our subsidiaries in China.

As of December 31, 2012, our loan and security agreement in the U.S. included the following:

- An $8.0 million revolving line of credit available through September 2014. In October 2011, we drew down the full $8.0 million. As of December 31, 2012, $8.0 million was outstanding under the revolving line of credit and $0.0 million was available for borrowing.

- A $20.0 million acquisition advance, expiring in September 2015. Proceeds of the acquisition advance may be used to make permitted business acquisitions. Advances may be drawn in two tranches and are due and payable in equal monthly installments of principal and interest such that all amounts will be repaid by the acquisition line maturity date. The advances bear interest at a rate of LIBOR plus 2%. In October 2011, we drew down the full $20.0 million in connection with its acquisition of Santur. As of December 31, 2012, $14.2 million was outstanding under the acquisition advance and the total available borrowing capacity under this facility was $5.8 million.

- A $7.0 million equipment line advance for capital expenditures in the U.S. Advances may be drawn in four tranches and are due and payable in equal monthly installments of principal and interest such that all amounts will be repaid by September 2015. Borrowings under this facility bear interest at a rate of LIBOR plus 2%. As of December 31, 2012, $0.0 million was outstanding under the acquisition advance and the total available borrowing capacity under this facility was $7.0 million.

Our U.S. loan and security agreement requires us to maintain specified financial covenants, including a liquidity ratio, and restricts our ability to incur additional debt or to engage in specified transactions and is secured by substantially all of our U.S. assets, other than intellectual property assets. As of December 31, 2012, we were in compliance with all covenants contained in this agreement.

Our subsidiaries in China have short-term line of credit facilities with several banking institutions. These short-term loans have an original maturity date of one year or less as of December 31, 2012. 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 December 31, 2012, we had no short-term loans outstanding.

Operating activities

In 2012, net cash used in operating activities was $8.8 million. Cash used in operating activities was primarily related to cash payments to our employees and suppliers in excess of cash receipts from customers. During the year ended December 31, 2012, we recognized net loss of $17.5 million, which incorporated non-cash charges, including depreciation and amortization of $18.7 million, stock-based compensation expenses of $4.8 million and provision for inventories of $3.1 million. These amounts were partially offset by the purchase of inventory of $11.8 million, a reduction of accounts payable of $3.0 million and a reduction of accrued and other liabilities of $1.6 million.

In 2011, net cash used in operating activities was $12.6 million. Cash used in operating activities was primarily related to cash payments to our employees and suppliers in excess of cash receipts from customers. During the year ended December 31, 2011, we recognized net loss of $14.8 million, which incorporated non-cash charges, including goodwill impairment charges of $13.1 million, depreciation and amortization of $12.9 million and stock-based compensation expenses of $3.2 million. These amounts were partially offset by the gain on sale of our investment in an unconsolidated investee of $13.8 million, the purchase of inventory of $8.5 million to replenish our inventories in preparation for higher customer demand in future periods, and extended payment terms with certain suppliers, as evidenced by the net increase in accounts payable and accrued liabilities of $5.0 million during the period.

Table of Contents

In 2010, net cash provided by operating activities was $13.6 million. Cash provided by operating activities was primarily related to cash receipts from customers in excess of cash payments to our employees and suppliers. During the year ended December 31, 2010, we recognized net income of $3.3 million. However, that net income incorporated non-cash charges, including depreciation and amortization of $12.1 million, stock-based compensation expenses of $1.6 million and non-cash increases to our asset reserve accounts of $1.6 million. These amounts were partially offset as we spent an additional $6.0 million to increase our inventories to meet customer demands of seasonally higher sales volumes in the second and third quarter of the year and for future sales and a $3.2 million increase in prepaid expenses. However, not all of the inventory purchases were paid for during the year ended December 31, 2010, due to extended payment terms with certain suppliers, as evidenced by our net increase in accounts payable and accrued liabilities of $4.1 million during the period.

Investing activities

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

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

In 2010, net cash used for investing activities was $24.7 million. We purchased $15.8 million of capital equipment and invested $8.1 million in shares of an unconsolidated investee. In addition, we completed our sale of Archcom and, as a result, received the remaining $0.6 million in cash proceeds, offset by the transfer of the cash of Archcom of $1.7 million to the buyer.

Financing activities

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

In 2011, net cash provided by financing activities was $102.7 million. In February 2011, we completed our initial public offering, which generated proceeds of $86.5 million, net of offering expenses. We received cash proceeds of $28.0 million from our newly amended lending arrangement, drawn by us in connection with our acquisition of Santur, which was partially offset by $14.2 million of cash used for the repayment of existing bank loans. In addition, we received $1.2 million of proceeds from the issuance of notes payable, net of repayment. We also received $0.9 million of proceeds from purchase of our equity securities pursuant to our employee stock purchase program.

In 2010, net cash used for financing activities was $7.3 million. We used $9.6 million of cash for the repayment of bank loans, net of proceeds, and $1.3 million for the repayment of notes payable, net of proceeds. In addition, we incurred $2.4 million of offering costs associated with our initial public offering, which was not completed until 2011. Our uses of cash were partially offset by $6.0 million of proceeds received from the issuance of preferred stock, net of issuance costs.

Table of Contents

Contractual obligations and commitments

The following summarizes our contractual obligations as of December 31, 2012:

		Payments due by period			
(in thousands)	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Notes payable [1]	$ 12,003	$ 12,003	$ 0	$ 0	$ 0
Debt obligations [2]	22,167	5,000	17,167	0	0
Operating leases [3]	6,298	1,888	2,276	1,166	968
Purchase commitments [4]	19,534	19,534	0	0	0
Contingent consideration [5]	7,500	7,500	0	0	0
Asset retirement obligations [6]	1,000	0	0	0	1,000
	68,502	45,925	19,443	1,166	1,968
Expected interest payments [7]	777	446	331	0	0
Total commitments	$ 69,279	$ 46,371	$ 19,774	$ 1,166	$ 1,968

(1) Frequently, we direct our banking partners to issue notes payable to our suppliers in China in exchange for accounts payable. The notes payable are non-interest bearing and are generally due within nine months of issuance. The amount presented in the table represents the principal portion of the obligations.

(2) We have a loan and security agreements in the U.S. that provide various credit facilities, including lines of credit and term loans. The amount presented in the table represents the principal portion of the obligations. The debt obligations outstanding as of December 31, 2012 bear interest at a rate of approximately 2.2%. All of the outstanding debt was subject to fluctuations in interest rates. Interest is paid monthly over the term of the debt arrangement.

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

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

(5) We are obligated to pay up to an additional $7.5 million for the acquisition of Santur, contingent upon Santur meeting gross profit performance objectives in 2012. As of December 31, 2012, the fair value of the contingent consideration was $1.0 million.

(6) We have an asset retirement obligation of $1.0 million associated with our facility lease in California, which expires in October 2019. This obligation is included in other noncurrent liabilities in the consolidated balance sheet as of December 31, 2012.

(7) We calculate the expected interest payments based on our outstanding debt obligations at prevailing interest rates as of December 31, 2012.

Off-balance sheet arrangements

During the years ended December 31, 2012, and 2011, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K.

Recent accounting pronouncements

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

Table of Contents

In July 2012, the Financial Accounting Standard Board issued amendments to the FASB Accounting Standard Codification relating to indefinite-lived intangible assets for impairments. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity s financial statements for the most recent annual or interim period have not yet been issued. The adoption of this guidance did not have a material impact on our results of operations, cash flows or financial condition.

In May 2011, the FASB issued amendments to the FASB Accounting Standard Codification relating to fair value measurements. The amendments clarify the application of existing fair value measurement requirements and results in common measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments are effective for the Company during interim and annual periods beginning after December 15, 2011. The new guidance became effective for the Company beginning January 1, 2012. The adoption of this guidance did not have a material impact to the Company s consolidated financial statements.

In June 2011, the FASB issued amendments to the FASB Accounting Standard Codification relating to presentation of comprehensive income. The amendments require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments should be applied retrospectively, and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this guidance on January 1, 2012 and the application of this guidance resulted in financial statement presentation changes only.

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Interest rate fluctuation risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. To achieve this objective, we invest our excess cash in a variety of securities, including U.S. government agency securities, corporate notes and bonds, foreign bonds and money market funds meeting certain criteria. These securities are classified as available-for-sale. Consequently, our available-for-sale securities are recorded on the balance sheet at fair value with unrealized gains or losses. We have determined that the gross unrealized gains or losses on the available-for-sale securities at December 31, 2012 are temporary in nature. We may sell these marketable securities investments in the future to fund future operating needs. As a result, we recorded all our marketable securities in short-term investments as of December 31, 2012, 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 December 31, 2012 and 2011, we did not have outstanding debt in China. As of December 31, 2012 and 2011, our U.S. debt was based on floating rates of interest and is subject to fluctuations in interest rates. As of December 31, 2012 and 2011, we had not hedged our interest rate risk.

As of December 31, 2012 and 2011, we had $22.2 million and $27.2 million outstanding under our U.S. credit facilities, respectively, which was subject to fluctuations in interest rates. For the year ended December 31, 2012, a hypothetical 10% increase in the interest rate could result in approximately $49,000 of additional annual interest expense. Comparatively, for the year ended December 31, 2011, a hypothetical 10% increase in the interest rate could result in approximately $61,000 of additional annual interest. The hypothetical changes and assumptions made above will be different from what actually occurs in the future. Furthermore, the computations do not anticipate actions that may be taken by our management should the hypothetical market changes actually occur over time. As a result, actual impacts on our results of operations in the future will differ from those quantified above.

Table of Contents

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 years ended December 31, 2012 and 2011, we recognized foreign currency transaction losses of $0.2 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 majority 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 year ended December 31, 2012, a 10% depreciation in RMB against the U.S. dollar would have resulted in an $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 income for the period.

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

Inflation risk

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

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of NeoPhotonics Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, consolidated statements of redeemable convertible preferred stock, redeemable common stock and stockholders equity and comprehensive income (loss) and consolidated statements of cash flows present fairly, in all material respects, the financial position of NeoPhotonics Corporation and its subsidiaries (the Company) at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) because a material weakness in internal control over financial reporting related to the reconciliation of inventory count results to the Company s accounting records existed as of that date. 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. The material weakness referred to above is described in Management s Report on Internal Control Over Financial Reporting appearing under Item 9A. We considered this material weakness in determining the nature, timing, and extent of audit tests applied in our audit of the December 31, 2012 consolidated financial statements, and our opinion regarding the effectiveness of the Company s internal control over financial reporting does not affect our opinion on those consolidated financial statements. The Company s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in management s report referred to above. Our responsibility is to express opinions on these financial statements and on the Company s internal control over financial reporting based on our audits (which were integrated audits in 2012 and 2011). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

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

/s/ PricewaterhouseCoopers LLP

San Jose, California

March 15, 2013

Table of Contents

NEOPHOTONICS CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)	**December 31, 2012**	**December 31, 2011**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 36,940	$ 32,321
Short-term investments	64,301	54,063
Restricted cash	2,626	3,227
Accounts receivable, net of allowance for doubtful accounts of $963 and $506 at December 31, 2012 and 2011, respectively	70,354	68,877
Inventories	43,793	35,341
Prepaid expenses and other current assets	7,630	5,882
Current assets held-for-sale	0	1,687
Total current assets	225,644	201,398
Long-term investments	188	92
Property, plant and equipment, net	54,440	56,344
Other intangible assets, net	14,213	17,999
Other long-term assets	1,147	1,049
Long-term assets held-for-sale	0	167
Total assets	$ 295,632	$ 277,049
LIABILITIES, REDEEMABLE COMMON STOCK AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 36,308	$ 37,599
Notes payable	12,003	14,620
Current portion of long-term debt	5,000	5,000
Accrued and other current liabilities	19,959	18,299
Current liabilities held-for-sale	0	1,681
Total current liabilities	73,270	77,199
Long-term debt, net of current portion	17,167	22,166
Deferred income tax liabilities	653	927
Other noncurrent liabilities	1,724	3,103
Total liabilities	92,814	103,395
Commitments and contingencies (note 11)		
Redeemable common stock	5,000	0
Stockholders equity (deficit):		
Preferred stock, $0.0025 par value		
At December 31, 2012: 10,000,000 shares authorized, no shares issued or outstanding; At December 31, 2011: 10,000,000 shares authorized, no shares issued or outstanding	0	0
Common stock, $0.0025 par value		
At December 31, 2012: 100,000,000 shares authorized, 30,546,155 shares issued and outstanding; At December 31, 2011: 100,000,000 shares authorized, 24,862,585 shares issued and outstanding	76	62
Additional paid-in capital	433,996	392,792
Accumulated other comprehensive income	11,829	11,353
Accumulated deficit	(248,083)	(230,553)

Total stockholders equity	197,818	173,654
Total liabilities, redeemable common stock and stockholders equity	$ 295,632	$ 277,049

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)	Years ended December 31, 2012	2011	2010
Revenue	$ 245,423	$ 201,029	$ 177,679
Cost of goods sold	184,163	150,944	123,373
Gross profit	61,260	50,085	54,306
Operating expenses:			
Research and development	38,288	30,855	20,962
Sales and marketing	13,241	11,686	9,078
General and administrative	25,808	21,900	16,628
Amortization of purchased intangible assets	1,316	994	1,144
Adjustment to fair value of contingent consideration	(554)	(1,287)	0
Goodwill impairment charges	0	13,106	0
Restructuring charges	68	1,297	0
Total operating expenses	78,167	78,551	47,812
Income (loss) from operations	(16,907)	(28,466)	6,494
Interest income	592	407	187
Interest expense	(568)	(422)	(612)
Other income (expense), net	575	14,246	(108)
Total interest and other income (expense), net	599	14,231	(533)
Income (loss) before income taxes	(16,308)	(14,235)	5,961
Provision for income taxes	(1,364)	(1,155)	(2,289)
Income (loss) from continuing operations	(17,672)	(15,390)	3,672
Income (loss) from discontinued operations, net of tax	142	636	(401)
Net income (loss)	(17,530)	(14,754)	3,271
Net income attributable to noncontrolling interests	0	0	(80)
Net income (loss) attributable to NeoPhotonics	(17,530)	(14,754)	3,191
Deemed dividend on beneficial conversion of Series X redeemable convertible preferred stock	0	(17,049)	0
Accretion of redeemable convertible preferred stock	0	(7)	(113)
Net income (loss) attributable to NeoPhotonics Corporation common stockholders	$ (17,530)	$ (31,810)	$ 3,078
Basic net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:			
Continuing operations	$ (0.62)	$ (1.45)	$ 0.00
Discontinued operations	$ 0.00	$ 0.03	$ 0.00
Net income (loss)	$ (0.62)	$ (1.42)	$ 0.00

Diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:			
Continuing operations	$ (0.62)	$ (1.45)	$ 0.00
Discontinued operations	$ 0.00	$ 0.03	$ 0.00
Net income (loss)	$ (0.62)	$ (1.42)	$ 0.00
Weighted average shares used to compute net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:			
Basic	28,529,849	22,359,802	1,945,111
Diluted	28,529,849	22,359,802	3,123,994

See accompanying Notes to Consolidated Financial Statements.

66

Table of Contents

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	2012	2011	2010
Net income (loss)	$ (17,530)	$ (14,754)	$ 3,191
Other comprehensive income (loss), net of tax			
Foreign currency translation adjustments	101	3,265	2,395
Unrealized gains (losses) on available-for-sale securities, net of tax	375	(307)	4,412
Unrealized gain on equity investment, net of tax		8,291	
Less: Reclassification adjustment for gain on sale of equity investment included in net income		(12,703)	
Other comprehensive income (loss), net of tax	476	(1,454)	6,807
Comprehensive income (loss)	$ (17,054)	$ (16,208)	$ 9,998

Table of Contents

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENT OF REDEEMABLE CONVERTIBLE PREFERRED STOCK, REDEEMABLE COMMON STOCK AND STOCKHOLDERS EQUITY

(In thousands, except share data)	Redeemable Common stock Shares	Redeemable Common stock Amount	Redeemable convertible preferred stock Shares	Redeemable convertible preferred stock Amount	Common stock Shares	Common stock Amount	Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	NeoPhotonics Corporation stockholders deficit	Noncontrolling interests	Total deficit
Balances at December 31, 2009	0	$ 0	6,655,609	$ 205,450	1,924,627	$ 5	$ 91,894	$ 6,000	$ (218,990)	$ (121,091)	$ 1,509	$ (119,582)
Comprehensive income								6,807	3,191	9,998	80	10,078
Issuance of Series X preferred stock for cash	0	0	2,401	5,978	0	0	0	0	0	0	0	0
Accretion of preferred stock to redemption value	0	0	0	113	0	0	(113)	0	0	(113)	0	(113)
Acquisition of noncontrolling interest	0	0	0	0	0	0	(199)	0	0	(199)	95	(104)
Sale of majority-owned interest	0	0	0	0	0	0	0	0	0	0	(1,684)	(1,684)
Issuance of common stock upon exercise of stock options	0	0	0	0	27,265	0	114	0	0	114	0	114
Issuance of common stock upon exercise of warrants	0	0	0	0	3,508	0	13	0	0	13	0	13
Repurchases of common stock	0	0	0	0	(120)	0	(1)	0	0	(1)	0	(1)
Vesting of early exercised stock options	0	0	0	0	0	0	43	0	0	43	0	43
Stock-based compensation expense	0	0	0	0	0	0	1,598	0	0	1,598	0	1,598
Balances at December 31, 2010	0	$ 0	6,658,010	$ 211,541	1,955,280	$ 5	$ 93,349	$ 12,807	$ (215,799)	$ (109,638)	$ 0	$ (109,638)
Comprehensive loss								(1,454)	(14,754)	(16,208)	0	(16,208)
Accretion of preferred stock to redemption value	0	0	0	7	0	0	(7)	0	0	(7)	0	(7)
Deemed dividend on beneficial conversion of Series X redeemable convertible preferred stock	0	0	0	17,049	0	0	(17,049)	0	0	(17,049)	0	(17,049)
Issuance of common stock upon initial public offering at $11.00 per share, net of issuance costs of $4,263	0	0	0	0	8,625,000	22	83,949	0	0	83,971	0	83,971
Conversion of preferred stock into shares of common stock	0	0	(6,658,010)	(228,597)	14,038,489	35	228,562	0	0	228,597	0	228,597
Issuance of common stock upon exercise of stock options	0	0	0	0	79,144	0	340	0	0	340	0	340
Repurchase of common stock	0	0	0	0	(51)	0	0	0	0	0	0	0
Issuance of common stock under employee stock purchase plan	0	0	0	0	164,723	0	863	0	0	863	0	863
Vesting of early exercised stock options	0	0	0	0	0	0	19	0	0	19	0	19
Stock-based compensation expense	0	0	0	0	0	0	2,766	0	0	2,766	0	2,766
Balances at December 31, 2011	0	$ 0	0	$ 0	24,862,585	$ 62	$ 392,792	$ 11,353	$ (230,553)	$ 173,654	$ 0	$ 173,654

68

Table of Contents

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENT OF REDEEMABLE CONVERTIBLE PREFERRED STOCK, REDEEMABLE COMMON STOCK AND STOCKHOLDERS EQUITY (Continued)

(In thousands, except share data)	Redeemable Common stock Shares	Redeemable Common stock Amount	Redeemable convertible preferred stock Shares	Redeemable convertible preferred stock Amount	Common stock Shares	Common stock Amount	Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	NeoPhotonics Corporation stockholders deficit	Noncontrolling interests	Total deficit
Balances at December 31, 2011	0	$ 0	0	$ 0	24,862,585	$ 62	$ 392,792	$ 11,353	$ (230,553)	$ 173,654	$ 0	$ 173,654
Comprehensive loss								476	(17,530)	(17,054)	0	(17,054)
Accretion of preferred stock to redemption value	0	0	0	0	0	0	0	0	0	0	0	0
Deemed dividend on beneficial conversion of Series X redeemable convertible preferred stock	0	0	0	0	0	0	0	0	0	0	0	0
Initial public offering cost adjustment	0	0	0	0	0	0	63	0	0	63	0	63
Issuance of common stock for investment	0	5,000	0	0	4,972,905	12	34,527	0	0	34,539	0	34,539
Issuance of common stock upon exercise of stock options	0	0	0	0	190,554	1	101	0	0	102	0	102
Issuance of common stock under employee stock purchase plan	0	0	0	0	520,111	1	1,865	0	0	1,866	0	1,866
Stock-based compensation expense	0	0	0	0	0	0	4,648	0	0	4,648	0	4,648
Balances at December 31, 2012	0	$ 5,000	0	$ 0	30,546,155	$ 76	$ 433,996	$ 11,829	$ (248,083)	$ 197,818	$ 0	$ 197,818

See accompanying Notes to Consolidated Financial Statements.

69

Table of Contents

NEOPHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Cash flows from operating activities			
Net income (loss)	$ (17,530)	$ (14,754)	$ 3,271
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	18,716	12,931	12,122
Goodwill impairment charges	0	13,106	0
Stock-based compensation expense	4,777	3,156	1,598
Deferred taxes	221	(452)	(32)
Loss on disposal of property and equipment	152	224	178
Share of loss of an unconsolidated investee	0	0	620
Gain on sale of an unconsolidated investee, net of direct cost	0	(13,867)	0
Gain on discontinued operations	(750)	0	0
Allowance for doubtful accounts	312	535	388
Provision for inventories	3,132	680	1,175
Change in assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(1,802)	(2,750)	(682)
Inventories	(11,828)	(8,508)	(5,958)
Prepaid expenses and other current assets	386	2,140	(3,167)
Accounts payable	(2,992)	(452)	6,648
Accrued and other liabilities	(1,584)	(4,499)	(2,579)
Net cash provided by (used in) operating activities	(8,790)	(12,510)	13,582
Cash flows from investing activities			
Purchase of property, plant and equipment	(12,738)	(11,677)	(15,744)
Purchase of marketable securities	(155,887)	(172,972)	0
Proceeds from sale of marketable securities	104,258	113,909	0
Proceeds from maturity of securities	40,935	4,623	0
Decrease (increase) in restricted cash	608	(48)	353
Acquisition of Santur, net of cash acquired	0	(38,986)	0
Acquisition of noncontrolling interest in subsidiary	0	0	(104)
Purchase of shares of an unconsolidated investee	0	0	(8,077)
Proceeds received on sale of discontinued operations, net of tax	1,825	0	0
Proceeds from sale of an unconsolidated investee	0	21,288	0
Proceeds received (cash transferred) upon sale of Archcom	0	0	(1,118)
Net cash used in investing activities	(20,999)	(83,863)	(24,690)
Cash flows from financing activities			
Proceeds from initial public offering of common stock, net of issuance costs	0	86,412	(2,441)
Proceeds from issuance of preferred stock, net of issuance costs	0	0	5,978
Proceeds from issuance of common stock, net of issuance costs	39,636	0	0
Repurchases of common stock	0	0	(1)
Proceeds from exercise of stock options and warrants	238	341	127
Proceeds from issuance of stock under ESPP	1,832	863	0
Proceeds from bank loans	0	28,000	13,728
Repayment of bank loans	(5,000)	(14,214)	(23,373)
Proceeds from issuance of notes payable	25,959	29,390	26,925
Repayment of notes payable	(28,601)	(28,157)	(28,246)
Net cash provided by (used in) financing activities	34,064	102,635	(7,303)
Effect of exchange rates on cash and cash equivalents	180	758	456
Net increase (decrease) in cash and cash equivalents	4,455	7,020	(17,955)

Cash and cash equivalents at the beginning of the period	32,485	25,465	43,420
Cash and cash equivalents at the end of the period	$ 36,940	$ 32,485	$ 25,465
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 571	$ 368	$ 728
Cash paid for income taxes	531	1,532	2,881
Supplemental disclosure of noncash investing and financing activities:			
Increase in accounts payable and accrued liabilities related to property and equipment purchases	(2,551)	(986)	(727)
Accretion of redeemable convertible preferred stock		7	113
Conversion of preferred stock to common stock upon IPO		228,597	0

See accompanying Notes to Consolidated Financial Statements.

70

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The company and basis of presentation

Business and organization

NeoPhotonics Corporation (NeoPhotonics or the Company) is a leading designer and manufacturer of PIC-based modules and subsystems for bandwidth-intensive, high-speed communications networks. NeoPhotonics, formerly known as NanoGram Corporation, was incorporated in Delaware in 1996 to develop nanoparticles for use in industrial applications. In November 2002, the Company spun out two companies, changed its name to NeoPhotonics Corporation, and focused on the design, development and manufacturing of planar lightwave circuits for optical communication platforms.

Discontinued operations

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

Correction in classification of Consolidated Statement of Cash Flows

The Company made the following correction in classification of the Consolidated Statement of Cash Flows for the year ended December 31, 2010:

During the first quarter of 2011, the Company determined that cash payments made in 2010 for initial public offering related expenses had been incorrectly classified as operating cash flow activities in the consolidated statements of cash flows, and that such payments should be classified as financing cash flow activities. The Company has revised the 2010 statement of cash flows to correct for the classification. The correction resulted in an increase to Net Cash Provided by Operating Activities of $2,441,000, with a corresponding increase to Net Cash Used in Financing Activities for the year ended December 31, 2010.

Management has assessed the impact of this correction on the 2010 annual consolidated statement of cash flows and has concluded that the corrections are not material, either individually or in the aggregate, to the previously reported cash flows.

Reclassifications

Certain reclassifications have been made to prior period financial statements to conform to current year presentation.

Consolidation

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S. (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.

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Reverse stock split

On November 29, 2010, the Company filed its Amended and Restated Certificate of Incorporation which effected a 1-for-25 reverse stock split of all outstanding shares of the Company s stock, including common stock and redeemable convertible preferred stock. Fractional shares of Series X preferred stock were issued. Any fractional shares of common stock and Series 1, 2 and 3 preferred stock resulting from the reverse stock split were settled in cash equal to the fraction of a share to which the holder was entitled.

Following the amendment, the Company s authorized capital stock consisted of 21,420,000 shares, comprising: (i) 14,000,000 shares of common stock, par value $0.0025 per share, (ii) 20,000 shares of Series X redeemable convertible preferred stock, par value $0.0025 per share, and (iii) 7,400,000 shares of Series 1, 2 and 3 redeemable convertible preferred stock, par value $0.0025 per share.

All shares, stock options, warrants to purchase common stock and per share information presented in the consolidated financial statements has been adjusted to reflect the reverse stock split on a retroactive basis for all periods presented and all share information is rounded down to the nearest whole share after reflecting the reverse stock split.

Initial Public Offering

In February 2011, the Company completed its initial public offering of 8,625,000 shares of its common stock, including the full underwriters over-allotment option, at a public offering price of $11.00 per share. Net cash proceeds from the initial public offering were approximately $88.2 million, prior to deducting offering expenses.

In connection with the closing of the initial public offering, all of the shares of Series 1, Series 2 and Series 3 preferred stock outstanding automatically converted into 6,639,513 shares of common stock on a 1-for-1 basis and all of the shares of Series X preferred stock outstanding automatically converted into 7,398,976 shares of common stock on a 400-for-1 basis.

On February 10, 2011, the Company filed its Amended and Restated Certificate of Incorporation in connection with the closing of its initial public offering. Following the amendment, the Company s authorized capital stock consisted of 110,000,000 shares, comprising: (i) 100,000,000 shares of common stock, par value $0.0025 per share and (ii) 10,000,000 shares of preferred stock, par value $0.0025 per share.

2. Summary of significant accounting policies

Use of estimates

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

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair value of financial instruments

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, notes receivable, accounts payable and notes payable approximate their respective historical fair values due to their short-term maturities.

Concentration of credit risk and significant customers

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

For the year ended December 2012, three customers accounted for 36%, 16% and 15% of the Company s total revenue, respectively. For the year ended December 31, 2011, a single customer accounted for 51%. For the year ended December 31, 2010, two customers accounted for 50% and 10% of the Company s total revenue, respectively. No other customers accounted for 10% or more of total revenue in any year presented.

As of December 31, 2012, two customers accounted for 42% and 16% of the Company s total accounts receivable, respectively. As of December 31, 2011, a single customer accounted for 47% of total accounts receivable. No other customers accounted for 10% or more of total accounts receivable as of 2012 or 2011.

Restricted cash

As a condition of the notes payable lending arrangements of the Company s subsidiaries in China, these subsidiaries are required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the notes payable are paid. These balances have been excluded from the Company s cash and cash equivalents balance and are classified as restricted cash on the Company s consolidated balance sheets. As of December 31, 2012 and 2011, the amount of restricted cash was $2.6 million and $3.2 million, respectively.

Cash, cash equivalents and investments

Highly liquid investments with a maturity of 90 days or less at the date of purchase are considered cash equivalents. Cash and cash equivalents consist of bank deposits and money market funds used for operational purposes. Cash equivalents are recognized at fair value. Short-term investments consist of debt securities and money market funds with maturities of 12 months or less. Long-term investments consist of debt securities with maturities greater than 12 months. Short-term and long-term investments are classified as available-for-sale investments and are recognized at fair value.

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

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Equity investments. Equity securities are classified as available-for-sale and are reported at fair market value and unrealized gains and losses are included in accumulated other comprehensive income as a separate component of stockholders equity (deficit) on the consolidated balance sheets. As of December 31, 2010, the Company s investment in equity securities was classified as long-term based on the Company s intent and ability to hold the investment in Ignis for more than 12 months from the balance sheet date. During the second quarter of 2011, Ignis was purchased by another company and, as a result, the Company sold its investment in Ignis.

Fair Value Measurements

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

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

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

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

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

In connection with our acquisition of Santur in October 2011, we may be required to pay the former owners of Santur up to an additional $7.5 million in cash, contingent upon Santur s gross profit performance during 2012. The fair value of the contingent consideration was measured at the date of acquisition and is re-measured each reporting period and any changes in the fair value of the contingent consideration are recognized as a gain or loss in the consolidated statements of operations. The contingent consideration is valued with level three

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

inputs. We estimated the fair value of its liability using the expected cash flow approach with inputs being probability-weighted revenue and gross margin projections and a discount rate based on a weighted-average cost of capital. As of December 31, 2012 and 2011, the fair value of the contingent consideration was $1.0 million and $1.5 million, respectively and is included in other current liabilities on the Company s consolidated balance sheet.

Non-Recurring Fair Value Measurements

During 2011, the Company recorded a goodwill impairment charge of $13.1 million (Refer to Note 7). These fair value measurements were calculated using unobservable inputs, using both the income and market approach, which are classified as Level 3 within the fair value hierarchy. Inputs for the income approach included the amount and timing of future cash flows based on the Company s operational budgets, strategic plans, terminal growth rates assumptions and other estimates. The primary input for the market approach included market multiples for guideline companies that operate in a similar business environment.

Accounts receivable

Accounts receivable include trade receivables and notes receivables from customers. The Company receives notes receivable from certain customers in China that are secured by the customer s affiliated financial institution. The notes are generally due within 6 months and may be redeemed early by the Company at a discount.

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

Inventories

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

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

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net tangible assets, identifiable intangible assets and in-process research and development acquired in a business combination. Goodwill is not subject to amortization, but is subject to at least an annual assessment for impairment.

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company evaluates goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. The Company performs its annual goodwill impairment testing as of December 31 of each year. In fiscal year 2012, the Financial Accounting Standards Board (*FASB*) amended its guidance to simplify testing goodwill for impairment. The amended guidance allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If an entity determines that as a result of the qualitative assessment that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the quantitative test is required. Otherwise, no further testing is required. The Company recognized a goodwill impairment charge of $13.1 million due to a decline in its market capitalization during the fourth quarter of 2011. The Company does not have any goodwill on its consolidated balance sheets as of December 31, 2011 and 2012.

Long-lived assets

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

Buildings	20-30 years
Machinery and equipment	5 years
Furniture, fixtures and office equipment	5 years
Software	5-7 years
Leasehold improvements	5 years or lease term, if shorter

Repairs and maintenance costs are expensed as incurred.

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

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

If one or more of such facts or circumstances exist, the Company will evaluate the carrying value of long-lived assets to determine if impairment exists, by comparing it to estimated undiscounted future cash flows over the remaining useful life of the assets. If the carrying value of the assets is greater than the estimated future cash flow, the assets are written down to the estimated fair value. The Company s cash flow estimates contain management s best estimates, using appropriate and customary assumptions and projections at the time. Any write-down would be treated as a permanent reduction in the carrying amount of the asset and an operating loss would be recognized. During the years ended December 31, 2012, 2011 and 2010, no impairment charges were recognized.

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenue recognition

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

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

Product warranties

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

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

	Years ended December 31,		
	2012	2011	2010
Beginning balance	$ 1,443	$ 299	$ 489
Warranty accruals	385	393	191
Assumed warranty from Santur	0	999	0
Settlements and adjustments	(756)	(248)	(381)
Ending balance	$ 1,072	$ 1,443 (1)	$ 299

(1) Included within the ending balance is an accrual of $0.3 million relating to a specific part, for which the liability was assumed as part of the acquisition of Santur. This part was related to one product manufactured in 2006, and Santur experienced product returns through the acquisition date. The amount recorded represents the Company s best estimate of the liability to be incurred at the time of the acquisition. Since October 2011 the Company has not experienced any claims for this product and it believes warranty claims are remote. Therefore, the Company released this obligation in the fourth quarter of 2012.

Research and development

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

77

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Advertising costs

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

Stock-based compensation

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

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

The first share purchase rights were granted February 2, 2011, the first day NeoPhotonics Corporation common stock was listed on the New York Stock Exchange. The Company accounts for the stock purchase rights at the grant date (first day of the offering period) by valuing the two purchase periods separately, May and November each year. The stock purchase rights are accounted for at fair value, utilizing the Black-Scholes option-pricing model. The expense for each purchase period is recognized on a straight-line basis over the requisite service period, from the beginning of the offering period through the respective purchase date.

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

In August 2011, the Company began granting restricted stock units. Restricted stock units are valued at the closing sales price as quoted on the New York Stock Exchange on the date of grant, and are converted into shares of common stock upon vesting on a one-for-one basis. Vesting of restricted stock units is subject to the employee s continuing service to the Company. The compensation expense related to the restricted stock units is determined using the fair value of common stock on the date of grant, and the expense is recognized on a straight-line basis over the vesting period.

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

Income taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities in the financial statements and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in the consolidated statement of operations in the period that includes the enactment date.

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Foreign currency translations

Monetary assets and liabilities denominated in currencies other than the U.S. dollar are translated into U.S. dollars at the rates of exchange at the balance sheet date. Transactions in currencies other than the U.S. dollar during the year are converted into the U.S. dollar at the applicable rates of exchange prevailing on the day transactions occurred. Transaction gains and losses are recognized in other income (expense), net in the consolidated statements of operations. Exchange losses recognized were $0.2 million, $0.1 million, and $0.0 million for the years ended December 31, 2012, 2011 and 2010, respectively.

The financial records of certain of the Company s subsidiaries are maintained in local currencies other than the U.S. dollar, such as the Chinese Renminbi (RMB), Japan Yen and Russian Ruble, which are their functional currencies. Assets and liabilities are translated at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates and revenue, expenses, gains and losses are translated using the average exchange rate for the period. Translation adjustments are reported as foreign currency translation adjustments and are shown as a separate component of other comprehensive income (loss) in the consolidated statements of redeemable convertible preferred stock, stockholders equity and comprehensive income (loss).

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

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

Diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders is calculated by dividing net income (loss) attributable to NeoPhotonics Corporation common stockholders and income allocable to participating securities to the extent they are dilutive, by the weighted average number of common shares and potential dilutive common share equivalents outstanding during the period if the effect is dilutive. The Company s potential dilutive common share equivalents consist of incremental common shares issuable upon the exercise of options and warrants to purchase common shares and upon conversion of its redeemable convertible preferred stock. The Company s non-vested early-exercised stock options are considered

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

a participating security and are included in the Company s computation of basic net income (loss) per share attributable to NeoPhotonics Corporation common stockholders. The Company s redeemable convertible preferred stock met the definition of a participating security until this stock was converted to common stock in connection with the closing of the Company s initial public offering.

Comprehensive income (loss)

Comprehensive income (loss) includes all changes in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) consists of net income (loss), foreign currency translation adjustments, unrealized gains or losses on cost method investments and net income attributable to noncontrolling interests.

Recent accounting pronouncements

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

In July 2012, the Financial Accounting Standard Board issued amendments to the FASB Accounting Standard Codification relating to indefinite-lived intangible assets for impairments. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity s financial statements for the most recent annual or interim period have not yet been issued. The adoption of this guidance did not have a material impact on our results of operations, cash flows or financial condition.

In May 2011, the FASB issued amendments to the FASB Accounting Standard Codification relating to fair value measurements. The amendments clarify the application of existing fair value measurement requirements and results in common measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments are effective for the Company during interim and annual periods beginning after December 15, 2011. The new guidance became effective for the Company beginning January 1, 2012. The adoption of this guidance did not have a material impact to the Company s consolidated financial statements.

In June 2011, the FASB issued amendments to the FASB Accounting Standard Codification relating to presentation of comprehensive income. The amendments require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments should be applied retrospectively, and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this guidance on January 1, 2012 and the application of this guidance resulted in financial statement presentation changes only.

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Discontinued Operations

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

As of December 31 2011, the net assets of Broadband are classified as held-for-sale in the Company s consolidated balance sheets. Details of the net assets held-for-sale is as follows (in thousands):

	December 31, 2011
Cash and cash equivalents	$ 164
Accounts receivable, net	873
Inventories	484
Prepaid expenses and other current assets	166
Current assets held-for-sale	$ 1,687
Property, plant and equipment	$ 167
Long-term assets held-for-sale	$ 167
Accounts payable	$ 1,225
Accrued and other current liabilities	456
Current liabilities held-for-sale	$ 1,681

The results of operations associated with Broadband are presented as discontinued operations in the Company s consolidated statements of operations for the years ended December 31, 2012, 2011 and 2010. Revenue and the components of net income related to the discontinued operations for all periods were as follows (in thousands):

	Years ended December 31,		
	2012	2011	2010
Revenue	$ 590	$ 5,085	$ 6,459
Income (loss) from discontinued operations before income taxes	$ 256	$ 318	$ (408)
Benefit from (provision for) income taxes	(114)	318	7
Net income (loss) from discontinued operations	$ 142	$ 636	$ (401)

81

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Cash, cash equivalents and investments

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

	As of December 31, 2012				As of December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents								
Money market funds	$ 11	$ 0	$ 0	$ 11	$ 11	$ 0	$ 0	$ 11
Short-term investments								
Money market funds	7,259	0	0	7,259	2,205	0	0	2,205
Corporate bonds	23,151	43	(1)	23,193	17,403	19	(224)	17,198
Commercial paper	0	0	0	0	7,497	0	(30)	7,467
U.S. federal agencies	27,241	10	0	27,251	11,447	3	0	11,450
Foreign bonds and notes	4,682	14	0	4,696	4,128	4	(80)	4,052
Municipal obligations	1,902	0	0	1,902	2,651	0	0	2,651
Total investments in short-term investments	64,235	67	(1)	64,301	45,331	26	(334)	45,023
Total investments	$ 64,246	$ 67	$ (1)	$ 64,312	$ 45,342	$ 26	$ (334)	$ 45,034

Realized gains and losses on the sale of marketable securities during the year ended December 31, 2012 and 2011 were immaterial.

The following table summarizes the estimated fair value of the investments in marketable securities, designated as available-for-sale and classified by the contractual maturity date of the security as of December 31, 2012 and 2011 (in thousands):

	December 31, 2012	December 31, 2011
Less than 1 year	$ 51,861	$ 28,505
Due in 1 to 2 years	10,550	9,934
Due in 2 to 5 years		4,192
Due after 5 years	1,901	2,403
Total	$ 64,312	$ 45,034

The Company s marketable securities are liquid and may be sold in the future to fund future operating needs. As a result, the Company recorded all its marketable securities in short-term investment. As of December 31, 2012 and 2011, the Company determined that the gross unrealized losses on our available-for-sale investments are temporary in nature and no investments in marketable securities that were in an unrealized loss position for a period in excess of 12 months.

82

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	As of December 31, 2012				As of December 31, 2011			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Money market funds	$ 7,270	$	$	$ 7,270	$ 2,216	$	$	$ 2,216
Marketable securities								
Corporate bonds		23,193		23,193		17,198		17,198
Commercial paper						7,467		7,467
U.S. federal agencies		27,251		27,251		11,450		11,450
Foreign bonds and notes		4,696		4,696		4,052		4,052
Municipal obligations		1,902		1,902		2,651		2,651
	$ 7,270	$ 57,042	$	$ 64,312	$ 2,216	$ 42,818	$	$ 45,034

83

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	Years ended December 31, 2012	2011	2010
Numerator:			
Income (loss) from continuing operations	$ (17,672)	$ (15,390)	$ 3,672
Less: Accretion of redeemable convertible preferred stock	0	(7)	(113)
Less: deemed dividend on beneficial conversion of Series X redeemable convertible preferred stock	0	(17,049)	0
Less: income from continuing operations attributable to noncontrolling interests	0	0	(80)
Less: income from continuing operations attributable to redeemable convertible preferred stockholders	0	0	(3,479)
Income (loss) from continuing operations attributable to NeoPhotonics Corporation common stockholders	$ (17,672)	$ (32,446)	$ 0
Income (loss) from discontinued operations	$ 142	$ 636	$ (401)
Less: loss from discontinued operations attributable to redeemable convertible preferred stockholders	0	0	401
Income (loss) from discontinued operations attributable to NeoPhotonics Corporation common stockholders	$ 142	$ 636	$ 0
Net income (loss) attributable to NeoPhotonics Corporation common stockholders	$ (17,530)	$ (31,810)	$ 0
Denominator:			
Weighted average shares used to compute basic net income (loss) per share attributable to NeoPhotonics Corporation common stockholders	28,529,849	22,359,802	1,945,111
Effect of dilutive securities:			
Common stock options	0	0	1,178,883
Weighted average shares used to compute diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders	28,529,849	22,359,802	3,123,994
Basic net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:			
Continuing operations	$ (0.62)	$ (1.45)	$ 0.00
Discontinued operations	$ 0.00	$ 0.03	$ 0.00
Net income (loss)	$ (0.62)	$ (1.42)	$ 0.00
Diluted net income (loss) per share attributable to NeoPhotonics Corporation common stockholders:			
Continuing operations	$ (0.62)	$ (1.45)	$ 0.00

Discontinued operations	$	0.00	$	0.03	$	0.00
Net income (loss)	$	(0.62)	$	(1.42)	$	0.00

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 basic weighted average common shares outstanding.

In determining the allocation of income to participating securities for the purposes of computing basic and diluted net income (loss) per share under the two-class method, the Company considers that net income attributable to NeoPhotonics Corporation common stockholders in 2010 should be attributable to the redeemable convertible preferred stockholders, given the dividend preferences of the preferred stock. As a result, there would be no income or loss remaining, either from continuing or discontinued operations attributable to common stockholders. For the years ended December 31, 2012 and 2011, as the stockholders of the redeemable convertible preferred stock do not have a contractual obligation to share in the Company s losses, all components of net loss have been attributed to common stockholders.

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

	Years ended December 31,		
	2012	2011	2010
Employee stock options	1,498,867	991,123	293,383
Common stock warrants	4,482	4,482	4,482
Employee stock purchase plan	20,018	86,762	0
Restricted stock units	386,259	130,391	0
Redeemable convertible preferred stock, on an if-converted basis (1)	0	1,481,841	14,038,489
	1,909,626	2,694,599	14,336,354

(1) For the purposes of the table above, the Series 1, 2 and 3 preferred stock have been converted on a 1-for-1 basis and the Series X preferred stock has been converted on a 400-for-1 basis.

6. Acquisition of Santur

On September 29, 2011, the Company entered into an Agreement and Plan of Merger (the Merger Agreement), by and among the Company, Dulcimer Acquisition Corp., a wholly owned subsidiary of the Company (Merger Sub), Santur and Shareholder Representative Services, LLC, solely in its capacity as the Stockholder Representative. On October 12, 2011 (the closing date) the Company completed its acquisition and in accordance with the terms of the Merger Agreement, Merger Sub merged with and into Santur (the Merger), with Santur continuing as the surviving corporation and becoming a wholly owned subsidiary of the Company.

The total consideration paid by the Company was approximately $44.4 million of cash, including an aggregate amount of $6.0 million that was withheld and placed into escrow to cover certain indemnity obligations from the closing date through October 11, 2013. In addition, such holders are also entitled to receive up to an additional $7.5 million, in the aggregate, as measured by Santur s quarterly gross profit during 2012. As of December 31, 2012 and 2011, the fair value of the contingent consideration was $1.0 million and $1.5 million, respectively.

In connection with the acquisition, the Company incurred approximately $1.0 million in acquisition-related costs related primarily to investment banking, legal, accounting and other professional services. The acquisition

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

costs were expensed as incurred and were included in general and administrative expenses in the 2011 consolidated statement of operations.

Santur was headquartered in Fremont, California, and was known as a leading designer and manufacturer of Indium Phosphide (InP)-based PIC products. Santur products are designed for 40Gbps and 100Gbps networks and include lasers, modulators and photodiodes. The acquisition of Santur enhances our existing product portfolio. In addition, the Company combines Santur s technology with its own to create new products for 100Gbpts coherent systems.

The Company accounted for its acquisition of Santur using the acquisition method of accounting for business combinations. Santur s tangible and identifiable intangible assets acquired and liabilities assumed were recorded based upon their estimated fair values as of the closing date of the acquisition. The excess purchase price over the value of the net assets acquired was recorded as goodwill. The following table summarizes the purchase accounting and the net tangible assets acquired as of the date of acquisition (in thousands):

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

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

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

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

Net Tangible Assets

Santur s tangible assets acquired and liabilities assumed as of October 12, 2011 were reviewed and adjusted to their fair value. The Company increased Santur s historical value of fixed assets by $5.8 million to adjust the

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Intangible Assets

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

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

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

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets, and represents the highly skilled and valuable assembled workforce, the ability to generate new products and services as a combined company and expected synergistic benefits of the transaction. In accordance with applicable accounting standards, goodwill is not amortized but instead is tested for impairment at least annually or, more frequently if certain indicators are present.

Santur s results of operations from October 12, 2011 through December 31, 2011 were included in the Company s consolidated statement of operations for the year ended December 31, 2011. During the year ended December 31, 2011, Santur contributed $5.8 million of revenue and $13.8 million of operating loss, which included the impact from purchase accounting related adjustments, such as the amortization of purchased intangibles, amortization of acquisition related fixed asset and inventory step-up, adjustment to the fair value of contingent consideration, retention expense, and acquisition related costs. The following table presents pro forma results of operations of the Company and Santur, as if the companies had been combined as of the beginning of the earliest period presented. The unaudited pro forma results of operations are not necessarily indicative of

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

results that would have occurred had the acquisition taken place on January 1, 2010, or of future results. Included in the pro forma results are fair value adjustments based on the fair values of assets acquired and liabilities assumed as of the acquisition date of October 12, 2011. Pro-forma results include: (i) amortization of intangible assets related to the acquisition, (ii) depreciation expense associated with the fair value adjustment to Santur s property, plant and equipment, (iii) stock-based compensation expense, and (iv) interest income (expense) associated with Santur s debt eliminated in connection with the acquisition. The pro forma information for the years ended December 31, 2011 and 2010 is as follows (in thousands, except per share amounts):

	Years ended December 31,	
	2011	2010
Total revenues	$ 236,449	$ 242,873
Net loss	(29,352)	(7,963)
Net loss attributable to NeoPhotonics Corporation	(29,352)	(8,043)
Net loss attributable to NeoPhotonics Corporation common stockholders	(46,408)	(8,156)
Basic and diluted net loss per share attributable to NeoPhotonics Corporation common stockholders	(2.08)	(4.19)

7. Goodwill and purchased intangible assets

Goodwill

Goodwill is tested for impairment annually on the last day of the fourth quarter. During the first step of the Company s annual impairment analysis in the fourth quarter of 2011, the Company determined that the carrying amount of the Company s goodwill might not have been recoverable. After completing the second step of the Company s December 31, 2011 impairment analysis, the Company recognized a goodwill impairment charge of $13.1 million. As the result, the Company does not have any goodwill on its consolidated balance sheets as of December 31, 2011 and 2012.

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

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

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

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

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the changes in the carrying amount of goodwill (in thousands):

Balance as of December 31, 2009 and 2010	$ 4,323
Additional goodwill from acquisition of Santur Corporation	8,783
Goodwill impairment	(13,106)
Balance as of December 31, 2011	$

Purchased intangible assets

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

	December 31, 2012			December 31, 2011		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Technology and patents	$ 32,176	$ (22,869)	$ 9,307	$ 32,145	$ (20,489)	$ 11,656
Customer relationships	11,898	(8,148)	3,750	11,788	(6,746)	5,042
Leasehold interest	1,355	(241)	1,114	1,352	(195)	1,157
Non-compete agreements	950	(908)	42	950	(806)	144
	$ 46,379	$ (32,166)	$ 14,213	$ 46,235	$ (28,236)	$ 17,999

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

	Years ended December 31,		
	2012	2011	2010
Cost of goods sold	$ 2,472	$ 598	$ 2,237
Operating expenses	1,316	994	1,144
Total	$ 3,788	$ 1,592	$ 3,381

The estimated future amortization expense of purchased intangible assets as of December 31, 2012, is as follows (in thousands):

2013	$ 3,619
2014	3,503
2015	3,483
2016	2,750
2017	49

Thereafter	809
	$ 14,213

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Balance sheet components

Accounts receivable, net

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

	December 31,	
	2012	2011
Accounts receivable	$ 66,338	$ 60,655
Trade notes receivable	4,979	8,728
Allowance for doubtful accounts	(963)	(506)
	$ 70,354	$ 68,877

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

Balance at December 31, 2009	$ (1,702)
Provision for bad debt	35
Write-offs, net of recoveries	85
Balance at December 31, 2010	(1,582)
Provision for bad debt	(196)
Write-offs, net of recoveries	1,272
Balance at December 31, 2011	(506)
Provision for bad debt	(457)
Write-offs, net of recoveries	0
Balance at December 31, 2012	$ (963)

Inventories

Inventories consist of the following (in thousands):

	December 31,	
	2012	2011
Raw materials	$ 19,038	$ 16,892
Work in process	8,940	4,991
Finished goods	15,815 (1)	13,458
	$ 43,793	$ 35,341

(1) $4.5 million of finished goods inventory was at vendor managed inventory locations.

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property, plant and equipment, net

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

	December 31,	
	2012	2011
Buildings	$ 16,484	$ 16,331
Machinery and equipment	92,139	82,535
Furniture, fixtures, software and office equipment	8,300	7,474
Leasehold improvements	4,373	4,015
	121,296	110,355
Less: Accumulated depreciation	(66,856)	(54,011)
	$ 54,440	$ 56,344

Depreciation expense was $12.4 million, $10.8 million and $8.6 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Accrued and other current liabilities

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

	December 31,	
	2012	2011
Employee-related	$ 12,293	$ 9,523
Other	7,666	8,776
	$ 19,959	$ 18,299

9. Investment and equity accounting

During the first three quarters of 2010, the Company purchased shares of Ignis, a Norwegian company traded on the Oslo Borse (Norway stock exchange) for total consideration of $8.1 million. After such purchases, the Company had an ownership percentage in Ignis of 9%, 17% and 23% as of March 31, June 30 and September 30, 2010, respectively. During the fourth quarter of 2010, the Company s ownership percentage in Ignis decreased to 19%, due to new shares issued by Ignis.

For 2010, the Company recognized a $0.6 million loss relating to its share of Ignis loss. As December 31, 2010, the Company had an investment balance of $12.1 million, including $4.4 million in unrealized gains relating to the Company s investment in Ignis.

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

91

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Debt

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

	December 31, 2012			December 31, 2011		
	Carrying Amount	Fair Value	Weighted Average Interest Rate	Carrying Amount	Fair Value	Weighted Average Interest Rate
Notes payable	$ 12,003	$ 12,003		$ 14,620	$ 14,620	
Total long-term debt	22,167	21,228	2.20%	27,166	25,455	2.24%
Less: current portion of long-term debt	(5,000)	(4,892)		(5,000)	(4,890)	
Total long-term debt, net of current portion	$ 17,167	$ 16,336		$ 22,166	$ 20,565	

The fair value of the short-term loans, notes payable and debt have been calculated using an estimate of the interest rate the Company would have had to pay on the issuance of liabilities with a similar maturity and discounting the cash flows at that rate. The fair values do not necessarily give an indication of the amount that the Company would currently have to pay to extinguish any of this debt.

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.

Short-term bank loans

The Company s subsidiaries in China have short-term line of credit facilities from various banking institutions. These short-term line of credit facilities have an original maturity date of one year or less and one such facility agreement is secured by the Company s manufacturing facility in China. Amounts requested by the Company are not guaranteed and are subject to funds and currency availability. The interest rate charged is fixed on the borrowing date for the term of the loan. The short-term line of credit facilities typically do not require any specific covenants. As of December 31, 2012, the Company had no short-term loans outstanding.

Long-term debt

The Company has a loan and security agreement with a bank for an available credit facility. The components of the available credit facilities as of December 31, 2012 are as follows:

As of December 31, 2012 and 2011, $8.0 million was outstanding under the revolving line of credit agreement and $0.0 million was available for borrowing. Amounts are due on or before September 2014 and borrowings under this facility bear interest at a rate of LIBOR plus 2%.

As of December 31, 2012 and 2011, no amounts were outstanding under the equipment advance line and all $7.0 million was available for borrowing. This equipment line advance for capital expenditures

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

in the U.S. Advances may be drawn in four tranches and are due and payable in equal monthly installments of principal and interest such that all amounts will be repaid by September 2015. Borrowings under this facility will bear interest at a rate of LIBOR plus 2%.

As of December 31, 2012 and 2011, $14.2 million and $19.2 million was outstanding under the acquisition advance and $5.8 million and $0.8 million was available for borrowing, respectively. This $20.0 million acquisition advance expires in September 2015. Proceeds of the acquisition advance may be used to make permitted business acquisitions. Advances may be drawn in two tranches and are due and payable in equal monthly installments of principal and interest such that all amounts will be repaid by the acquisition line maturity date. The advances bear interest at a rate of LIBOR plus 2%.

In connection with the loan and security agreement, the Company issued a warrant to the lender to purchase 4,482 shares of common stock at an exercise price of $29.00 per share. As of December 31, 2012 and 2011, the warrant had not been exercised.

The Company s U.S. loan and security agreement requires maintenance of specified financial covenants, including a liquidity ratio, and restricts our ability to incur additional debt or to engage in specified transactions and is secured by substantially all of the Company s U.S. assets, other than intellectual property assets. As of December 31, 2012 and 2011, the Company was in compliance with all covenants contained in this agreement.

At December 31, 2012, maturities of long-term debt were as follows (in thousands):

Less than 1 year	$ 5,000
1-3 years	17,167
	$ 22,167

11. Commitments and contingencies

Leases

The Company leases various facilities under non-cancelable operating leases. As of December 31, 2012, the future minimum commitments under all operating leases are as follows (in thousands):

Years ending December 31,	
2013	$ 1,888
2014	1,215
2015	1,061
2016	666
Thereafter	1,468
	$ 6,298

The Company recognizes rent expense on a straight-line basis over the lease period. Rent expense under the Company s operating leases was $2.3 million, $1.9 million and $1.1 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Litigation

From time to time, the Company is subject to various claims and legal proceedings, either asserted or unasserted, that arise in the ordinary course of business. The Company accrues for legal contingencies if the

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Indemnifications

In the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and provide for general indemnification. The Company s exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations. As of December 31, 2012, the Company does not have any material indemnification claims that were probable or reasonably possible.

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Purchase obligations

The Company has purchase obligations with certain suppliers for the purchase of goods and services entered in the ordinary course of business. As of December 31, 2012, total outstanding purchase obligations were $19.5 million, primarily due within the next 12 months.

Other contingencies

Under California s recently enacted Global Warming Solutions Act, the Company designed and installed additional pollution control equipment at the San Jose, California, manufacturing plant to reduce perfluorocarbon emissions. As of December 31, 2012, the San Jose and Fremont, California, manufacturing facilities are in compliance with the Global Warming Solutions Act.

12. Stockholders Equity

Common stock

As of December 31, 2012, the Company had reserved the following shares of authorized but unissued common stock:

Stock option plans	4,081,378
Stock purchase plans	257,734
Warrants	4,482
	4,343,594

Private Sale of Common Stock

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

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

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Equity incentive programs

Plan descriptions

2004 Stock Option Plan

In March 2004, the Company adopted the 2004 Stock Option Plan (the 2004 Plan) for the benefit of its eligible employees, consultants and independent directors. The 2004 Plan provides for the issuance of options to purchase common stock to eligible employees, consultants and independent directors. Options granted under the 2004 Plan may be either incentive stock options or nonqualified stock options. Under the terms of the 2004 Plan, awards may be granted at prices not less than 100% of the fair value of the Company s common stock, as determined by the Company s board of directors, on the date of grant for an incentive stock option and not less than 85% of the fair value of the Company s common stock on the date of grant for a non-qualified stock option. Options vest over a period of time as determined by the board of directors, generally over a four year period, and expire ten years from date of grant. Subject to adjustment for certain changes in the Company s capital structure, the maximum aggregate number of shares of common stock that may be issued under the 2004 Plan is 3,010,769.

Stock options granted under the Company s stock option plan provide employee option holders, if approved by the Company s board of directors, the right to elect to exercise unvested options in exchange for restricted common stock, which are subject to a repurchase right held by the Company at the original issuance price in the event the optionees employment is terminated. Any repurchased shares are not returned to the available share pool for future stock option grants. The shares purchased by the employees pursuant to the early exercise of stock options are deemed to be outstanding.

In February 2011, in connection with the closing of the Company s initial public offering and execution of the associated underwriting agreement, shares authorized for issuance under the 2004 Plan were cancelled (except for those shares reserved for issuance upon exercise of outstanding stock options). As of December 31, 2012, options to purchase 1,758,432 shares were outstanding under the 2004 Plan and no shares were available for future grant.

2007 Stock Appreciation Grants Plan

In October 2007, the Company adopted its 2007 Stock Appreciation Grants Plan (the 2007 Plan). The 2007 Plan provides for the grant of units (stock appreciation units) entitling the holder upon exercise to receive cash in an amount equal to the amount by which the Company s common stock has appreciated in value. Each stock appreciation unit entitles a participant to a cash payment in the amount of the excess of the fair market value of a share of common stock on the exercise date over the fair market value of a share of common stock on the award date.

The total appreciation available to a participant from the exercise of an award is equal to the number of stock appreciation units being exercised, multiplied by the amount of appreciation per stock appreciation unit. The stock appreciation units granted under the 2007 Plan were primarily granted to employees or consultants of the Company s subsidiaries in China.

The Company re-measured the fair value (based on the market price of the Company s common stock at the relevant period end) of all vested and outstanding stock appreciation units and adjusts compensation expense and corresponding liability accordingly. The Company also recognized compensation expense for additional vested stock appreciation units. As of December 31, 2012, 212,534 stock appreciation units were outstanding. The Company does not intend to grant additional stock appreciation units under the 2007 Plan.

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2010 Equity Incentive Plan

In April 2010, the Company adopted its 2010 Equity Incentive Plan (the 2010 Plan). The 2010 Plan will terminate on April 13, 2020, unless sooner terminated by the board of directors.

The 2010 Plan provides for the grant of incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance-based stock awards, and other forms of equity compensation, or collectively, stock awards, all of which may be granted to employees, including officers, and to non-employee directors and consultants. Additionally, the 2010 Plan provides for the grant of performance cash awards. Incentive stock options may be granted only to employees. All other awards may be granted to employees, including officers, and to non-employee directors and consultants.

Options granted under the 2010 Plan may be either incentive stock options or nonqualified stock options. Restricted stock units may also be granted under the 2010 Plan. Under the terms of the 2010 Plan, awards may be granted at prices not less than 100% of the fair value of the Company s common stock, as determined by the Company s board of directors, on the date of grant for an incentive stock option and not less than 85% of the fair value of the Company s common stock on the date of grant for a non-qualified stock option. Options vest over a period of time as determined by the board of directors, generally over a three to four year period, and expire ten years from date of grant.

Initially, the aggregate number of shares of the Company s common stock that may be issued pursuant to stock awards under the 2010 Plan after the 2010 Plan becomes effective is 865,420 shares. Then, the number of shares of the Company s common stock reserved for issuance under the 2010 Plan will automatically increase on January 1st each year, starting on January 1, 2012 and continuing through January 1, 2020, by 3.5% of the total number of shares of the Company s common stock outstanding on December 31 of the preceding calendar year, or such lesser number of shares of common stock as determined by the Company s board of directors. The maximum number of shares that may be issued pursuant to the exercise of incentive stock options under the 2010 Plan is 8,000,000 shares. As of December 31, 2012, stock options to purchase and restricted stock units to convert to a total of 1,556,228 shares of common stock were outstanding under the 2010 Plan and 44,947 shares were reserved for future issuance.

In December 2012, the board of the Company approved to increase 1,500,000 shares available for issuance to provide performance-based equity awards to key employees, with subject to approval by the Company s stockholders in June 2013. No shares may be issued until stockholder approval is obtained, and such grants shall be forfeited if the stockholder approval is not obtained. These shares are not included in our financial statements and disclosures.

2010 Employee Stock Purchase Plan

In February 2011, the Company adopted its 2010 Employee Stock Purchase Plan (the 2010 ESPP). The 2010 ESPP was implemented through a series of offerings of purchase rights to eligible U.S. employees. The offering period is for 12 months beginning November 16th of each year, with two purchase dates on May 15th and November 15th.

The 2010 ESPP initially authorizes the issuance of 342,568 shares of the Company s common stock pursuant to purchase rights granted to employees or to employees of designated affiliates. The number of shares of common stock reserved for issuance will automatically increase on January 1st of each year, starting January 1, 2012 and continuing through January 1, 2020, in an amount equal to the lesser of (1) 3.5% of the total number of shares of common stock outstanding on December 31st of the preceding calendar year, (2) 600,000

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

shares of common stock or (3) such lesser number of shares of common stock as determined by the Company s board of directors. As of December 31, 2012, the Company had 257,734 shares reserved for future issuance. The Company issued 520,111 shares during the year ended December 31, 2012.

2011 Inducement Award Plan

In September 2011, the Company adopted its 2011 Inducement Award Plan (the 2011 Plan). The 2011 Plan provides for awarding options, stock appreciation rights, restricted stock grants, restricted stock units and other awards to new employees of the Company and its affiliates, including as a result of future business acquisitions. All options shall be designated as non-statutory stock options.

The number of shares reserved for issuance under the 2011 Plan is 750,000 shares. The exercise price of awards shall be not less than 100% of the fair market value of the Company s common stock on the date of grant. Each stock appreciation right grant will be denominated in shares of common stock equivalents. Options and stock appreciation rights have a maximum term of ten years measured from the date of grant, subject to earlier termination following the individual s cessation of service with the Company. As of December 31, 2012, stock options to purchase a total of 384,050 shares of common stock were outstanding under the 2011 Plan and 365,950 shares were reserved for future issuance.

Stock options and restricted stock units

The following table summarizes the Company s stock option and restricted stock unit activity during the year ended December 31, 2012:

		Stock Options		Restricted Stock Units	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Number of Units	Weighted Average Grant Date Fair Value
Balance at December 31, 2011	330,177	2,631,524	$ 5.99	517,445	$ 6.97
Authorized for issuance	870,190	0	$ 0	0	$ 0
Granted	(942,955)	309,846	$ 5.03	633,109	$ 5.27
Exercised/Converted	0	(56,119)	$ 4.24	(162,664)	$ 6.94
Forfeited	125,256	(111,364)	$ 7.27	(63,067)	$ 6.53
Balance at December 31, 2012	382,668	2,773,887	$ 5.87	924,823	$ 5.84

The following table summarizes information about stock options outstanding as of December 31, 2012:

	Options Outstanding			
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in Thousands)
Vested and expected to vest	2,700,338	$ 5.87	6.64	$ 2,237
Exercisable	1,817,751	$ 5.60	5.65	$ 1,950

The fair value of options vested during the year ended December 31, 2012, 2011 and 2010 was $2.1 million, $1.0 million and $0.9 million, respectively. The intrinsic value of options vested and expected to vest and exercisable as of December 31, 2012 is calculated based on the difference between the exercise price and the fair

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

value of the Company s common stock as of December 31, 2012. The intrinsic value of options exercised during the year ended December 31, 2012, 2011 and 2010, was $52,000, $371,000 and $144,000, respectively.

The following table summarizes information about restricted stock units outstanding as of December 31, 2012:

	Restricted Stock Units Outstanding			
	Number of Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in Thousands)
Vested and expected to vest	836,731	$ 5.84	1.33	$ 4,803

The fair value of restricted stock units vested during the year ended December 31, 2012, 2011 and 2010 was $1.1 million, $0.0 million and $0.0 million, respectively. The intrinsic value of restricted stock units vested and expected to vest as of December 31, 2012 is calculated based on the fair value of the Company s common stock as of December 31, 2012. The intrinsic value of restricted stock units converted during the year ended December 31, 2012, 2011 and 2010, was $810,000, $0 and $0 respectively.

Stock appreciation units

The following table summarizes the Company s stock appreciation unit activity during the year ended December 31, 2012:

	Stock Appreciation Units	Weighted-Average Exercise Price
Stock appreciation units outstanding as of December 31, 2011	261,627	$ 6.86
Stock appreciation units exercised	(16,552)	$ 4.25
Stock appreciation units cancelled	(32,541)	$ 6.80
Stock appreciation units outstanding as of December 31, 2012	212,534	$ 7.07

The fair value of stock appreciation units vested during the year ended December 31, 2012, 2011 and 2010 was $0.3 million, $0.1 million and $0.1 million, respectively. The intrinsic value of stock appreciation units vested and expected to vest and exercisable as of December 31, 2012 is calculated based on the difference between the exercise price and the fair value of the Company s common stock as of December 31, 2012. The intrinsic value of stock appreciation units exercised during the year ended December 31, 2012, 2011 and 2010, was $15,130, $15,000 and $0.

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Stock-based compensation

Stock options

The following table summarizes the stock-based compensation expense recognized for stock options for the years ended December 31, 2012, 2011 and 2010 (in thousands):

	Years ended December 31,		
Stock options	**2012**	**2011**	**2010**
Cost of goods sold	$ 273	$ 175	$ 116
Research and development	744	523	372
Sales and marketing	364	387	378
General and administrative	766	704	729
	$ 2,147	$ 1,789	$ 1,595

The weighted-average fair value of options granted was $3.33, $4.15 and $7.54 per share for the years ended December 31, 2012, 2011 and 2010, respectively. At December 31, 2012, there was $3.5 million of unrecognized stock-based compensation expense for stock options that will be recognized over the remaining weighted-average period of 2.5 years.

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

	Years ended December 31,		
Stock options	**2012**	**2011**	**2010**
Weighted-average expected term (years)	6.77	6.69	6.59
Weighted-average volatility	72%	71%	73%
Risk-free interest rate	0.99% 2.70%	1.62% 2.92%	2.51% 3.19%
Expected dividends	0 %	0 %	0 %

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

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

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

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

The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

Stock appreciation units

Stock appreciation units are re-measured each period at fair value. In February 2011, the Company recorded a catch-up expense associated with vested stock appreciation units. Vested stock appreciation units first became exercisable upon the expiration of the lock-up period associated with the initial public offering. Due to the contingent nature of the awards prior to the initial public offering, the Company had not recorded any compensation expense associated with these awards. Therefore, in February 2011, the Company recognized compensation expense representing the number of vested stock appreciation units at that date, multiplied by the fair value of the award. Subsequently, the Company recognizes a charge (credit) for any changes in the fair value of the vested awards.

The following table summarizes the expense recognized for stock appreciation units for the year ended December 31, 2012 and 2011 (in thousands):

Stock appreciation units	**Year ended December 31, 2012**	**Year ended December 31, 2011**
Cost of goods sold	$ 13	$ 146
Research and development	26	127
Sales and marketing	0	51
General and administrative	88	28
	$ 127	$ 352

As of December 31, 2012 and 2011, the liability for the settlement of the stock appreciation units were $0.4 million and $0.4 million, respectively, and were included in accrued and other current liabilities on the consolidated balance sheet. Based on the fair value of the stock appreciation units as of December 31, 2012, the Company has $0.09 million of unrecognized stock-based compensation expense for stock appreciation units that would be recognized over the remaining weighted-average period of 1.3 years.

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

Stock appreciation units	**Year ended December 31, 2012**	**Year ended December 31, 2011**
Weighted-average expected term (years)	2.88	3.91
Weighted-average volatility	68%	74%
Risk-free interest rate	0.21% 0.63%	0.36% 2.42%
Expected dividends	0 %	0 %

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

Volatility. Due to the limited history of the trading of the Company s common stock since the initial public offering in February 2011, the expected volatility used by the Company is based on volatility of similar entities.

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In evaluating similarity, factors such as industry, stage of life cycle, size, and financial leverage are taken into consideration. The term over which volatility was measured was commensurate with the expected term.

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

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

Employee stock purchase plan

The following tables summarize the components of the ESPP expense for the year ended December 31, 2012 and 2011 (in thousands):

ESPP	Years ended December 31, 2012	Years ended December 31, 2011
Cost of goods sold	$ 206	$ 79
Research and development	417	254
Sales and marketing	116	91
General and administrative	96	80
	$ 835	$ 504

As of December 31, 2012, there was $0.8 million of unrecognized stock-based compensation expense for stock purchase rights that will be recognized over the remaining offering period, through May 2013. The value of the stock purchase right consists of: (1) the 15% discount on the purchase of the stock, (2) 85% of the call option and (3) 15% of the put option. The call option and put option were valued using the Black-Scholes option pricing model with the following assumptions:

ESPP	Year ended December 31, 2012	Year ended December 31, 2011
Weighted-average expected term (years)	0.75	0.71
Weighted-average volatility	60%	68%
Risk-free interest rate	0.04% 0.16%	0.04% 0.23%
Expected dividends	0 %	0 %

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

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

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

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

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted stock units

The following table summarizes the stock-based compensation expense recognized for restricted stock units for the year ended December 31, 2012 and 2011 (in thousands):

Restricted stock units	Year ended December 31, 2012	Year ended December 31, 2011
Cost of goods sold	$ 308	$ 103
Research and development	557	129
Sales and marketing	454	118
General and administrative	349	113
	$ 1,668	$ 463

The weighted-average fair value of restricted stock units granted was $5.27 and $6.97 per share for the year ended December 31, 2012 and 2011, respectively. At December 31, 2012, the Company has $3.8 million of unrecognized stock-based compensation expense for restricted stock units that will be recognized over the remaining weighted-average period of 2.2 years.

14. Income taxes

The benefit from (provision for) income taxes is based upon the income (loss) before income taxes as follows (in thousands):

	Years Ended December 31,		
	2012	2011	2010
U.S. Operations	$ (25,599)	$ (20,712)	$ (8,589)
Non-U.S. Operations	9,291	6,477	14,550
	$ (16,308)	$ (14,235)	$ 5,961

The components of the benefit from (provision for) income taxes consisted of the following (in thousands):

	Years Ended December 31,		
	2012	2011	2010
Current			
U.S. Federal Tax	$ (103)	$ (257)	$ 10
U.S. State Tax	0	0	0
Non-U.S. Foreign Tax	(1,119)	(1,350)	(2,331)
	(1,222)	(1,607)	(2,321)
Deferred			
U.S. Federal Tax	0	0	0
U.S. State Tax	0	0	0
Non-U.S. Foreign Tax	(142)	452	32

Total provision for income taxes from continuing operations	(1,364)	(1,155)	(2,289)
Benefit from (provision for) income taxes and discontinued operations	(114)	318	7
Total Provision	$ (1,478)	$ (837)	$ (2,282)

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The benefit from (provision for) income taxes differs from the amount obtained by applying the U.S. federal statutory tax rate as follows (in thousands, except percentages):

	Years Ended December 31,		
	2012	**2011**	**2010**
U.S. Federal Statutory Rate	34%	34%	34%
Tax at U.S. Statutory Rate	$ 5,599	$ 4,840	$ (2,027)
State Income Taxes, Net of Benefit	967	397	(1,893)
Nondeductible Expenses	96	138	299
Stock-based Compensation	(529)	(511)	(320)
Change in Valuation Allowance	(7,308)	(811)	(276)
Research and Development	0	485	225
Foreign Rate Differences	(656)	3,555	2,368
Earn Out Adjustment Not Taxable	132	438	0
Foreign Income Inclusion	0	(5,140)	0
Change to Prior Year Deferred Balances	826	0	0
Acquisition-related Costs	(491)	(4,585)	0
Foreign Permanent Items	0	0	(209)
Other	0	39	(456)
	$ (1,364)	$ (1,155)	$ (2,289)

The table below summarizes the movement in the Company s deferred tax asset valuation allowance (in thousands):

Balance at December 31, 2009	$ 56,623
Credit to Expense	(68)
Deductions Write-Offs	(114)
Balance at December 31, 2010	56,441
Credit to Expense	(413)
Deductions Write-Offs	15,486
Balance at December 31, 2011	71,514
Credit to Expense	7,370
Deductions Write-Offs	(881)
Balance at December 31, 2012	$ 78,003

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred income tax assets and liabilities comprise the following (in thousands):

	December 31, 2012	December 31, 2011
Deferred Tax Assets		
Net Operating Loss Carryforwards	$ 69,969	$ 67,635
Federal and State Credits	7,747	6,822
Reserves, Accruals and Other	5,498	4,254
Fixed Assets and Intangibles	902	647
Total Deferred Tax Assets	84,116	79,358
Valuation Allowance	(78,003)	(71,514)
Total Deferred Tax Assets, Net of Valuation Allowance	6,113	7,844
Deferred Tax Liabilities		
Acquired Intangibles	(5,362)	(6,875)
Net Deferred Tax Assets	$ 751	$ 969
Reported As:		
Current Deferred Tax Assets, Included Within Prepaid Expenses and Other Current Assets	$ 1,333	$ 1,896
Long-term Deferred Tax Assets, Included Within Other Long-term Assets	71	
Deferred Income Tax Liabilities	(653)	(927)
Net Deferred Tax Assets	$ 751	$ 969

The net valuation allowance increased by $6.5 million during the year ended December 31, 2012. As of December 31, 2012, the Company had net operating loss, or NOL, carryforwards for 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 has begun to expire in the current year. The Company also had federal and state research credit carryovers of $3.7 million and $9.2 million, respectively. The federal research credits will expire beginning in 2018. The state research credit has no expiration. Utilization of the NOL and tax credit carryforwards are subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitation may result in the expiration of NOL and tax credit carryforwards before utilization. During the 2012 tax year, the Company completed an updated study pursuant to Section 382 of the IRC to determine if an additional ownership change (for Section 382 purposes) occurred and, if so, whether there was an additional limitation on the Company s ability to use NOLs and other tax attributes as a result of a potential ownership change . No change was determined for the year ended December 31, 2012 and accordingly no new limitations were determined.

The deferred tax assets listed above do not include NOL carryforwards that are expected to expire unutilized as a result of existing ownership changes.

As of December 31, 2012, the Company s undistributed earnings of foreign subsidiaries were $25.9 million. The Company intends to reinvest these earnings indefinitely in its foreign subsidiaries. Accordingly, no deferred tax liability has been established relative to these earnings. If these earnings were distributed to the United States in the form of dividends or otherwise, or if the shares of the relevant foreign subsidiaries were sold or otherwise transferred, the Company would be subject to additional U.S. income taxes subject to an adjustment for foreign tax credit, and foreign withholding taxes. Determination of the amount of unrecognized deferred income tax liability related to these earnings is not practicable.

105

Table of Contents

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2012, 2011 and 2010, certain of the Company s subsidiaries benefited from various tax incentives, including tax holidays and reduced tax rates ranging from 15% to 25%, for operating in special economic zones or for engaging in certain qualifying business activities in China. The Company realized benefits from the reduced tax rate for the years ended December 31, 2012, 2011 and 2010 as follows (in thousands):

	Years Ended December 31, 2012	Years Ended December 31, 2011	Years Ended December 31, 2010
Tax Provision (Benefit) for China Entities at Statutory Rate of 25%	$ 2,261	$ 1,060	$ 3,971
Tax Provision (Benefit) for China Entities Included in the Consolidated Statement of Operations	1,347	580	2,291
Tax Benefit From Preferential Tax Rate	$ 914	$ 480	$ 1,680
Shares Used to Compute Impact of Tax Benefits per Basic and Diluted Share	28,529,849	22,359,802	1,945,111
Impact of Tax Benefits per Basic and Diluted Share	$ 0.03	$ 0.02	$ 0.00

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 China 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, the Company s China subsidiaries may be subject to the uniform income tax rate of 25% unless they are able to qualify for preferential status. Currently, they have qualified for a preferential 15% tax rate that is available for new and high technology enterprises. The preferential rate applies to 2012, 2011 and 2010. The preferential rate has been approved by China for the rate to remain at 15% for 2013 and 2014. In order to retain the preferential rate, the Company must meet certain operating conditions, satisfy certain product requirements, meet certain headcount requirements and maintain certain levels of research expenditures. The Company believes it will continue to meet the requirements.

Tax effects of a position are recognized only if it is more likely than not to be sustained based solely on its technical merits as of the reporting date. At December 31, 2012, the Company had $12 million of unrecognized tax benefits, $0.2 million of which would affect its effective tax rate if recognized.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at December 31, 2009	$ 4,091
Gross Increases for Tax Positions of Prior Years	0
Gross Increases for Tax Positions of Current Year	1,010
Balance at December 31, 2010	5,101
Gross Increases for Tax Positions of Prior Years	119
Gross Increases for Tax Positions of Current Year	3,994
Balance at December 31, 2011	9,214
Gross Increases for Tax Positions of Prior Years	70
Releases for Tax Positions of Prior Years	(26)
Gross Increases for Tax Positions of Current Year	2,735

Balance at December 31, 2012	$ 11,993

NEOPHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company recognizes interest and penalties related to uncertain tax positions, if any, as a component of its income tax provision. For all years presented, the Company recognized no interest and penalties related to uncertain tax positions, as the uncertain tax position balances offset deferred tax assets, which are subject to a valuation allowance.

Uncertain tax positions relate to potential obligations related to permanent establishment in the Company s global subsidiaries and to the determination of the research and experimental tax credit and certain transfer pricing issues. The Company does not consider that it is reasonably possible that there will be a material change in its uncertain tax positions in the next 12 months.

The Company files income tax returns in the U.S federal jurisdiction and various state and foreign jurisdictions. As of December 31, 2012, the Company s federal returns for the year ended December 31, 2009 through the current period and most state returns for the year ended December 31, 2008 through the current period are still open to examination. In addition, all of the net operating losses and research and development credit carryforwards that may be utilized in future years are still subject to examination. The Company is not currently subject to U.S. federal, state and local, or non-U.S. income tax examinations by any tax authorities.

15. Segment and geographic information

The Company operates in one reportable segment. The Company s Chief Executive Officer, who is considered to be the chief operating decision maker, manages the Company s operations as a whole and reviews financial information presented on a consolidated basis for purposes of evaluating financial performance and allocating resources.

The following tables set forth the Company s revenue and asset information by geographic region. Revenue is classified based on the location of the customer. Such classification recognizes that for many customers, including those in North America or in Europe, designated shipping points are often in China or elsewhere in Asia. Long-lived assets in the tables below comprise only property, plant and equipment (in thousands):

	Years ended December 31,		
	2012	**2011**	**2010**
Revenue:			
China	$ 121,236	$ 129,390	$ 100,872
United States	66,007	31,180	27,245
Japan	14,771	15,085	17,376
Other	43,409	25,374	32,186
Total consolidated revenue	$ 245,423	$ 201,029	$